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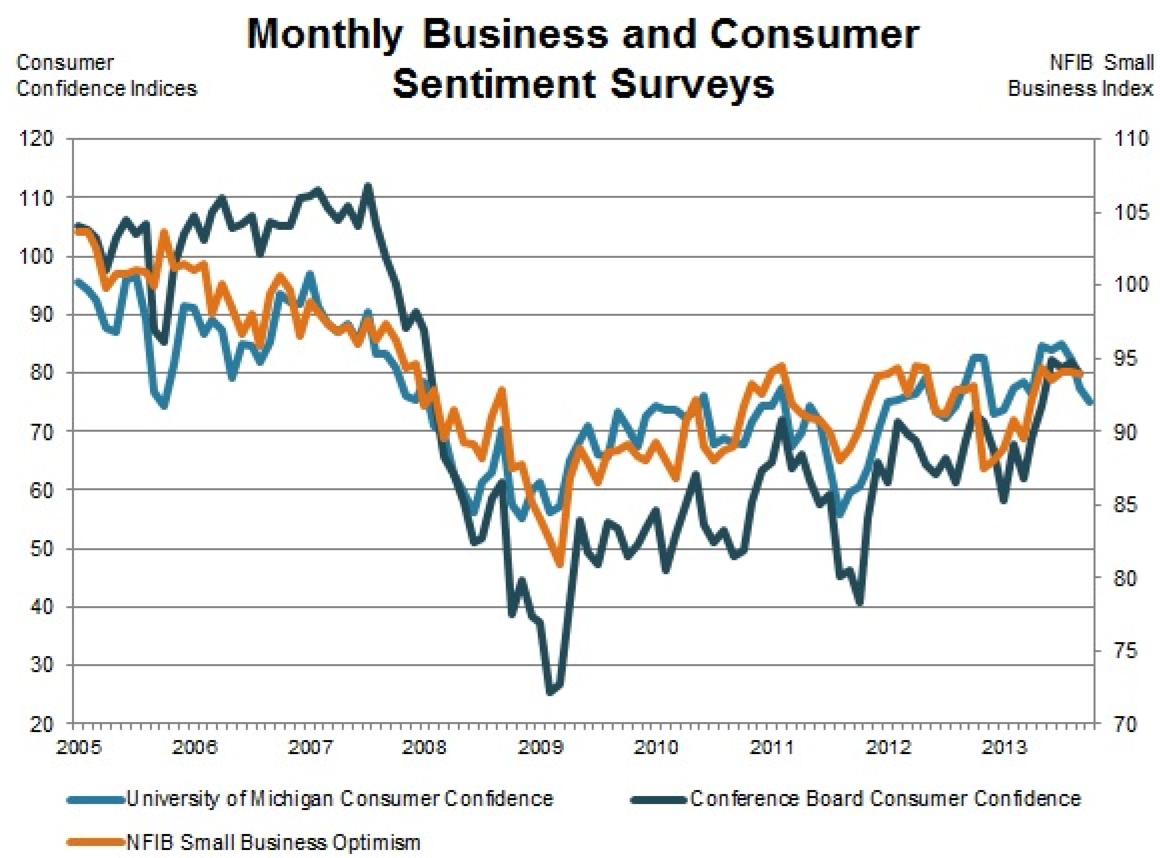
MONDAY ECONOMIC REPORT

October 15, 2013



Due to the federal government shutdown, several key data points were not released last week. This included the latest reports on international trade, job openings, producer prices, retail trade and wholesale trade. The vacuum in public data makes it more difficult to ascertain whether or not gains in many aspects of the domestic economy were continuing. This leaves us looking elsewhere for clues about current trends. Our perceptions about the present and future U.S. economic environment remain somewhat frozen as to where they were on September 30. For instance, the Manufacturers Alliance for Productivity and Innovation (MAPI) survey tended to echo the more upbeat tone from other similar surveys, with an accelerated pace for new orders, exports, utilization and domestic investment.

Yet, the budgetary impasse has reduced perceptions about the economy and heightened frustrations with the political process as a whole. Surveys released last week observed lower consumer and small business confidence levels, with each falling from higher levels during the summer. In the case of the University of Michigan's consumer sentiment figure, the decline brought the index back to levels not seen since January, when we were still in the aftermath of the fiscal cliff deal. This shows that the fiscal crisis has zapped confidence and increased uncertainty. However, the National Federation of Independent Business (NFIB) survey, while edging slightly lower, still points to an upward trend for the year.

Interestingly, small business owners responding to the NFIB survey labeled government regulations as their most important problem. This was the second month in a row that “red tape” has topped the list, with taxes and poor sales following closely behind in second and third place.

Last week, President Obama nominated Janet Yellen to be the next Federal Reserve Board chair. This ends months of speculation about who would replace outgoing Chairman Ben Bernanke, whose term expires January 31, 2014. Notably, the President made his announcement on the day that the Federal Reserve released the minutes of the September 17–18 Federal Open Market Committee (FOMC) meeting. These minutes highlight the intense debate within the committee over when to start tapering its purchases of $85 billion in long-term and mortgage-backed securities. Financial markets expected this to begin at that meeting, but most FOMC participants wanted to see more data showing a rebound in the economy before acting. The impending budget battles were also a factor.

There continues to be speculation that the Federal Reserve will start to decelerate its quantitative easing program by year’s end, but in my view, the earliest that any taper would occur at this point would be at the FOMC’s December 17–18 meeting.

With the federal government shutdown now going into its third week, we are not expected to get consumer price index and housing starts data. In addition, the Federal Reserve has announced that it will be unable to produce industrial production data until the government reopens. It is also an open question about when the backlog of postponed data sources might be released after the budget issues are resolved, as the calendar could suddenly become quite busy in the coming weeks. Meanwhile, survey data from the New York and Philadelphia Federal Reserve Banks are still expected to be released this week, with the data more than likely reflecting the pickup that we saw prior to the shutdown. Other highlights include the Federal Reserve’s Beige Book and new data on homebuilder optimism, leading indicators and production sentiment in California.

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Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

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Consumer Credit

Tuesday, October 8
*International Trade**
*Job Openings and Labor Turnover Survey**

This Week's Indicators:

Monday, October 14
COLUMBUS DAY

Tuesday, October 15
California Manufacturing Survey
New York Fed Empire State Manufacturing Survey

NFIB Small Business Survey

Wednesday, October 9
FOMC Minutes (September 17–18 Meeting)
*Wholesale Trade**

Thursday, October 10
MAPI Manufacturing Survey

Friday, October 11
*Producer Price Index**
*Retail Sales**
University of Michigan Consumer Sentiment

**These data releases were postponed due to the federal government shutdown.*

Wednesday, October 16
*Consumer Price Index***
Federal Reserve's Beige Book
NAHB Housing Market Index

Thursday, October 17
*Housing Starts and Permits***
*Industrial Production***
Philadelphia Fed Manufacturing Survey

Friday, October 18
Conference Board's Leading Economic Indicators

***These data releases may be postponed due to the federal government shutdown.*

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Summaries of Last Week's Economic Indicators

Consumer Credit

The Federal Reserve Board reported that U.S. consumer credit outstanding rose 5.4 percent in August, led by strong growth in nonrevolving debt. Total consumer debt outstanding was $3.037 trillion, with $848.9 billion in revolving credit and $2.188 trillion in nonrevolving credit.

The recent increases have stemmed from nonrevolving credit, primarily from auto and student loans. Nonrevolving loans have risen 5.3 percent year-to-date and 8.2 percent over the past 12 months. These loans have helped to finance greater motor vehicle sales—one of the larger drivers of economic growth of late. However, the greatest growth has been in student lending, which the federal government now administers.

Student lending has grown 13.7 percent year-to-date and 20.4 percent year-over-year. Excluding student loans, nonrevolving credit would have risen just 1.7 percent and 3.3 percent, respectively, over the same time periods.

In contrast to nonrevolving credit increases, the level of revolving loans has barely budged for much of the past year or so. Over the past 12 months, revolving credit—which includes credit cards and other credit lines—has risen by only 0.25 percent. Since August 2011, revolving loans have grown a paltry 1.3 percent.

This suggests consumers have been more hesitant to use credit cards when making purchases. On the one hand, it means Americans continue to deleverage, taking on less revolving debt. Yet, the jump in student lending has already stirred policy conversations, and the hesitance to take on additional borrowing for consumer purchases might be tied to continued anxieties about the larger economy. The latest data, for instance, indicate only modest gains in personal spending, with confidence in the economy dipping on fiscal budget worries.

FOMC Minutes (September 17–18 Meeting)

In a week that was dominated by news of the nomination of Janet Yellen to be the next Federal Reserve Board chair, the Federal Reserve also released the minutes of its most recent FOMC meeting. At its September 17–18 meeting, the FOMC chose to continue purchasing $85 each month in long-term and mortgage-backed securities as part of its effort to stimulate the economy. This surprised financial markets, which expected the Federal Reserve to start "tapering," or slowing, the level of its asset purchases.

That meeting also produced economic projections that were slightly lower than its June outlook, with a softer economy than desired. While there has been progress overall, the pace of expansion was not what many FOMC members had hoped for, particularly in labor markets. The August employment numbers, which were released just prior to the meeting, had been somewhat disappointing. The committee also anticipated the current federal budget impasse and was wary of moving too quickly in light of any downgrades that might result from a government shutdown. With that as context, the minutes say the following about the debate over monetary policy actions:

> *In their discussion of monetary policy for the period ahead, members reviewed the degree of improvement in economic activity and labor market conditions since the asset purchase program began a year ago and judged that, taking into account the extent of federal fiscal retrenchment, the improvement was consistent with growing underlying strength in the broader economy. However, all members but one judged that it would be appropriate for the Committee to await more evidence that progress would be sustained before adjusting the pace of asset purchases. In the view of one member, the progress to date in labor markets and in broader economic conditions amply supported a reduction in purchases.*

Kansas City Federal Reserve Bank President Esther L. George is the “one member” referenced here, as she was the lone dissenter to the FOMC’s decision to not taper its quantitative easing program. In general, George continues to be concerned about the time horizons for the Federal Reserve’s accommodative monetary policies, and she worries about the long-term inflationary risks associated with these actions.

However, overall pricing pressures remain subdued, with core inflation remaining below the 2 percent threshold set by the FOMC. The Federal Reserve’s economic projections anticipate core inflation remaining below this threshold through 2016, but as always, it will continue to monitor incoming data on this topic.

International Trade
This data release was postponed due to the federal government shutdown.

Job Openings and Labor Turnover Survey
This data release was postponed due to the federal government shutdown.

MAPI Manufacturing Survey
MAPI reported that its composite index rose sharply this quarter, up to 66 in September from 58 in June’s survey. This marks the third consecutive quarter with an increase and brings the index to its highest point since the end of 2011, reflecting manufacturers’ optimism on news of the Federal Reserve’s continued quantitative easing.

Many individual indices show strong momentum going into the end of the year. Current orders, which compare expected orders in the third quarter to a year ago, shot up to 70 from 53 in June. Looking at export demand over the same time period, export orders were up to 61 from a meager 45 just last quarter, marking its first expansionary move since the same time period last year.

Another notable improvement was capacity utilization, which grew from 21.2 percent to 30.0 percent over the quarter, although it still lies below its long-term average of 32.0 percent. Inventories remain unchanged during this period, and new orders are still outpacing shipments—a positive sign for production in the near term.

These improvements are optimistic signs of increasing domestic and international demand for manufactured goods as we near the end of the year.

Interest rate expectations took a turn for the worse, dropping from 81 to 71 on the individual index as businesses voice concern over a potential shift in Federal Reserve policy regarding rates. The Federal Reserve has facilitated cheap financing by keeping rates low in recent years. In addition, one unfortunate caveat regarding the MAPI survey is that the results were due on September 30 (before the government shutdown) and do not reflect real concerns about the impact on retailers if the government funding impasse is not resolved.

NFIB Small Business Survey

The NFIB reported that small business owners' sentiment declined marginally, down from 94.1 in August to 93.9 in September. In general, the Small Business Optimism Index has not shifted much since May, averaging 94.0 over the five-month period. On the one hand, this continues to suggest improvement in perceptions since earlier in the year. For example, from November 2012 to March 2013, the five-month average was 88.9. Yet, the stall in sentiment growth after April is notable, indicating some persistent challenges facing the sector.

The index remains below 100, its threshold for stronger growth in the small business sector. This means that small business owners continue to worry about economic weaknesses. The last time the NFIB's index had a reading greater than 100 was October 2006.

The percentage of respondents saying the next three months were a good time to expand edged slightly higher from 6 percent to 8 percent. This was not far from the 7.6 percent average observed over the past five months. Economic worries and frustrations with the political environment were the main reasons cited by those saying it was not a good time to expand. Twenty-four percent of respondents said that government regulations were the most important problem, followed by taxes (18 percent) and poor sales (17 percent).

Looking at the various components, the data were mostly mixed. Sales and earnings continue to be weak; however, the net percentage of those expecting increased sales in the next three months increased, up from 5 percent to 8 percent. On the employment front, hiring was stagnant in September, with the net down from 4 percent to zero. The net percentage of small business owners planning to add workers in the next three months decreased from 10 percent to 9 percent, with that rate virtually unchanged since July.

Meanwhile, 25 percent of respondents plan to make capital expenditures over the next three to six months, the fastest pace since March. In addition, inventories continue to shrink, with a net 2 percent planning to decrease their stockpiles over the next three to six months.

Producer Price Index

This data release was postponed due to the federal government shutdown.

Retail Sales

This data release was postponed due to the federal government shutdown.

University of Michigan Consumer Sentiment

Consumer confidence has declined each month since July, when it hit a six-year high, according to the University of Michigan and Thomson Reuters. The Consumer Sentiment Survey's index declined from 85.1 in July to 77.5 in September to 75.2 in October. This was the lowest level of confidence since January's 73.8 reading, when Americans were still in the aftermath of the fiscal cliff deal.

Frustrations with the current federal budgetary impasse, resulting in the ongoing government shutdown and pushing up against the nation's debt ceiling, have wiped out sentiment gains from earlier in the year. This is a preliminary figure, with a final index number released on Friday, October 25. How the budget debate evolves in the coming days could influence October's confidence numbers.

A diminished economic outlook has fueled the drop in consumer sentiment since the summer. The expectations component's index peaked at 77.8 in June and has dropped to 63.9 in October. The view of current economic conditions has been lowered somewhat over the past few months, but not by the same proportions as future-oriented measures. The index for current conditions decreased from its peak of 98.6 in July to 92.6 in September, but it edged slightly higher in October to 92.8.

Looking at the big picture, the drop in consumer confidence, which was also seen in a recent Gallup survey, highlights public frustrations with the political process and worries about economic growth. Previous results also focused on the slow growth rate in the labor market, and these types of surveys have often hinged on pocketbook issues. The real test will come when we see how consumer anxieties impact spending. Unfortunately, due to the government shutdown, we did not receive retail sales data last week, which might have given us some clues about Americans' purchasing patterns.

Wholesale Trade
This data release was postponed due to the federal government shutdown.

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