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MONDAY ECONOMIC REPORT

Sharp Price Growth Erodes Real Earnings and Purchasing Power

By Chad Moutray – August 16, 2021

The Weekly Toplines

- Consumer prices rose 0.5% in July, reflecting some moderation in costs for used cars and trucks and transportation services, both of which have risen sharply in recent months. Still, the consumer price index has risen 5.3% (seasonally adjusted) over the past 12 months, the same year-over-year pace as in June, remaining the fastest since September 2008.

- Core consumer inflation (which excludes food and energy) increased a seasonally adjusted 4.2% year-over-year in July, slowing from 4.5% in June, which was the most since November 1991.

- The average hourly earnings of production and nonsupervisory workers in manufacturing have risen 4.5% year-over-year, up to $23.86 in July. Yet, real average hourly earnings for production and nonsupervisory workers in manufacturing have fallen 1.0% since November, as consumer inflation has reduced the real earnings of everyday manufacturing workers.

- Similarly, producer prices for final demand goods and services have jumped a seasonally adjusted 7.7%, the biggest increase on record. At the same time, core producer prices have increased a record 6.1% since July 2020.

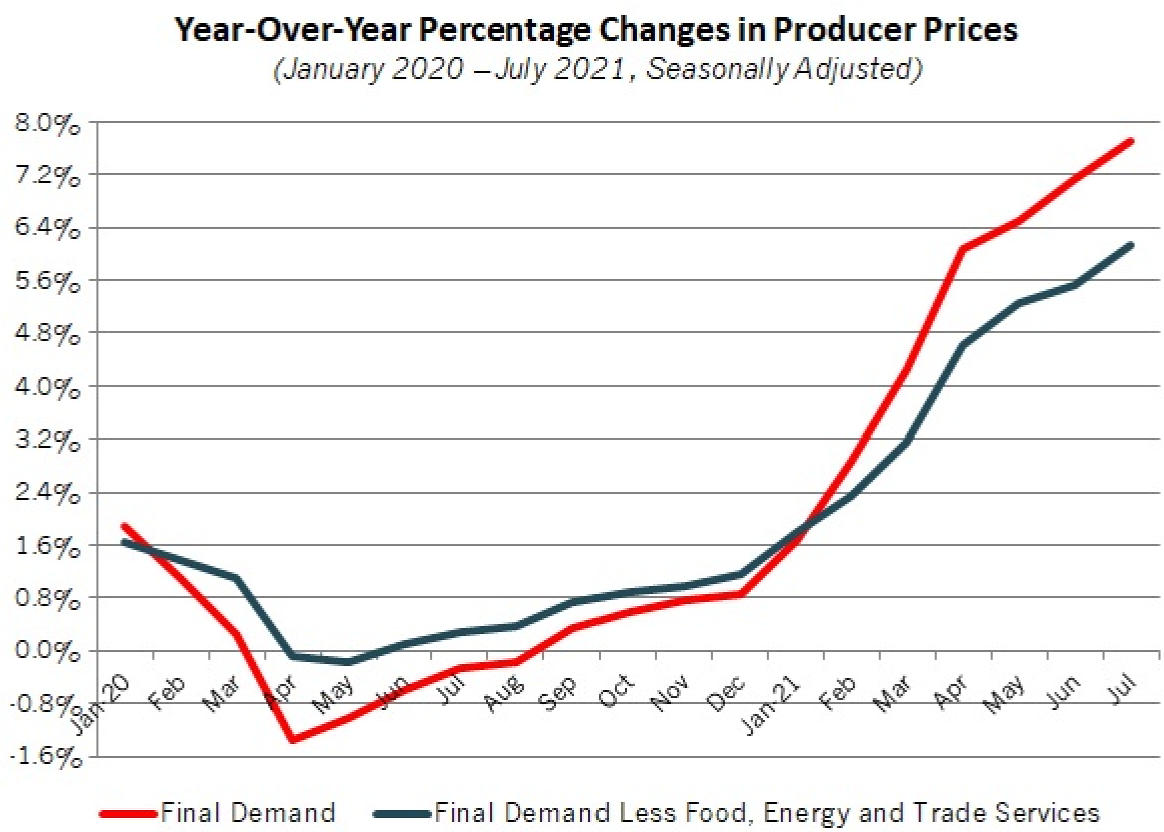
- Manufacturing leaders continue to cite supply chain disruptions and soaring costs as key challenges. That will put pressure on the Federal Reserve. In my view, the Federal Open Market Committee will start the process of tapering asset purchases at its next meeting in September, with the federal funds rate edging higher by mid-2022.

- Meanwhile, manufacturing job openings eased from a record 853,000 in May to 826,000 in June, remaining highly elevated and above 800,000 for the third straight month. Manufacturers continue to cite difficulties with attracting and retaining talent as one of their top concerns.

- In the larger economy, nonfarm business job openings rose to 10,073,000 in June, a new record. In June, there were 9,484,000 unemployed Americans, which translates to 0.94 unemployed workers for every one job opening in the U.S. economy. That speaks to the tightness of the labor market, with more job openings than people looking for work.

- The Small Business Optimism Index declined from 102.5 in June to 99.7 in July. The percentage of respondents suggesting they had job openings they were unable to fill edged up from 46% to 49%, a new record, and the percentage of respondents saying there were few or no qualified applicants for job openings ticked up from 56% to 57%, matching the all-time high in May.

- With that said, consumer confidence dropped to the lowest level since December 2011, according to preliminary data from the University of Michigan and Thomson Reuters. Americans felt more concerned about the continued spread of the delta variant of COVID-19 and its impacts on the economic outlook.



Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, August 9
Job Openings and Labor Turnover Survey

Tuesday, August 10
NFIB Small Business Survey
Productivity and Costs

Wednesday, August 11
Consumer Price Index

Thursday, August 12
Producer Price Index
Weekly Initial Unemployment Claims

This Week's Indicators:

Monday, August 16
New York Fed Manufacturing Survey

Tuesday, August 17
Industrial Production
NAHB Housing Market Index
Retail Sales

Wednesday, August 18
Housing Starts and Permits

Thursday, August 19
Conference Board Leading Indicators
Philadelphia Fed Manufacturing Survey

Friday, August 13
University of Michigan Consumer Sentiment (Preliminary

Weekly Initial Unemployment Claims

Friday, August 20
State Employment Report

Deeper Dive

- **Consumer Price Index:** Consumer prices rose 0.5% in July, slowing from the 0.9% gain in June, which was the highest in three years. Food and energy costs rose 0.7% and 1.6%, respectively, for the month, with gasoline prices up 2.4%.

  Excluding food and energy, consumer prices decelerated from 0.9% growth in June (which, along with April's reading, was the strongest pace since April 1982) to 0.3% in July. After very sharp increases in the prior three months, including a 10.5% gain in June, used car and truck prices moderated to 0.2% growth in July. The cost of transportation services, which were also strong in recent months, declined 1.1% in July. The price of new vehicles remained elevated, rising 1.7% for the month.

  Over the past 12 months, the consumer price index has risen 5.3% (seasonally adjusted), the same year-over-year pace as in June, remaining the fastest since September 2008. Meanwhile, core inflation (which excludes food and energy) increased a seasonally adjusted 4.2% year-over-year in July, slowing from 4.5% in June, which was the most since November 1991.

  Overall, price pressures have accelerated sharply for consumers, but these data also suggest that some moderation is already underway, especially for used cars and trucks and transportation services. Consumer price growth will remain elevated for the foreseeable future, but this report does give some credence to the notion that at least some of the cost increases were transitory.

- **Job Openings and Labor Turnover Survey:** Manufacturing job openings eased from a record 853,000 in May to 826,000 in June, remaining highly elevated and above 800,000 for the third straight month. In June, job openings slowed a bit from all-time highs in May for both durable (down from 480,000 to 465,000) and nondurable (down from 373,000 to 362,000) goods. With strong demand and a need to ramp up production, manufacturers must hire more workers to be able to increase capacity, pushing job postings to unprecedented levels. These data offer an encouraging sign that manufacturers feel confident enough about economic growth over the coming months for their businesses to post new jobs. Yet, manufacturing business leaders continue to cite difficulties with attracting and retaining talent as one of their top concerns.

  In the larger economy, nonfarm business job openings rose from 9,483,000 in May to 10,073,000 in June, a new record. In June, there were 9,484,000 unemployed Americans, which translates to 0.94 unemployed workers for every one job opening in the U.S. economy. That speaks to the tightness of the labor market, with more job openings than people looking for work. Note that the number of unemployed Americans fell further in July, down to 8,702,000.

  In June, manufacturers hired 469,000 workers, up from 427,000 in May, with increased hiring for both durable and nondurable goods firms. At the same time, total separations rose from 380,000 to 436,000. Therefore, net hiring (or hiring minus separations) was 33,000 in June, somewhat slower than the gain of 47,000 in May.

Nonfarm business layoffs dropped from 1,353,000 in May to 1,310,000 in June, the lowest level on record for a series dating to December 2000. Meanwhile, layoffs in the manufacturing sector decreased from 110,000 to 98,000, a four-month low.

Finally, it is important to look at the "churn" in the labor market, as this provides an indication of the health of the economy. For instance, workers do not switch jobs if there is nervousness in the economic outlook. Quits in the manufacturing sector jumped from 245,000 in May to 307,000 in June, the most since December 2000. At the same time, nonfarm payroll quits rose from 3,630,000 to 3,869,000, which was just shy of the record set in April (3,992,000).

- **NFIB Small Business Survey:** The National Federation of Independent Business reported that the Small Business Optimism Index declined from 102.5 in June to 99.7 in July, reflecting some renewed anxieties in the business outlook for small firms. The percentage of respondents saying that the next three months would be a "good time to expand" pulled back from the post-pandemic high of 15% to 13%, and the net percentage reporting greater sales over the next three months dropped from 7% to -4%.

  As with other surveys, pricing pressures remain very elevated. In July, the net percentage of respondents reporting higher prices today than three months ago inched down from a record 47% to 46%. In addition, the net percentage planning a price increase over the next three months remained an all-time high at 44%.

  The labor market remained challenging. The percentage of respondents suggesting they had job openings they were unable to fill edged up from 46% to 49%, a new record, and the percentage of respondents saying there were few or no qualified applicants for job openings ticked up from 56% to 57%, matching the all-time high in May. At the same time, the percentage of respondents planning to increase hiring over the next three months eased from a record 28% to 27%. Respondents once again cited difficulties in obtaining enough labor as the top "single most important problem."

- **Producer Price Index:** Producer prices for final demand goods and services rose 1.0% in July, matching the gain in June. At the same time, producer prices for final demand goods grew 0.6% in July, moderating from the increase of 1.2% in June. Energy costs rose solidly for the third straight month, up 2.6% in July, but prices for food declined for the first time since December, down 2.1% for the month. Excluding food and energy, producer prices for final demand goods rose 1.0% in July, matching the gain in June. Meanwhile, producer prices for final demand services increased 1.1% in July, the fastest monthly pace on record (for a series dating to November 2009), including 1.7% and 2.7% growth for trade costs and transportation and warehousing costs, respectively.

  Over the past 12 months, producer prices for final demand goods and services have jumped a seasonally adjusted 7.7%, the biggest increase on record. (The non-seasonally adjusted figure was 7.8%, also an all-time high.) Meanwhile, core producer prices have increased a record 6.1% since July 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.

In my view, the Federal Open Market Committee will start the process of tapering asset purchases at its next meeting in September, with the federal funds rate edging higher by mid-2022.

- **Productivity and Costs:** Manufacturing labor productivity jumped 6.9% at the annual rate in the second quarter, rebounding strongly after dropping 1.3% in the first quarter. Output in the sector rose 3.8% in the second quarter, increasing for the fourth straight quarter, but hours worked and real hourly compensation declined 2.9% and 3.3%, respectively. Unit labor costs fell 1.9%. Labor productivity for durable and nondurable goods increased 4.6% and 7.8% in the second quarter, respectively. Output in the nondurable goods sector jumped 9.9% in the second quarter, but durable goods output decreased 1.4%.

  Meanwhile, nonfarm business labor productivity increased 2.3% in the second quarter, slowing from the 4.3% gain in the first quarter. Output soared 7.9% in the second quarter, extending the 8.4% increase in the first quarter and up strongly for the fourth consecutive month. These data continue to reflect the rebounding of the economy, especially in services. Hours worked rose 5.5%, with unit labor costs increasing 1.0%.

- **University of Michigan Consumer Sentiment:** Consumer confidence dropped from 81.2 in July to 70.2 in August, the lowest level since December 2011, according to preliminary data from the University of Michigan and Thomson Reuters. Americans felt more concerned about the current and future economic outlook, particularly as the delta variant of COVID-19 has continued to spread so rapidly around the country. More specifically, "… the extraordinary surge in negative economic assessments also reflects an emotional response, mainly from dashed hopes that the pandemic would soon end." The decline in August extended the easing in sentiment in July, which was mainly attributed to Americans becoming more aware of inflationary pressures in the economy.

- **Weekly Initial Unemployment Claims:** Initial unemployment claims totaled 375,000 for the week ending Aug. 7, down from 387,000 for the week ending July 31 and a four-week low. Meanwhile, continuing claims decreased from 2,980,000 for the week ending July 24 to 2,866,000 for the week ending July 31—the lowest figure since the COVID-19 pandemic began. Continuing claims were consistent with 2.1% of the workforce, down from 2.2% in the previous report.

  At the same time, 12,055,290 Americans received some form of unemployment insurance benefit (including state and federal programs) for the week ending July 24. That figure fell from 12,974,883 for the week ending July 17, largely on reduced state and pandemic benefits assistance.

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