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MONDAY ECONOMIC REPORT

Essential Takes on Leading Economic Indicators

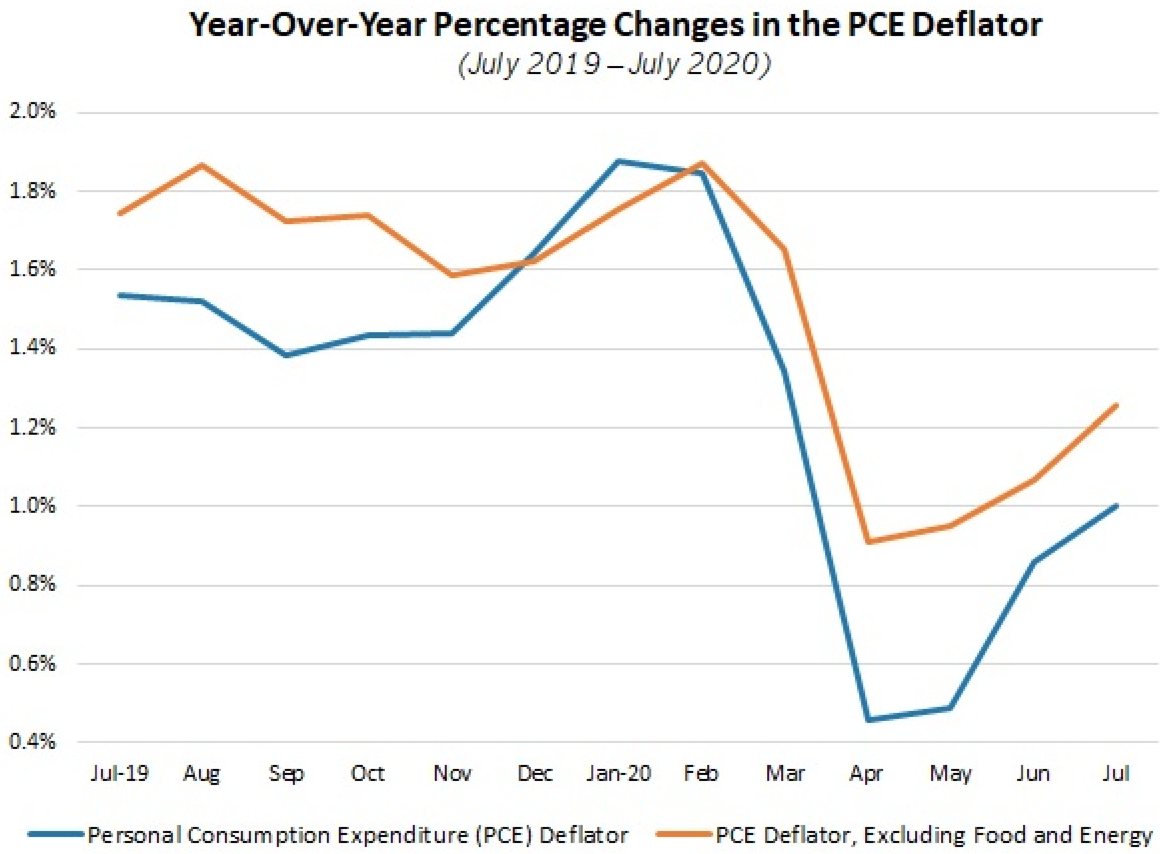
By Chad Moutray, Ph.D., CBE – August 31, 2020– SHARE

When Doves Fly: The Federal Reserve Will Accept Higher Inflation in Short Run

The Weekly Toplines

- In a long-anticipated speech, Federal Reserve Chair Jerome Powell said that monetary policymakers would be willing to accept core inflation above the Federal Open Market Committee's stated goal of 2%, so long as the longer-term average achieved that goal. The FOMC affirmed the more "dovish" change in strategy in a statement made afterward. With core inflation well below that goal right now, the test of this new policy will have to come later.
- Therefore, as part of its dual mandate to have stable prices and to encourage full employment, the FOMC is more willing to let inflation run "hotter" than it might have in the past to promote faster economic growth. In addition, it means that the Federal Reserve is likely to have easier monetary policy for the foreseeable future—something that it had already acknowledged.
- The personal consumption expenditures deflator increased 0.3% in July, but it has risen just 1% year-over-year, and core inflation, which excludes food and energy costs, has increased 1.3% over the past 12 months.
- New orders for durable goods jumped 11.2% in July, extending the 15.0% and 7.7% gains in May and June, respectively, with the sector rebounding from steep declines due to the COVID-19 pandemic. Despite the improvement, new orders for durable goods have dropped 5.0% year-over-year, or with transportation equipment excluded, sales have fallen 1.0% since July 2019.
- Similarly, manufacturers in the Kansas City and Richmond Federal Reserve Bank districts reported stronger growth in August, with cautious optimism in their outlook for the next six months.
- New single-family home sales soared 13.9% from 791,000 units in June to 901,000 units in July, the best reading since December 2006. Historically low mortgage rates have helped buoy the market. Over the past 12 months, new single-family home sales have jumped 36.3%, up from 661,000 units in July 2019 and with robust gains across the country.

- Personal spending rose 1.9% in July, increasing for the third straight month. At the same time, personal consumption expenditures have fallen 2.8% since July 2019, down from a decline of 16.3% year-over-year in April. Consumers spent 7% less on services in July than one year earlier, but encouragingly, durable and nondurable goods spending rose 12.6% and 3.3% year-over-year, respectively.
- The saving rate, which had soared to an all-time high of 33.7% in April, declined for the third consecutive month to 17.8% in July. However, that remains highly elevated, well above the 7.5% average in 2019, suggesting that consumers remain cautious in their spending despite progress in the economy since the depths of the pandemic.
- Meanwhile, personal income edged up 0.4% in July, rising for the first time since April. These data have been heavily influenced by transfer payments over the past few months. Unemployment insurance has soared from $27.8 billion in February to $1.47 trillion in June, pulling back to $1.36 trillion in July. In addition, government assistance checks were largely responsible for the 12.2% increase in personal income in April. Overall, personal income has risen 8.2% since July 2019.
- In July, wages and salaries and proprietors’ income both increased 1.4%. However, these figures fell 1.1% and 2.3% year-over-year, respectively. Manufacturing wages and salaries rose from $848.9 billion in June to $868.9 billion in July, down 3.9% from $904.6 billion one year earlier.
- Consumer confidence measures provided mixed results last week. The University of Michigan and Thomson Reuters reported that Americans felt more upbeat in their outlook, but the Conference Board’s index declined to the lowest level since May 2014 on lingering worries about COVID-19 and household finances. Both reflected sentiment that was well below prepandemic levels.
- The U.S. economy contracted by 31.7% at the annual rate in the second quarter, the largest decline in the history of the series, which dates to 1947. Moving forward, real GDP should rise by at least 18% in the third quarter as economic activity resumes, albeit with lingering reluctance for many participants, at least until there is more certainty regarding the virus and its spread. The outlook is for economic growth to shrink 4.1% in 2020, expanding 3.5% in 2021.



Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, August 24
Chicago Fed National Activity Index

Tuesday, August 25
Conference Board Consumer Confidence
New Home Sales
Richmond Fed Manufacturing Survey

Wednesday, August 26
Durable Goods Orders and Shipments

Thursday, August 27
Gross Domestic Product (Revision)
Kansas City Fed Manufacturing Survey
Weekly Initial Unemployment Claims

Friday, August 28
International Trade in Goods (Preliminary)

This Week's Indicators:

Monday, August 31
Dallas Fed Manufacturing Survey

Tuesday, September 1
Construction Spending
ISM® Manufacturing Purchasing Managers' Index®

Wednesday, September 2
ADP National Employment Report
Factory Orders and Shipments

Thursday, September 3
International Trade Report
Productivity and Costs (Revision)
Weekly Initial Unemployment Claims

Friday, September 4
BLS National Employment Report

Personal Consumption Expenditures Deflator
Personal Income and SpendingUniversity of Michigan Consumer Sentiment (Revision)

Deeper Dive

- **Chicago Fed National Activity Index**: The Chicago Federal Reserve Bank's National Activity Index slowed from 5.33 in June to 1.18 in July, but the data continue to reflect strong rebounds in the economy over the past three months. Indeed, the three-month moving average jumped to 3.59 in July, up from -2.78 in June and a new all-time high. Readings at -0.70 or lower are consistent with the U.S. economy being in a recession. Solid growth in the NAI provides some optimism that the nation is beyond the worst of the severe COVID-19 recession seen in the spring months, even as challenges persist.

  Employment and production have helped the NAI recover in recent months. In July, manufacturing production rose 3.4%, even as output in the sector has fallen 7.7% year-over-year. At the same time, manufacturers have added 623,000 workers over the past three months, but there remain 740,000 fewer workers since February. The unemployment rate fell to 10.2%—a rate that continues to be highly elevated.

- **Conference Board Consumer Confidence**: According to the Conference Board, consumer confidence fell to the lowest level since May 2014 in the latest survey, with the headline index dropping from 91.7 in July to 84.8 in August. Americans felt less upbeat about both current and future economic conditions, largely on lingering uncertainties surrounding the COVID-19 pandemic and household finances. Along those lines, the percentage of respondents suggesting that business conditions were "good" declined from 17.5% to 16.4%, while the percentage feeling that conditions were "bad" increased from 38.9% to 43.6%.

  The labor market also remained weaker than desired. The percentage of respondents feeling jobs were "plentiful" decreased from 22.3% to 21.5%. At the same time, those saying jobs were "hard to get" rose from 20.1% to 25.2%. In terms of the jobs outlook, the percentage of respondents expecting more jobs in the next six months edged down slightly from 29.6% to 29.1%, while those predicting fewer jobs inched up from 21.3% to 21.9%.

- **Durable Goods Orders and Shipments**: New orders for durable goods jumped 11.2% in July, extending the 15.0% and 7.7% gains in May and June, respectively, with the sector rebounding from steep declines due to the COVID-19 pandemic. Transportation equipment sales rose sharply in July, up 35.6%, boosted by automobiles and defense aircraft. Excluding transportation equipment, new durable goods orders increased 2.4% in July, with higher sales in every major category. Nondefense capital goods excluding aircraft—a proxy for capital spending in the U.S. economy—rose 1.9% in July, building on 1.5% and 4.3% increases in May and June, respectively.

New durable goods orders have bounced back strongly after plummeting dramatically in April due to the pandemic and widespread closures and supply chain disruptions. Over the past 12 months, new orders for durable goods have dropped 5.0%, or with transportation equipment excluded, sales have fallen 1.0% since July 2019. At the same time, core capital goods orders have declined 0.2% year-over-year. Each measure has improved handsomely over the past three months. For example, core capital goods were down 7.3% year-over-year in April.

Meanwhile, shipments of durable goods have risen 4.1%, 15.2% and 7.3% in May, June and July, respectively. In the latest data, shipments increased 2.5% without transportation equipment included. Since July 2019, durable goods shipments have fallen 1.6%, and excluding transportation, shipments have declined 0.8% year-over-year. In addition, core capital goods shipments have decreased 0.4% over the past 12 months, a nice turnaround after falling 8.1% year-over-year in April.

- **Gross Domestic Product (Revision):** The U.S. economy contracted by 31.7% at the annual rate in the second quarter, the largest decline in the history of the series, which dates to 1947. The latest data reflect a slight improvement from the original estimate of a 32.9% decrease. With the nation grappling with the COVID-19 pandemic, economic activity was severely curtailed under stay-at-home orders, business closures and unprecedented operational disruptions for manufacturers and other firms. Moving forward, real GDP should rise by at least 18% in the third quarter as economic activity resumes, albeit with lingering reluctance for many participants, at least until there is more certainty regarding the virus and its spread. The outlook is for economic growth to shrink 4.1% in 2020, expanding 3.5% in 2021.

  Breaking down the details in this report:

  - **Personal consumption expenditures** fell an annualized 34.1% in the second quarter, extending the 6.9% decline in the first quarter and contributing to 24.76% of the drop in headline real GDP. The bulk of this decline stemmed from service-sector spending, reflecting the extent of business closures. Durable goods spending fell 12.5% and 1.3% in the first and second quarters, respectively, with nondurable goods spending off 14.9% in the second quarter.
  - **Business investment** fell a whopping 46.2% at the annual rate, with nonresidential and residential investment down 26.0% and 37.9%, respectively. Activity declined sharply across the board, with gross private domestic investment subtracting 8.66% from headline growth. This included private inventories, which have declined for five straight quarters and shrunk real GDP by 3.46% in the second quarter, as firms have reduced their spending on stockpiles.

  - **Net exports** added 0.90% to top-line growth in the second quarter, being a positive contributor to real GDP for four consecutive quarters. However, that masks the true story, which reflects a massive decline in trade volumes in the quarter. Goods exports and imports plummeted 66.3% and 49.5% at annual rates in the second quarter.
  - **Government spending** provided mixed results. Federal government spending rose an annualized 17.6% in the second quarter, reflecting the uptick in transfer payments and adding 1.23% to real GDP growth. It was a rare bright spot. In contrast, state and local government spending dropped 5.5% at the annual rate, subtracting 0.41% from top-line growth.
- **International Trade in Goods (Preliminary):** In advance statistics, the goods trade deficit rose from $70.99 billion in June to $79.32 billion in July, the highest pace since December 2018. In July, the increase in goods imports (up from $173.84 billion to $194.33 billion) outpaced the rise in goods exports (up from $102.86 billion to $115.01 billion), pushing the goods trade deficit higher. Each has bounced back following steep declines in the spring due to the COVID-19 pandemic and global recession, with goods imports rising to the best reading since February.

  Goods exports and imports increased across the board in July, with very sizable gains for automotive vehicles, capital goods, consumer goods and industrial supplies. Final data will be released Sept. 3, which will also include the service-sector trade surplus.

- **Kansas City Fed Manufacturing Survey:** Manufacturing activity continued to rebound in the district, with the composite index of general business conditions rising from 3 in July to 14 in August, the highest reading since November 2018. Expansions for new orders, shipments, production and employment each accelerated in August, with the sector bouncing back from sharp declines in the spring due to the COVID-19 pandemic. Forty-five percent of respondents said sales had risen in the month, up from 36% in July. Export orders rose ever so slightly for the first time since February, and prices for raw materials also picked up on stronger economic growth.

  Moving forward, respondents continued to feel cautiously positive about increased growth over the next six months, even with slight pullbacks in the outlook for production and shipments. Overall, 46% of manufacturers expect new orders to rise moving forward, with 27% predicting declining sales. At the same time, 43% and 25% anticipate more hiring and capital spending, respectively. The sample comments note difficulties with firms finding enough talent.

- **New Home Sales:** New single-family home sales soared 13.9% in July, building on the 20.5% and 15.1% increases in May and June, respectively, with the housing market recovering from steep declines at the beginning of the COVID-19 pandemic. New home sales rose from 791,000 units in June to 901,000 units in July, the best reading since December 2006. Historically low mortgage rates have helped buoy the market, with sales growth in July in every region of the country except for the Northeast. Over the past 12 months, new single-family home sales have jumped 36.3%, up from 661,000 units in July 2019 and with robust gains across the country.

Inventories of new homes for sale have narrowed significantly, declining from 4.6 months of supply in June to 4.0 months in July, which has helped boost prices. The median sales price in July was $330,600, up 7.2% from the $308,300 median one year ago.

- **Personal Consumption Expenditures Deflator:** The PCE deflator increased 0.3% in July, slowing from the gain of 0.5% in June but rising for the third straight month. After experiencing sharp deflationary pressures in March and April at the beginning of the COVID-19 pandemic, the latest data suggest that costs have stabilized since then. More importantly, the PCE deflator has risen just 1% year-over-year, and core inflation, which excludes food and energy costs, has increased 1.3% over the past 12 months. Energy prices rose 2.5% in July, but food costs declined 0.9%. On a year-over-year basis, energy prices have fallen 11.4%, with prices for food up 4.3%.

  Despite higher costs in the past three months, the core PCE deflator has remained below 2% for 19 straight months. More than anything, the Federal Reserve remains more worried about economic growth than inflation, as seen in the extraordinary measures taken over the past few months to help prop up the economy and to address credit and liquidity concerns in financial markets.

  In a long-anticipated speech, Federal Reserve Chair Jerome Powell said that monetary policymakers would be willing to accept core inflation above the Federal Open Market Committee's stated goal of 2%, so long as the longer-term average achieved that goal. The FOMC affirmed the more "dovish" change in strategy in a statement made afterward. With core inflation well below that goal right now, the test of this new policy will have to come later. The implications, however, are twofold. First, it suggests that—as part of its dual mandate to have stable prices and to encourage full employment—the FOMC is more willing to let inflation run "hotter" than it might have in the past to promote faster economic growth. Second, it means that the Federal Reserve is likely to have easier monetary policy (e.g., very low interest rates, aggressive bond purchasing) for the foreseeable future—something that it had already acknowledged.

- **Personal Income and Spending:** Personal consumption expenditures rose 1.9% in July, increasing for the third straight month, with Americans continuing to spend modestly after pulling back dramatically in their purchasing in the spring due to COVID-19. Durable and nondurable goods spending rose 3.1% and 1.4% in July, respectively. At the same time, consumers remain more anxious than the headline number might suggest. Over the past 12 months, personal spending has fallen 2.8% since July 2019, down from a decline of 16.3% year-over-year in April. Consumers spent 7% less on services in July than one year earlier, but encouragingly, durable and nondurable goods spending rose 12.6% and 3.3% year-over-year, respectively.

Along those lines, the saving rate, which had soared to an all-time high of 33.7% in April, declined for the third consecutive month to 17.8% in July. However, that remains highly elevated, well above the 7.5% average in 2019, suggesting that consumers remain cautious in their spending despite progress in the economy since the depths of the pandemic.

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In July, wages and salaries and proprietors' income both increased 1.4%. However, these figures fell 1.1% and 2.3% year-over-year, respectively. Manufacturing wages and salaries rose from $848.9 billion in June to $868.9 billion in July, down 3.9% from $904.6 billion one year earlier.

- **Richmond Fed Manufacturing Survey:** Manufacturing activity in the Richmond Federal Reserve Bank's district expanded strongly in August, with the sector continuing to bounce back from the lowest reading in the survey's history in April. The composite index of general business activity rose from 10 in July to 18 in August, rising for the second straight month. The underlying data provided mixed results. New orders and the average workweek accelerated, and capital spending and hiring grew in August for the first time since the COVID-19 pandemic began. At the same time, shipments and capacity utilization slowed slightly for the month. The forward-looking indicators remained encouraging despite pulling back somewhat in August, suggesting that manufacturers in the region expect increased activity over the next six months.

  Raw material costs increased from 0.93% at the annual rate in July to 1.62% in August. In addition, manufacturers' expectations for input price growth changed little in the latest survey. Respondents anticipate an annualized 1.91% increase in costs six months from now, edging down from 1.97% in the prior survey.

- **University of Michigan Consumer Sentiment (Revision):** Consumer confidence edged up from 72.5 in July to 74.1 in August, according to final data from the University of Michigan and Thomson Reuters. That represents an improvement from the preliminary estimate for the Index of Consumer Sentiment of 72.8 in August. Americans felt more upbeat in their outlook for the future, with their assessments of current conditions little changed. Still, consumer confidence remains well below the levels seen before the COVID-19 outbreak. The headline index reached a nearly two-year high in February at

101.0, before plummeting to 71.8 in April, the lowest level since December 2011.

- **Weekly Initial Unemployment Claims:** Initial unemployment claims declined from 1,104,000 for the week ending Aug. 15 to 1,006,000 for the week ending Aug. 22. Overall, initial claims have decelerated overall since peaking at 6,867,000 for the week ending March 28, averaging 1,068,000 over the past four weeks. However, they remain highly elevated, illustrating continuing pain in the labor market. To put the current numbers in perspective, initial claims peaked during the Great Recession at 665,000 for the week ending March 28, 2009.

  Meanwhile, continuing claims dropped from 14,758,000 for the week ending Aug. 8. to 14,535,000 for the week ending Aug. 15. As such, 9.9% of the workforce received unemployment insurance in the latest data, down from 10.1% in the previous report.

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