MONDAY ECONOMIC REPORT

Even with May Decline, Retail Sales Have Soared 18% Since Pandemic Began

By Chad Moutray – June 21, 2021

The Weekly Toplines

- Retail sales fell 1.3% in May, pulled lower by sharply reduced sales at motor vehicles and parts dealers, among other segments. Yet, it is important to put the current data into perspective. Retail spending has soared 18.0% since February 2020, buoyed by stimulus benefits and a rebounding economy.

- In addition, retail sales should continue to grow strongly over the coming months as the U.S. economy continues to reopen and as supply chain disruptions in the marketplace stabilize.

- Manufacturing production rose 0.9% in May, bouncing back after edging down 0.1% in April. More importantly, output in the manufacturing sector is off just 0.5% from pre-pandemic levels, and manufacturing capacity utilization increased from 74.9% in April to 75.6% in May, the best rate since December 2019.

- Manufacturing activity in the New York and Philadelphia Federal Reserve Bank districts expanded solidly once again in June, even with some easing. In the Empire State Manufacturing Survey, delivery times narrowed to the slowest on record, and in both regions, input and final product prices continue to accelerate sharply.

- New residential construction activity rose 3.6% from 1,517,000 units at the annual rate in April to 1,572,000 units in May, with stronger single-family and multifamily housing starts. While activity has decelerated in the past couple months, housing starts remain solid overall despite rising construction costs and difficulties in finding talent.

- Home builders remain optimistic about growth over the next six months, and housing permits signal continued strength moving forward. Housing permits have risen 13.7% since February 2020, with single-family and multifamily permitting up 12.0% and 17.5% over the past 15 months, respectively.

- Producer prices for final demand goods jumped 1.5% in May. Excluding food and energy, producer prices for final demand goods rose 1.1% in May, a new monthly record. At the same time, costs for transportation and warehousing soared 1.9% in May, extending the record 2.1% gain in April.

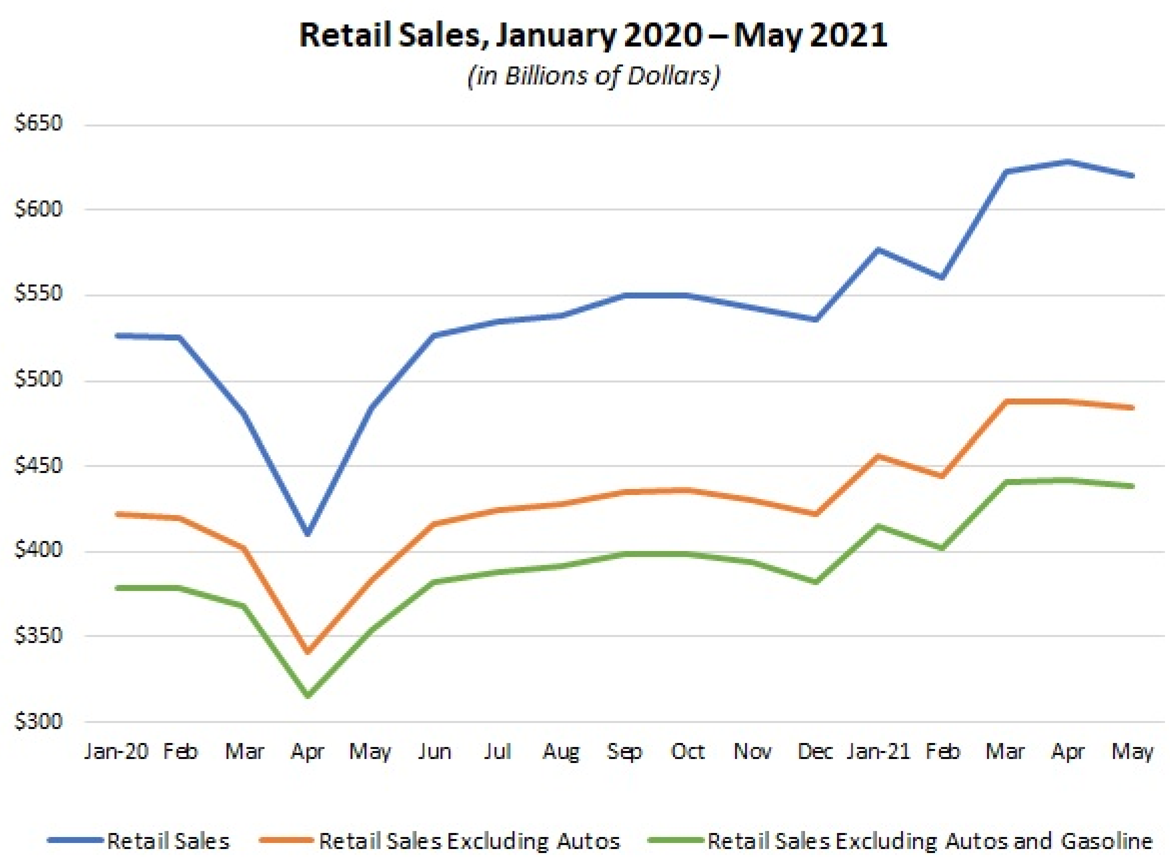
- Over the past 12 months, producer prices for final demand goods and services have jumped a seasonally adjusted 6.5%, the biggest increase on record. Over the past 15 months, producer prices have risen 5.2%, and core producer prices have risen by a record 5.3% since May 2020, with a gain of 4.3% since February 2020.

- The Federal Open Market Committee kept the target federal funds rate unchanged at zero to 25 basis points, as expected. While inflation has risen sharply, the Federal Reserve continues to feel that such increases are transitory, the result of very strong pent-up demand and supply shocks that will likely abate over the coming months.

- The Federal Reserve also released the latest economic projections , with participants expecting 7.0% real GDP growth in 2021 and core PCE inflation averaging 3.0% this year. Despite these robust figures, the FOMC sees growth moderating to 3.3% in 2022, with core PCE inflation stabilizing to 2.1% next year. The unemployment rate is seen falling to 4.5% in 2021 and 3.8% in 2022, essentially bringing the U.S. labor market to full employment over the next year or so.

- As the economy continues to improve, the Federal Reserve will be under increasing pressure to normalize its extremely accommodative policies. I would expect that the Federal Reserve will start to taper, or slow, its asset purchases later this year. In addition, once these purchases have ended, I would forecast a federal funds rate increase in mid-2022.

- With that said, the Federal Reserve's monetary policy moves will hinge on incoming data. If pricing pressures are less transitory than the FOMC assumes, it might need to accelerate its normalization plans.



Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

This Week's Indicators:

Monday, June 14
None

Tuesday, June 15
Industrial Production
NAHB Housing Market Index
New York Fed Manufacturing Survey
Producer Price Index
Retail Sales

Wednesday, June 16
FOMC Monetary Policy Statement
Housing Starts and Permits

Thursday, June 17
Conference Board Leading Indicators
Philadelphia Fed Manufacturing Survey
Weekly Initial Unemployment Claims

Friday, June 18
None

Monday, June 21
Chicago Fed National Activity Index

Tuesday, June 22
Existing Home Sales
Richmond Fed Manufacturing Survey

Wednesday, June 23
IHS Markit Flash U.S. Manufacturing PMI
New Home Sales
State Employment Report

Thursday, June 24
Durable Goods Orders and Shipments
Gross Domestic Product (Second Revision)
International Trade in Goods (Preliminary)
Kansas City Fed Manufacturing Survey
Real GDP by Industry
Weekly Initial Unemployment Claims

Friday, June 25
Personal Consumption Expenditures Deflator
Personal Income and Spending
University of Michigan Consumer Sentiment (Revision)

Deeper Dive

- **Conference Board Leading Indicators:** The Leading Economic Index increased 1.3% in May, building on the strong 1.4% and 1.3% gains in March and April, respectively. More importantly, the LEI has surpassed the recent peak in January 2020. These data point to robust growth over the coming months. New manufacturing orders data contributed 0.22 to the headline index in May, with the sector continuing to be a bright spot in the economy. Other positive contributors included consumer confidence, initial unemployment claims, the interest rate spread, lending conditions and the stock market. Building permits provided a slight drag on the LEI in May.

  Meanwhile, the Coincident Economic Index rose 0.4% in May. Manufacturing production rose 0.9% in May, rebounding after edging down in April, and output in the sector is just 0.5% below pre-pandemic levels. All four of the subcomponents were positive contributors to the CEI in May, including industrial production, manufacturing and trade sales, nonfarm payrolls and personal income less transfer payments.

- **FOMC Monetary Policy Statement:** The Federal Open Market Committee kept the target federal funds rate unchanged at zero to 25 basis points, as expected. The Federal Reserve noted strong output and labor market growth, especially as the economy reopens and more Americans get vaccinated. While inflation has risen sharply, the FOMC continues to feel that such increases are transitory, the result of very strong pent-up demand and supply shocks that will likely abate over the coming months.

  Along those lines, the Federal Reserve also released the latest economic projections, with participants expecting 7.0% real GDP growth in 2021 and core PCE inflation averaging 3.0% this year. Despite these robust figures, the FOMC sees growth moderating to 3.3% in 2022, with core PCE inflation stabilizing to 2.1% next year. The unemployment rate is seen falling to 4.5% in 2021 and 3.8% in 2022, essentially bringing the U.S. labor market to full employment over the next year or so.

The Federal Reserve has a dual mandate of price stability and full employment. Regarding core inflation, it strives for pricing pressures to average 2% over the long run. This means that it would be willing to experience core inflation that is "hotter than normal" so long as the long-run average stabilizes around its 2% goal. For its part, the FOMC has been more concerned about economic growth that has been below trend, with unemployment remaining elevated, than it has been with inflation.

As the economy continues to improve, the Federal Reserve will be under increasing pressure to normalize its extremely accommodative policies. The FOMC is currently purchasing at least $120 billion in Treasury and mortgage-backed securities each month. I would expect that the Federal Reserve will start to taper, or slow, its asset purchases later this year. In addition, once these purchases have ended, I would forecast a federal funds rate increase in mid-2022.

With that said, the Federal Reserve's monetary policy moves will hinge on incoming data. If pricing pressures are less transitory than the FOMC assumes, it might need to accelerate its normalization plans.

- **Housing Starts and Permits:** New residential construction activity rose 3.6% from 1,517,000 units at the annual rate in April to 1,572,000 units in May. Housing starts strengthened in every region of the country except the Northeast. Single-family starts increased 4.2% from 1,054,000 units to 1,098,000 units, and multifamily construction activity rose 2.4% from 463,000 units to 474,000 units.

  While new residential construction activity has decelerated from March's pace (1,725,000 units), which was the strongest since July 2006, housing starts remain solid despite rising construction costs and difficulties in finding talent. Indeed, the current pace is roughly equivalent to the average seen over the past eight months (1,576,500 units). In addition, the current pace is not far from the pre-pandemic reading in February 2020 (1,589,000 units), and single-family starts have risen 4.1% over the past 15 months, up from 1,055,000 units. More importantly, builders remain optimistic about growth over the coming months, albeit with some easing in the past couple months (see the NAHB Housing Market Index below).

  Indeed, the housing permits data—a proxy of future activity in the sector—are consistent with robust growth moving forward. While permits declined 3.0% from an annualized 1,733,000 units in April to 1,681,000 units in May, this remains a solid figure (and one that is higher than the current pace of housing starts). In May, single-family permitting decreased 1.6% from 1,148,000 units to 1,130,000 units, and multifamily activity fell 5.8% from 585,000 units to 551,000 units. Housing permits have risen 13.7% since February 2020, with single-family and multifamily permitting up 12.0% and 17.5% over the past 15 months, respectively.

- **Industrial Production:** Manufacturing production rose 0.9% in May, bouncing back after edging down 0.1% in April. Durable and nondurable goods production increased 1.0% and 0.8% for the month, respectively. Output in the motor vehicles and parts sector soared 6.7% in May, rebounding after plummeting 5.7% in April, with the chip shortage and supply chain issues continuing to factor into those shifts. Excluding motor vehicles, manufacturing production increased 0.4% in May. Manufacturing capacity utilization increased from 74.9% in April to 75.6% in May, the best rate since December 2019.

Manufacturing production has soared 18.3% over the past 12 months, but it is important to note that output in the sector tumbled 19.6% between February and April 2020. Since February 2020, output in the manufacturing sector is down 0.5% from pre-pandemic levels. Moving forward, I would expect for manufacturers to be back to pre-pandemic levels by July, with production rising 6.3% in 2021 overall.

In May, the underlying data provided mixed results. In addition to motor vehicles and parts, the largest manufacturing production gains occurred in printing and related support activities (up 3.2%), apparel and leather goods (up 2.6%), chemicals (up 2.2%), computer and electronic products (up 1.6%) and furniture and related products (up 1.5%). In contrast, sectors that saw declining output for the month included paper (down 1.6%), aerospace and miscellaneous transportation equipment (down 1.0%), wood products (down 0.8%) and primary metals (down 0.8%).

Ten of the major manufacturing sectors experienced increased production over the past 15 months, or since the COVID-19 pandemic began. This included sizable gains in output since February 2020 in apparel and leather goods (up 6.7%), computer and electronic products (up 6.6%), aerospace and miscellaneous transportation equipment (up 5.5%), chemicals (up 2.7%) and machinery (up 2.3%).

Meanwhile, total industrial production increased 0.8% in May, strengthening after inching up just 0.1% in April. Mining and utilities production rose 1.2% and 0.2% for the month, respectively. Since February 2020, industrial production remains down 1.4%. Total capacity utilization rose from 74.6% in April to 75.2% in May. That remains below the 76.3% pace seen 15 months ago before the pandemic.

- **NAHB Housing Market Index:** The Housing Market Index declined from 83 in May to 81 in June, a 10-month low, according to the National Association of Home Builders and Wells Fargo. The decline in sentiment stemmed from higher building material and lumber costs, with respondents also noting supply chain and worker shortages and low inventories as concerns. With that said, builders remained very upbeat in their overall assessments of the housing market.

  The index for current single-family home sales decreased from 88 in May to 86 in June, with the index for expected single-family sales edging down from 81 to 79. These are very solid readings, and as such, builders continued to feel extremely optimistic about increased sales moving forward despite the challenges mentioned above.

- **New York Fed Manufacturing Survey:** Manufacturing activity continued to expand solidly in June, according to the Empire State Manufacturing Survey, despite the composite index slipping from 24.3 in May to 17.4 in June. New orders, shipments, employment and the average employee workweek slowed for the month but continued to increase modestly. Input costs and selling prices both pulled back slightly from May's record paces, but the acceleration in pricing pressures remained robust, speaking to the supply chain challenges seen in the sector nationally. In the New York Federal Reserve's district, delivery times narrowed to the slowest on record.

  Meanwhile, manufacturers in the region remained very upbeat about growth over the next six months, with the forward-looking composite index rising from 36.6 in May to

47.7 in June, the best reading in one year. Roughly 6 in 10 respondents predict new orders and shipments expanding moving forward, with 44.7% and 27.2% anticipating more hiring and capital spending, respectively.

The index for expected prices received jumped to the highest since August 2008, pointing to anticipated inflation in the prices for final products being sold. At the same time, the future-oriented index for prices paid decelerated for the second straight month from April's reading, which was the highest since March 2011, but with 70.2% of those completing the survey still forecasting increases.

- **Philadelphia Fed Manufacturing Survey:** Manufacturing activity continued to expand strongly in June despite slowing slightly in some measures. The composite index declined from 31.5 in May to 30.7 in June, with new orders, inventories and the average employee workweek decelerating. At the same time, shipments and employment strengthened. The median capacity utilization rate was 70–80% compared to 60–70% last year at this time, but supply chain issues (79.5%) and labor issues (69.2%) were the largest constraints on utilization in the second quarter.

  The index for prices paid rose at the briskest rate since June 1979. Likewise, prices received also increased sharply at a rate not seen since October 1980. The data speak to the severity of supply chain disruptions in the system, with delivery times also elevated despite pulling back from a record pace.

  Manufacturers in the district remain very positive in their outlook, with the forward-looking composite index rising from 52.7 in May to 69.2 in June. More than 74% of business leaders expect orders and shipments to rise over the next six months, with 59.4% and 44.0% predicting higher employment and capital spending, respectively.

- **Producer Price Index:** Producer prices for final demand goods and services rose 0.8% in May, building on the 0.6% gain in April. At the same time, producer prices for final demand goods jumped 1.5% in May, continuing a trend of solid gains year to date. Food and energy costs increased 2.6% and 2.2% for the month, respectively. Excluding food and energy, producer prices for final demand goods rose 1.1% in May, a new monthly record. At the same time, producer prices for final demand services increased 0.6% for the month. Costs for transportation and warehousing soared 1.9% in May, extending the record 2.1% gain in April.

  Over the past 12 months, producer prices for final demand goods and services have jumped a seasonally adjusted 6.5%, the biggest increase on record. To adjust for "base effects" given the deflationary pressures seen at this time last year, it might be more helpful to look at how prices have risen since February 2020, or before the pandemic. Producer prices have risen 5.2% over the past 15 months, a still rapid pace of inflation. Meanwhile, core producer prices have risen by a record 5.3% since May 2020, with a gain of 4.3% since February 2020.

  Manufacturing leaders continue to cite supply chain disruptions as a key challenge, and the data reflect additional sharp rises in raw material prices. While some of these increases will likely be transitory, there will also likely be some cost pressures that will not abate, particularly given the strength of the rebounding economy. That will put pressure on the Federal Reserve and its stance of keeping rates near zero with aggressive bond-buying for the foreseeable future. If cost pressures are less transitory than the Federal Reserve believes, the shift toward normalization could be sooner.

- **Retail Sales**: Retail sales fell 1.3% in May, pulling back after increasing 0.9% in April. Retail sales for motor vehicles and parts dealers plummeted 3.7%, with that sector grappling with reduced inventories because of the chip shortage and supply chain disruptions. Excluding automobiles, retail spending declined 0.7% for the month.

  While these data are disappointing, it is important to put them into perspective. Retail spending has soared from $525.8 billion in February 2020 before the pandemic to $620.2 billion in May 2021, jumping a whopping 18.0% over that 15-month period. These data have been buoyed by stimulus benefits, but also a rebounding economy. In addition, retail sales should continue to grow strongly over the coming months as the U.S. economy continues to reopen and as supply chain disruptions in the marketplace stabilize.

  In May, the underlying data provided mixed results. Retail sales rose for clothing and accessories stores (up 3.0%), food services and drinking places (up 1.8%), health and personal care stores (up 1.8%), department stores (up 1.6%), food and beverage stores (up 1.0%) and gasoline stations (up 0.7%). At the same time, spending declined for building material and garden supply stores (down 5.9%), miscellaneous store retailers (down 5.0%), motor vehicles and parts dealers (down 3.7%), electronics and appliance stores (down 3.4%), general merchandise stores (down 3.3%), furniture and home furnishings stores (down 2.1%) and nonstore retailers (down 0.8%).

- **Weekly Initial Unemployment Claims**: Initial unemployment claims totaled 412,000 for the week ending June 12, rising for the first time in seven weeks, up from 375,000 for the week ending June 5. Initial claims have averaged 417,000 over the past six weeks. Meanwhile, continuing claims inched up from 3,517,000 for the week ending May 29 to 3,518,000 for the week ending June 5, remaining consistent with 2.5% of the workforce.

  At the same time, 14,828,950 Americans received some form of unemployment insurance benefit (including state and federal programs) for the week ending May 29. That figure was down from 15,388,823 for the week ending May 22, largely from reduced state and federal pandemic assistance.

Questions or comments? Email NAM Chief Economist Chad Moutray at cmoutray@nam.org.