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MONDAY ECONOMIC REPORT

Manufacturing Value-Added Output Rose to a Record $2.52 Trillion in Q2:2021

By Chad Moutray – October 4, 2021

The Weekly Toplines

- The U.S. economy grew 6.7% at the annual rate in the second quarter. Real value-added output in manufacturing rose by an annualized 5.5% in the second quarter, with the sector accounting for 11.1% of real GDP.

- Manufacturing value-added output increased from $2.444 trillion in the first quarter to $2.525 trillion in the second quarter, an all-time high. Both durable goods and nondurable goods set new records. Real value-added output in manufacturing rose to a record $2.329 trillion in the second quarter, as expressed in chained 2012 dollars.

- The current forecast is for 5.8% growth in 2021 overall, with real GDP rising 3.8% in 2022. In addition, real GDP should rise by 4.5% in the third quarter, downshifting somewhat from prior estimates due to challenges related to supply chain disruptions and rising COVID-19 cases.

- The ISM® Manufacturing Purchasing Managers' Index® expanded robustly once again, with the headline index rising from 59.9 in August to 61.1 in September. New orders and production remained solid, albeit with some easing in the latter. The employment data were consistent with challenges in hiring, with 47% noting difficulties in increasing their workforce.

- The ISM® survey noted continuing concerns with supply chain disruptions, rising costs and workforce shortages. Prices accelerated in September, even as they have pulled back from June's pace, which was the fastest since July 1979.

- New orders for durable goods jumped 1.8% to a record $263.5 billion in August, buoyed by strength in nondefense aircraft and parts sales, which can be highly volatile month to month. Excluding transportation equipment, new durable goods orders increased 0.2% to $182.7 billion, also an all-time high.

- Nondefense capital goods excluding aircraft—a proxy for capital spending in the U.S. economy—rose to a record $77.1 billion in August. This increase marked an encouraging sign that businesses are investing at a very healthy pace, consistent with an optimistic outlook for the coming months. It also mirrored—in my view—the record pace of job openings in the sector, with firms also investing more in human capital.

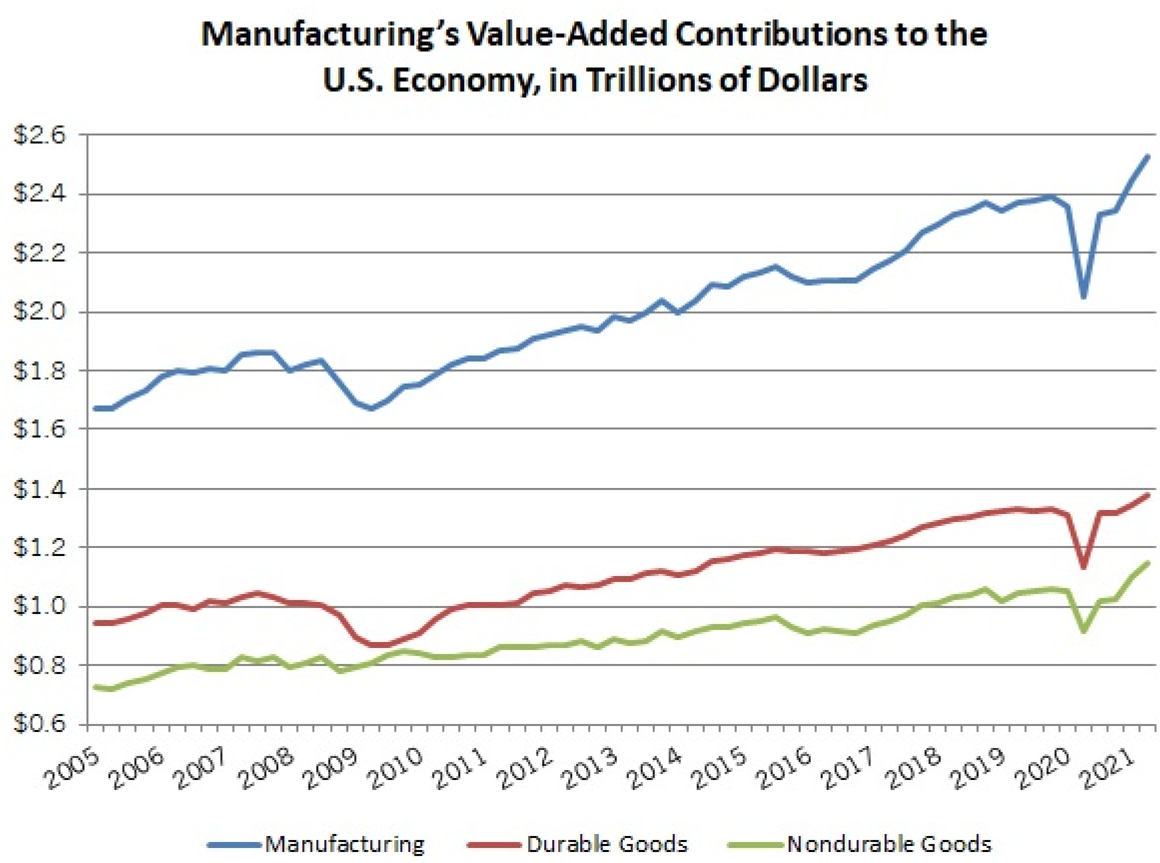
- Private manufacturing construction spending declined 1.7% to $73.63 billion in August, a four-month low. Relative to pre-pandemic levels, private manufacturing construction has declined 3.3% from $76.16 billion in February 2020.

- Personal consumption expenditures increased 0.8% in August, rebounding after edging down by 0.1% in July. Since February 2020, personal spending has increased a solid 7.7%. Meanwhile, personal income rose 0.2% in August, with wages and salaries increasing 0.5% for the month. Since February 2020, manufacturing wages and salaries have increased 4.8%.

- Consumer confidence fell to the lowest level since February, declining from 115.2 in August to 109.3 in September, according to the Conference Board. Americans felt less upbeat about the current and future economy, largely on concerns about the spread of the delta variant and on inflationary worries.

- The PCE deflator rose 0.4% in August, and excluding food and energy prices, the PCE deflator increased 0.3% in August. Overall, the PCE deflator has risen 4.3% year-over-year, the greatest increase since January 1991. Core inflation has increased 3.6% since August 2020, the same year-over-year pace as in June and July, remaining the fastest pace of inflation since May 1991.

- I continue to expect the Federal Open Market Committee to announce that it will start tapering its asset purchases at its November 2–3 meeting, with a possible interest rate hike in mid-2022.



Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

This Week's Indicators:

Monday, September 27
Dallas Fed Manufacturing Survey
Durable Goods Orders and Shipments

Tuesday, September 28
Conference Board Consumer Confidence
International Trade in Goods (Preliminary)
Richmond Fed Manufacturing Survey

Wednesday, September 29
None

Thursday, September 30
Gross Domestic Product (Second Revision)
Real GDP by Industry
Weekly Initial Unemployment Claims

Friday, October 1
Construction Spending
ISM® Manufacturing Purchasing Managers' Index®
Personal Consumption Expenditures Deflator
Personal Income and Spending

Monday, October 4
Factory Orders and Shipments

Tuesday, October 5
International Trade Report

Wednesday, October 6
ADP National Employment Report

Thursday, October 7
Consumer Credit
Weekly Initial Unemployment Claims

Friday, October 8
BLS National Employment Report

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Deeper Dive

- **Conference Board Consumer Confidence**: Consumer confidence fell to the lowest level since February, declining from 115.2 in August to 109.3 in September, according to the Conference Board. Americans felt less upbeat about the current and future economy, largely on concerns about the spread of the delta variant and on inflationary worries. The percentage of respondents suggesting that business conditions were “good” decreased from 20.2% to 19.3%, while the percentage feeling that conditions were “bad” grew from 24.1% to 25.4%. At the same time, the percentage of respondents suggesting jobs were “plentiful” edged up from 55.6% to 55.9%, while those saying jobs were “hard to get” rose from 11.2% to 13.4%.

Regarding the outlook, the percentage of consumers anticipating better business conditions over the next six months slipped from 23.4% to 21.5%, while those predicting a worsening of conditions inched up from 17.4% to 17.6%. Meanwhile, the percentage of respondents expecting more jobs in the next six months declined from 23.1% to 21.5%, while those expecting fewer jobs increased from 18.0% to 20.3%. Along those lines, 17.3% of consumers predicted higher incomes in the months ahead, down from 18.2%, with the percentage anticipating reduced incomes rising from 9.9% to 11.5%.

- **Construction Spending:** Private manufacturing construction spending declined 1.7% from $74.94 billion in July to $73.63 billion in August, a four-month low. Demand in the manufacturing sector remained strong, but there were constraints on capacity. This report should provide some optimism for improvements in construction activity moving forward. Yet, uncertainties persist related to supply chain disruptions and COVID-19, which might be holding back faster growth. Relative to pre-pandemic levels, private manufacturing construction has declined 3.3% from $76.16 billion in February 2020.

  Total private nonresidential spending decreased 1.0% in August, and since February 2020, activity has fallen 12.5%. For the month, construction activity increased for communication and office projects, with the largest declines in the health care, lodging, manufacturing, power, religious and transportation categories.

  Overall, total private construction spending edged down 0.1% in August, but with 9.9% growth since February 2020. The August figure was boosted by strength in the housing market, which grew 0.4% in July to a new record high, soaring 29.0% over the past 18 months. Meanwhile, public construction spending was up 0.5% in August, but with a decline of 8.0% from the pre-pandemic pace.

- **Dallas Fed Manufacturing Survey:** Manufacturing activity expanded in September at the slowest pace since July 2020. The composite index of general business conditions declined from 9.0 in August to 4.6 in September. With that said, the underlying data were mixed. New orders, hours worked and capital expenditures each weakened somewhat for the month, but capacity utilization, production, shipments and employment improved. The sample comments noted ongoing challenges with supply chain disruptions, workforce shortages and soaring input prices, much like other surveys. The index for raw material costs rose from 74.9 to 80.4, or just shy of the record seen in June (80.8). Growth was similar in wages and benefits and finished goods prices, easing from the all-time highs in June but still rising strongly. Meanwhile, the index for finished goods jumped from 38.1 to 44.0, an all-time high.

  Looking ahead, manufacturers in the Texas district remained positive in their outlook for the next six months, but with the forward-looking composite measure decreasing from 15.1 to 11.5, a 14-month low. Optimism about growth in new orders, production and shipment slipped slightly but remained solid. Hiring expectations soared to a new record, and manufacturers expressed optimism that wages and benefits, input costs and prices for finished goods would remain highly elevated over the next six months.

- **Durable Goods Orders and Shipments:** New orders for durable goods jumped 1.8%, rising from $258.9 billion in July to a record $263.5 billion in August. Nondefense aircraft and parts, which can be highly volatile month to month, soared 77.9% in August after plummeting by 36.3% in July. These results buoyed transportation equipment sales by 5.5% for the month. Excluding transportation equipment, new durable goods orders increased 0.2% in August. Although orders slowed from the 0.8% gain seen in July, they also rose to an all-time high, up from $182.2 billion to $182.7 billion.

  In addition to nondefense aircraft and parts, demand strengthened in August for fabricated metal products (up 2.0%), computers and electronic products (up 1.4%) and electrical equipment and appliances (up 1.3%). In contrast, new orders declined for motor vehicles and parts (down 3.1%), primary metals (down 1.5%) and machinery (down 1.2%).

  Nondefense capital goods excluding aircraft—a proxy for capital spending in the U.S. economy—rose from $76.7 billion in July to a record $77.1 billion in August. This increase marked an encouraging sign that businesses are investing at a very healthy pace, consistent with an optimistic outlook for the coming months. It also mirrored—in my view—the record pace of job openings in the sector, with firms also investing more in human capital.

  Overall, while durable goods orders slowed in August beyond nondefense aircraft and parts, the data continued to reflect a very strong upward trend. Orders rose 11.0% year to date, or 9.0% with transportation equipment excluded. Similarly, core capital goods orders have grown 7.6% since December 2020.

  Meanwhile, durable goods shipments declined 0.5% in August, pulling back from a record $257.3 billion to $256.1 billion. Shipments of motor vehicles and parts were off by 2.7% for the month. With transportation equipment excluded, shipments of durable increased by 0.5% in August, to a new all-time high ($182.6 billion). So far this year, durable goods shipments have risen 9.4%, or 13.7% excluding transportation equipment. In addition, core capital goods shipments increased 0.7% from $74.4 billion to $74.9 billion, an all-time high, with 6.9% year to date.

- **Gross Domestic Product (Second Revision):** The U.S. economy grew 6.7% at the annual rate in the second quarter. This figure is higher than the previous estimate of 6.6% and builds on the 6.3% gain seen in the first quarter. Overall, second quarter real GDP was buoyed by consumer spending and nonresidential fixed investment, with both continuing to rebound solidly. At the same time, federal government spending, net exports, residential investment and spending on inventories held back faster growth.

  More importantly, real GDP is now 0.9% above the pre-pandemic levels seen at the end of 2019. This improvement represents a relatively quick turnaround given the magnitude of the decline in activity seen in the February to April 2020 recession. The current forecast is for 5.8% growth in 2021 overall, with real GDP rising 3.8% in 2022. In addition, real GDP should rise by 4.5% in the third quarter, downshifting somewhat from prior estimates due to challenges related to supply chain disruptions and rising COVID-19 cases.

- **International Trade in Goods (Preliminary):** The goods trade deficit rose from $86.82 billion in July to $87.60 billion in August. While these figures remained below June's all-time high ($92.01 billion), the goods trade deficit remained elevated. This deficit has averaged nearly $89 billion year to date in 2021, up from the annual averages of $71.79 billion and $76.84 billion in 2019 and 2020, respectively. In August, goods exports increased from $147.94 billion to $149.04 billion, a new all-time high. But goods imports were also higher, rising from $234.76 billion to $236.64 billion.

In the latest data, the increase in goods exports was led by strength in industrial supplies (up $3.15 billion) and consumer goods (up $429 million), which was enough to offset declines for automotive vehicles (down $1.06 billion), foods, feeds and beverages (down $733 million) and capital goods (down $655 million). Meanwhile, stronger imports for consumer goods (up $2.79 billion) and industrial supplies (up $1.67 billion) helped buoy goods imports in August. The largest decline in goods imports for the month was in automotive vehicles (down $1.57 billion). Final data, which will also include the service-sector trade surplus, will be released Oct. 5.

- **ISM® Manufacturing Purchasing Managers' Index®:** The Institute for Supply Management® reported that manufacturing activity expanded robustly once again, with the headline index rising from 59.9 in August to 61.1 in September. New orders (unchanged at 66.7) remained very healthy, with production (down from 60.0 to 59.4) slowing slightly but with a still-solid reading. Employment (up from 49.0 to 50.2) rebounded in September. More than anything, these data reflected challenges in hiring, with 85% of respondents saying that they were currently hiring, but 47% noting challenges in doing so. Exports (down from 56.6 to 53.4) grew modestly for the month, despite some deceleration.

  The sample comments noted continuing concerns with supply chain disruptions, rising costs and workforce shortages, while also recognizing solid growth in orders. Indices for the backlog of orders (down from 68.2 to 64.8), supplier delivery times (up from 69.5 to 73.4) and customer inventories (up 30.2 to 31.7) were consistent with still-significant supply chain challenges in the sector.

  Prices (up from 79.4 to 81.2) accelerated in September. However, these data have pulled back from June's reading (92.1), which reported the fastest increase since July 1979. Overall, cost pressures remained very significant, consistent with other indicators, including the most recent NAM outlook survey, which cited soaring prices as the top concern.

- **Personal Consumption Expenditures Deflator:** The PCE deflator rose 0.4% in August, mirroring the gain seen in July. Food prices increased 0.4% for the month, with energy costs up 1.9%. Excluding food and energy prices, the PCE deflator increased 0.3% in August, the same pace as in July. Overall, the PCE deflator has risen 4.3% year-over-year, the greatest increase since January 1991. Core inflation has increased 3.6% since August 2020, the same year-over-year pace as in June and July, remaining the fastest pace of inflation since May 1991.

  Rising raw material costs continued to be a major concern for manufacturers, These data were consistent with price growth in other economic indicators, especially with supply chain disruptions and soaring pent-up demand in the marketplace. Indeed, core inflation is likely to remain elevated, even if there is some stabilization by early 2022.

  For its part, the Federal Reserve is likely to accept inflation that runs a little hotter than what has been seen in recent years, particularly if the longer-term average continues to hover around 2%, which is its stated goal. With that said, I expect the Federal Open

Market Committee to announce that it will start tapering its asset purchases at its November 2–3 meeting, with a possible interest rate hike in mid-2022.

- **Personal Income and Spending:** Personal consumption expenditures increased 0.8% in August, rebounding after edging down by 0.1% in July. Nondurable goods spending rose 2.1% for the month, but durable goods purchases were off 0.4%. Service-sector expenditures increased 0.6% in August, continuing to improve as more Americans get out and about. Since February 2020, personal spending has increased a solid 7.7%, with durable and nondurable goods soaring 27.0% and 17.1%, respectively, and with service-sector purchases up 2.0% over that time frame.

  Meanwhile, personal income rose 0.2% in August, slowing from the 1.1% gain seen in July. Since the start of the pandemic, personal income has jumped 9.0%. Wages and salaries increased 0.5% for the month, with total manufacturing wages and salaries also up 0.5% from $971.6 billion in July to $976.9 billion in August. Since February 2020, total wages and salaries have increased 6.0%, with manufacturing data up 4.8% over the past 18 months.

  The personal saving rate decreased from 10.1% in July to 9.4% in August. Despite easing, the saving rate remained elevated, even as it decelerated from record highs during the worst of the pandemic. For comparison purposes, the saving rate averaged 7.6% in 2019 before COVID-19. These data suggest that Americans remained somewhat cautious about spending, despite economic progress year to date.

- **Real GDP by Industry:** The U.S. economy grew 6.7% at the annual rate in the second quarter. (See above.) According to the Bureau of Economic Analysis, real value-added output in the manufacturing sector rose from $2.298 trillion at the annualized rate in the first quarter to a record $2.329 trillion in the second quarter, as expressed in chained 2012 dollars. This increase suggests that the sector has continued to rebound strongly, even with lingering challenges from COVID-19 and supply chain and workforce issues. In the latest data, real value-added output for durable goods increased from $1.272 trillion to a record $1.286 trillion. Nondurable goods activity rose from $1.025 trillion to $1.043 trillion, the highest level since the fourth quarter of 2007.

  Overall, real value-added output in manufacturing grew 5.5% at the annual rate in the second quarter, adding 0.63 percentage points to headline real GDP growth. Manufacturing accounted for 11.1% of real GDP in the second quarter, unchanged from the first quarter.

  Digging into the data, manufacturing value-added output increased from $2.444 trillion in the first quarter to $2.525 trillion in the second quarter, an all-time high. Value-added output rose to new record levels in the second quarter for both durable goods (up from $1.347 trillion to $1.375 trillion) and nondurable goods (up from $1.097 trillion to $1.150 trillion). Similarly, manufacturing gross output increased from $5.987 trillion in the first quarter to a record $6.234 trillion in the second quarter. Durable goods also rose to an all-time high, up from $3.061 trillion to $3.144 trillion. Gross output in the nondurable goods sector increased from $2.926 trillion to $3.090 trillion, the best reading since the third quarter of 2014.

- **Richmond Fed Manufacturing Survey:** Manufacturing activity in the Richmond Federal Reserve Bank's district contracted slightly for the first time since May 2020. The composite index of general business activity dropped from 9 in August to -3 in September. New orders, shipments and capacity utilization all decreased for the month, with the average workweek and capital expenditures slowing. On the other hand, the backlog of orders, employment and equipment and software spending accelerated. Wage growth pulled back from the strongest on record but remained elevated. Supplier challenges continued to keep lead times highly elevated, but the backlog of orders narrowed a bit. Meanwhile, the forward-looking indicators remained encouraging, with manufacturers in the district expecting continued solid growth in activity over the next six months.

Inflation remained a significant challenge. Raw material costs soared from growth of 11.05% in August to a whopping 14.01% in September. Firms reported that the prices received for their goods and services increased 9.13% in September, edging down from 9.25% in August. Likewise, respondents noted that they anticipated an annualized 6.24% increase in costs six months from now, inching up from 6.20% in the prior release. Manufacturers in the district noted that they anticipated expected prices received increasing 5.82%, reflecting little change from 5.03% in the July report.

- **Weekly Initial Unemployment Claims:** Initial unemployment claims totaled 362,000 for the week ending Sept. 25, rising for the third straight month, and up from 351,000 for the week ending Sept. 18. Meanwhile, continuing claims were little changed, inching down from 2,820,000 for the week ending Sept. 11 to 2,802,000 for the week ending Sept. 18. Continuing claims were consistent with 2.0% of the workforce, up from 1.9% in the previous report.

  At the same time, 5,027,581 Americans received some form of unemployment insurance benefit (including state and federal programs) for the week ending Sept. 11. That figure was down dramatically from 11,250,306 for the week ending Sept. 4. The large decrease in the latest figures stemmed from sizable declines in pandemic unemployment assistance, even with state and extended benefits ticking higher.