MONDAY ECONOMIC REPORT

Manufacturers' Optimism Rises to Highest Level in Nearly Three Years

By Chad Moutray – June 28, 2021

The Weekly Toplines

- In the second quarter NAM Manufacturers' Outlook Survey , 90.1% of respondents felt either somewhat or very positive about their company outlook, rising for the fourth straight quarter and the best reading in nearly three years. Respondents are predicting the highest levels of production, sales and job growth in Outlook Survey history. Three-quarters of manufacturers expect revenues will be back to pre-pandemic levels by the end of 2021.

- Rising raw material costs once again topped the list of primary business challenges in the second quarter, with record paces expected for input costs and product prices over the next 12 months. In addition to rising costs, other top worries in the second quarter include the inability to attract and retain a quality workforce, supply chain challenges, transportation and logistics costs and rising health care and insurance costs.

- The PCE deflator rose 0.4% in May, and since February 2020, the PCE deflator has risen 3.3%, with core inflation up 3.1% over the past 15 months.

- The IHS Markit Flash U.S. Manufacturing PMI expanded at a record pace, buoyed by stronger growth in output, future output and employment despite severe supply chain challenges. Raw material costs and output prices soared once again at all-time-high rates.

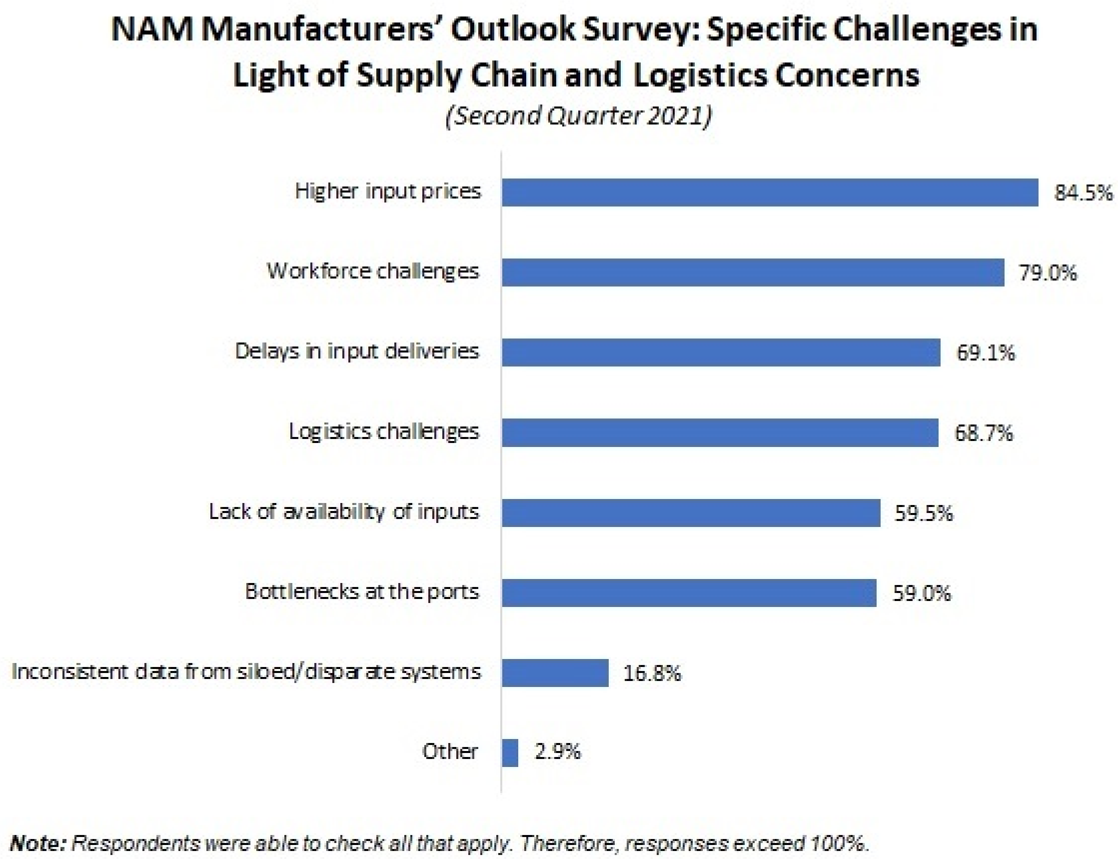
- Manufacturing in the Kansas City and Richmond Federal Reserve Bank's district also continued to expand rapidly, with a strong outlook despite lingering supply chain and workforce challenges and elevated costs.

- New orders for durable goods rose 2.3% in May and have jumped 9.7% since February 2020, or 16.3% over the past 15 months with transportation equipment excluded. Similarly, core capital goods orders have soared 15.9% from pre-pandemic levels, with shipments rising to a new record in the latest data.

- After soaring by a record-breaking 20.9% in March, fueled by stimulus checks to many Americans, personal income decreased 13.1% and 2.0% in April and May, respectively. Even with those pullbacks, personal income has jumped 5.7% year to date.

- In the manufacturing sector, total wages and salaries have risen 3.4% over the past five months, with 5.0% growth since February 2020.

- Personal spending was flat in May but has soared 5.3% over the past 15 months. The saving rate remained elevated at 12.4% in May.
- The U.S. economy grew 6.4% at the annual rate in the first quarter. Real GDP remains just 0.9% shy of the pre-pandemic levels seen at the end of 2019, and the U.S. economy should return to that pace in the current (second) quarter.
- Value-added output in the manufacturing sector rose to $2.444 trillion in the first quarter, an all-time high, including records for durable and nondurable goods. Real manufacturing value-added output, expressed in chained 2012 dollars, also increased to a record level. Manufacturing accounted for 11.1% of real GDP in the first quarter.



Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

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

This Week's Indicators:

Monday, June 28
Dallas Fed Manufacturing Survey

Tuesday, June 29
Conference Board Consumer Confidence

Wednesday, June 30
ADP National Employment Report

Thursday, July 1
Construction Spending

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
NAM Manufacturers' Outlook 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)

ISM® Manufacturing Purchasing Managers' Index®
Weekly Initial Unemployment Claims

Friday, July 2
BLS National Employment Report
Factory Orders and Shipments
International Trade Report

Deeper Dive

- **[Chicago Fed National Activity Index](#):** The U.S. economy rebounded in May after softening in April, according to the Chicago Federal Reserve Bank. The National Activity Index improved from -0.09 in April to 0.29 in May, and the three-month moving average rose from 0.17 to 0.81. More importantly, the data suggest that growth is expanding above its historical trend, spurred by the reopening of the U.S. economy and strong demand for goods and services.

  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. Production-related indicators added 0.29 to the NAI in May, bouncing back after pulling the index down by 0.05 in April. Other components of the NAI were mixed. The labor market variables contributed 0.16 to the headline index on solid hiring figures in May, including 23,000 additional manufacturing workers and with the unemployment rate dropping to 5.8%. At the same time, housing data softened, with rising costs and low inventories dampening activity. The personal consumption and housing category subtracted 0.18 from the top-line figure in May.

- **Durable Goods Orders and Shipments:** New orders for durable goods rose 2.3% in May, rebounding from the 0.8% decline in April. Motor vehicle sales bounced back somewhat from April's 8.1% decrease, rising 2.1% in May, even as the sector continues to cope with supply chain issues, especially the chip shortage. Excluding transportation equipment, new durable goods orders increased 0.3% in May, slowing from the 1.7% gain in April.

  In the latest data, the underlying data were mixed. In addition to automobiles, demand strengthened for nondefense aircraft and parts (up 27.4%), primary metals (up 2.2%), electrical equipment, appliances and components (up 1.3%) and other durable goods (up 1.0%). In contrast, new orders declined in May for defense aircraft and parts (down 1.5%), fabricated metal products (down 1.1%), machinery (down 0.4%) and computers and electronic products (down 0.3%). Nondefense capital goods excluding aircraft—a proxy for capital spending in the U.S. economy—edged down 0.1% from the record $75.3 billion in April to $75.2 billion in May.

  Overall, durable goods have risen sharply since February 2020, jumping 9.7% over the past 15 months, or 16.3% with transportation equipment excluded. Similarly, core capital goods orders have soared 15.9% over the past 15 months, as firms have ramped up activity on the brighter economic outlook.

  Meanwhile, durable goods shipments increased 0.4% from $247.4 billion in April to $248.3 billion in May, a record. With transportation equipment excluded, shipments of durable goods rose 0.7% in May, also to a new all-time high ($177.3 billion). Over the past 15 months, durable goods shipments have risen 4.9%, or 11.7% excluding transportation equipment. In addition, core capital goods shipments increased 0.9% from $72.6 billion to $73.3 billion, an all-time high, with 12.8% growth since February 2020.

- **Existing Home Sales:** The National Association of Realtors reported that existing home sales fell for the fourth straight month, edging down 0.9% from 5.85 million units in April to 5.80 million units in May, an 11-month low. NAR Chief Economist Lawrence Yun attributed the decline to low inventory but also noted affordability as a challenge. The May data weakened in every region of the country except for the Midwest. Single-family sales declined for the fifth consecutive month, down from 5.13 million units in April to 5.08 million units in May, but condominium and co-op sales remained at 720,000 units.

  Since the pandemic began, existing home sales have risen a modest 1.8% since February 2020, but on a year-over-year basis (against a challenging comparable month in May 2020), growth was a robust 44.6%.

  Inventories of existing homes for sale have risen from a record low of 1.9 months of supply on the market in December and January to 2.5 months in May, but the supply of homes on the market remains historically low overall. The median sales price for existing homes has jumped 23.6% year-over-year, up to $350,300 in May, a new record.

- **Gross Domestic Product (Second Revision):** The U.S. economy grew 6.4% at the annual rate in the first quarter, unchanged from the previous estimate and building on the 4.3% gain in the fourth quarter. In this revision, stronger durable goods consumption, exports, inventory spending, personal consumption expenditures and nonresidential fixed investment were offset by higher imports than previously estimated.

  Overall, first quarter real GDP was buoyed by robust rebounds in consumer spending and sizable growth in business fixed investment and government spending, but growth would have been larger if not for weaknesses in spending on inventories and nonresidential structures and in net exports. More importantly, real GDP remains just 0.9% shy of the pre-pandemic levels seen at the end of 2019, and the U.S. economy should return to that pace in the current (second) quarter, even as growth remains well below trend (of where it would have been without COVID-19). The current forecast is for 6.5% growth in 2021 overall, boosted by more Americans getting vaccinated, pent-up consumer and business demand and government stimulus.

- **IHS Markit Flash U.S. Manufacturing PMI:** Manufacturing activity in the U.S. expanded at a record pace, for a data series dating to May 2007, with the preliminary headline index rising from 62.1 in May to 62.6 in June. The data were buoyed by stronger growth in output (up from 58.1 to 59.2), future output (up from 70.7 to 74.5) and employment (up from 53.3 to 53.9), with new orders (down from 65.3 to 63.4) and exports (down from 56.7 to 54.6) slowing but still impressive. Yet, raw material costs (up from 78.8 to 83.8) and output prices (up from 70.9 to 71.8) soared once again at all-time-high rates, and respondents continued to cite severe supply chain disruptions. At the same time, the IHS Markit Flash U.S. Services PMI decelerated from a record 70.4 in May to 64.8 in June—a figure that continued to reflect very healthy economic growth.

  Meanwhile, the IHS Markit Flash Eurozone Manufacturing PMI was unchanged at 63.1 in June, with the headline index remaining at an all-time high. This was led by slightly stronger expansions for output and employment, with hiring rising at the best rate since January 2018. New orders and exports softened somewhat but remained very robust, and respondents remained upbeat in their assessments of future output. Input costs and product prices both soared at record paces in June, for the data series dating to June 1997. In addition, the IHS Markit Flash Eurozone Composite Output PMI jumped from 57.1 to 59.2, the highest since June 2006, and buoyed by renewed service-sector activity as Europe begins to reopen on the lifting of recent COVID-19 restrictions.

  Manufacturing activity improved in Germany in June but slowed in France and, outside the Eurozone, in the United Kingdom, in preliminary survey results from IHS Markit. The expansions were solid in each of these countries, with manufacturers very optimistic about future production.

- **International Trade in Goods (Preliminary):** In advance statistics, the goods trade deficit rose from $85.73 billion in April to $88.11 billion in May. Goods imports increased from $230.50 billion to $232.39 billion, and goods exports declined from $144.77 billion to $144.28 billion.

  In May, increased goods exports for consumer goods (up $954 million), foods, feeds and beverages (up $91 million) and other goods (up $22 million) were not enough to offset reduced exports for capital goods (down $559 million), automotive vehicles (down $557 million) and industrial supplies (down $444 million). Meanwhile, goods imports were buoyed by strength in industrial supplies (up $2.23 billion) and foods, feeds and beverages (up $835 million). Final data will be released July 2, which will also include the service-sector trade surplus.

- **Kansas City Fed Manufacturing Survey:** Manufacturing activity continued to expand rapidly, with the composite index of general business conditions edging up from 26 in May to 27 in June. Employment, the average employee workweek and exports strengthened for the month, but new orders, production and shipments softened somewhat. The sample comments noted supply chain and logistics constraints, workforce recruitment challenges and rising raw material costs. On the topic of costs, the index for raw materials prices pulled back from a record 86 in May to 79 in June but remained extremely elevated. The index for prices received for finished products also eased slightly from an all-time high of 51 to 48.

  At the same time, respondents continued to feel very upbeat about additional growth over the next six months, with the forward-looking composite index rising from 33 in May to 37 in June, a new high. Respondents expected growth in capital expenditures to increase at the strongest pace since September 2018.

- **NAM Manufacturers' Outlook Survey:** In the second quarter survey, 90.1% of respondents felt either somewhat or very positive about their company outlook. It was the fourth straight quarterly increase in optimism in the survey, with the outlook bouncing back from the 33.9% reading one year ago, which was the worst since the Great Recession. More importantly, this suggests that manufacturers had the strongest outlook in nearly three years, since the third quarter of 2018, and manufacturers are predicting the highest levels of production, sales and job growth in Outlook Survey history.

  Respondents were asked when they expect revenues to return to pre-pandemic levels. Encouragingly, 48.5% said that their revenues had recovered by the end of the first quarter of 2021. Three-quarters of manufacturers completing this survey anticipate that their revenues will be back to pre-pandemic levels by the end of 2021, with 88.7% saying the same thing by the end of 2022.

  Rising raw material costs once again topped the list of primary business challenges in the second quarter, cited by 86.6% of respondents. In addition, manufacturers predict 7.5% growth on average for input costs over the next 12 months, the fastest pace since the question was added to the survey in the second quarter of 2018. Respondents expect product prices to rise 5.6% on average between now and this time next year, a new record in the more than 23 years that this survey has existed.

  In addition to rising costs, other top worries in the second quarter include the inability to attract and retain a quality workforce (77.5%), supply chain challenges (71.3%), transportation and logistics costs (60.1%) and rising health care and insurance costs (50.4%).

- **New Home Sales:** New single-family home sales fell from 817,000 units at the annual rate in April to 769,000 units in May, a 12-month low. It was the fourth straight monthly decline, pulling back from January's pace of 993,000 units, which was the strongest pace since December 2006. In May, sales fell sharply in the South and were flat in the Midwest but increased in the Northeast and West. New single-family home sales have risen 9.2% year-over-year, but since February 2020 (or before the COVID-19 pandemic), activity has increased 5.3%.

There were 5.1 months of supply on the market in May, also a 12-month high and up from 4.2 months and 4.6 months in March and April, respectively. The median sales price for new homes jumped to $374,400 in May, a new record and up 18.1% from $317,100 one year ago.

- **Personal Consumption Expenditures Deflator:** The PCE deflator rose 0.4% in May, slowing from the 0.6% gains in March and April. Food prices increased 0.3% for the month, but energy costs were flat. Excluding food and energy prices, the PCE deflator increased 0.5% in May, easing after rising 0.7% in April, the most since October 2001. Overall, the PCE deflator has risen 3.9% year-over-year, the most since August 2008, and core inflation has increased 3.4% since May 2020, the fastest pace since April 1992. To be fair, there are "base effects" that are skewing these data, with deflationary pressures in the comparison month last year. Since February 2020, the PCE deflator has risen 3.3%, with core inflation up 3.1% over the past 15 months.

  Rising raw material costs continue to be a major concern for manufacturers, as noted in the latest NAM Manufacturers' Outlook Survey (see above), and these data are consistent with price growth in other economic indicators, with supply chain disruptions and soaring pent-up demand in the marketplace. As such, cost pressures have accelerated, but the key will be whether those price increases are transitory or more sustained.

  Core inflation is likely to remain highly elevated in the coming months. To the extent that the current price growth is transitory, the Federal Reserve is likely to accept inflation that runs a little hotter than we have become accustomed to, particularly if the longer-term average continues to hover around 2%, which is its stated goal. With that said, I would expect the Federal Open Market Committee to start the process of tapering its asset purchases by year's end, with a possible interest rate hike in mid-2022.

- **Personal Income and Spending:** After soaring by a record-breaking 20.9% in March, fueled by stimulus checks to many Americans, personal income decreased 13.1% and 2.0% in April and May, respectively. The data have been highly volatile over the past few months, largely on federal stimulus payments, but the bottom line is that personal income has jumped 5.7% year to date, even with the pullback in the past two months.

  On the topic of stimulus, total unemployment insurance payments were $458.8 billion in May, down from $495.1 billion in April. Unemployment insurance payments in total have averaged $517.4 billion in the first five months of 2021, up from the average of $296.5 billion in the fourth quarter of 2020. At the same time, other government social benefits plummeted from $4.75 trillion in March, an all-time high, to $1.40 trillion in April and $864.7 billion in May.

  Total wages and salaries increased 0.8% in May, or 3.7% year to date. In the manufacturing sector, wages and salaries rose from $965.7 billion in April to $973.5 billion in May, and wages and earnings in the sector have risen 3.4% over the past five months. More importantly, manufacturing wages and salaries have jumped 5.0% since before the pandemic, up from $926.9 billion in February 2020.

  Meanwhile, personal consumption expenditures were flat in May following 5.0% and 0.9% gains in March and April, respectively. Durable and nondurable goods spending fell 2.8% and 0.4% in May, respectively, but service-sector purchases increased 0.7% for the month as the economy continues to rebound amid more Americans getting vaccinated. Over the past 15 months, personal spending has increased 5.3%, with durable and nondurable goods soaring 33.4% and 12.7% since February 2020, respectively, but with service-sector purchases down 1.2% over that time frame.

The personal saving rate remains very elevated despite slipping from 27.6% in March to 14.5% in April to 12.4% in May. This suggests that Americans continue to save much of the extra dollars and earnings, even as spending has risen sharply since the pandemic began. For comparison purposes, the saving rate averaged 7.5% in 2019.

- **Real GDP by Industry:** The U.S. economy grew 6.4% at the annual rate in the first quarter (see above). According to the Bureau of Economic Analysis, real value-added output in the manufacturing sector rose from $2.234 trillion at the annualized rate in the fourth quarter to a record $2.270 trillion in the first quarter, as expressed in chained 2012 dollars. This suggests that the sector has rebounded strongly following COVID-19-related weaknesses over the past year. The previous peak was in the fourth quarter of 2019 ($2.236 trillion). In the latest data, real value-added output for durable goods increased from $1.250 trillion to $1.296 trillion, a record pace, but with nondurable goods activity declining from $982.8 billion to $972.2 billion.

  Overall, real value-added output in manufacturing grew 6.5% at the annual rate in the first quarter, adding 0.73 percentage points to headline real GDP growth. Manufacturing accounted for 11.1% of real GDP in the first quarter, up from 10.9% in the fourth quarter.

  Digging into the data, manufacturing value-added output increased from $2.348 trillion in the fourth quarter to $2.444 trillion in the first quarter, an all-time high. The previous record was in the fourth quarter of 2019 ($2.370 trillion). Value-added output for durable (up from $1.333 trillion to $1.366 trillion) and nondurable (up from $1.014 trillion to $1.078 trillion) goods both rose to new record levels in the first quarter. Similarly, manufacturing gross output increased from $6.186 trillion in the fourth quarter to a record $6.409 trillion in the first quarter, with an all-time high for durable goods, up from $3.290 trillion to $3.345 trillion. Gross output in the nondurable goods sector increased from $2.896 trillion to $3.064 trillion, the best in seven years.

- **Richmond Fed Manufacturing Survey:** Manufacturing businesses in the Richmond Federal Reserve Bank's district continued to expand solidly, with the composite index of general business activity rising from 18 in May to 22 in June, an eight-month high. The index for new orders soared to the best reading since September 1997, buoying the headline number. At the same time, shipments, capacity utilization, capital spending and employment softened somewhat for the month. The backlog of orders and vendor lead times pulled back from record levels but remained highly elevated. Meanwhile, the forward-looking indicators remained encouraging, with manufacturers in the district expecting continued solid growth in activity over the next six months. The index for expected employment jumped to an all-time high.

  Raw material costs eased from growth of 9.82% in May to 9.42% in June—a rate that remains extremely robust. Firms reported that the prices received for their goods and services increased 5.00% in June, slowing slightly from 5.41% in the previous survey. Likewise, respondents anticipate an annualized 5.19% increase in costs six months from now, decelerating from 6.71% in the prior release. Manufacturers in the district see expected prices received increasing by 4.80%, or little changed from 4.81% in the May report.

- **State Employment Report:** Michigan created the most net new manufacturing jobs in May, adding 4,600 workers. Other states with notable employment growth for the month included Wisconsin (up 3,500), Texas (up 3,200), Arkansas (up 2,500), California (up 2,400) and Illinois (up 2,000). Over the past 15 months, just six states have notched increased manufacturing employment since February 2020, or since the pandemic began. Those states were Utah (up 5,200), Arkansas (up 1,200), Nevada (up 1,100), Nebraska (up 700), Alaska (up 200) and Montana (up 100). The largest declines over that time period occurred in big states, such as California (down 71,700), Michigan (down 48,900), Texas (down 39,200), Illinois (down 38,300) and Ohio (down 38,000).

  The national unemployment rate was 5.8% in May, and the rate fell in 21 states and the District of Columbia in the latest data. Hawaii had the highest unemployment rate in the country at 8.1%, followed by New Mexico (8.0%), California (7.9%), New York (7.8%), Nevada (7.8%) and Connecticut (7.7%). At the other end of the spectrum, the lowest unemployment rates in the United States in May occurred in New Hampshire (2.5%), Nebraska (2.6%), Vermont (2.6%), Utah (2.7%), South Dakota (2.8%) and Idaho (3.0%).

- **University of Michigan Consumer Sentiment (Revision):** Consumer confidence rose from 82.9 in May to 85.5 in June, according to final data from the University of Michigan and Thomson Reuters. This was lower than the previous estimate of 86.4. Americans felt more upbeat in their assessments of future conditions, particularly for upper-income households, but their views of the current economic environment slipped somewhat since May. Consumers are keenly aware of higher prices, with an expectation that interest rates will need to rise over the next year. On a more favorable note, most survey respondents also anticipate reduced unemployment over the coming months.

- **Weekly Initial Unemployment Claims:** Initial unemployment claims totaled 411,000 for the week ending June 19, off slightly from the 418,000 for the week ending June 12. Initial claims have averaged 417,000 over the past seven weeks. Meanwhile, continuing claims declined from 3,534,000 for the week ending June 5 to 3,390,000 for the week ending June 12, the lowest since the week of March 21, 2020. This was consistent with 2.4% of the workforce, down from 2.5% in the previous release.

  At the same time, 14,845,450 Americans received some form of unemployment insurance benefit (including state and federal programs) for the week ending June 5. That figure increased slightly from 14,841,694 for the week ending May 29.

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Take Action

- **Second Quarter Economic Outlook Webinar—** The Q2 Manufacturers' Outlook Survey shows optimism among manufacturers is near a three-year high. However, the top concerns for manufacturers are large-scale issues, ones seemingly often out of a manufacturer's control. Facing these external pressures, explore efficient options to mitigate one controllable risk that affects several other risks and subsequent costs: the mental and physical fatigue facing your current workforce. Join us for a review of the latest survey results, current economic indicators and how a focus on one of the top issues could positively impact several of the other top 10 issues. The next webinar will be on Thursday, July 8, at 2:00 p.m. EDT. Click here to register.

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