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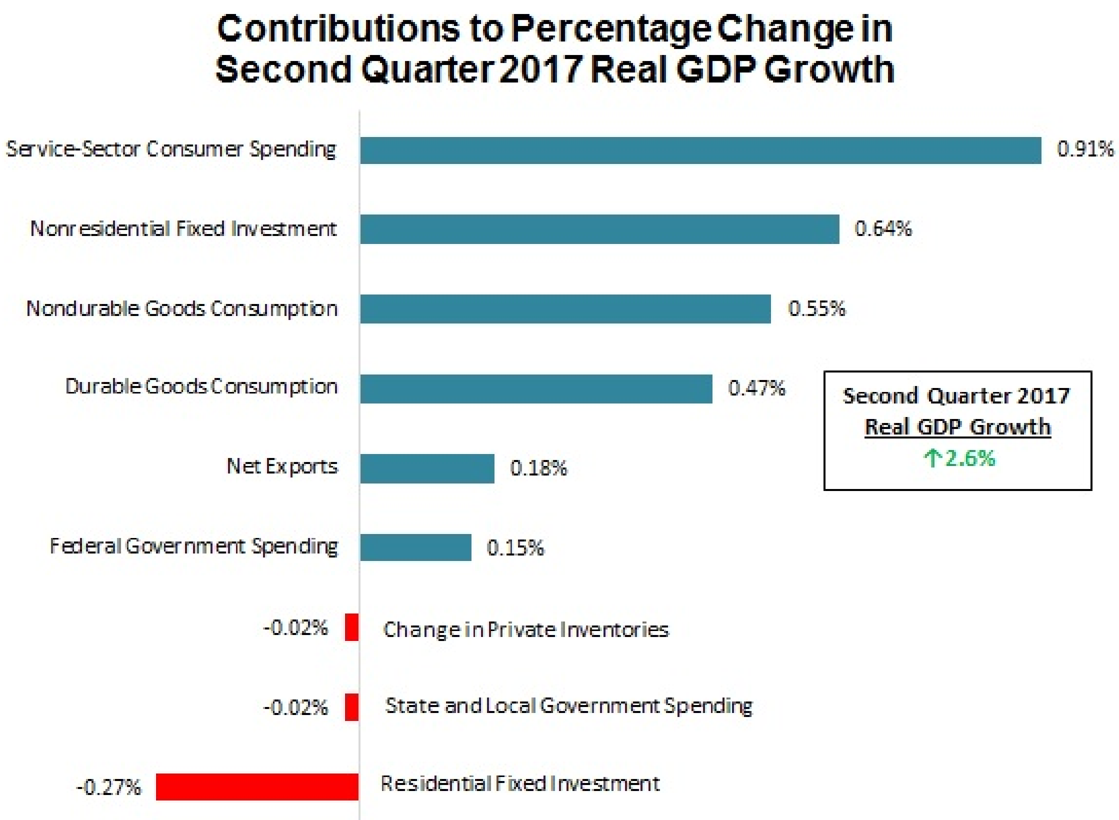
Monday Economic Report

July 31, 2017



The U.S. economy grew by an annualized 2.6 percent in the second quarter, according to preliminary data, with real GDP up 1.9 percent at the annual rate in the first half of 2017. Looking at the underlying data, consumer and business spending were the bright spots, with net exports also making a positive contribution for the second straight quarter. Personal consumption expenditures rose by 2.8 percent in the second quarter, boosted by increased spending for both durable and nondurable goods products. In addition, nonresidential fixed investment increased by 5.2 percent in the second quarter. Most promisingly, equipment spending soared in the latest data to its fastest pace since the third quarter of 2015, up 8.2 percent, with 4.9 percent growth in structures spending. Nonetheless, other components of gross private domestic investment were weaker than desired, including residential investment and inventories.

For the year as a whole, I am currently predicting real GDP growth of 2.2 percent, with 2.6 percent growth for the current third quarter. This is not far from the 2.1 percent average growth rate seen since the Great Recession, but I continue to believe that there is upward potential in the forecast, especially for 2018, if pro-growth policies are enacted.

Turning to manufacturing, new durable goods orders leapt 6.5 percent, up from $230.7 billion in May to $245.6 billion in June, rebounding from declines in both April and May. This was the highest level since July 2014's all-time high of $290.7 billion. Nonetheless, the bulk of that increase stemmed from a jump in nondefense aircraft and parts orders (up from $11.0 billion in May to $25.3 billion in June), likely centering around the International Paris Air Show. Excluding transportation equipment, new durable goods orders were up by 0.2 percent in June, extending the 0.6 percent gain seen in May. New durable goods orders have generally trended in the right direction over the course of the past 12 months. New durable goods have soared 16.1 percent since June 2016, but excluding transportation, the year-over-year gain was a still quite healthy 6.8 percent.

Sentiment surveys in the sector continued to reflect expansions and general optimism about the coming months, mirroring the upbeat outlook seen in the recent NAM survey. For instance, the IHS Markit Flash U.S. Manufacturing PMI rose to its highest point since March, up from 52.0 in June to 53.2 in July. Hopefully, this is a sign that the springtime lull has stabilized, with U.S. manufacturers reporting better growth in new orders and output in the latest survey than in recent months. Similarly, surveys from the Kansas City and Richmond Federal Reserve Banks note modest growth in both of their districts once again in July, even with some easing in activity in the Kansas City region. Encouragingly, the hiring figure in the Richmond data was the highest reading in the survey's history.

Meanwhile, after soaring to new multiyear highs in each of the last few reports, the IHS Markit Flash Eurozone Manufacturing PMI declined from 57.4 in June, a level not seen since April 2011, to 56.8 in July, a three-month low. Despite the somewhat slower growth in this latest survey, the underlying trend remains positive, with European manufacturers continuing to expand at decent rates. New orders and output decelerated in July but mostly reflected strong growth, with exports and employment remaining promising. In a similar way, the future output index indicated healthy expectations for the next six months, albeit with some easing. The forward-looking index had been at its highest point since it was introduced in mid-2012 in June, and the current data are not far from that level. Helping to buoy the Eurozone data was France, where activity in the manufacturing sector was at its fastest pace since April 2011. German activity was also not far from its six-year high.

Beyond those data points, consumer confidence data were mixed last week. On the positive side, the Consumer Confidence Index from the Conference Board rebounded in July after a springtime lull, and it was just a few points shy of the 16-year high experienced in March. Americans were more upbeat about both the current and future economic environment in that report, with more Americans feeling that business conditions were "good" and optimistic about the job market. In contrast, the Index of Consumer Sentiment from the University of Michigan and Thomson Reuters slipped in July to its lowest reading since the election, mainly from a weakening in expectations moving forward, largely on political anxieties. As noted in past reports, there remained significant differences in perceptions based on political affiliation, with the steepest declines in this latest survey from Republicans.

Finally, the residential market also had mixed news in the latest figures—beyond the drag seen in the second quarter real GDP data described above. Existing home sales have been highly volatile year-to-date, up one month only to be followed by a decline the next. Following that pattern, existing home sales dropped 1.8 percent in June after rising by 1.1 percent in May. Despite inventories rising in June, National Association of Realtors Chief Economist Lawrence Yun continued to note a shortage of listings in many key markets. Not surprisingly, this is helping to push median prices higher. At the same time, new home sales increased 0.8 percent in June, extending the 4.8 percent gain in May. Even with the second straight monthly advance in the headline number, new home sales remain off from March's nine-and-a-half-year high.

There were signs of ongoing progress in June, both for the manufacturing sector and in the labor market. This week, analysts will be looking for those gains to continue in new July data from the Institute for Supply Management's Manufacturing Purchasing Managers' Index and in the latest jobs numbers. Manufacturers have added 41,000 net new workers year to date—an improvement from last year's weaknesses that has been boosted by stronger demand and production, both domestically and globally. In addition, the Dallas Federal Reserve Bank will release its latest manufacturing survey, and the Census Bureau will highlight factory orders and shipments. There will also be updates on construction spending, international trade and personal income and spending.

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Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, July 24
Existing Home Sales
IHS Markit Flash Manufacturing PMIs for the United States and Eurozone

Tuesday, July 25
Conference Board Consumer Confidence
Richmond Fed Manufacturing Survey

Wednesday, July 26
FOMC Monetary Policy Statement
New Home Sales

Thursday, July 27
Chicago Fed National Activity Index
Durable Goods Orders and Shipments
International Trade in Goods (Preliminary)
Kansas City Fed Manufacturing Survey

Friday, July 28
Employment Cost Index
Gross Domestic Product
University of Michigan Consumer Sentiment (Revised)

This Week's Indicators:

Monday, July 31
Dallas Fed Manufacturing Survey

Tuesday, August 1
Construction Spending
ISM Manufacturing Purchasing Managers' Index
Personal Income and Spending

Wednesday, August 2
ADP National Employment Report

Thursday, August 3
Factory Orders and Shipments

Friday, August 4
BLS National Employment Report
International Trade Report

Summaries for Last Week`s Economic Indicators

Chicago Fed National Activity Index

The Chicago Federal Reserve Bank reported that growth in the U.S. economy in June rebounded from the pullback seen in May. These data have seen month-to-month seesaw volatility thus far in 2017, so hopefully, we can build on June's positive findings moving forward in the second half of the year. The National Activity Index (NAI) increased from -0.30 in May to 0.13 in June. Index readings below zero suggest the economy is growing below its historical trend, with positive readings indicating the opposite. The three-month moving average also stabilized, up from -0.08 in May to 0.06 in June, which would indicate growth just slightly above the historical trend.

For its part, production-related indicators added 0.09 to the headline index in June, improving after subtracting 0.16 in May in the prior release. Helping to explain this figure, manufacturing production increased by 0.2 percent in June, with year-over-year growth of 1.2 percent. Employment-related indicators also bounced back from a slight drag in May, contributing 0.06 to the NAI in June. Nonfarm payroll employment grew by 222,000 in June, with the manufacturing workforce up by 1,000. At the same time, personal consumption and housing reduced the NAI by 0.04 on weak retail sales and residential starts and permits figures. Despite relatively strong housing data in June, residential activity remained below its historical trend producing a slight drag on the NAI.

Conference Board Consumer Confidence

The Conference Board said that consumer sentiment rebounded in July after a springtime lull. The Consumer Confidence Index increased from 117.3 in June to 121.1 in July, which was not far from March's 16-year high (124.9). To illustrate the jump in sentiment, the headline index has averaged 118.3 year-to-date in 2017, up from an average of 95.6 in the same seven-month period in 2016. In this report, the improvement in perceptions stemmed from better assessments of both current (up from 143.9 to 147.8) and future (up from 99.6 to 103.3) conditions. The measure for the current economic environment rose to a level not seen since July 2001. Overall, more consumers said business conditions were "good," up from 30.6 percent to 33.3 percent, with 13.5 percent citing "bad" conditions, which was unchanged.

In addition, the percentage of respondents feeling jobs were "plentiful" rose from 32.0 percent to 34.1 percent, with those saying jobs were "hard to get" edging down from 18.4 percent to 18.0 percent. Meanwhile, income expectations were mixed, but more favorable than not. The percentage expecting an improvement in their incomes declined from 20.9 percent to 20.0 percent, but this was still higher than those feeling that their incomes would fall, which ticked up from 9.3 percent to 10.0 percent.

Durable Goods Orders and Shipments

The Census Bureau said that growth in new durable goods orders leapt 6.5 percent, up from $230.7 billion in May to $245.6 billion to June, rebounding from declines in both April and May. This was the highest level since July 2014's all-time high of $290.7 billion. Nonetheless, the bulk of that increase stemmed from a jump in nondefense aircraft and parts orders (up from $11.0 billion in May to $25.3 billion in June), likely centering around the International Paris Air Show. Excluding transportation equipment, new durable goods orders were up by 0.2 percent in June, extending the 0.6 percent gain seen in May. New durable goods orders have generally trended in the right direction over the course of the past 12 months. New durable goods have soared 16.1 percent since June 2016, but excluding transportation, the year-over-year gain was a still quite healthy 6.8 percent.

Looking more closely at the various durable goods sectors in June, the data were mixed. There were increased sales for fabricated metal products (up 0.7 percent), other durable goods (up 0.5 percent), machinery (up 0.2 percent) and primary metals (up 0.1 percent). In contrast, sales were weaker for electrical equipment and appliances (down 1.7 percent), motor vehicles and parts (down 0.6 percent) and computers and electronic products (down 0.3 percent). The bottom line is that new orders for core capital goods (or nondefense capital goods excluding aircraft) was off 0.1 percent in June. This figure is often seen as a proxy for capital spending in the U.S. economy. On a year-over-year basis, core capital goods have risen 5.6 percent, up from $60.1 billion in June 2016 to $63.4 billion in this release.

Meanwhile, durable goods shipments were unchanged in June. Much like the new orders the data describes above, the long-term picture continues to trend higher. Since June 2016, durable goods shipments have risen at decent rates, up 4.3 percent, with year-over-year growth of 5.4 percent when transportation equipment shipments were excluded. In addition, shipments of core capital goods have also improved over the past 12 months, up 4.0 percent year-over-year.

Employment Cost Index

The Bureau of Labor Statistics (BLS) report that manufacturing compensation rose 0.6 percent in the second quarter, picking up from the 0.5 percent pace seen in the first quarter. On a year-over-year basis, compensation in the sector grew 2.1 percent. Manufacturing wages and salaries were up 0.5 percent in the second quarter, with benefits also up 0.5 percent. Private sector manufacturing workers earned 2.4 percent more over the past 12 months in wages and salaries, with benefit costs up 1.5 percent year-over-year. BLS does not break down various benefit costs, including health insurance, in its quarterly releases.

Overall, the employment cost index for private sector workers also increased by 0.5 percent in the second quarter, slowing after rising by 0.8 percent in the first quarter. Private sector wages and salaries and benefits rose by 0.5 percent and 0.6 percent in this report, respectively. Over the past 12 months, total compensation for private sector workers increased 2.4 percent, with wages and salaries and benefits up 2.4 percent and 2.2 percent, respectively.

Existing Home Sales

The National Association of Realtors said that existing home sales dropped 1.8 percent in June after rising by 1.1 percent in May. Sales decreased from an annualized 5.62 million units in May to 5.52 million units in June. This continued a seesaw pattern of being up one month and down the next that we have seen since November. In June, activity increased in the Midwest but was down in every other region of the country. Sales declined for single-family homes, down from 4.98 million to 4.88 million, but were unchanged for condo/co-op at 640,000 units. On a year-over-year basis, existing home sales have edged up 0.7 percent from June 2016's pace of 5.48 million units.

In terms of inventories, there were 4.3 months of supply on the market in June, up from 3.5 months in January and 4.2 months in May. Despite the slight increase in inventories for the month, NAR Chief Economist Lawrence Yun described how levels continue to remain low overall, saying, "The demand for buying a home is as strong as it has been since before the Great Recession. Listings in the affordable price range continue to be scooped up rapidly, but the severe housing shortages inflicting many markets are keeping a large segment of would-be buyers on the sidelines." The median price for an existing home sold in June was $263,800, up 6.5 percent year-over-year.

Gross Domestic Product

The Bureau of Economic Analysis said that the U.S. economy grew by an annualized 2.6 percent in the second quarter, according to preliminary data. In addition, it revised first quarter growth down from 1.4 percent to 1.2 percent. As a result, the real GDP increased by 1.9 percent at the annual rate in the first half of 2017. For the year as a whole, I am currently predicting real GDP growth of 2.2 percent, with 2.6 percent growth for the current third quarter. This is not far from the 2.1 percent average growth rate seen since the Great Recession, but I continue to believe that there is upward potential in the forecast, especially for 2018, if pro-growth policies are enacted.

Looking at the underlying data, consumer and business spending were the bright spots, with net exports also making a positive contribution for the second straight quarter. Personal consumption expenditures rose by 2.8 percent in the second quarter, accelerating from the 1.9 percent pace seen in the first quarter on an increased willingness to purchase goods. Along those lines, durable goods spending was marginally negative in the first quarter with consumers more cautious, but jumped 6.3 percent at the annual rate in the second quarter. With that said, spending on motor vehicles remained soft. Nondurable goods spending was also stronger, up 3.8 percent in the second quarter. Overall, personal spending contributed 1.93 percentage points to the top-line growth figure of 2.6 percent, including 1.02 percent from goods spending.

Fixed investment was the biggest strength in the first quarter data, and while it remained encouraging in the second quarter, the rate of growth slowed somewhat. Nonresidential fixed investment increased by 5.2 percent in the second quarter, extending the 7.2 percent growth rate from the first quarter. Most promisingly, equipment spending soared in the latest data to its fastest pace since the third quarter of 2015, up 8.2 percent, with 4.9 percent growth in structures spending. Nonetheless, other components of gross private domestic investment were weaker than desired. Residential investment fell by 6.8 percent, pulling back from strong gains in both prior releases. At the same time, private inventories stabilized in the second quarter, but once again served as a drag on growth, mainly from the farm sector. In total, gross private domestic investment added 0.34 percentage points to the headline number, with positives from nonresidential fixed investment outweighing weaknesses in residential and inventories numbers.

Meanwhile, the trade picture has improved so far in 2017 relative to challenges seen in each of the past two years, with positive contributions to real GDP in both the first and second quarters. Goods exports increased by 2.8 percent in the second quarter, with goods imports up by 2.0 percent. The export of services rose 6.5 percent in this release. Therefore, net exports added 0.18 percentage points to real GDP growth.

IHS Markit Flash Manufacturing PMIs for the United States and Eurozone

After soaring to new multiyear highs in each of the last few reports, the IHS Markit Flash Eurozone

Manufacturing PMI declined from 57.4 in June, a level not seen since April 2011, to 56.8 in July, a three-month low. Despite the somewhat slower growth in this latest survey, the underlying trend remains positive, with European manufacturers continuing to expand at decent rates. New orders (down from 58.7 to 57.1) and output (down from 58.7 to 56.9) decelerated in July but mostly reflected strong growth, with exports (unchanged at 57.4) and employment (up from 55.9 to 56.0) remaining promising. In a similar way, the future output index (down from 67.4 to 66.5) indicated healthy expectations for the next six months, albeit with some easing. The forward-looking index had been at its highest point since it was introduced in mid-2012 in June, and the current data is not far from that level.

In addition to data for Europe as a whole, IHS Markit also released preliminary figures for France (up from 54.8 to 55.4) and Germany (down from 59.6 to 58.3), which were both encouraging despite mixed results in July. French manufacturing activity expanded at its fastest pace since April 2011.

Meanwhile, the IHS Markit Flash U.S. Manufacturing PMI rose to its highest point since March. The headline index increased from 52.0 in June to 53.2 in July. Hopefully, this is a sign that the springtime lull has stabilized, with U.S. manufacturers reporting better growth in new orders (up from 51.6 to 53.4) and output (up from 52.9 to 54.3) in the latest survey than in recent months. Employment (unchanged at 52.4) continued to grow modestly, but exports (down from 51.0 to 49.9) slipped ever-so-barely into contraction territory for the first time since September. Nonetheless, respondents continued to be mostly optimistic about future output (up from 66.1 to 66.2).

International Trade in Goods (Preliminary)

The Census Bureau released advanced statistics on international trade in goods. Specifically, the goods trade deficit narrowed for the second straight month from $66.33 billion in May to $63.86 billion in June in preliminary data. The lower figure stemmed from a pickup in goods exports (up from $126.78 billion to $128.57 billion) that corresponded with reduced goods imports (down from $193.11 billion to $192.43 billion). Final data will be released on August 4. Note that a surplus in service-sector activity, which was $20.99 billion in May, also assisted the U.S. trade deficit.

In June, the boost to goods exports came largely from increases in capital goods (up $923 million), foods, feeds and beverages (up $555 million) and automotive vehicles (up $367 million). In contrast, consumer goods exports were lower, down $355 million. Meanwhile, goods imports for industrial supplies (down $1.20 billion) and consumer goods (down $859 million) dropped sharply for the month, with a sizable increase for automotive vehicles (up $999 million).

Kansas City Fed Manufacturing Survey

The Kansas City Federal Reserve Bank reported that manufacturing activity expanded for the eighth straight month and continued to expand at a modest pace in July. With that said, the composite index of general business conditions edged down from 11 in June to 10 in July. The underlying data were mixed. On the positive side, new orders (up from 4 to 10) grew at a faster pace for the month to its best reading since March, and hiring (unchanged at 15) remained strong. Yet, other measures slowed, including production (down from 23 to 4) and the average workweek (down from 7 to 1). Nonetheless, shipments (down from 23 to -2) slipped into contraction for the first time in one year, and exports (down from 3 to -2) dropped for only the second time this year. The sample comments tended to mirror these differing views, ranging from signs of optimism in terms of sales to other respondents citing caution on capital spending and lingering challenges in identifying quality labor candidates.

Meanwhile, manufacturers continued to be optimistic about the next six months, albeit with some easing from the prior survey. The forward-looking composite index declined from 25 to 19. At least 43 percent of those completing the survey expect sales, production and shipments to be higher moving forward, with 36 percent and 29 percent seeing more hiring and capital spending, respectively. At the same time, business leaders in the Kansas City Fed’s district also see export growth not changing by much over the coming months, which, if true, could limit growth in overall demand.

New Home Sales

The Census Bureau and the Department of Housing and Urban Development reported that new home sales increased 0.8 percent in June, extending the 4.8 percent gain in May. New residential sales rose from an annualized 605,000 units in May to 610,000 in June. Even with the second straight monthly advance in the headline number, new home sales remain off from March's nine-and-a-half-year high (638,000). The jump in June stemmed from stronger demand for new single-family homes in the Midwest and West, with weaker data in the South. On a year-over-year basis, new home sales have risen 9.1 percent from June 2016's pace of 559,000. As such, the longer-term trend remains favorable.

In June, the number of months of supply on the market inched up from 5.3 months to 5.4 months. This was up from 5.0 months in March, indicating a slight pickup in the inventories of new homes for sale over the past three months. The average sales price was $379,500 in June, up 4.2 percent from $364,300 one year ago.

Richmond Fed Manufacturing Survey

The Richmond Federal Reserve Bank reported that manufacturing activity in its district expanded more strongly in July, with activity accelerating to a 3-month high. The composite index of general business activity rose from 11 in June to 14 in July. (Note that these data have been revised from the prior release to reflect a new seasonal adjustment.) The sector has now expanded for 10 straight months – a sign that conditions have improved from more lackluster activity prior to that. Year-to-date, the headline index has averaged 13.3 so far in 2017, up from 2.1 in the same period in 2016. In July, manufacturers in the mid-Atlantic region noted monthly pickups in new orders (up from 14 to 18), employment (up from 5 to 10), the average workweek (up from 1 to 9) and wages (up from 10 to 17), with shipments growth unchanged (13). The backlog of orders (up from -4 to 11) increased for the first time since April.

Looking ahead six months, manufacturing respondents were quite optimistic in their outlook. The key variables all suggest healthy gains in the months ahead for new orders (up from 42 to 50), shipments (down from 40 to 50), capacity utilization (up from 33 to 38), employment (up from 31 to 33), the average workweek (up from 17 to 19) and capital expenditures (down from 28 to 33). Encouragingly, the hiring figure was the highest reading in the survey's history. This would suggest that manufacturers are more enthusiastic about investing in their firms for the future.

Meanwhile, manufacturers in the district said that prices paid for raw materials increased by 1.78 percent at the annual rate in July, unchanged from June but up from 0.93 percent in May. Moving forward, those completing the survey anticipate pricing pressures to accelerate somewhat. Raw material prices are expected to grow 1.55 percent at the annual rate six months from now. This was up from 1.11 percent and 1.44 percent in May and June, respectively.

University of Michigan Consumer Sentiment (Revised)

Consumer confidence slipped in July, according to final data from the University of Michigan and Thomson Reuters. The Index of Consumer Sentiment dropped from 95.1 in June to 93.4 in July, its lowest reading since the election. With that said, the underlying data were quite mixed. Americans were more upbeat about current conditions (up from 112.5 to 113.4), with that measure at its highest point in 12 years. Yet, the decline in July stemmed from a weakening in expectations for the future (down from 83.9 to 80.5), largely based on political anxieties. As noted in past reports, there remained significant differences in perceptions based on political affiliation, with the steepest declines in this latest survey from Republicans, who are frustrated about the lack of movement on the policy front.

According to Richard Curtin, the Surveys of Consumers chief economist, the latest data are consistent with GDP growth of 2 percent in 2017, with personal consumption increasing by 2.4 percent.

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