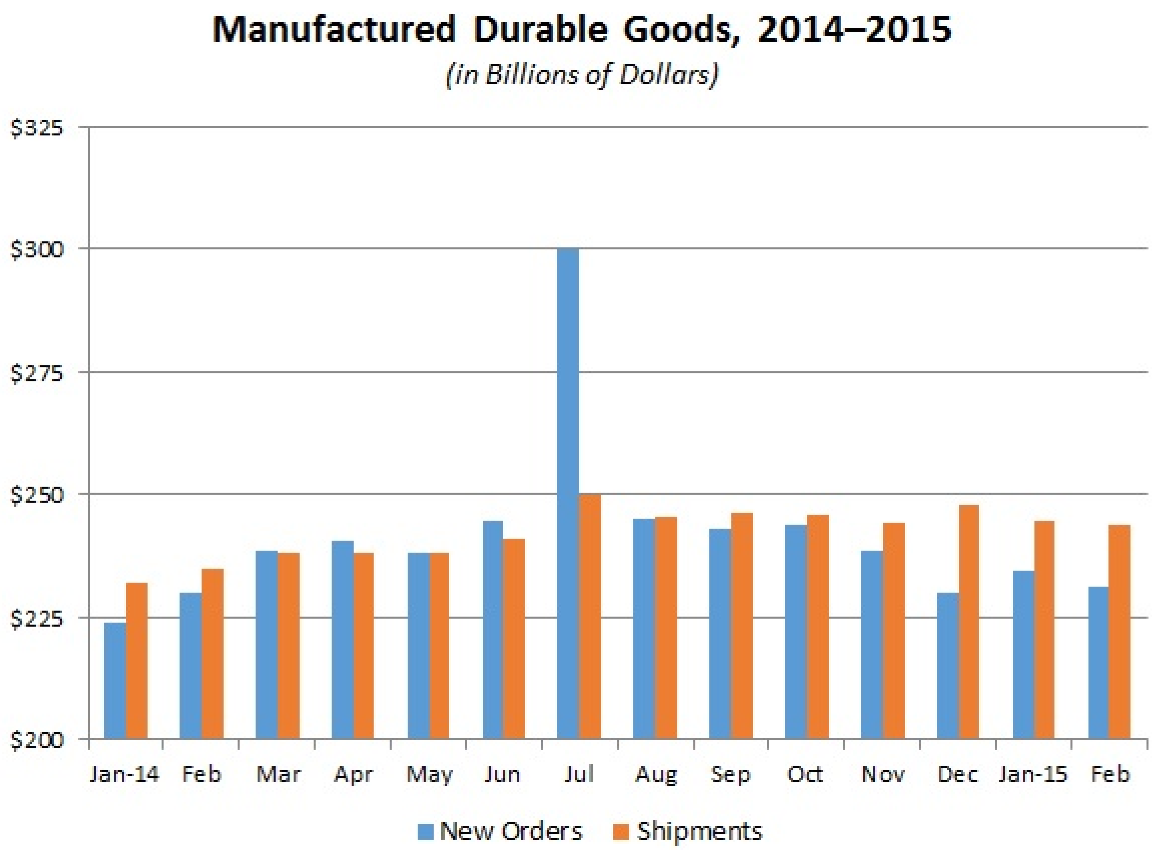
A Publication of the National Association of Manufacturers

Monday Economic Report

March 30, 2015



As we have seen in past weeks, economic data continue to reflect dampened activity in the early months of 2015 as a result of a number of significant headwinds. These challenges range from weak economic growth abroad, to a significantly strengthened U.S. dollar, to the sharp drop in crude oil prices. Weather and the West Coast ports slowdown have also been relevant factors in some of the softness that we have seen in the reports released since December. As a result, the first quarter is likely to grow around 1.8 percent. This would be less than the 2.2 percent growth rate in real GDP seen during the fourth quarter. Nonetheless, I am predicting 2.8 percent growth in real GDP in 2015, reflecting a slight deceleration in my outlook for the year. The expectation is that we will see some rebounds moving forward, with manufacturers continuing to be more upbeat about the coming months, even with some challenges likely to continue.

Several reports provide a mixed picture of the current state of the manufacturing sector globally. Last week, manufacturing surveys from the Kansas City and Richmond Federal Reserve Banks both contracted for the first time in 12 months in March. On the positive side, respondents in these regions remain more upbeat in their outlook for the next six months, even as their enthusiasm has diminished somewhat. Along those lines, new durable goods orders declined 1.4 percent in February, falling for the fifth time in the past seven months. Much of the decrease in February stemmed from reductions in demand for transportation equipment, but the broader market was also soft. Durable goods shipments were also lower. Still, they were a bit more encouraging over a longer time horizon, up 3.9 percent over the past 12 months.

In contrast, the Markit Flash U.S. Manufacturing PMI increased from 55.1 in February to 55.3 in March, indicating relatively decent growth. In particular, there were strong expansions cited in new orders and output, with hiring up modestly but exports declining. That squares with other surveys, including the most recent NAM/*IndustryWeek* one, showing a mostly positive outlook among manufacturers, even with the headwinds mentioned earlier.

Meanwhile, consumer confidence has also slipped a little, down for the second straight month in March, even as Americans continue to be more positive today than a year ago. Similarly, the housing market has experienced a number of challenges lately, including snowstorms in the Midwest and Northeast and reduced inventory levels. The good news was that both existing and new home sales rebounded somewhat in February. In other news, the consumer price index rose for the first time in four months as gasoline prices began to rebound slightly (but continue to remain well below where they were just a few months ago). On a year-over-year basis, core inflation has increased 1.7 percent.

On the international front, manufacturing activity improved to its highest level since May 2014 in the Eurozone, but growth on the continent will continue to be sluggish for the foreseeable future. At the same time, Chinese manufacturers reported declines in activity for the third time in the past four months, with growth continuing to decelerate. China has reduced its target real GDP growth rate for 2015 to 7 percent.

This week, there will be a number of high-profile indicators released that will provide additional gauges on the current economy. This includes personal income and spending on Monday, consumer confidence on Tuesday, the Institute for Supply Management’s Purchasing Managers’ Index on Wednesday, international trade on Thursday and new jobs numbers on Friday. In addition, we will learn more about manufacturing activity from the latest Dallas Federal Reserve Board survey and factory orders and shipments data from the Census Bureau.

Chad Moutray
Chief Economist
National Association of Manufacturers

*P.S. — I am excited to announce that **Honeywell Aerospace Global Economist Christopher Reed** will prepare the Monday Economic Report for April 6. This will give us an opportunity to gain insights from a well-respected economist with on-the-ground expertise in the sector.*

Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

This Week's Indicators:

Monday, March 23
Chicago Fed National Activity Index
Existing Home Sales

Tuesday, March 24
Consumer Price Index
Markit Flash PMIs for the United States, China, Japan and the Eurozone
New Home Sales
Richmond Fed Manufacturing Survey

Wednesday, March 25
Durable Goods Orders and Shipments

Thursday, March 26
Kansas City Fed Manufacturing Survey

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

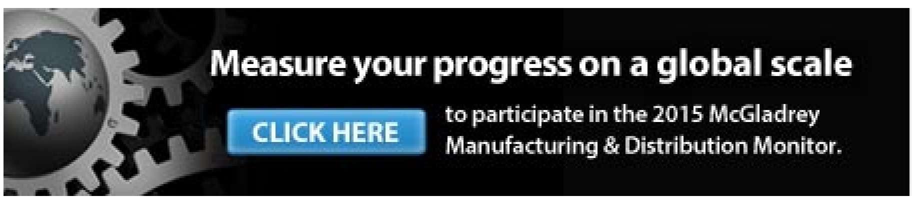
Monday, March 30
Dallas Fed Manufacturing Survey
Personal Income and Spending

Tuesday, March 31
Conference Board Consumer Confidence

Wednesday, April 1
ADP National Employment Report
Construction Spending
ISM Purchasing Managers' Index

Thursday, April 2
Factory Orders and Shipments
International Trade Report

Friday, April 3
BLS National Employment Report



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Summaries for Last Week`s Economic Indicators

Chicago Fed National Activity Index

The U.S. economy is operating slightly below its potential, according to the Federal Reserve Bank of Chicago. The National Activity Index (NAI) edged marginally lower, down from -0.10 in January to -0.11 in February. Negative values indicate that the economy is expanding below its historical average, and the NAI has contracted for three straight months. This mirrors softer economic data in other indicators as well, with headwinds coming from weaker international growth, a stronger U.S. dollar, the West Coast ports slowdown, softer-than-desired retail sales and weather.

Along those lines, manufacturing production declined for the third straight month in February, down 0.2 percent. Production-related indicators subtracted 0.07 points from the NAI in February. In addition, housing starts decreased sharply from an annualized 1,081,000 units in January to 897,000 in February, and as a result, the personal consumption and housing category reduced the NAI by 0.17 points. On the positive side, there was better news on the labor market front, with the unemployment rate dropping to 5.5 percent and nonfarm payrolls growing by at least 200,000 for 12 consecutive months. Employment-related indicators added 0.11 points to the NAI.

Consumer Price Index

The Bureau of Labor Statistics reported that the Consumer Price Index (CPI) rose for the first time in four months, up 0.2 percent in February. This was largely due to higher gasoline prices, which increased 2.4 percent for the month. To be fair, the price of regular gasoline remains 33.5 percent lower today than 12 months ago. Indeed, the average price of regular gasoline declined from \$3.639 a gallon on June 23 to

$1.982 a gallon on January 26, according to the Energy Information Administration. It then rose to $2.256 a gallon on February 23 and has since edged up to $2.347 last week.

Meanwhile, food prices increased 0.2 percent in February, with 3.0 percent growth over the past 12 months. Despite the higher overall figure for food, data were mixed. Prices were higher for beef, eggs, fish, fresh fruits, juices, poultry and spices. In contrast, coffee, dairy products, fats and oils, fresh vegetables and pork prices were lower for the month.

Excluding food and energy, core consumer prices were also up 0.2 percent in February, and on a year-over-year basis, core inflation has increased 1.7 percent. That is up slightly from 1.6 percent in January. There were notable price increases in February, including for apparel, household furnishings, medical care, new vehicles, shelter expenses and transportation services.

Yet, this report continues to reflect core pricing growth of less than 2 percent, which is the Federal Reserve's stated goal. In fact, core CPI has been below 2 percent consistently for 25 straight months, having last exceeded that threshold in February 2013. As such, pricing pressures have remained mostly in check, freeing the Federal Reserve to pursue accommodative measures. This will be true even when the Federal Open Market Committee begins to increase short-term rates in the coming months.

Durable Goods Orders and Shipments

The Census Bureau reported that new durable goods orders declined 1.4 percent in February, falling for the fifth time in the past seven months. Much of the decrease in February stemmed from reductions in demand for transportation equipment, with new orders in that sector down 3.5 percent for the month. This included a reduction in sales for motor vehicles and parts (down 0.5 percent) and fewer nondefense and defense aircraft orders (down 8.9 percent and 33.1 percent, respectively). Note that aircraft orders can be quite volatile from month to month, as nondefense aircraft orders had increased 122.2 percent in January. Therefore, we often look at the data by stripping out the transportation equipment sector, and in doing so, durable goods orders decreased by 0.4 percent, which is still a soft figure. This mirrors other data showing a number of headwinds dampening demand and output in the early months of 2015.

New durable goods orders rose just 0.6 percent between February 2014 and February 2015. Excluding transportation, this figure would be 2.3 percent year-over-year. The data paint the demand picture more positively than they perhaps should, as last year's figure was lower due to poor weather conditions at the beginning of 2014. New durable goods orders averaged $243.0 billion in 2014. In February 2015, new durable goods were $231.3 billion, reflecting a deceleration over the past six months from $245.0 billion in August 2014. (I avoid comparisons to July 2014, as it was an outsized figure boosted by strong nondefense aircraft orders, with $299.9 billion.) We hope to see the data rebound moving forward.

In this most recent analysis, other sectors with declines in new durable goods orders included fabricated metal products (down 2.0 percent), machinery (down 1.8 percent) and computers and related products (down 0.9 percent). Core capital goods orders (or nondefense capital goods excluding aircraft) dropped 2.6 percent in February. In contrast, electrical equipment and appliances (up 4.1 percent), communications equipment (up 3.0 percent) and primary metals (up 1.0 percent) saw higher orders for the month.

Meanwhile, durable goods shipments edged lower in February, down 0.2 percent. Shipments have also declined in five of the past seven months. However, the shipments data are more encouraging than new orders, with shipments up 3.9 percent over the past 12 months. This reflects a modest pace of growth that stands in sharp contrast to the softer demand numbers. In February, there were increased shipments for machinery (up 0.6 percent), computers and electronic products (up 0.5 percent) and electrical equipment and appliances (up 0.1 percent). Other major sectors had declines.

Existing Home Sales

The National Association of Realtors® (NAR) reported that existing home sales inched slightly higher, up from an annualized 4.82 million units in January to 4.88 million in February. This was down from 5.07 million existing home sales at the annual rate in December. In general, we have seen softness in the housing market, particularly in the Midwest and Northeast, due to a number of significant snowstorms.

A reduction in inventories has also been a factor in explaining the weaker data, with 4.6 months of supply on the market in February, down from 5.6 months of supply in August. According to NAR Chief Economist Lawrence Yun, “Insufficient supply appears to be hampering prospective buyers in several areas of the country and is hiking prices to near unsuitable levels.” The median home price in February was $202,600, or 7.5 percent more than 12 months ago.

Gross Domestic Product (Second Revision)
The Bureau of Economic Analysis reported that real GDP grew 2.2 percent in the fourth quarter. As such, headline growth did not change in this second revision from the earlier estimate, released last month. The U.S. economy expanded 2.4 percent in 2014, only slightly better than the 2.3 percent and 2.2 percent rates in 2012 and 2013, respectively. Of course, that somewhat understates the strength of the economy midyear, when real GDP growth averaged a rather robust 4.8 percent in the second and third quarters.

There were slight revisions to consumer spending, inventory replenishment and exports, but these largely offset one another. The underlying trend continues to be strength in terms of consumer and business spending, with the two collectively adding 3.6 percentage points to growth. This was counteracted, however, by a decline of 1.4 percentage points from net exports and government spending. Some softer spots in this report in the fourth quarter were reduced equipment spending, weaknesses in growing export sales abroad and less spending on inventories.

I am predicting 2.8 percent growth in real GDP in 2015, reflecting a slight deceleration in my outlook for the year. In particular, we have seen softer-than-desired figures for housing, industrial production and retail sales, with a number of headwinds dampening activity. As a result, the first quarter is likely to grow around 1.8 percent. The expectation is that we will see some rebounds moving forward, with manufacturers continuing to be more upbeat about the coming months, even with some challenges (such as sluggish global growth and a stronger U.S. dollar) likely to continue.

Kansas City Fed Manufacturing Survey
The Kansas City Federal Reserve Bank reported that manufacturing activity declined in March, contracting for the first time in 12 months. The composite index of general business conditions declined from 1 in February to -4 in March. Perhaps more worrisome, the decline in new orders accelerated (down from -10 to -20), falling for the third straight month. The sample comments provide clues about why this is the case, with respondents noting a number of headwinds impacting their demand. These include snowstorms, reduced crude oil prices, the stronger U.S. dollar and the West Coast ports slowdown.

Shipments from manufacturers in the region slowed to a crawl in March (down from 7 to 0). Several other indicators were negative for the month, such as production (down from 5 to -2), employment (up from -4 to -2), the average workweek (down from 1 to -17) and export orders (up from -13 to -9). As such, we have seen very soft economic data to start 2015 in the district, mirroring results seen in other areas of the country. One positive is the reduction in raw material costs (down from -6 to -12), spurred along by lower commodity prices.

This weaker current environment has dampened enthusiasm in the overall economic outlook. It remains positive, but at reduced levels from just a few months ago. The expected composite index, which looks ahead at activity six months from now, has fallen from 21 in November to 11 in February to 4 in March. Despite the deceleration in attitudes, manufacturers in the district continue to be somewhat optimistic looking ahead. One-third of respondents predict increased sales, 44 percent anticipate higher production levels, and at least half of the respondents see increased hiring and capital spending. This should provide some encouragement, even with some disappointing results in the first quarter of 2015 so far.

Markit Flash PMIs for the United States, China, Japan and the Eurozone

The HSBC Flash China Manufacturing PMI reflected reduced activity again, down from 50.7 in February to 49.2 in March. It has contracted in three of the past four months now, reflecting a decelerated growth rate in China. The country has reduced its target real GDP growth rate for 2015 to 7 percent. New orders (down from 50.4 to 49.3), exports (up from 47.1 to 49.0) and employment (down from 49.3 to 47.0) were all below 50 in March, the threshold signifying growth. It was the reduction in demand that pushed the headline index lower. On the positive side, output (unchanged at 50.8) continues to expand modestly for the month, and the decrease in input prices (up from 42.2 to 44.7) has helped manufacturers in terms of costs, even as the rate of decline was less in March.

Meanwhile, the Markit Flash Japan Manufacturing PMI declined from 51.6 to 50.4, its lowest level since May 2014. (Japan's economy slowed last spring due to the imposition of a new tax, but recovered somewhat since then.) The slower activity in March stemmed from a drop in new orders (down from 51.0 to 49.5), mirroring China. Other figures continued to grow, but at a lower rate. This includes exports (down from 53.7 to 52.2), output (down from 53.5 to 52.0) and employment (down from 50.7 to 50.1). The latter data point suggests that hiring essentially has stagnated. Overall, the Japanese economy is growing slowly, with real GDP up 0.4 percent in the fourth quarter but down 0.7 percent year-over-year. Still, industrial production increased significantly in January, up 3.7 percent.

In contrast to China and Japan, we have seen some progress in Europe. The Markit Flash Eurozone Manufacturing PMI rose from 51.0 to 51.9, its highest level since May 2014. The underlying data were higher across-the-board, including new orders (up from 50.9 to 52.2), output (up from 52.2 to 53.5), exports (up from 51.8 to 52.6) and hiring (up from 50.6 to 51.2). A pickup in activity would be welcome news, particularly given the sluggishness of growth seen on the continent recently. For instance, industrial production decreased 0.1 percent in January, its first decline in five months, and real GDP grew just 0.3 percent in the fourth quarter. The European Central Bank plans to spend 1 trillion euros over the next 18 months in an effort to boost growth in the Eurozone.

Closer to home, the Markit Flash U.S. Manufacturing PMI increased from 55.1 to 55.3, indicating decent growth in the sector domestically. In particular, there were strong expansions in new orders (up from 55.8 to 56.4) and output (up from 57.3 to 58.2). The production measure was at its fastest pace in six months. Employment increased more modestly (up from 52.8 to 53.7). On the negative side, exports (down from 51.7 to 49.3) suffered from weaknesses abroad and an accelerated U.S. dollar, contracting for just the second time in the past year.

Final data points for all of these measures will be out on Wednesday, April 1.

New Home Sales

The Census Bureau and the U.S. Department of Housing and Urban Development reported that new home sales grew strongly in February, increasing for the third straight month. There were 539,000 new single-family houses sold in February at the annual rate, up from 500,000 units in January. This represents a significant improvement from the annualized 432,000 single-family units sold in February 2014, or a 24.8 percent year-over-year gain. This most recent report found stronger sales activity in the Northeast, which rebounded from snowstorm-induced declines in January. However, the Midwest and West were weaker in February.

One challenge has been the tighter supply of new homes for sale, which was also seen in the existing home sales data (see above). There were 4.7 months of supply on the market in February, down from 5.1 months in January and 5.5 months in September.

Richmond Fed Manufacturing Survey

The Richmond Federal Reserve Bank reported that manufacturing activity contracted in March, declining for the first time in 12 months. The composite index of general business conditions decreased from zero in February to -8 in March. The underlying data were lower across-the-board, reflecting weaknesses for the month in terms of overall activity and a deterioration from February's numbers. This included new orders (down from -2 to -13), shipments (down from -1 to -13), capacity utilization (down from -4 to -7) and the average workweek (up from -6 to -4). 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. On the positive side, hiring (up from 4 to 6) continued to grow modestly, providing some encouragement moving forward.

Indeed, manufacturers in the region continue to be relatively upbeat about the next six months. Respondents were more optimistic about new orders (up from 24 to 35), shipments (up from 30 to 37), employment (up from 12 to 23) and capital spending (up from 27 to 32). These indicators are expected to increase strongly over the coming months.

Meanwhile, the inflationary data edged higher in March, even as they remain quite modest overall. Manufacturers in the region said that prices paid for raw materials grew 0.62 percent at the annual rate in March, up from 0.32 percent in February. This pace was down sharply from the 2.22 percent rate in October. Looking ahead six months, respondents anticipate raw material prices to increase 1.53 percent at the annual rate, up from the 0.91 percent pace last month.

University of Michigan Consumer Sentiment

The University of Michigan and Thomson Reuters reported that consumer confidence slipped somewhat for the second straight month. The Consumer Sentiment Index has declined from 98.1 in January to 95.4 in February to 93.0 in March. On the positive side, March's revised figure was an improvement from the preliminary estimate of 91.2 reported two weeks ago. Also of note, consumer confidence in January had been the highest in 11 years, and even with the decreases seen since then, Americans continue to be more positive today than a year ago, with the index measuring 80.0 in March 2014.

However, the data also suggest that the public remains anxious, mirroring the caution seen in recent retail sales data. The University of Michigan survey indicates some easing in both current and expected measures over the past two months. The Conference Board will release its measure of consumer confidence on March 31.

Connect with the Manufacturers

Questions or comments?

Contact Chief Economist Chad Moutray at cmoutray@nam.org.