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MONDAY ECONOMIC REPORT

With Supply Chain Issues, Manufacturing Production Edges Down in June

By Chad Moutray – July 19, 2021

The Weekly Toplines

- Manufacturing production edged down 0.1% in June, pulling back after rising 0.9% in May. Motor vehicles and parts production plummeted 6.6% in June, with the chip shortage and supply chain issues continuing to restrict activity. Excluding motor vehicles, manufacturing production increased 0.2% in June, a disappointing but at least positive reading.

- Manufacturing capacity utilization ticked down from 75.4% in May, the highest since January, to 75.3% in June. Since February 2020, output in the manufacturing sector is down 0.8% from pre-pandemic levels. Moving forward, I would expect for manufacturers to be back to pre-pandemic levels in the third quarter, with production rising 6.3% and 3.3% in 2021 and 2022, respectively.

- Regional manufacturing surveys from the New York and Philadelphia Federal Reserve Banks reflected significant expansions in activity in July, with the Empire State Manufacturing Survey's headline index jumping to a record high. Input costs also rose sharply once again in both surveys. The Philly Fed report noted record expected growth in hiring over the next six months.

- Consumer prices soared 0.9% in June, the largest monthly gain in three years. Excluding food and energy, consumer prices also increased 0.9% in June, matching the reading in April, which was the strongest pace since April 1982. The consumer price index has risen 5.3% year-over-year (seasonally adjusted), the fastest growth since September 2008, and core inflation (which excludes food and energy) increased 4.5% year-over-year, the most since November 1991.

- Meanwhile, producer prices for final demand goods and services rose 1.0% in June, with 7.1% growth (seasonally adjusted) over the past 12 months, the biggest on record. Core producer prices have increased a record 5.5% since June 2020.

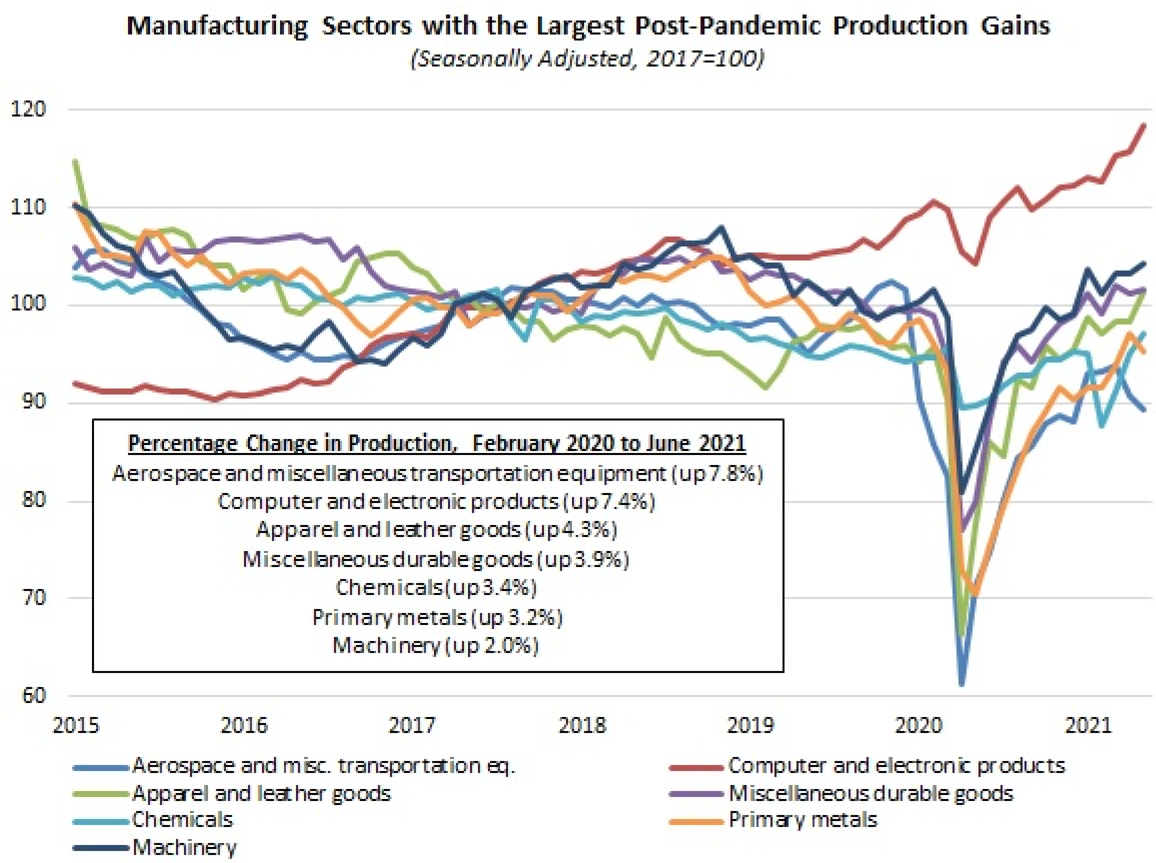
- Manufacturing leaders continue to cite supply chain disruptions as a key challenge, and the data reflect additional sharp rises in raw material prices. While some of these increases will likely be transitory, there will also likely be some cost pressures that will not abate, particularly given the strength of the rebounding economy. That will put pressure on the Federal Reserve and its stance of keeping rates near zero with aggressive bond-buying for the foreseeable future.

- In my view, the Federal Open Market Committee will start the process of tapering asset purchases by year's end (if not in the coming months), with the federal funds rate edging higher by mid-2022.

- Even so, Federal Reserve Chair Jerome Powell's congressional testimony last week continued to suggest that the Fed was not yet ready to alter its current path on asset purchases and rates.

- Yet, consumer sentiment slipped to a five-month low in preliminary data, largely on worries about pricing pressures in the economy, according to the University of Michigan and Thomson Reuters.

- More encouragingly, retail sales rose 0.6% in June, but spending on motor vehicles and parts fell 2.0% for the month. Excluding automobiles, retail spending increased 1.3% in June. Overall, retail sales have jumped 18.2% since the pandemic began, and with motor vehicles and parts excluded, spending soared to an all-time high, up 16.4% over the past 16 months.



Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, July 12
None

Tuesday, July 13
Consumer Price Index
NFIB Small Business Survey

This Week's Indicators:

Monday, July 19
NAHB Housing Market Index

Tuesday, July 20
Housing Starts and Permits

Wednesday, July 21
None

Wednesday, July 14
Producer Price Index

Thursday, July 15
Industrial Production
New York Fed Manufacturing Survey
Philadelphia Fed Manufacturing Survey
Weekly Initial Unemployment Claims

Friday, July 16
Retail Sales
University of Michigan Consumer Sentiment (Preliminary

Thursday, July 22
Chicago Fed National Activity Index
Conference Board Leading Indicators
Existing Home Sales
Kansas City Fed Manufacturing Survey
Weekly Initial Unemployment Claims

Friday, July 23
IHS Markit Flash U.S. Manufacturing PM

Deeper Dive

- **Consumer Price Index:** Consumer prices soared 0.9% in June, the largest monthly gain in three years and building on the 0.6% gain in May. Food and energy costs rose 0.8% and 1.5%, respectively, for the month, with gasoline prices up 2.5%. Excluding food and energy, consumer prices also increased 0.9% in June, matching the reading in April, which was the strongest pace since April 1982. Used car and truck prices jumped 10.5% in June, rising 30.4% in the past three months. For the month, prices for new vehicles, transportation services, apparel and shelter also had solid gains.

  Over the past 12 months, the consumer price index has risen 5.3% (seasonally adjusted), the fastest growth since September 2008. Adjusting for the deceleration seen last spring, consumer prices have jumped 4.7% since February 2020, pointing to very strong upward pressures overall. Meanwhile, core inflation (which excludes food and energy) increased 4.5% year-over-year, the most since November 1991. Adjusting for the year-over-year "base effects," core consumer prices have risen 4.2% over the past 16 months.

  As such, pricing pressures have accelerated sharply. For their part, manufacturers continue to cite rising raw material costs as a primary concern. This report will put pressure on the Federal Reserve, likely accelerating their plans for tapering asset purchases and increasing interest rates, even as some of the price increases (e.g., used cars and trucks) might be transitory.

- **Industrial Production:** Manufacturing production edged down 0.1% in June, pulling back after rising 0.9% in May. Nondurable goods production rose 0.2% in June, but output in the durable goods sector fell 0.2%. Motor vehicles and parts production plummeted 6.6% in June, with the chip shortage and supply chain issues continuing to restrict activity. Excluding motor vehicles, manufacturing production increased 0.2% in June, a disappointing but at least positive reading. Manufacturing capacity utilization ticked down from 75.4% in May, the highest since January, to 75.3% in June.

  Manufacturing production has risen 9.8% over the past 12 months, but it is important to note that output in the sector tumbled 19.6% between February and April 2020. Since February 2020, output in the manufacturing sector is down 0.8% from pre-pandemic levels. Moving forward, I would expect for manufacturers to be back to pre-pandemic levels in the third quarter, with production rising 6.3% and 3.3% in 2021 and 2022, respectively.

In June, the underlying data provided mixed results. The largest manufacturing production increases for the month occurred in primary metals (up 4.0%), aerospace and miscellaneous transportation equipment (up 3.7%), printing and related support activities (up 1.7%), petroleum and coal products (up 1.4%) and miscellaneous durable goods (up 1.2%). At the same time, in addition to motor vehicles and parts, sectors that saw declining output in June included electrical equipment, appliances and components (down 2.2%), apparel and leather goods (down 1.4%) and nonmetallic mineral products (down 1.1%), among others.

Eight of the major manufacturing sectors experienced increased production over the past 16 months, or since the COVID-19 pandemic began. This included sizable gains in output since February 2020 in aerospace and miscellaneous transportation equipment (up 7.8%), computer and electronic products (up 7.4%), apparel and leather goods (up 4.3%), miscellaneous durable goods (up 3.9%), chemicals (up 3.4%) and primary metals (up 3.2%). At the other end of the spectrum, motor vehicles and parts production has plummeted 13.2% year to date, with a decline of 13.8% since February 2020, highlighting the damage done from the chip shortage over the past few months.

Meanwhile, total industrial production increased 0.4% in June, slowing from the 0.7% gain in May. Mining and utilities production rose 1.4% and 2.7% for the month, respectively. Since February 2020, industrial production remains down 1.2%. Total capacity utilization rose from 75.1% in May to 75.4% in June, a post-pandemic high. With that said, total capacity utilization was 76.3% in February 2020 before the pandemic.

- **New York Fed Manufacturing Survey:** Manufacturing activity continued at a record pace, according to the Empire State Manufacturing Survey, with the composite index jumping from 17.4 in June to 43.0 in July. New orders and shipments surged in July, with employment also accelerating. Inventories rebounded, but the average employee workweek softened slightly. Input costs pulled back for the second straight month from May’s record growth rates, but 78.8% of respondents continued to suggest that raw material prices were higher for the month, a very solid pace of acceleration. At the same time, the index for selling prices soared to an all-time high in July. With supply chain challenges lingering, delivery times once again narrowed to the slowest on record.

  Meanwhile, manufacturers in the region remained very upbeat about growth over the next six months, albeit with the forward-looking composite index declining from 47.7 in June to 39.5 in July. More than half of those completing the survey predict increased new orders, shipments and employment moving forward, with 38.4% forecasting more capital spending. The index for prices received jumped at a record pace, with 62.6% of respondents saying that the prices they charge for their products would rise over the coming months. Input costs also accelerated, remaining highly elevated and not far from the record rate in April.

- **NFIB Small Business Survey:** The National Federation of Independent Business reported that the Small Business Optimism Index jumped from 99.6 in May to 102.5 in June, an eight-month high. The percentage of respondents saying that the next three months would be a “good time to expand” inched up from 13% to 15%, a post-pandemic high, and the net percentage reporting greater sales over the past three months increased from 7% to 9%, the most since December 2019. Economic and political concerns are the primary reasons cited for those stating that now is not a good time for expansion.

As with other surveys, pricing pressures have picked up. In June, the net percentage of respondents reporting higher prices today than three months ago soared from 40% to 47%, the highest in the history of the series, which dates to January 1986. In addition, the net percentage planning a price increase over the next three months edged up from 43% to a record 44%.

The labor market remains strong but also challenging. The percentage of respondents planning to increase hiring over the next three months ticked up from 27% to a record 28%. At the same time, the percentage of respondents suggesting they had job openings they were unable to fill pulled back from a record 48% to 46%, and the percentage of respondents saying there were few or no qualified applicants for job openings ticked down from the all-time high of 57% to 56%. Respondents once again cited difficulties in obtaining enough labor as the top “single most important problem .”

Regarding capital spending, 53% of small firms have made an investment over the past six months, down from 59% in the previous survey and the lowest since December. In addition, the percentage of respondents planning to make a capital investment over the next three to six months declined from 27% to 25%.

- **Philadelphia Fed Manufacturing Survey:** Manufacturing activity continued to expand strongly in July despite slowing slightly in some measures. The composite index declined from 30.7 in June to 21.9 in July, with new orders, shipments, employment and the average employee workweek decelerating. The index for prices paid pulled back in July from June’s pace, which was the fastest since June 1979, but remained highly elevated. Similarly, the index for prices received slowed in July from the previous reading, which was the briskest since October 1980. Price growth remains a significant challenge, however. Overall, the data speak to the severity of supply chain disruptions in the system, with delivery times also elevated despite pulling back from a record pace for the second consecutive month.

  Manufacturers in the district remain very positive in their outlook, despite the forward-looking composite index decreasing from 69.2 in June to 48.6 in July. Nearly 73% of respondents predict higher shipments over the next six months, with 61.1% forecasting more new orders. Business leaders anticipate very strong growth in hiring moving forward, with the expected hiring index jumping to a new record level. Growth in capital spending was seen rising at a pace not seen since April 1984.

- **Producer Price Index:** Producer prices for final demand goods and services rose 1.0% in June, building on the 0.8% gain in May and the strongest monthly increase since January. At the same time, producer prices for final demand goods jumped 1.2% in June, extending the 1.5% increase in May and continuing a trend of very solid gains year to date. Food and energy costs increased 0.8% and 2.1% for the month, respectively. Excluding food and energy, producer prices for final demand goods rose 1.0% in June, pulling back from a record 1.1% in May. Meanwhile, producer prices for final demand services increased 0.8% for the month, including 2.1% and 0.9% growth for trade costs and transportation and warehousing costs, respectively.

  Over the past 12 months, producer prices for final demand goods and services have jumped a seasonally adjusted 7.1%, the biggest increase on record. (The non-seasonally adjusted figure was 7.3%, also an all-time high.) To adjust for “base effects” given the deflationary pressures seen at this time last year, it might be more helpful to look at how prices have risen since February 2020, or before the pandemic.

Producer prices have risen 6.2% over the past 16 months, a still very rapid pace of inflation. Meanwhile, core producer prices have increased a record 5.5% since June 2020, with a gain of 4.8% since February 2020.

Manufacturing leaders continue to cite supply chain disruptions as a key challenge, and the data reflect additional sharp rises in raw material prices. While some of these increases will likely be transitory, there will also likely be some cost pressures that will not abate, particularly given the strength of the rebounding economy. That will put pressure on the Federal Reserve and its stance of keeping rates near zero with aggressive bond-buying for the foreseeable future.

In my view, the Federal Open Market Committee will start the process of tapering asset purchases by year's end (if not in the coming months), with the federal funds rate edging higher by mid-2022.

- **Retail Sales:** Retail sales rose 0.6% in June, recovering some of the 1.7% decline in May. With that said, retail sales for motor vehicles and parts dealers fell 2.0% in June, extending the decline of 4.6% in May, with that sector grappling with reduced inventories because of the chip shortage and supply chain disruptions. Excluding automobiles, retail spending increased 1.3% for the month.

  Overall, retail spending has soared from $525.8 billion in February 2020 before the pandemic to $621.3 billion in June 2021, jumping a whopping 18.2% over that 16-month period. At the same time, retail sales excluding motor vehicles and parts soared to $489.2 billion in the latest data, a new all-time high and up 16.4% since February 2020. These data have been buoyed by stimulus benefits, but also a rebounding economy. In addition, retail sales should continue to grow strongly over the coming months as the U.S. economy continues to reopen and as supply chain disruptions in the marketplace stabilize, particularly for autos.

  In June, retail sales increased for department stores (up 5.9%), miscellaneous store retailers (up 3.4%), electronics and appliances stores (up 3.3%), clothing and accessories stores (up 2.6%), gasoline stations (up 2.5%), food services and drinking places (up 2.3%), health and personal care stores (up 1.6%), nonstore retailers (up 1.2%) and food and beverage stores (up 0.6%). At the same time, in addition to motor vehicles and parts, other segments with reduced spending in June included furniture and home furnishings stores (down 3.6%), sporting goods and hobby stores (down 1.7%) and building material and garden supply stores (down 1.6%).

  These data reflect an evolving spending pattern for consumers, with purchases shifting to away-from-home sales in many of these categories. There was good news for department stores, with sales rising to the best reading since May 2018. Likewise, spending at food services and drinking places jumped to a new record level in June, topping $70 billion for the first time. Nonetheless, it is also important to note that sales among nonstore retailers have risen by a very sharp 34.1% since February 2020.

- **University of Michigan Consumer Sentiment (Preliminary):** Consumer confidence declined from 85.5 in June to 80.8 in July, a five-month low, according to preliminary data from the University of Michigan and Thomson Reuters. Americans have become more aware of inflationary pressures in the economy, which was the top concern. The statement reads, "Consumers' complaints about rising prices on homes, vehicles and household durables has reached an all-time record." As a result, consumers felt less upbeat about both current and future economic conditions in July. On the positive side, consumers continue to have elevated savings rates, which should provide a cushion moving forward. In addition, with the economy continuing to reopen and with additional stimulus (e.g., the childcare tax credit payments), Americans should continue increasing their retail spending in the coming months.

- **Weekly Initial Unemployment Claims:** Initial unemployment claims totaled 360,000 for the week ending July 10, down from 386,000 for the week ending July 3 and a post-pandemic low. Meanwhile, continuing claims declined from 3,367,000 for the week ending June 26 to 3,241,000 for the week ending July 3 and the lowest since the COVID-19 pandemic began. Continuing claims remained consistent with 2.4% of the workforce.

  At the same time, 13,836,598 Americans received some form of unemployment insurance benefit (including state and federal programs) for the week ending June 26. That figure fell from 14,208,877 for the week ending June 19, largely on reduced pandemic and state assistance.

Take Action

- **Best Practices on Manufacturing Engagement and Retention Webinar—** The Manufacturing Institute and the American Psychological Association examined best practices for retention among manufacturers and explored the motivating factors that affect worker retention using both a survey and structured interviews. Join the MI and the APA on Tuesday, July 20, at 11:00 a.m. EDT for a webinar on the findings of that analysis. The webinar will focus on work flexibility and employee satisfaction, recognition and experiences and feature a “retention toolbox” for managers. Panelists include former APA Senior Director of the Office of Applied Psychology David Ballard and Schneider Electric Senior Vice President of Human Resources Mai Lan Nguyen. Click here to register.