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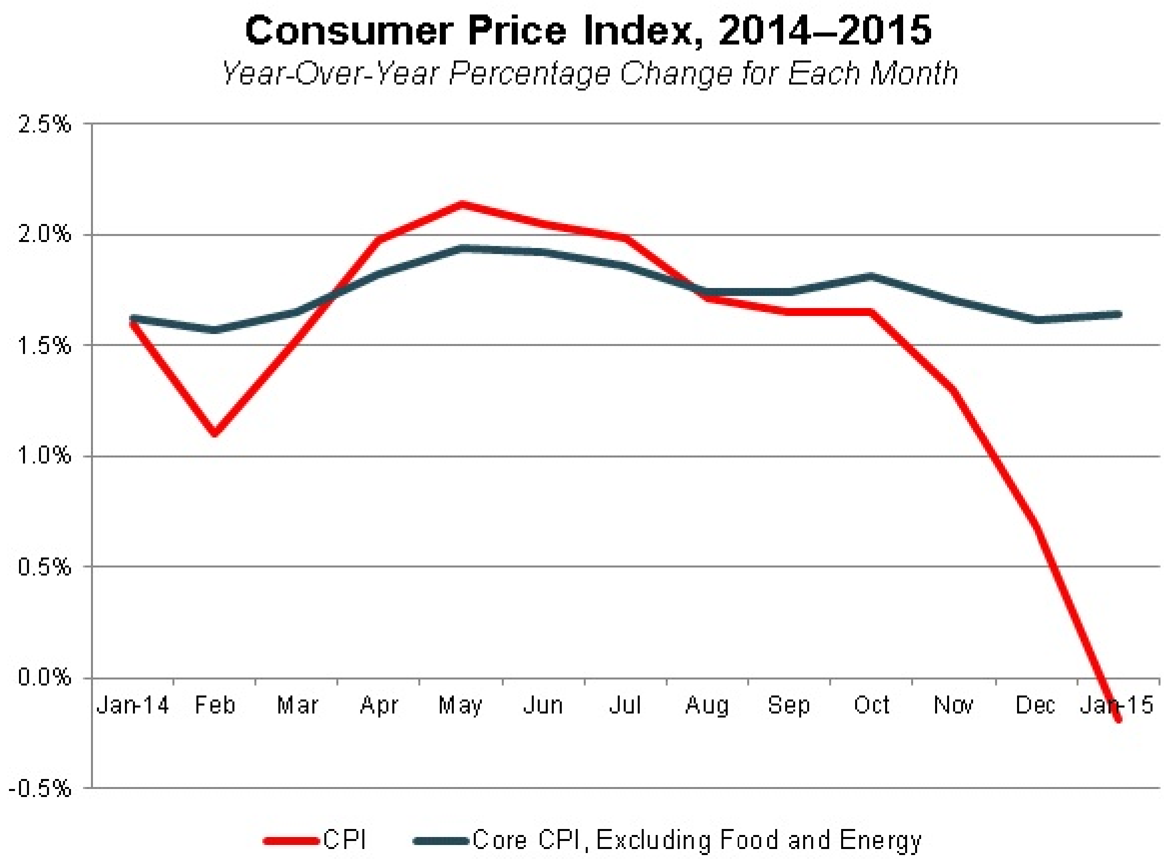
Monday Economic Report

March 2, 2015



While manufacturers remain mostly optimistic in their outlook, we have seen softness in a number of recent economic indicators. Slower economic growth internationally, a stronger U.S. dollar, reduced crude oil prices and the West Coast ports slowdown have been cited as reasons for this weaker-than-desired performance. Along those lines, real GDP growth in the fourth quarter was revised lower, down from 2.6 percent to 2.2 percent. In addition, surveys from the Dallas, Kansas City and Richmond Federal Reserve Banks all reflected decelerated levels of new orders and exports. Most notably, Texas manufacturers have been adversely impacted by the sharp drop in petroleum prices, dampening demand throughout the energy supply chain and for the larger regional economy. Yet, even in the Dallas report, respondents continued to be more positive than negative in their expectations for sales, production, employment and capital spending over the next six months.

Meanwhile, the latest data on new durable goods orders brought mixed news. On the positive side, orders rose 2.8 percent in January, rebounding from the 3.7 percent decline in December. This was largely due to a sharp increase in nondefense aircraft orders. Still, if you exclude transportation equipment, new durable goods orders increased just 0.3 percent, well below the growth seen in the headline figure. Moreover, growth in durable goods orders and shipments has been less than desired over the past six months—a trend that we hope starts to reverse with January's increase. On a year-over-year basis, durable goods orders have risen 5.4 percent, but that strength is somewhat misleading, as it builds off of the significant weather-related slowdowns seen at the beginning of last year.

Last week, the Energy Information Administration said that the average price of regular gasoline was $2.256 per gallon. This ticked up from $1.982 a gallon at the end of January, but remained well below the $3.639 per gallon average observed during the week of June 23, 2014, just eight months ago. As noted, this has had negative ripple effects for many manufacturers. Nonetheless, it has also helped to reduce inflationary pressures in the economy. The consumer price index, for example, has decreased 0.2 percent over the past 12 months, the first negative year-over-year pace since October 2009. This mirrored producer price index (PPI) data released earlier.

Both consumer and small business sentiment hit pre-recessionary peaks over the past few months, and yet, in each case, this was followed by a slight pullback in confidence. For instance, the Conference Board's measure of consumer confidence declined from 103.8 in January, its highest level since August 2007, to 96.4 in February. Those taking this survey were more pessimistic in their responses about the future, particularly regarding job growth and expected income. The decrease in attitudes in this report mirrored similar drops in perceptions in the most recent University of Michigan and National Federation of Independent Business surveys. At the same time, each of these reports continue to show upward movement in perceptions overall, with Americans more optimistic today than one year ago.

In other news, the housing market has started 2015 with some weakness. Significant snowfalls in the Midwest and Northeast have likely contributed to slower activity. The National Association of Realtors® reported that existing home sales fell to their lowest levels in nine months. Moreover, the weather likely contributed to a decline in supplies of homes for sale as well. These findings were also noted in data on new home sales from the Census Bureau and the U.S. Department of Housing and Urban Development, which dipped marginally from the month before. Over a longer time horizon, however, new home sales of single-family residences have continued to inch higher. In addition, the outlook for the coming months remains encouraging.

This morning, the Institute for Supply Management will release its latest manufacturing Purchasing Managers' Index (PMI), providing the latest glimpse of activity nationally. Markit will also provide final PMI numbers for a number of global economies, including China, which improved slightly in February's preliminary figures after contracting for two straight months. In addition, this week, we will learn about vehicle sales on Tuesday and overall durable goods orders on Thursday. The biggest highlight of the week will come on Friday, with new jobs numbers for February. Other economic indicators coming out next week include the latest data on construction spending, labor productivity, international trade and personal income and spending.

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Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, February 23
Chicago Fed National Activity Index
Dallas Fed Manufacturing Survey
Existing Home Sales

Tuesday, February 24
Conference Board Consumer Confidence
Richmond Fed Manufacturing Survey

Wednesday, February 25
HSBC Flash China Manufacturing PMI
New Home Sales

Thursday, February 26
Consumer Price Index
Durable Goods Orders and Shipments
Kansas City Fed Manufacturing Survey

Friday, February 27
Gross Domestic Product (Revision)
University of Michigan Consumer Sentiment (Revision)

This Week's Indicators:

Monday, March 2
Construction Spending
ISM Purchasing Managers' Index
Personal Income and Spending

Tuesday, March 3
Vehicle Sales

Wednesday, March 4
ADP National Employment Report
Beige Book

Thursday, March 5
Factory Orders and Shipments
Labor Productivity (Revision)

Friday, March 6
BLS National Employment Report
International Trade

Summaries for Last Week`s Economic Indicators

Chicago Fed National Activity Index

The Chicago Federal Reserve Bank's National Activity Index (NAI) improved somewhat, up from -0.07 in December to +0.13 in January. Positive values indicate that the U.S. economy is expanding above its historic average, while negative numbers suggest the opposite. Meanwhile, the three-month moving average, which helps to smooth out month-to-month volatility, was virtually unchanged, down from +0.34 to +0.33. Overall, the data show that at least some of the economy's year-end softness began to ease with the new year.

Production in the sector rose 0.2 percent in January after holding flat in December. One could also say that growth remained less than desired in both December and January, even with a better number in the latter. The labor market also positively contributed to the NAI, with nonfarm payrolls exceeding 200,000 for 11 straight months and manufacturing employment up 18,800 per month on average since 2013. In contrast, the consumption and housing category continued to be a drag on the NAI, with reduced housing starts in January and disappointing retail sales data.

Conference Board Consumer Confidence

The Conference Board reported that consumer sentiment fell sharply in February. The Consumer Confidence Index declined from a revised 103.8 in January to 96.4 in February. The original January figure was reported to be 102.9, making for the highest point since August 2007. The February change mirrored similar drops in perceptions in the most recent University of Michigan (see below) and National Federation of Independent Business surveys. Still, the depth of the pullback in February was larger than expected, suggesting that the American public remains anxious.

Survey respondents expressed more pessimism about the future. The expectations component fell from 97.0 in January to 87.2 in February, serving as a drag on the overall headline figure. The data have been highly volatile over the past few months, ranging from a low of 86.4 in September to January's high. February's decrease can be further seen in the reductions of confidence regarding future income. The percentage of respondents expecting their incomes to increase dropped from 19.5 percent to 15.1, with those anticipating income declines rising from 10.8 percent to 12.0 percent. Likewise, the percentage of individuals stating that jobs were "hard to get" rose from 24.6 percent to 26.2 percent.

The more downbeat assessment of the labor market contrasts with recent actual improvements. January's increase was a significant one, with February's easing bringing the data back to a more consistent trend line. As such, the public's attitudes about the economy have largely risen over a longer time horizon, with those taking the survey seeming more upbeat today than one year ago. Nonetheless, the outlook measure has vacillated over the past six months. This perhaps helps to explain why consumers remain more cautious than desired.

Consumer Price Index

The Bureau of Labor Statistics found that the Consumer Price Index (CPI) fell 0.7 percent in January. This mirrored PPI data released the week before. More importantly, consumer prices have decreased 0.2 percent over the past 12 months, the first negative year-over-year pace since October 2009. Of course, this downward shift in inflation has been spurred by lower gasoline prices, which fell 18.7 percent in January alone. Indeed, the average price of regular gasoline declined from $3.639 a gallon during the week of June 23 to $1.982 a gallon the week of January 26, according to the Energy Information Administration. (It has begun to rise a bit since then, with an average of $2.256 per gallon this week.)

Meanwhile, food prices remained unchanged in January, with food purchased for the home down 0.2 percent and food away from home up 0.2 percent. Lower costs for dairy products, eggs, fruits, meats and vegetables offset increased prices for cereals and bakery products. Interestingly, many of the categories that were off in January have seen significant increases over the past year. On a year-over-year basis, food prices have risen 3.2 percent.

Excluding food and energy, core consumer prices rose 0.2 percent in January, and over the past 12 months core inflation has increased 1.6 percent. As such, core CPI has continued to remain below the Federal Reserve's stated goal of 2 percent at the annual rate, which it has now done for 24 consecutive months. In January, medical care, new vehicles, shelter expenses and transportation services saw notable price increases; however, the price of apparel, household furnishings and used cars and trucks declined.

Dallas Fed Manufacturing Survey

The Dallas Federal Reserve Bank reported that manufacturing activity contracted in its district for the second straight month. The composite index of general business conditions fell from -4.4 in January to -11.2 in February, its lowest level since April 2013. Reduced crude oil prices have had negative ripple effects throughout the Texas economy, and indeed, many of the sample comments reflected weaker demand throughout the energy supply chain. Beyond energy-related softness, other challenges noted in the comments included the West Coast ports slowdown, a stronger U.S. dollar, increased health insurance costs and regulatory burdens.

The February data show weaknesses across-the-board. New orders (down from -7.7 to -12.2), shipments (down from 6.0 to -3.3), employment (down from 9.0 to 1.3) and capital spending (down from 0.0 to -4.8) all saw lower index values. Indeed, roughly one-third of respondents said that new orders were declining for the month, with just 21.5 percent suggesting that their sales were rising. (The percentage with increasing new orders fell from 25.8 percent in January.) The index for production remained unchanged at 0.7, suggesting an ever-so-slight expansion in output for the month. That might be better news if not for the fact that the production index had measured 16.4 in December, illustrating the quickness in which these data points have worsened.

On the positive side, manufacturers in the region remained more upbeat about the next six months, brushing aside the current softness. The forward-looking composite index improved from -6.4 in January to 5.5 in February. Along those lines, 45.0 percent of respondents said that they expect new orders to rise in the coming months, with 19.7 percent anticipating declines. Measures for production, capacity utilization, shipments, employment and capital expenditures were also relatively optimistic, which was encouraging. In fact, roughly 3 out of 10 manufacturers in the survey expect to add new workers or increase their investments over the next six months. Yet, two-thirds of these respondents also cite finding qualified workers as a major challenge.

Durable Goods Orders and Shipments

According to the Census Bureau, new durable goods orders rose 2.8 percent in January, rebounding from the 3.7 percent decline observed in December. It marks the strongest increase in durable goods orders in six months, with demand off in four of the past five months. As such, manufacturing activity since July 2014 has been less than desired, providing a bit of a contrast with better demand and sentiment data elsewhere. The sluggish global economic environment has likely played a role in this softness. On a year-over-year basis, durable goods orders have risen 5.4 percent, but this strength is somewhat misleading, as it builds off of the significant weather-related slowdowns seen 12 months ago.

In January, transportation equipment orders rose 9.1 percent on healthy increases for nondefense aircraft sales. Aircraft demand is often choppy, batched together around key dates. If you were to exclude nondefense aircraft, transportation equipment orders would have fallen by 0.2 percent in January. Motor vehicles and parts sales, for instance, were down 2.9 percent.

In the broader market, durable goods demand was higher, but less positive than the headline figure. New durable goods excluding transportation rose 0.3 percent in January, with core capital goods orders (or nondefense capital goods excluding aircraft) up 0.6 percent. Machinery (up 1.9 percent), computers and electronic products (up 1.0 percent) and other durable goods (up 0.2 percent) had increased new orders. Yet, declining orders for electrical equipment and appliances (down 3.4 percent), primary metals (down 0.3 percent) and fabricated metal products (down 0.2 percent) somewhat offset these gains.

Meanwhile, durable goods shipments decreased 1.1 percent in January and have declined in four of the past six months. Excluding transportation, durable goods shipments were off 0.8 percent. As the data would suggest, orders were largely negative in most sectors, including motor vehicles and parts (down 3.0 percent), primary metals (down 2.5 percent) and machinery (down 1.5 percent). There were some exceptions, however. For instance, nondefense aircraft and parts (up 9.2 percent), computers and related products (up 3.2 percent) and other durable goods (up 0.5 percent) recorded increased shipments for the month.

Existing Home Sales

According to the National Association of Realtors® (NAR), existing home sales fell from an annualized 5.07 million units in December to 4.82 million units in January. This marks the slowest pace of sales growth since April 2014. Lawrence Yun, NAR's chief economist, attributed some of this decline to heavy snowstorms, but he added that "low housing supply and the ongoing rise in home prices above the pace of inflation appeared to slow sales despite interest rates remaining near historic lows." The data were weaker in every region of the country, but the Northeast and the West saw the greatest losses.

Condominium and co-op sales have decreased for the third straight month in January, down 3.5 percent for the month. Single-family sales also contracted, down 5.1 percent in January, but this comes on the heels of a relatively strong December. On a year-over-year basis, existing single-family home sales increased 3.9 percent. In January, there were 4.7 months of supply on the market, up from 4.4 months in December but below the 5.6 months of supply observed six months ago. The median home price reached $199,600, or 6.2 percent higher year-over-year.

Gross Domestic Product (Revision)

Real GDP grew 2.2 percent in the fourth quarter, according to the Bureau of Economic Analysis. This was down from the previous estimate of 2.6 percent growth. Slower growth in inventory replenishment and stronger import growth accounted for the bulk of the revision. For the year as a whole, real GDP rose 2.4 percent in 2014, only slightly better than the 2.3 percent and 2.2 percent rates in 2012 and 2013, respectively. Still, this was largely the result of a decline in activity in the first quarter due to weather and other factors, with real GDP growth averaging a healthy 4.8 percent pace in the second and third quarters. As of right now, growth in the first quarter of 2015 should be roughly 2.8 percent, and I am still forecasting growth of around 3.0 percent for all of 2015.

Looking specifically at the fourth quarter report, the underlying trends remained the same. Consumer and business spending contributed positively to overall growth, collectively adding 3.67 percentage points to real GDP for the quarter. Americans spent 4.5 percent more at the annual rate on goods, helping to buoy the overall economy. Nonresidential fixed investment rose an annualized 4.8 percent, which, while slower than the prior two quarters, was still a decent pace. Equipment spending was a soft spot, with reduced levels for computers and industrial and transportation equipment. In addition, spending on inventories added just 0.12 percent to real GDP growth instead of 0.82 percent as originally estimated.

In contrast, net exports and government expenditures served as significant drags on growth in the fourth quarter, collectively subtracting 1.47 percentage points from real GDP. Growth in exports slowed significantly, down from 7.5 percent in the third quarter to 2.3 percent in the fourth quarter. At the same time, goods imports picked up, increasing at an 11.1 percent annual rate in the fourth quarter. This was stronger than the 9.8 percent pace in the earlier estimate. As a result, net exports (or exports minus imports) subtracted 1.15 percent from real GDP. With a stronger U.S. economy, one would expect imports to pick up, but weaknesses abroad have hurt manufacturers' ability to increase their international sales.

At the same time, government spending once again served as a drag on growth, reducing real GDP in the fourth quarter by 0.32 percentage points. This stemmed primarily from lower federal defense spending, which had increased in the third quarter on end-of-fiscal-year expenditures.

HSBC Flash China Manufacturing PMI

The HSBC Flash China Manufacturing PMI shifted to a marginal expansion in February, improving slightly after contracting for two straight months. The headline index increased from 49.7 in January to 50.1 in February, but the underlying data were mixed. New orders (down from 50.8 to 50.4) and output (up from 50.1 to 50.8) grew slowly for the month, even as the pace of sales slipped a bit. At the same time, new export orders (down from 51.1 to 47.1) and employment (up from 49.1 to 49.3) declined on net. Export sales, in particular, deteriorated to its lowest level since August 2013, which was disappointing. The index for hiring, which has contracted now for 24 consecutive months, increased to a seven-month high, with the pace of the decline decreasing. Final PMI data will come out today.

Looking at Chinese economic indicators, real GDP grew 7.3 percent year-over-year in the fourth quarter, unchanged from the third. The Chinese economy grew 7.4 percent in 2014 as a whole, reflecting decelerating growth. It could continue to slow further in 2015, perhaps to 7.0 percent. On the positive side, industrial production expanded 7.9 percent year-over-year in December, up from 7.2 percent in November. This follows healthy gains in the Chinese manufacturing sector (up 8.9 percent year-over-year). Retail sales also accelerated a little, increasing 11.9 percent year-over-year in December and up from 11.7 percent in November. Similarly, fixed asset investments also moved higher, up from 17.9 percent year-over-year in November to 18.1 percent in December. Nonetheless, the annual rate of private-sector fixed asset investments has fallen dramatically, as the year-over-year pace dipped to 23.1 percent in December 2013.

Kansas City Fed Manufacturing Survey

The Kansas City Federal Reserve Bank reported that manufacturing activity slowed to a near crawl in

February, mirroring the easing we have seen in other regions. The composite index of general business conditions dropped from 8 in December to 3 in January to 1 in February. The silver lining, of course, is that activity in the sector continues to expand, albeit barely, as it has now for 14 straight months. Still, the weaker headline figure was pulled lower by contracting levels of new orders (down from -8 to -10), exports (down from -7 to -13) and employment (down from 0 to -4). Respondents cited several reasons for the softness, including sluggish global growth, reduced crude oil prices and the West Coast ports slowdown.

At the same time, production (up from -2 to 5), shipments (up from -5 to 7) and the average workweek (up from -10 to 1) all shifted positive in February, providing a bit of encouragement. In addition, the index for raw material prices (down from 8 to -6) turned negative for the first time since July 2009, with lower energy costs pushing down inflationary pressures in recent months. As noted, however, the fall in petroleum prices has also had undesirable consequences, reducing demand for many manufacturers.

Still, the outlook for manufacturers in the district remained mostly upbeat despite these current challenges. The future-oriented composite index dropped from 19 to 11 for the month, and several key measures eased as well. Yet, business leaders in the region continue to have optimistic expectations in their outlook. For instance, 46 percent of respondents anticipate increased production over the next six months, with 39 percent anticipating higher sales. Moreover, roughly 30 percent plan to add more workers and to spend more on capital investments. In contrast to these more positive prospects, however, new export orders are expected to remain a drag on growth.

New Home Sales

According to the Census Bureau and the U.S. Department of Housing and Urban Development, new home sales remained virtually unchanged in January. New single-family home sales dropped from an annualized 482,000 units in December to 481,000 in January. Over a longer time horizon, the data show that sales of new single-family residences have continued to inch higher, up from 399,000 units in July, which was the low-water mark for 2014. Over the past 12 months, new home sales rose 5.3 percent, up from 457,000 units in January 2014. The January report indicated stronger sales in the Midwest and South, but the Northeast was hampered by significant snowstorms (down from 31,000 units sold in December to 15,000 in January). This would suggest that the overall data might have been stronger otherwise.

In January, the market had 5.4 months of supply, unchanged from the month before. However, this dipped from the 5.7 months and 6.2 months of supply in November and July, respectively. Therefore, supplies of new homes for sale have continued to edge lower over the past few months. The median price of new homes for sale was $299,300, up 9.1 percent year-over-year from the $269,800 median in January 2014.

Richmond Fed Manufacturing Survey

The Richmond Federal Reserve Bank reported that manufacturing activity stagnated in February, ending 10 straight months of expansion in the district. The composite index of general business conditions declined from 6 in January to 0 in February, its lowest level since contracting in March 2014. Indeed, many of the underlying measures slipped into negative territory this month. This included new orders (down from 4 to -2), shipments (down from 10 to -1), capacity utilization (down from 9 to -4) and the average workweek (down from 8 to -6). As such, manufacturers clearly pulled back in a number of areas for the month likely due to global slowness, a stronger dollar and reduced commodity prices.

Yet, it was not all bad news, particularly for the labor market. While growth in employment decelerated again (down from 13 in December to 5 in January to 4 in February), hiring climbed for 12 consecutive months. This is encouraging. Moreover, the index for wages picked up somewhat, increasing from 3 to 8. To be fair, wage growth has also slowed from the paces seen just a few months ago, with the index measuring 15 in November, for instance.

Moving forward, manufacturers in the region remain relatively upbeat, albeit with some dampening from previous months. The expected new orders index, for example, has drifted lower, down from 34 in December to 29 in January to 24 in February. Yet, this still signifies decent growth in demand over the next six months, with similarly healthy gains anticipated for shipments, capacity, employment and capital expenditures.

Meanwhile, the inflationary data have continued to trend lower, largely due to reduced energy costs. Manufacturers in the region said that prices paid for raw materials grew 0.32 percent at the annual rate in February, down from 0.70 percent in January. This pace dropped sharply from the 2.22 percent rate in October. Looking ahead six months, respondents anticipate raw material prices to increase 0.91 percent at the annual rate, down from the 1.17 percent pace last month.

University of Michigan Consumer Sentiment (Revision)

Consumer confidence fell in February, according to data from the University of Michigan and Thomson Reuters. The Consumer Sentiment Index decreased from 98.1 in January, its highest level in 11 years, to 95.4 in February. Despite the drop, this was better than the original estimate of 93.6. Overall, the public was somewhat less upbeat in February than in January, with the measures of the current (down from 109.3 to 106.9) and expected (down from 91.0 to 88.0) economic environment off for the month. Still, Americans became more optimistic over the course of last year, with the index up from 80.0 in March 2014.

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Questions or comments?

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