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MONDAY ECONOMIC REPORT

Federal Reserve Chair Powell: Reducing Inflation Will Not Be Painless

By Chad Moutray – August 29, 2022

The Weekly Toplines

- In his speech at the Kansas City Federal Reserve Bank's economic policy symposium at Jackson Hole, Wyoming, Federal Reserve Board Chair Jerome Powell reiterated the Federal Open Market Committee's desire to bring core inflation back to its target of 2% over the long term. He added:

  " … without price stability, we will not achieve a sustained period of strong labor market conditions that benefit all. The burdens of high inflation fall heaviest on those who are least able to bear them."

- Yet, a more restrictive monetary policy will not be painless. Along these lines, he stated:

  "Reducing inflation is likely to require a sustained period of below-trend growth. Moreover, there will very likely be some softening of labor market conditions. While higher interest rates, slower growth and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses. These are the unfortunate costs of reducing inflation. But a failure to restore price stability would mean far greater pain."

- The PCE deflator edged down 0.1% in July, pulling back after rising 1.0% in June, which was the fastest pace of monthly growth since September 2005. Energy prices fell 4.8% in July, helping to pull the headline index lower. Food costs increased 1.3%, continuing to rise solidly year to date.

- Excluding food and energy prices, the PCE deflator inched up 0.1% in July. Overall, the PCE deflator has risen 6.3% over the past 12 months, decelerating from the 6.8%

year-over-year pace in June, which was the strongest since January 1982. The current outlook is for the core PCE deflator to be 3.8% year-over-year in December.

- On the manufacturing front, new orders for durable goods were essentially unchanged in the latest data, remaining near a record level. On a year-over-year basis, new durable goods orders have jumped 10.9% since July 2021, or 7.2% with transportation equipment excluded. Core capital goods orders rose 0.4% to a record level, up 8.5% year-over-year.

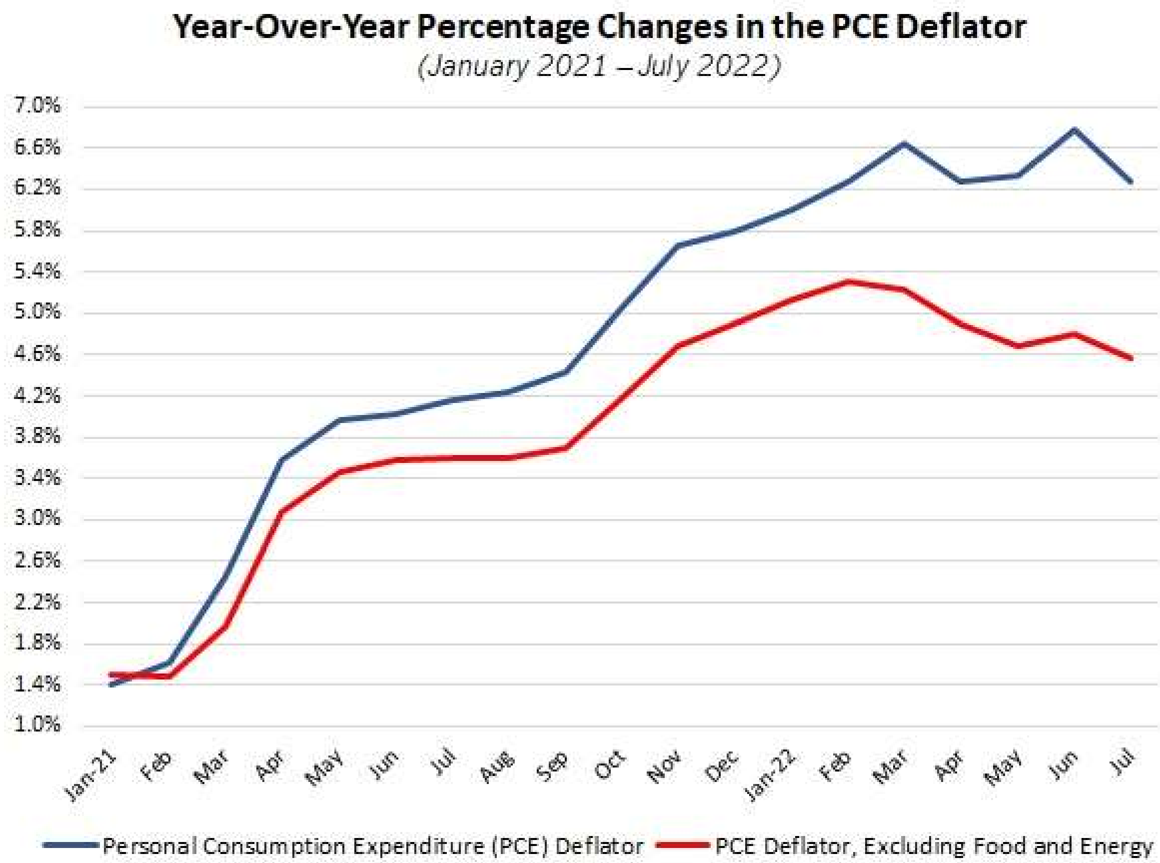
- The durable goods data provide mixed comfort. On the one hand, the manufacturing sector has proved to be surprisingly resilient over the past year in the face of numerous challenges, and that can be seen in the year-over-year figures. Yet, growth has slowed in some areas, even with some new records being set. It is also notable that these figures are in nominal terms, with higher prices likely inflating some of this growth.

- The manufacturing sentiment surveys released last week speak to the challenges faced in the sector, with activity often at the weakest pace in roughly two years. New orders declined in each, for instance. At the same time, manufacturers felt cautiously optimistic for the next six months, with expectations of reduced or moderated pricing pressures.

- After dropping to a record low in June (50.0), the Index of Consumer Sentiment has risen for two consecutive months, increasing from 51.5 in July to 58.2 in August, according to final data from the University of Michigan and Thomson Reuters. Even with gains in the past two releases, consumer confidence remains lower than desired, and Americans continued to worry about inflation, even as expectations for price growth moderated in August.

- Personal consumption expenditures edged up 0.1% in July, the weakest monthly reading since December. Despite some softening in the latest data, personal spending increased 8.7% year-over-year. Meanwhile, personal income rose 0.2% in July. With that said, manufacturing wages and salaries increased 0.9%, with 8.7% growth year-over-year. The personal saving rate was unchanged at 5.0% in July, remaining the lowest since August 2009.

- After soaring to a record $126.81 billion in March, the U.S. goods trade deficit edged lower for the fourth straight month, down from $98.59 billion in June to $89.06 billion in July, according to preliminary figures. In July, goods exports edged down from a record $181.35 billion to $180.97 billion, and goods imports dropped from $279.94 billion to $270.03 billion.



Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, Aug. 22
Chicago Fed National Activity Index

Tuesday, Aug. 23
New Home Sales
Richmond Fed Manufacturing Survey

This Week's Indicators:

Monday, Aug. 29
Dallas Fed Manufacturing Survey

Tuesday, Aug. 30
Conference Board Consumer Confidence
Job Openings and Labor Turnover Survey

S&P Global Flash U.S. Composite PMI

Wednesday, Aug. 24
Durable Goods Orders and Shipments

Thursday, Aug. 25
Gross Domestic Product (Revision)
Kansas City Fed Manufacturing Survey
Weekly Initial Unemployment Claims

Friday, Aug. 26
International Trade in Goods (Preliminary)
Personal Consumption Expenditures Deflator
Personal Income and Spending
University of Michigan Consumer Sentiment (Revision)

Wednesday, Aug. 31
None

Thursday, Sept. 1
Construction Spending
ISM® Manufacturing Purchasing Managers' Index®
Productivity and Costs (Revision)
Weekly Initial Unemployment Claims

Friday, Sept. 2
BLS National Employment Report
Factory Orders and Shipments

Deeper Dive

- **Chicago Fed National Activity Index:** After declining in the two prior months, the National Activity Index from the Chicago Federal Reserve Bank improved from -0.25 in June to 0.27 in July. The three-month moving average remained at -0.09 in July. Positive index readings suggest that the U.S. economy is growing above trend. As such, these data provide mixed news on the current economic environment, with stronger activity in July in some areas, but growth remains weaker than desired. Indeed, manufacturers have had to grapple with ongoing challenges, including supply chain disruptions, workforce shortages, soaring costs, COVID-19 and geopolitical uncertainties.

  Manufacturing production also bounced back in July, rising 0.7%, following declines in both May and June, as the sector continued to show surprising resilience in the face of the headwinds listed above. Indeed, manufacturing production has risen 3.2% over the past 12 months. With that in mind, production-related indicators added 0.16 to the NAI in July. Employment-related indicators were also a bright spot, contributing 0.09 to the top-line figure for the month, with the unemployment rate dropping to 3.5% and manufacturers adding 271,000 workers on net year to date.

- **Durable Goods Orders and Shipments**: New orders for durable goods were essentially unchanged in the latest data, inching down from a record $273.52 billion in June to $273.48 billion in July. It marked the slowest monthly growth since February. A large decrease occurred in defense aircraft and parts orders, which can be highly volatile from month to month. Excluding transportation equipment, new durable goods orders increased 0.3% from $179.88 billion to $180.47 billion, an all-time high. On a year-over-year basis, new durable goods orders have jumped 10.9% since July 2021, or 7.2% with transportation equipment excluded.

  In July, demand increased for nondefense aircraft and parts (up 14.5%), fabricated metal products (up 1.2%), computers and electronic products (up 0.5%), machinery (up 0.4%), other durable goods (up 0.4%) and motor vehicles and parts (up 0.2%). In contrast, defense aircraft and parts (down 49.8%), primary metals (down 1.4%) and electrical equipment, appliances and components (down 0.4%) had declining new orders in July.

  Core capital goods (or nondefense capital goods excluding aircraft)—a proxy for capital spending in the U.S. economy—rose 0.4% from $74.15 billion in June to a record $74.46 billion in July, with 8.5% growth year-over-year.

  Meanwhile, durable goods shipments increased 0.4% from $269.54 billion in June to a record $270.51 billion in July. On a year-over-year basis, durable goods shipments have soared 14.8% since July 2021, or 14.5% excluding transportation equipment. In addition, core capital goods shipments increased 0.7% from $73.47 billion to $73.96 billion, an all-time high, with 11.2% growth over the past 12 months.

  Overall, these data provide mixed comfort. On the one hand, the manufacturing sector has proved to be surprisingly resilient over the past year in the face of numerous challenges, and that can be seen in the year-over-year figures. Yet, on the other hand, growth has slowed in some areas, even with some new records being set. It is also notable that these figures are in nominal terms, with higher prices likely inflating some of this growth.

- **Gross Domestic Product (Revision)**: The U.S. economy shrank 0.6% at the annual rate in the second quarter, according to revised data, better than the original estimate of a 0.9% decrease and extending the decline of 1.6% in the first quarter. Despite the revision, the underlying trends remain similar to the previous estimate. Service-sector spending and net exports were bright spots in an otherwise weak quarter of activity in the U.S. economy. Goods spending was a drag on growth, along with private inventory spending, residential investment and government consumption. The current forecast is for 2% growth in real GDP in the third quarter, with 1.8% growth in 2022. In

2023, the outlook is for 1.6% growth.

The economic outlook carries sizable downside risks. These risks include uncertainties surrounding the Russian invasion of Ukraine, weaknesses in China and the emerging markets, lingering supply chain challenges and increased perceptions that a recession is imminent. Along those lines, there are signs that consumers and businesses are pulling back on spending. The housing market has also weakened significantly since the spring, weighed down by higher mortgage rates and reduced affordability.

- **International Trade in Goods (Preliminary)**: After soaring to a record $126.81 billion in March, the U.S. goods trade deficit edged lower for the fourth straight month, down from $98.59 billion in June to $89.06 billion in July, according to preliminary figures. That is the best reading since October. These data continued to be highly volatile and skewed by supply chain disruptions, petroleum prices and stronger economic growth in the U.S. relative to other markets. In July, goods exports edged down from a record $181.35 billion to $180.97 billion, and goods imports dropped from $279.94 billion to $270.03 billion.

  Goods exports declined $376 million in July. Increased exports for capital goods (up $2.02 billion), automotive vehicles (up $809 million) and other goods (up $668 million) were enough to offset decreased activity for industrial supplies (down $1.78 billion), foods, feeds and beverages (down $1.37 billion) and consumer goods (down $719 million). Meanwhile, goods imports plummeted by $9.91 billion in July, pulled lower by reduced imports for consumer goods (down $7.85 billion), industrial supplies (down $2.11 billion) and other goods (down $1.18 billion). Final data, which will include the service-sector trade surplus, will be released Sept. 7.

- **Kansas City Fed Manufacturing Survey**: Manufacturing activity expanded at the slowest pace since July 2020 in the Kansas City Federal Reserve Bank's district, with the composite index declining from 13 in July to 3 in August. Production and shipments contracted for the second time in three months, and the index for new orders deteriorated further to a post-pandemic low. Exports and the average employee workweek also fell in August, and hiring slowed. The index for raw material costs fell from 41 to 38, suggesting stronger net declines following robust growth since the beginning of 2021. Yet, manufacturers cited soaring costs and workforce challenges in their comments.

  Manufacturers in the district felt less positive about growth over the next six months, with the forward-looking composite index declining from 26 to 10. Expectations for new orders, production, shipments and employment eased in August, but capital expenditures strengthened. The forward-looking index of raw material costs fell below 50—which would suggest net declines—for the first time since December 2020.

- **New Home Sales:** New single-family home sales declined for the seventh straight month, down 12.6% from 585,000 units at the annual rate in June to 511,000 units in July, the weakest reading since January 2016. Sales fell in every region except for the Northeast. Higher mortgage rates and affordability have dampened enthusiasm sharply for new home sales year to date, and builders also cite lingering inflation, supply chain disruptions and workforce shortages as significant challenges in the housing market. Single-family home sales have plummeted 29.6% year-over-year, down from 726,000 units in July 2021.

  The supply of new single-family homes for sale on the market increased from 9.2 months in June to 10.9 months in July, the highest since March 2009. The median sales price for new homes was $439,400 in July, up 8.2% year-over-year but down from April's record ($458,200).

- **Personal Consumption Expenditures Deflator:** The PCE deflator edged down 0.1% in July, pulling back after rising 1.0% in June, which was the fastest pace of monthly growth since September 2005. Energy prices fell 4.8% in July, helping to pull the headline index lower. Yet, food costs increased 1.3%, continuing to rise solidly year to date. Excluding food and energy prices, the PCE deflator inched up 0.1% in July. Overall, the PCE deflator has risen 6.3% over the past 12 months, decelerating from the 6.8% year-over-year pace in June, which was the strongest since January 1982.

  Rising raw material costs continued to be a major concern for manufacturers, especially with supply chain disruptions, labor market tightness, geopolitical uncertainties and soaring pent-up demand in the marketplace. With that said, it is notable that core inflation has pulled back from 5.3% year-over-year growth in February, which was the strongest pace of inflation since April 1983. Core inflation should continue to moderate over the coming months, largely on more favorable comparison months. But core inflation should remain highly elevated and above the Federal Reserve's stated goal of 2% over the long term. The current outlook is for the core PCE deflator to be 3.8% year-over-year in December.

- **Personal Income and Spending:** Personal consumption expenditures edged up 0.1% in July, down from 1.0% in June and the weakest monthly reading since December. Spending on durable goods jumped 1.3% in July, but nondurable goods purchases fell 1.0%. Overall, goods purchasing decreased 0.2% for the month, but service-sector spending rose 0.3%. Despite some softening in the latest data, personal spending increased 8.7% year-over-year, with durable and nondurable goods consumption rising 9.2% and 10.3% over the past 12 months, respectively, and service-sector activity up 8.0% since July 2021.

Meanwhile, personal income rose 0.2% in July, easing from 0.7% in June. With that said, wages and salaries increased 0.8% for the month, with manufacturing wages and salaries up 0.9%. Over the past 12 months, total wages and salaries have soared 10.0%, with manufacturing wages and salaries rising 8.7% year-over-year. The softer personal income growth in July stemmed largely from weaknesses in proprietors' and rental income.

The personal saving rate was unchanged at 5.0% in July, remaining the lowest since August 2009. This suggests that Americans have continued to dip into their savings to finance at least some of their spending.

- **Richmond Fed Manufacturing Survey:** Manufacturing activity declined in August for the third time in the past four months, according to the Richmond Federal Reserve Bank. The composite index of general business activity decreased from 0 in July to -8 in August. New orders and the backlog of orders deteriorated further in the latest survey, with shipments returning to negative territory and capacity utilization improving but still negative. On the other hand, capital expenditures and hiring strengthened somewhat, with wage growth slowing but still strong.

  Meanwhile, manufacturers remained positive in their outlook for the next six months, with healthy gains predicted for capital spending and employment. Respondents expected wage growth to increase at elevated rates moving forward. With that said, manufacturers anticipated new orders to rise only slightly, perhaps suggesting some cautious optimism on future demand.

  Inflation remained a significant challenge, even with some easing from recent highs. Costs for raw materials rose 12.47% in August, with the prices received for goods and services up 9.31%. In addition, respondents anticipated an annualized 4.90% increase in costs six months from now, with the expected prices received rising 4.35%.

- **S&P Global Flash U.S. Manufacturing PMI:** Manufacturing production (down from 49.5 in July to 49.3 in August) contracted at the fastest pace since June 2020, pulling the S&P Global Flash U.S. Manufacturing PMI somewhat lower, down from 52.2 to 51.3. It was the weakest growth rate in 25 months. New orders (up from 48.6 to 48.9) and exports (up from 46.3 to 47.1) declined at slower paces in August. Hiring growth (down from 51.5 to 50.3) essentially stalled, softening to a seven-month low. Manufacturers continue to grapple with geopolitical and economic uncertainties, supply chain bottlenecks, workforce shortages and soaring costs. With that said, the index for future output (up from 63.4 to 67.2) signaled cautious optimism for production over the next six months. Raw material costs (down from 76.4 to 69.8) eased in August but remained highly elevated. Outside the manufacturing sector, the S&P Global Flash U.S. Services Business Activity Index deteriorated in the latest survey, down from 47.3 to 44.1, a 27-month low.

Meanwhile, the S&P Global Flash Eurozone Manufacturing PMI contracted for the second straight month, edging down from 49.8 in July to 49.7 in August, the lowest reading since June 2020. The deterioration of manufacturing activity stems from negative impacts from the Russian invasion of Ukraine and soaring costs, especially for energy. In August, the decline in new orders and output slowed slightly but remained significant, whereas exports fell further, dropping at the fastest pace since the start of the pandemic. Hiring softened to the weakest rate since February 2021. In addition, raw material costs decelerated to the slowest rate in 19 months but remained highly elevated. Nonetheless, the index for future output rebounded, suggesting cautious optimism for somewhat positive growth in production six months from now.

Manufacturing production also weakened in France and, outside the Eurozone, in the United Kingdom, with sentiment in both economies contracting at rates not seen since May 2020. German manufacturers also reported negative growth in August but with the decrease in new orders and output moderating slightly, even as service-sector growth slowed materially.

- **University of Michigan Consumer Sentiment (Revision)**: After dropping to a record low in June (50.0), the Index of Consumer Sentiment has risen for two consecutive months, increasing from 51.5 in July to 58.2 in August, according to final data from the University of Michigan and Thomson Reuters. This is better than the preliminary estimate of 55.1. Inasmuch as these data are highly correlated with falling gasoline prices, the increase should not be a surprise, and Americans felt more upbeat in their assessments of current and future conditions. Even with gains in the past two releases, consumer confidence remains lower than desired, and Americans continued to worry about inflation, even as expectations for price growth moderated in August.

- **Weekly Initial Unemployment Claims**: The week ending Aug. 20 saw 243,000 initial unemployment claims, edging down from 245,000 for the week ending Aug. 13. At the same time, the week ending Aug. 13 saw 1,415,000 continuing claims, down from 1,434,000 for the week ending Aug. 6. Both data points have trended somewhat higher since the spring, despite some pullbacks in the latest figures.

Take Action

Your Response Needed: NAM Q3 Manufacturers' Outlook Survey
If you have not already done so, please take a moment to complete the latest NAM Manufacturers' Outlook Survey, which includes special questions on the supply chain and recession outlook, inflation, energy reliability, the CHIPS and Science Act and green cards. This survey will help the NAM gauge how manufacturing sentiment has changed since the second quarter survey. Responses are due by Tuesday, Aug. 30, at 5:00 p.m. EDT. As always, all responses are anonymous.

Be Part of Manufacturing's Premier Workforce Event
The Manufacturing Institute—the workforce development and education partner of the NAM—invites you to its inaugural Workforce Summit on Oct. 18–20 at the Hyatt Regency in Cincinnati, Ohio, where manufacturers, thought leaders, educators, business association leaders and human resource and workforce development professionals will convene to discuss innovations in workforce development and the future of manufacturing. Register today to take advantage of the discounted early bird registration rate available until Labor Day.

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