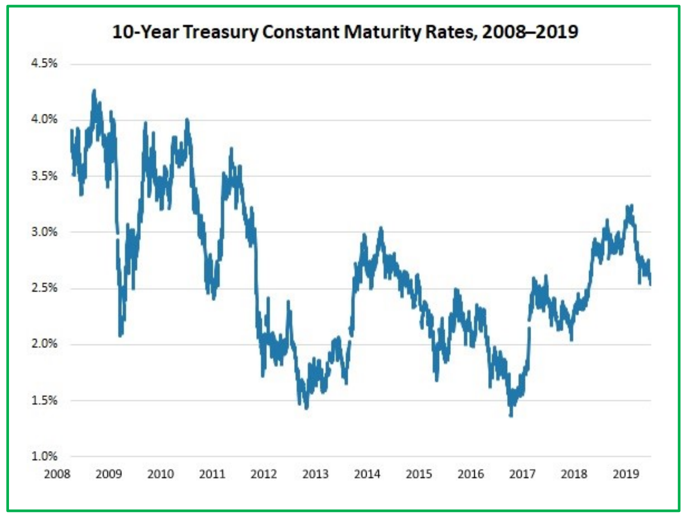
April 2019

Industry Economic Report

The Federal Reserve Hits the Pause Button for 2019

As expected, the Federal Open Market Committee left short-term rates unchanged, with the federal funds target range from 2.25 to 2.50 percent, which is where the committee left it after its December 18–19 meeting. More importantly, the Federal Reserve said it would be “patient” before taking further actions, looking for signs in the data that further normalization of rates would be warranted. This will likely mean one or possibly no rate hikes in 2019—a more “dovish” stance than just three months ago, consistent with slower economic growth with reduced pricing pressures.



The Federal Reserve forecasts 2.1 percent growth in 2019, down from an estimate of 2.3 percent in December’s projections, with 1.9 percent growth in 2020. The labor market is expected to remain solid, with the unemployment rate near 50-year lows. The FOMC predicts an unemployment rate of 3.7 percent and 3.8 percent in 2019 and 2020, respectively, with both 0.2 percentage points higher than in the estimate three months ago.

Freddie Mac reported that 30-year mortgage rates fell to 4.28 percent for a 30-year mortgage last week, the lowest rate since February 2018 and a nice reversal after nearing 5 percent in November. Reduced mortgage rates have helped to boost demand, with builder optimism rebounding from weaknesses at the end of last year and existing home sales jumping 11.8 percent in February.

In the Philadelphia Federal Reserve Bank’s district, manufacturing activity rebounded in March after declining for the first time since May 2016 in February, led by stronger new orders and shipments. Growth in hiring slowed slightly in March, but the labor market is expected to stay strong over the coming months. Indeed, 73.6 percent of respondents said their company was experiencing a skills shortage in 2019, up from 63.8 percent in 2018.

New orders for manufactured goods inched up 0.1 percent in January, edging slightly higher for the second straight month after falling in both October and November. Excluding transportation equipment, factory orders declined 0.2 percent in January. On a more encouraging note, new orders for core capital goods—a proxy for capital spending in the U.S. economy—increased 0.8 percent in January, with 4.1 percent growth over the past 12 months.

At the same time, sentiment data in the manufacturing sector have weakened lately. For instance, the IHS Markit Flash U.S. Manufacturing PMI dropped to 52.5 in March, the weakest pace since June 2017. New orders, output, exports and hiring slowed, even as these measures continued to reflect modest growth overall. Encouragingly, manufacturers completing the survey felt more upbeat about production over the next six months.

Separately, the IHS Markit Flash Eurozone Manufacturing PMI contracted for the second straight month, declining at the fastest pace since April 2013. Germany contracted for the third consecutive month, with output declining at the fastest pace since August 2012. In addition, French manufacturers reported contracting activity in March for the second time in the past four months on reduced sales, exports and production.

Deeper Dive

- Conference Board Leading Indicators: The Leading Economic Index increased 0.2 percent in February, up from being unchanged in January and the best monthly reading since September. It is hoped this is a sign the U.S. economy is rebounding from recent weaknesses, which should bode well for growth over the next six months. The bright spots in the February report included consumer confidence, the interest rate spread, lending conditions and stock prices, with new orders for manufactured goods providing a slight positive contribution to the headline index for the month. In contrast, the average workweek for production workers and weekly unemployment claims provided slight drags on the LEI in February.

  Meanwhile, the Coincident Economic Index rose 0.2 percent in February. All of the subcomponents of the CEI (industrial production, manufacturing and trade sales, nonfarm payrolls and personal income) helped to boost this measure for the month. With that said, manufacturing production declined for the second straight month, which likely prevented the CEI from increasing further.

- Existing Home Sales: The National Association of Realtors reported that existing home sales rose sharply, up 11.8 percent from an annualized 4.93 million units in January to 5.51 million units in February. NAR Chief Economist Lawrence Yun said, “A powerful combination of lower mortgage rates, more inventory, rising income and higher consumer confidence is driving the sales rebound.” Sales increased in every region of the country except for the Northeast, which was flat. Single-family home sales jumped 13.3 percent for the month, with co-op and condominium sales unchanged in February.

  Over the past 12 months, existing home sales decreased 1.8 percent, off from 5.61 million units in February 2018. There were 3.5 months of supply on the market in the latest figures, the lowest level in one year. The median sales price for existing homes rose 3.6 percent year-over-year in February to $249,500.

- Factory Orders and Shipments: New orders for manufactured goods inched up 0.1 percent in January, edging slightly higher for the second straight month after falling in both October and November. With that said, sizable increases occurred for nondefense aircraft and parts sales, which helped boost the headline number and can be quite volatile from month to month. Excluding transportation equipment, factory orders declined 0.2 percent in January.

On a more encouraging note, new orders for core capital goods (or nondefense capital goods excluding aircraft)—a proxy for capital spending in the U.S. economy—increased 0.8 percent in January to $68.9 billion, ending two months of declines. Nonetheless, core capital goods spending has drifted lower since reaching an all-time high in July ($69.9 billion).

Core capital goods spending has increased a modest 4.1 percent over the past 12 months, and overall, factory orders rose 4.2 percent year-over-year, or 1.8 percent excluding transportation. Meanwhile, shipments declined 0.4 percent in January, falling for the fourth consecutive month, but have increased a modest 3.0 percent since January 2018.

- FOMC Monetary Policy Statement: As expected, the Federal Open Market Committee left short-term rates unchanged, with the federal funds target range from 2.25 to 2.50 percent, which is where the committee left it after its December 18–19 meeting. More importantly, the Federal Reserve said it would be "patient" before taking further actions, looking for signs in the data that further normalization of rates would be warranted.

  To echo that point, the new economic projections support the view that policymakers are not eager to raise rates. In December, FOMC participants appeared to predict two rate hikes in 2019 and one increase in 2020. Now, the latest estimates would be consistent with one hike in the federal funds rate in 2019 with no increase in 2020. Moreover, the summary of participant responses reflects a desire from many participants for no changes this year either. My own view is that the FOMC will not raise rates until mid-2020 at the soonest—reflective of a more "dovish" stance and consistent with slower economic growth with reduced pricing pressures.

  The Federal Reserve forecasts 2.1 percent growth in 2019, down from an estimate of 2.3 percent in December's projections, with 1.9 percent growth in 2020. The labor market is expected to remain solid, with the unemployment rate near 50-year lows. The FOMC predicts an unemployment rate of 3.7 percent and 3.8 percent in 2019 and 2020, respectively, with both 0.2 percentage points higher than in the estimate three months ago. The FOMC also estimates core inflation to remain at the Federal Reserve's stated target of 2 percent.

- IHS Markit Flash U.S. Manufacturing PMI: Manufacturing activity in the United States grew at the weakest pace since June 2017, with the headline index dropping from 53.0 in February to 52.5 in March, according to preliminary data. Data decreased across the board, including new orders, output, exports and hiring, even as these measures continued to reflect modest growth overall. Encouragingly, manufacturers completing the survey felt more upbeat about production over the next six months. Pricing pressures continued to decelerate, with raw material costs expanding at the weakest pace since August 2017.

  Separately, IHS Markit also released survey results for the Eurozone, with manufacturing activity contracting for the second straight month and declining at the fastest pace since April 2013. The IHS Markit Flash Eurozone Manufacturing PMI dropped from 49.3 in February to 47.6 in March. Germany contracted for the third consecutive month, with output declining at the fastest pace since August 2012. In addition, French manufacturers reported contracting activity in March for the second time in the past four months on reduced sales, exports and production.

- NAHB Housing Market Index: The National Association of Home Builders and Wells Fargo reported that confidence stabilized in March, with respondents optimistic about activity over the next six months. The Housing Market Index held steady at 62 in March, and builders remained upbeat that reduced mortgage rates will help boost demand and increase overall affordability. Confidence improved in every region except the Midwest. Indeed, builders' views of expected single-family sales over the next six months increased in March (up from 68 to 71) to the best reading since October. With that said, respondents continued to cite challenges with higher construction costs and worker shortages.

- Philadelphia Fed Manufacturing Survey: Manufacturing activity rebounded in March after declining for the first time since May 2016 in February. The composite index of general business activity jumped from -4.1 in February to 13.7 in March, with new orders and shipments bouncing back from contractions in the prior survey. Growth in hiring slowed slightly in March, but the labor market is expected to stay strong over the coming months. Indeed, 73.6 percent of respondents said their company was experiencing a skills shortage in 2019, up from 63.8 percent in 2018. In addition, firms continued to be upbeat about the next six months, albeit with some easing in expectations in some measures. Nearly 41 percent anticipate higher sales moving forward, with 38.1 percent and 32.0 percent predicting increased employment and capital spending, respectively.

- State Employment Report: Michigan created the most net new manufacturing jobs in February, adding 5,700 workers. Arkansas (up 1,900), Tennessee (up 1,800), South Carolina (up 1,400), Texas (up 1,400) and Missouri (up 1,100) also topped the list of manufacturing employment gains in February. In addition, Texas saw the greatest job gains in the sector over the past 12 months, with manufacturing employment in the state up 27,100 since February 2018. Other states with the fastest manufacturing job growth year-over-year included Michigan (up 10,100), Washington (up 9,500), Missouri (up 8,200), Iowa (up 7,800), Tennessee (up 7,800) and Ohio (up 7,500). Meanwhile, Iowa, New Hampshire, North Dakota and Vermont had the lowest unemployment rates in the nation in February at 2.4 percent.

NATIONAL ASSOCIATION OF Manufacturers

Source: National Association of Manufacturers – NAM Monday Economic Report, March 25, 2019