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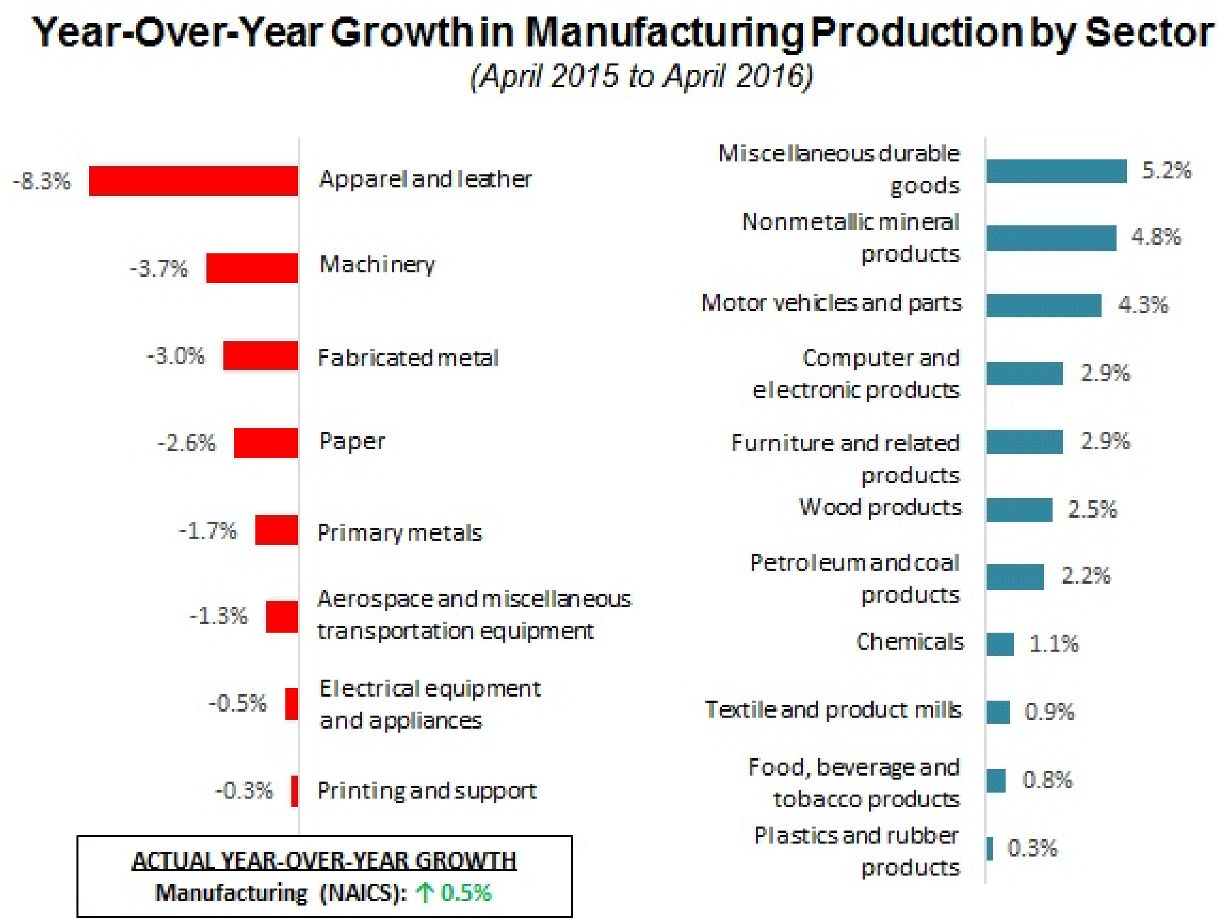
Monday Economic Report

May 23, 2016



After disappointing manufacturing activity in the first quarter of 2016, the sector rebounded somewhat in April. Manufacturing production grew 0.3 percent in April, offsetting the 0.3 percent decline in March. This was led by renewed strength in machinery (up 2.4 percent) and motor vehicles and parts (up 1.3 percent), among other segments. Capacity utilization in the sector also edged higher, up from 75.1 percent to 75.3 percent. As such, these were further signs that manufacturing might be stabilizing. Yet, the data also illustrate the significant challenges facing the sector over the past year, including a strong dollar, weak export markets and still-low commodity prices. On a year-over-year basis, manufacturing production has risen just 0.4 percent since April 2015. With that in mind, it should be no surprise that manufacturing leaders remain cautious in their outlook.

Total industrial production also rallied in April, up 0.7 percent, after declining in both February and March.

Utilities output jumped 5.8 percent in April, but mining production fell 2.3 percent, down for the eighth straight month. Indeed, mining output has plummeted 13.4 percent year-over-year, pushing overall industrial production down 1.1 percent over the past 12 months. At the same time, regional manufacturing sentiment surveys from the New York and Philadelphia Federal Reserve Banks both slipped back into contraction territory in May, suggesting that the sector's challenges persist even with recent signs of progress. Despite that current weakness, manufacturers in both districts remained cautiously upbeat about the next six months.

New residential construction activity improved in April after unexpected softness in March. Housing starts rose 6.6 percent, up from an annualized 1,099,000 in March to 1,172,000 in April. While this pace remained below the February level of 1,213,000, it was a step in the right direction. Starts for both single-family (up from 753,000 to 778,000) and multifamily (up from 346,000 to 394,000) were higher, with both achieving multi-month highs. Existing home sales also moved in the right direction, up 1.7 percent in April and extending the 5.7 percent gain in March. Homebuilders were also more positive about sales of single-family homes over the next six months. This should provide some encouragement moving forward that the residential market should pick up in the second half of this year. I continue to predict 1.24 million units started by the end of 2016.

Meanwhile, one of the larger news stories last week came from the minutes of the April 26–27 Federal Open Market Committee (FOMC) meeting. Specifically, participants left open the possibility of an increase in the federal funds rate at the June FOMC meeting. While the Federal Reserve acknowledged softer-than-desired economic growth in the first quarter and ongoing global challenges, the outlook for the coming months was "encouraging," with recent progress in labor market, housing and consumer spending data. The economic projections during the March 15–16 meeting indicated that FOMC participants predict two increases in short-term rates in 2016. With that said, this news was a shock for those in financial markets who had begun to price out a June rate hike, particularly after weak jobs numbers in April. In the end, the FOMC will be data-dependent, making news between now and then highly relevant. Fortunately, core inflation remained modest in new data out last week, even as consumer prices have begun to edge higher, mainly on increased energy costs.

We will get further evidence about the health of the manufacturing sector this week, hopefully providing more clues about stabilization in the sector. This will include Flash Manufacturing PMI data for the United States and Eurozone as well as regional surveys from the Richmond and Kansas City Federal Reserve Banks. In addition, the Census Bureau will release preliminary numbers on durable goods orders and shipments. Other releases to look for this week include the latest data on consumer confidence and new home sales.

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P.S.: If you have not already done so, please take a moment to complete the latest ***Manufacturers' Outlook Survey from the National Association of Manufacturers.*** *This 24-question survey helps us to gauge how manufacturing sentiment has changed since March's survey. It also includes special questions on monetary policy, regulatory compliance costs, health insurance, tax reform and international trade.*

To complete the survey, click here. Responses are due by ***Friday, May 27,*** *at 12:00 p.m. EDT. As always, all responses are anonymous.*

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Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, May 16
NAHB Housing Market Index
New York Fed Manufacturing Survey

Tuesday, May 17
Consumer Price Index
Housing Starts and Permits
Industrial Production

Wednesday, May 18
None

Thursday, May 19
Chicago Fed National Activity Index
Conference Board Leading Indicators
Philadelphia Fed Manufacturing Survey

Friday, May 20
Existing Home Sales
State Employment Report

This Week's Indicators:

Monday, May 23
Markit Flash Manufacturing PMIs for the United States and Eurozone

Tuesday, May 24
New Home Sales
Richmond Fed Manufacturing Survey

Wednesday, May 25
International Trade in Goods (Preliminary)

Thursday, May 26
Durable Goods Orders and Shipments
Kansas City Fed Manufacturing Survey

Friday, May 27
University of Michigan Consumer Sentiment (Revised)

Summaries for Last Week`s Economic Indicators

Chicago Fed National Activity Index

The National Activity Index (NAI) was positive in April for only the second time in the past nine months. Positive numbers indicate that the U.S. economy is growing above its historical trend, with negative readings suggesting the opposite. The NAI rose from -0.55 in March to 0.10 in April, its highest level since January. However, the three-month moving average dropped from -0.18 to -0.22, suggesting that economic growth remained less than desired in April, even with some progress.

Rebounding manufacturing production helped to buoy the NAI in April. The contribution of production-related indicators to the NAI increased from -0.39 to 0.19. Consumer spending, hiring and housing were slight drags on the NAI for the month, albeit less so than in the prior report.

Conference Board Leading Indicators

The Conference Board's Leading Economic Index (LEI) increased 0.6 percent in April, rebounding from being unchanged in March. Better manufacturing numbers contributed to this improvement in the headline number, including increased new orders and a longer workweek for production workers. There were also positive contributions to the LEI from building permits, unemployment claims, the S&P 500, the interest rate spread and overall lending conditions. The one negative was consumer confidence for business conditions, which pulled back somewhat in April.

There was a similar story for the Coincident Economic Index (CEI), which assesses current conditions. The CEI was flat in March but rose 0.3 percent in April. All four components of the CEI—industrial production, nonfarm payrolls, personal income and manufacturing and trade sales—were positive contributors to the index. Industrial production rose in April after declining in both February and March.

Consumer Price Index

The Bureau of Labor Statistics reported that consumer prices grew at their fastest rate in more than three years, up 0.4 percent in April, boosted by higher energy costs. Gasoline prices increased 8.1 percent in April, extending the 2.2 percent gain in March. Indeed, the average price of regular conventional retail gasoline rose from $1.72 per gallon at the end of February to $2.08 at the end of April, according to the Energy Information Administration. To be fair, gasoline prices have fallen 13.8 percent over the past 12 months, with energy costs much lower today than a few years ago.

Meanwhile, food prices increased 0.2 percent in April, offsetting the 0.2 percent decline in March. Higher prices for cereal and bakery products, dairy products and nonalcoholic beverages offset lower costs for fruits and vegetables as well as eggs. Food costs have risen 0.9 percent year-over-year. At the same time, core inflation, which excludes energy and food prices, was up 0.2 percent in April, with year-over-year growth of 2.1 percent. In April, costs rose for medical care, shelter expenses and transportation services, but they were lower for apparel, household furnishings and new and used vehicles.

Overall, inflation remains subdued, with lower relative energy costs keeping a lid on pricing pressures. Yet, core inflation has now exceeded 2 percent for five consecutive months, a sign that prices have begun to tick higher, even if they are not yet a significant concern for the Federal Reserve.

Existing Home Sales

The National Association of Realtors® reported that existing home sales rose 1.7 percent in April, extending the 5.7 percent gain in March. There were 5.45 million units sold in April at the annual rate, up from 5.36 million in March. As such, activity essentially returned to the pace in December and January, and existing home sales have risen 6.0 percent year-over-year, up from 5.14 million in April 2015. In this release, the Midwest saw the largest improvements, with weaker sales in the South and West, and condominium and co-op sales increased to their highest level of the year so far.

At the same, inventories of existing home sales picked up, rising from 4.4 months of supply on the market to 4.7 months. This was a five-month high. The median price of existing homes for sale was $232,500, up 6.3 percent year-over-year.

Housing Starts and Permits

New residential construction activity improved in April after unexpected softness in March. Housing starts rose 6.6 percent, up from an annualized 1,099,000 in March to 1,172,000 in April. While this pace remained below the February level of 1,213,000, it was a step in the right direction. Starts for both single-family (up from 753,000 to 778,000) and multifamily (up from 346,000 to 394,000) were higher, with both achieving multi-month highs.

At the same time, housing permits were also higher, up 3.6 percent in April following decreases in each of the past four months. Permitting rose from 1,077,000 in March to 1,116,000 in April. Single-family (up from

725,000 to 736,000) and multifamily (up from 352,000 to 380,000) housing permits increased in April, although both were at a pace below what was seen in the starts data. Permitting figures are helpful in providing clues about future activity. As such, higher levels should indicate stronger growth moving forward.

The housing market has been one of the brighter spots in the U.S. economy, and yet, starts have not changed much on a year-over-year basis, with activity struggling to sustain 1.2 million starts for any length of time. In fact, housing starts were off 1.7 percent from the April 2015 pace of 1,192,000 units. With that said, I continue to predict 1.24 million units started by the end of 2016.

Industrial Production

After disappointing manufacturing activity in the first quarter of 2016, the sector rebounded somewhat in April. Manufacturing production grew 0.3 percent in April, offsetting the 0.3 percent decline in March. This was led by renewed output strength in machinery (up 2.4 percent) and motor vehicles and parts (up 1.3 percent), among other segments. Capacity utilization in the sector also edged higher, up from 75.1 percent to 75.3 percent. As such, these were further signs that manufacturing might be stabilizing, consistent with some sentiment surveys and with the latest retail sales figures.

Yet, the data also illustrate the significant challenges facing the sector over the past year, including a strong dollar, weak export markets and still-low commodity prices. On a year-over-year basis, manufacturing production has risen just 0.4 percent since April 2015. Utilization rates have also been softer than desired, easing since peaking at 75.8 percent in July 2015. With that in mind, it should be no surprise that manufacturing leaders remain cautious in their outlook.

Looking more closely at the April data, durable goods production rose 0.6 percent, with output from nondurable goods entities unchanged for the month. In addition to healthy gains for machinery and automobiles, there were notable increases for food, beverage and tobacco products (up 0.6 percent), nonmetallic mineral products (up 0.6 percent), wood products (up 0.6 percent), fabricated metal products (up 0.5 percent) and plastics and rubber products (up 0.4 percent). In contrast, production declined for apparel and leather (down 2.3 percent), petroleum and coal products (down 1.8 percent), primary metals (down 1.2 percent), electrical equipment and appliances (down 0.9 percent) and chemicals (down 0.3 percent).

At the same time, industrial production also rallied in April, up 0.7 percent, after declining in both February and March. Utilities output jumped 5.8 percent in April, but mining production fell 2.3 percent, down for the eighth straight month. Indeed, mining output has plummeted 13.4 percent year-over-year, pushing overall industrial production down 1.1 percent over the past 12 months. Capacity utilization increased from 74.9 percent to 75.4 percent.

NAHB Housing Market Index

The National Association of Home Builders and Wells Fargo reported that confidence remained unchanged in May. The Housing Market Index has measured 58 for four straight months. Values greater than 50 indicate that builders are more confident than not, and this was the 23rd consecutive month above that threshold. With that said, sentiment has weakened somewhat since peaking at 65 in October. The report noted better growth in the Midwest and South, with softer activity in the Northeast.

Homebuilders were also more positive about sales of single-family homes over the next six months. The index of expected demand rose from 62 to 65, its highest reading so far in 2016. This should provide some encouragement moving forward that the residential market should pick up in the second half of this year.

New York Fed Manufacturing Survey

The New York Federal Reserve Bank reported that manufacturing activity contracted again in May after expanding in March and April. The Empire State Manufacturing Survey's composite index of general business conditions fell from 9.6 in April to -9.0 in May. As such, it suggested that the sector's challenges persist, with the headline index in negative territory in 9 of the past 12 months. This was a disappointing result, particularly given the hope that the past two months were a sign of stabilization in the region.

Along those lines, new orders (down from 11.1 to -5.5), shipments (down from 10.2 to -1.9), inventories (down from -4.8 to -7.3) and the average workweek (down from 1.9 to -8.3) were each lower in May. The percentage of respondents suggesting that orders at their company increased in the month declined from 35.3 percent to 22.1 percent. On the other hand, hiring edged marginally higher (up from 1.9 to 2.1), with very modest expansions in employment in May. Nonetheless, nearly 71 percent reported no change in hiring.

Despite the current struggles, manufacturers in the district remained cautiously optimistic about the next six months. Roughly 40 percent expect higher new orders and shipments in the months ahead, down from half in the past release, although that was down from half in the prior release. In addition, more than one-quarter anticipate increased hiring. Yet, there were also lingering signs that business leaders remain guarded. The pace of growth for capital expenditures (down from 22.1 to 3.1) and technology spending (down from 21.2 to 6.3) slowed significantly in May from the previous survey.

Philadelphia Fed Manufacturing Survey

The Philadelphia Federal Reserve Bank reported that manufacturing sentiment contracted for the second straight month in May, reflecting continued softness in the region. The Manufacturing Business Outlook Survey's composite index of business conditions edged lower, down from -1.6 in April to -1.8 in May. As such, respondents cited weaker growth over the past two months after reporting a brief rebound in March. Indeed, new orders returned to negative territory for the first time since February (down from 0.0 to -1.9), with 25.8 percent noting decreased sales and half citing no change in orders for the month.

Shipments (up from -10.8 to -0.5) and employment (up from -18.5 to -3.3) declined at a slower pace in May. Hiring has now fallen for five consecutive months. The average workweek continued to fall at a fairly fast rate (up from -16.2 to -15.1).

However, manufacturers in the district were cautiously optimistic. Half of those completing the survey expected higher orders and shipments in the next six months, and growth in capital spending is predicted to accelerate (up from 12.7 to 23.6), with 30 percent seeing investment picking up moving forward. Hiring should also grow at a decent rate (down from 14.2 to 12.0), albeit less robustly than foreseen in the prior release.

State Employment Report

Michigan created the most net new manufacturing jobs in April, according to the Bureau of Labor Statistics, adding 7,200 workers for the month. Indiana (up 3,300), Florida (up 2,600), Minnesota (up 1,900), Georgia (up 1,800) and South Carolina (up 1,600) also topped the list of manufacturing employment gains in April. At the same time, Michigan has generated the greatest job gains in the sector across the past 16 months, with manufacturing employment in the state up 20,400 since December 2014. Other states with the fastest job growth over that period included Georgia (up 14,200), Florida (up 12,900), Tennessee (up 12,800) and South Carolina (up 5,600).

The national unemployment rate was unchanged at 5.0 percent in April. The lowest unemployment rate in the country was South Dakota at 2.5 percent. A number of states were not far behind, including New Hampshire (2.6 percent), Nebraska (3.0 percent), Colorado (3.1 percent), Hawaii (3.2 percent), North Dakota (3.2 percent) and Vermont (3.2 percent). In contrast, the highest unemployment rates were in Alaska (6.6 percent), Illinois (6.6 percent), the District of Columbia (6.4 percent), West Virginia (6.4 percent), New Mexico (6.2 percent), Alabama (6.1 percent) and Mississippi (6.0 percent).

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Questions or comments?

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Center for Manufacturing Research