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MONDAY ECONOMIC REPORT

Essential Takes on Leading Economic Indicators

By Chad Moutray, Ph.D., CBE – February 3, 2020– SHARE

The U.S. Economy Grew 2.1% in the Fourth Quarter, 2.3% in 2019

The Weekly Toplines

- The U.S. economy grew 2.1% at the annual rate in the fourth quarter. Global headwinds and trade uncertainties continued to have large impacts on the underlying data, with businesses hesitant to invest in their firms and sizable declines in exports and imports, especially the latter.

- In 2019, real GDP rose by 2.3%, easing from 2.9% growth in 2018. The current forecast is for 1.3% growth in the first quarter of 2020, with the U.S. economy expanding by 1.8% for the year. With stabilizing global growth, particularly in manufacturing, and more certainty on trade, business investment will hopefully improve over the coming months.

- On the manufacturing front, manufacturing activity rebounded in the Dallas and Richmond Federal Reserve Bank districts, with cautious optimism for the next six months.

- New durable goods orders rose 2.4% in December, bouncing back after falling 3.1% in November. With that said, the latest figures are boosted by very strong defense aircraft and parts orders. Excluding transportation equipment, new orders edged down by 0.1%.

- New durable goods orders have fallen 3.7% over the past 12 months, with a decline of 1.0% with transportation equipment excluded. As such, durable goods manufacturers ended the year on another disappointing note. Core capital goods spending—a proxy for capital spending in the U.S. economy—decreased 0.9% in December, but on a year-over-year basis, this figure increased 0.9%.

- Private manufacturing wages and salaries rose 0.7% in the fourth quarter, up from 0.6% in the third quarter. That translated into 3.2% growth over the past 12 months, the fastest year-over-year pace of growth since the first quarter of 2002, or in nearly 18 years.

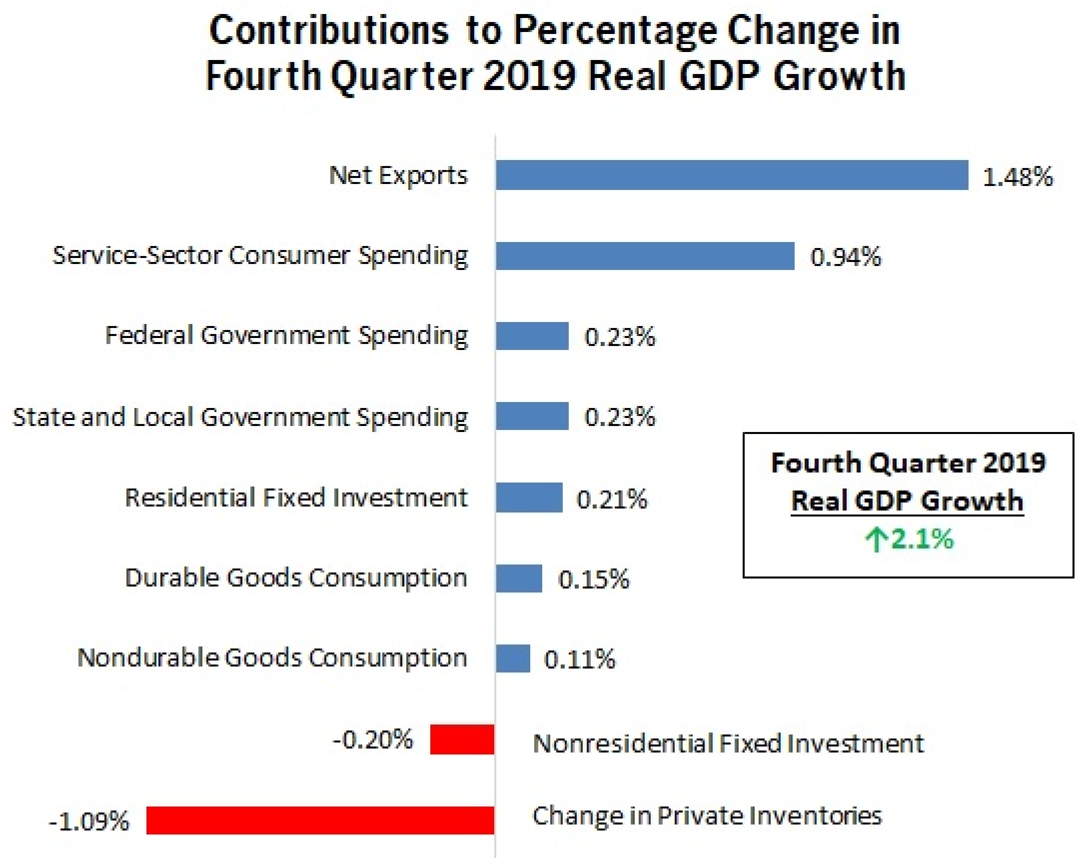
- Personal consumption expenditures rose 0.3% in December, jumping 5.0% over the past 12 months. With that said, personal spending was very disappointing one year ago, down 0.8% for the month of December 2018, and as such, the year-over-year comparisons speak as much to last year's weaknesses as to this year's modest gains.

- Americans were more confident in January, with higher sentiment readings from both the Conference Board and the University of Michigan. Overall, consumers responded favorably to strong labor market and upbeat views of income growth.

- As expected, the Federal Open Market Committee left interest rates unchanged after its Jan. 28–29 meeting, keeping the target federal funds rate between 1.50% to 1.75%. The Federal Reserve reduced short-term interest rates three times last year, and participants feel that those moves were sufficient to stimulate activity and reduce downturn risks.

- This morning, analysts will be looking for signs of stabilization in the ISM® Manufacturing Purchasing Managers' Index®, which has contracted for five consecutive months.

- Later this week, the first reading on employment for 2020 will be released. Manufacturing employment fell by 12,000 workers in December, but for 2019, the sector added roughly 3,800 workers per month on average. Hiring softened in light of weaknesses in the global economy and from anxieties about trade policy.



Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, January 27
Dallas Fed Manufacturing Survey
New Home Sales

Tuesday, January 28
Conference Board Consumer Confidence
Durable Goods Orders and Shipments
Richmond Fed Manufacturing Survey

Wednesday, January 29
FOMC Monetary Policy Statement
International Trade in Goods (Preliminary)

Thursday, January 30
Business Employment Dynamics
Gross Domestic Product

This Week's Indicators:

Monday, February 3
Construction Spending
ISM® Manufacturing Purchasing Managers' Index®
Senior Loan Officer Opinion Survey

Tuesday, February 4
Factory Orders and Shipments
Vehicle Sales

Wednesday, February 5
ADP National Employment Report
Consumer Credit
International Trade Report

Thursday, February 6
Productivity and Costs

Friday, February 7
BLS National Employment Report

Friday, January 31
Employment Cost Index
Personal Consumption Expenditures Deflator
Personal Income and Spending
University of Michigan Consumer Sentiment (Revision)

Deeper Dive

- **Business Employment Dynamics:** Net employment growth rose by 182,000 in the second quarter of 2019, slowing from the gain of 525,000 in the first quarter. Manufacturers had gross job gains of 415,000 in the second quarter, with 376,000 from expanding establishments and 39,000 from new establishments. At the same time, there were gross job losses of 425,000 in the second quarter, with 377,000 from contracting establishments and 48,000 from closing establishments. Therefore, there was a net employment change of 10,000 fewer workers in the manufacturing sector in the second quarter, down from the net gain of 26,000 in the fourth quarter and the first net decline since the third quarter of 2017.

  In addition, there were 6,000 manufacturing start-ups in the second quarter, or a rate of 1.9% of all establishments in the sector. Those new establishments (or "births") employed 24,000 workers in the second quarter, up from 20,000 in the first quarter. The pace of manufacturing start-ups has been relatively flat for about a decade, and notably, entrepreneurship in the sector (as well as economy-wide) has slowed from the rates in the 1990s and early 2000s.

- **Conference Board Consumer Confidence:** Consumer sentiment rose to a five-month high, with the headline index rising from 128.2 in December to 131.6 in January. Americans were more positive in their assessments of both current and future economic conditions. Consumers remain optimistic, buoyed by a strong labor market and upbeat views of income growth. Indeed, the percentage of respondents suggesting that business conditions were "good" rose from 39.0% to 40.8%, while those noting conditions were "bad" decreased from 11.0% to 10.4%.

  Meanwhile, the percentage of Americans feeling that jobs were "plentiful" increased from 46.5% to 49.0%, which remained significantly higher than those responding that jobs were "hard to get," which dropped from 13.0% to 11.6%. At the same time, 22.0% of consumers anticipate higher incomes moving forward, off from 22.7%, with those expecting income growth to be reduced inching up from 7.6% to 7.7%.

- **Dallas Fed Manufacturing Survey:** Manufacturers reported rebounding new orders, production, shipments and capacity utilization data in January. Still, the composite index remained slightly negative for the fourth consecutive month, up from -3.2 in December to -0.2 in January. The sample comments noted weaknesses in the auto and energy sectors, with lingering uncertainties in the global outlook but cautious optimism that activity might have “bottomed out.” In the latest surveys, the expansions for employment and capital expenditures slowed somewhat, but wages and benefits picked up.

Manufacturers in the Texas district continued to feel positive in their assessments for the next six months, with the forward-looking index for general business activity increasing from 6.4 in December to 7.6 in January. Nearly 48% of respondents predicted increased orders over the coming months, with 45.7% seeing more production. In addition, 37.4% and 34.5% of those completing the survey anticipate stronger hiring and capital spending over the coming months, respectively.

- **Durable Goods Orders and Shipments:** New durable goods orders rose 2.4% in December, bouncing back after falling 3.1% in November. With that said, the latest figures are boosted by very strong defense aircraft and parts orders for the month. Excluding transportation equipment, new orders for durable goods edged down by 0.1%, extending the 0.4% decline seen in November. New durable goods orders have fallen 3.7% over the past 12 months, with a decline of 1.0% with transportation equipment excluded.

  As such, durable goods manufacturers ended the year on another disappointing note, despite the stronger headline number, with global economic headwinds and trade uncertainties continuing to challenge the sector. We will be looking for signs of improvement in the coming months considering recent stabilization in some measures.

  In addition to defense aircraft and parts, sales increased for computers and electronic products, fabricated metal products and other durable goods in December. In contrast, orders declined for electrical equipment and appliances, machinery, motor vehicles and parts, nondefense aircraft and parts and primary metals. At the same time, new orders for core capital goods (or nondefense capital goods excluding aircraft)—a proxy for capital spending in the U.S. economy—decreased 0.9% in December, but on a year-over-year basis, this figure has increased 0.9%.

  Meanwhile, durable goods shipments were off by 0.2% in December, with a decline of 0.1% with transportation equipment excluded. Core capital goods shipments decreased 0.4% for the month. On a year-over-year basis, durable goods shipments were down 3.2%, or a decrease of 0.3% with transportation equipment excluded. Core capital goods shipments were essentially unchanged (up 0.01%) since December 2018.

- **Employment Cost Index:** Private manufacturing wages and salaries rose 0.7% in the fourth quarter, up from 0.6% in the third quarter. That translated into 3.2% growth over the past 12 months, the fastest year-over-year pace of growth since the first quarter of 2002, or in nearly 18 years. For all private-sector employees, wages and salaries were also up by 0.7% in the fourth quarter, slowing from the 0.9% gain seen in the third quarter, with 3.0% growth year-over-year.

Benefits costs for manufacturing employees increased 0.2% in the fourth quarter, easing from the 0.5% gain in the third quarter and the slowest gain since the third quarter of 2018. On a year-over-year basis, benefits have risen a modest 2.2%. Overall, total manufacturing compensation increased 0.7% for the quarter, or 2.8% year-over-year.

- **FOMC Monetary Policy Statement:** As expected, the FOMC left interest rates unchanged after its Jan. 28–29 meeting, keeping the target federal funds rate between 1.50% to 1.75%. The Federal Reserve reduced short-term interest rates three times last year, and participants feel that those moves were sufficient to stimulate activity and reduce downturn risks. The FOMC noted strength in the labor market and "moderate" growth in consumer spending and the economy, even as business investment and exports have been disappointing.

  It will continue to monitor incoming data to assess whether additional monetary policy changes are necessary. Assuming economic conditions do not deteriorate further, the Federal Reserve is likely to continue its current stance, hitting the pause button for the foreseeable future.

- **Gross Domestic Product:** The U.S. economy grew 2.1% at the annual rate in the fourth quarter, which closely aligned with consensus estimates and was the same pace as seen in the third quarter. Global headwinds and trade uncertainties continued to have large impacts on the underlying data, with businesses hesitant to invest in their firms and sizable declines in exports and imports, especially the latter. As a result, consumer spending, government expenditures, the housing market and net exports were positive contributors to real GDP growth in the fourth quarter, even as consumer goods purchases slowed. Nonresidential fixed investment and business inventory spending were the notable drags.

  In 2019, real GDP rose by 2.3%, easing from 2.9% growth in 2018. The forecast is for 1.3% growth in the first quarter of 2020, with the U.S. economy expanding by 1.8% for the year. With stabilizing global growth, particularly in manufacturing, and more certainty on trade, business investment will hopefully improve over the coming months.

  On that note, nonresidential fixed investment fell 1.5% at the annual rate in the fourth quarter, declining for the third straight quarter and pulled lower by significant decreases in both equipment and structures spending. Businesses also spent less on inventories. Nonresidential business investment and inventory spending subtracted 1.29% from top-line GDP growth in the latest release.

  More encouragingly, the housing market rebound continued for the second consecutive quarter, with residential investment up a solid 5.9%

at the annual rate. That was the fastest growth in two years, and housing activity added 0.21% to headline growth.

On the trade front, goods exports and imports declined 1.1% and 11.6% at annual rates, respectively, and were clearly impacted by ongoing trade tensions and slowing global growth. Total exports were up 1.4%, boosted by strength in service-sector trade, whereas overall imports were off 8.7%. As such, net exports were the largest positive contributor to real GDP growth in the fourth quarter, adding 1.48% to the headline figure.

Consumer spending rose by an annualized 1.8% in the fourth quarter, slowing from 3.2% growth in the prior release. Goods purchases eased from 5.3% growth in the third quarter to just 1.2% in the fourth quarter, with weaker spending on both durable and nondurable goods. Yet personal consumption expenditures contributed 1.20% overall to real GDP growth for the quarter. Government spending was also a positive contributor, adding 0.47%.

- **International Trade in Goods (Preliminary):** In advance statistics, the goods trade deficit widened in December after falling in November to the lowest level since October 2016. The goods trade deficit rose from $62.99 billion to $68.33 billion, a three-month high. Assuming those data hold, the goods trade deficit will average $71.46 billion in 2019, down from $73.95 billion in 2018 but up from $67.10 billion in 2017.

  The monthly shift came largely from sharply higher goods imports, which rose $5.76 billion in December primarily from increased consumer goods, industrial supplies and other goods imports. Higher energy costs likely boosted nominal industrial supplies activity for the month. At the same time, goods exports were little changed, up by $412 million, with higher exports for industrial supplies offsetting reduced exports for automotive vehicles. Final data will be released Feb. 5, which will also include the service-sector trade surplus.

- **New Home Sales:** New single-family home sales edged down 0.4% from 697,000 units in November to 694,000 units in December. The underlying data were mixed, with weaker sales in the Northeast and South overshadowing stronger activity in the Midwest and West. Despite the softer data at year's end, new home sales were strong in 2019, up a very robust 23.0% since December 2018 and another sign that the housing market has rebounded from recent woes. Indeed, homebuyers reacted favorably to reduced mortgage rates and a better outlook. New single-family home sales averaged 682,000 in 2019, up from 615,000 in 2018 and the fastest rate since 2007.

  There were 5.7 months of supply on the market in December, up from 5.5 months in November but down sharply from 7.4 months one year ago. The median sales price was $331,400 in the latest data, up just 0.5% from the $329,700 median in December 2018.

- **Personal Consumption Expenditures Deflator:** The PCE deflator rose 0.3% in December after edging up by 0.1% in November, the fastest monthly increase since April. Energy costs soared 1.5% in December, buoying the headline number, but food prices were flat for the second straight month. The core PCE deflator, which excludes food and energy prices, increased 0.2% in December, up from gains of 0.1% in each of the four prior months. Over the past 12 months, the PCE deflator rose 1.6%, up from 1.4% growth in November. At the same time, core inflation registered 1.6% in December, inching up from 1.5% year-over-year in November. Overall, the core PCE deflator remained below the Federal Reserve's stated goal of 2.0% core inflation in every month of 2019.

  The FOMC did not make any changes to its monetary policy stance last week *(see above)*, and if core inflation remains below 2% (which is expected), the Federal Reserve will continue to focus on extending the economic recovery without worry of inflationary pressures. The FOMC will likely keep interest rates unchanged in 2020 unless economic data suggest further weaknesses.

- **Personal Income and Spending**: Personal consumption expenditures rose 0.3% in December, slowing a bit from the 0.4% gain seen in November. Goods spending increased 0.3% for the month, led by strength in nondurable goods (up 0.9%) but pulled lower by reduced purchasing for durable goods (down 0.8%). On a year-over-year basis, personal spending jumped 5.0%, with durable and nondurable goods sales up 6.0% and 6.3% since December 2018, respectively. With that said, personal spending was very disappointing one year ago, down 0.8% for the month of December 2018, and as such, the year-over-year comparisons speak as much to last year's weaknesses as to this year's modest gains.

  Meanwhile, personal income was up 0.2% in December, easing from the 0.4% increase in November. Over the past 12 months, personal income rose 3.9%. Manufacturing wages and salaries were $929.6 billion in December, up from $928.1 billion in November and increasing a solid 3.8% over the past 12 months.

  The saving rate declined from 7.8% in November to 7.6% in December, a five-month low. Americans saved somewhat more in 2019 than 2018, with the saving rate averaging 8.0% in 2019, up from 7.7% in 2018. But the personal savings rate trended lower over the course of 2019, falling from 8.8% in December 2018, suggesting that consumers were more willing to open their pocketbooks as the year progressed.

- **Richmond Fed Manufacturing Survey:** Manufacturing activity rebounded sharply to begin the new year, with sentiment at its best level since September 2018. The composite index of general business activity jumped from -5 in December to 20 in January, buoyed by strong bounce backs for new orders, shipments, capacity utilization and shipments and accelerating employment and capital spending. This possibly suggests that manufacturers in the Richmond Federal Reserve Bank's district are encouraged by recent signs of stabilization in the global economy and in the aftermath of trade deals in December. With that said, equipment and software spending declined somewhat for the month.

Manufacturers in the region remain mostly optimistic about the next six months, with respondents predicting robust growth in activity moving forward. Firms continue to anticipate strong employment and wage growth, with ongoing difficulties in finding talent. Expenditures on services are one of the few categories with slightly negative expectations.

Raw material costs rose 1.21% at the annual rate in January, the slowest pace since May 2017 and down from 1.73% in December. Manufacturers also predict a deceleration in input price growth, with respondents expecting an annualized 1.51% increase six months from now, a rate not seen since July 2017 and down from 1.73% and 1.59% in the previous surveys, respectively.

- **University of Michigan Consumer Sentiment (Revision):** The Index of Consumer Sentiment improved from 99.3 in December to 99.8 in January, according to the University of Michigan and Thomson Reuters. That was better than the 99.1 preliminary reading estimated earlier. Americans were slightly more upbeat in their short-term outlook, but their assessments of current economic conditions slipped somewhat.

  The Index of Consumer Sentiment averaged 96.0 in 2019, off from 96.8 and 98.4 in 2017 and 2018, respectively. The current reading for January 2020 is above each of those averages.

Questions or comments? Email NAM Chief Economist Chad Moutray at cmoutray@nam.org.

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