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MONDAY ECONOMIC REPORT

U.S. Economy Grew 6.6% at the Annual Rate in the Second Quarter

By Chad Moutray – August 30, 2021

The Weekly Toplines

- The U.S. economy grew 6.6% at the annual rate in the second quarter, buoyed by consumer spending and nonresidential fixed investment, with both continuing to rebound solidly. At the same time, faster growth was held back by federal government spending, net exports, residential investment and spending on inventories.

- More importantly, real GDP is now 0.8% above the pre-pandemic levels seen at the end of 2019, a relatively quick turnaround given the magnitude of the decline in activity seen in the recession in February to April 2020. The current forecast is for 6.0% growth in 2021 overall, with real GDP rising 4.1% in 2022.

- New orders for durable goods edged down 0.1% in July from a record level in June, but headline growth was pulled lower by a sharp reduction in nondefense aircraft and parts sales, which can be highly volatile from month to month. Excluding transportation equipment, new durable goods orders increased 0.7% to a record $181.9 billion in July. Core capital goods spending also inched up ever so slightly to a record $76.53 billion.

- Overall, durable goods orders have risen sharply since February 2020, jumping 11.4% over the past 17 months, or 18.1% with transportation equipment excluded.

- After expanding at a record pace in July, the IHS Markit Flash U.S. Manufacturing PMI slowed a bit in August but continued to grow robustly. The rapid increase in the delta variant is having some dampening impacts, especially in the service sector. With supply chain challenges and strong demand, raw material costs and output prices both soared again at all-time-high rates.

- Manufacturing activity also eased somewhat in the Kansas City and Richmond Federal Reserve Bank districts, but with a still-encouraging outlook. Inflation remained a significant challenge.

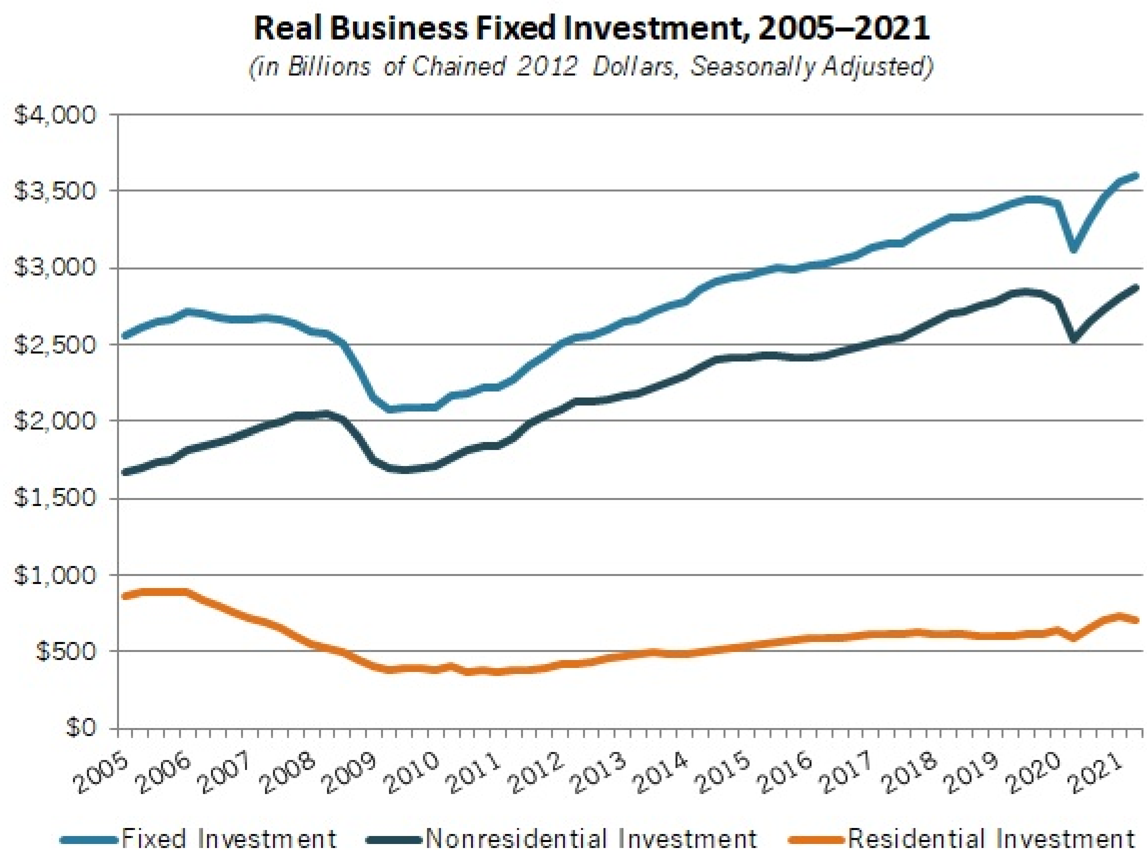
- The PCE deflator rose 0.4% in July, down from gains of 0.5% in both May and June. Overall, the PCE deflator has risen 4.2% year-over-year, the most since January 1991, and core inflation has increased 3.6% since July 2020, the same year-over-year pace as in June and the fastest pace of inflation since May 1991.

- I continue to expect the Federal Open Market Committee to start the process of tapering its asset purchases at its next meeting in September, with a possible interest rate hike in mid-2022. Federal Reserve Chair Jerome Powell's speech on Friday sets the stage for this to happen.

- Personal income rose 1.1% in July, the strongest monthly gain in four months, with 8.7% growth since February 2020. Manufacturing wages and salaries increased 1.2% in July, or 4.1% over the past 17 months.

- Meanwhile, personal consumption expenditures slowed to 0.3% growth in July, with reduced durable and nondurable goods spending. Still, personal spending has increased a solid 7.1% since February 2020. The saving rate remains elevated at 9.6%.

- Existing and new home sales increased in July, even as both have seen dampened activity since the spring on affordability issues. Inventories of homes for sale have increased, and yet, the median sales price in July was at or near a record high.



Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, August 23
Chicago Fed National Activity Index
Existing Home Sales
IHS Markit Flash U.S. Manufacturing PMI

Tuesday, August 24
New Home Sales

This Week's Indicators:

Monday, August 30
Dallas Fed Manufacturing Survey

Tuesday, August 31
Conference Board Consumer Confidence

Wednesday, September 1
ADP National Employment Report

Richmond Fed Manufacturing Survey

Wednesday, August 25
Durable Goods Orders and Shipments

Thursday, August 26
Gross Domestic Product (Revision)
Kansas City Fed Manufacturing Survey
Weekly Initial Unemployment Claims

Friday, August 27
International Trade in Goods (Preliminary)
Personal Consumption Expenditures Deflator
Personal Income and Spending
University of Michigan Consumer Sentiment (Revision

Construction Spending
ISM® Manufacturing Purchasing Managers' Index®

Thursday, September 2
Factory Orders and Shipments
International Trade Report
Productivity and Costs (Revision)
Weekly Initial Unemployment Claims

Friday, September 3
BLS National Employment Repor

Deeper Dive

- **Chicago Fed National Activity Index:** The U.S. economy rebounded in July after edging lower in June, expanding at the strongest pace since March, according to the Chicago Federal Reserve Bank. The National Activity Index rose from -0.01 in June to 0.53 in July, and the three-month moving average improved from 0.01 to 0.23. Positive index readings suggest that the U.S. economy is growing above trend, and as such, the data were somewhat assuring. Still, it would be nice to see stronger growth, and it was clear that activity was held back in some categories, likely due to continuing supply chain challenges and the increased spread of the delta variant.

  Production-related indicators contributed 0.38 to the NAI in July, bouncing back after subtracting 0.09 in June. Industrial production increased 0.9% in July, buoyed by manufacturing and mining activity. Manufacturing production jumped 1.4% in July, with output in the sector exceeding pre-pandemic levels for the first time. Employment growth also strengthened, with nonfarm payrolls rising by 943,000 in July and the unemployment rate dropping to 5.4%. Yet, housing and retail spending weakened for the month.

- **Durable Goods Orders and Shipments:** New orders for durable goods edged down 0.1%, pulling back from a record $257.6 billion in June to $257.2 billion in July. Nondefense aircraft and parts orders, which can be highly volatile from month to month, plummeted 48.9% in July, dragging down transportation equipment sales by 2.2%. Excluding transportation equipment, new durable goods orders increased 0.7% in July, rising from $180.6 billion to a record $181.9 billion.

  In the latest data, demand strengthened in July for motor vehicles and parts (up 5.8%), defense aircraft and parts (up 5.1%), machinery (up 2.9%), primary metals (up 2.7%) and fabricated metal products (up 0.3%). In addition to nondefense aircraft and parts, new orders also declined for electrical equipment, appliances and components (down 1.8%), computers and electronic products (down 0.4%) and other durable goods (down 0.4%).

  Nondefense capital goods excluding aircraft—a proxy for capital spending in the U.S.

economy—inched up ever so slightly (essentially unchanged) from $76.50 billion in June to a record $76.53 billion in July.

Overall, durable goods orders have risen sharply since February 2020, jumping 11.4% over the past 17 months, or 18.1% with transportation equipment excluded. Similarly, core capital goods orders have soared 18.0% since the pandemic began, as firms have ramped up activity on the brighter economic outlook.

Meanwhile, durable goods shipments increased 2.2% from $252.2 billion in June to $257.8 billion in July, a new record. With transportation equipment excluded, shipments of durable goods rose 1.2% in July, also to a new all-time high ($181.8 billion). Over the past 17 months, durable goods shipments have risen 8.9%, or 14.6% excluding transportation equipment. In addition, core capital goods shipments increased 1.0% from $73.7 billion to $74.5 billion, an all-time high, with 14.6% growth since February 2020.

- **Existing Home Sales:** Existing home sales rose 2.0% from 5.87 million units in June at the annual rate to 5.99 million units in July, rising for the second straight month, according to the National Association of Realtors. Growth was led in July by increased sales in the upper-end market, with activity in other segments remaining soft, according to NAR Chief Economist Lawrence Yun. In the latest data, sales strengthened in every region except the Northeast, which was flat for the month. Single-family sales increased 2.7% from 5.14 million units to 5.28 million units, the best reading since March, but condominium and co-op sales fell 2.7% from 730,000 units to 710,000 units. On a year-over-year basis, existing home sales have risen a modest 1.5% since July 2020.

  Inventories of existing homes for sale have risen from a record low of 1.9 months of supply on the market in December and January to 2.6 months in July. However, the supply of homes on the market remains historically low overall. The median sales price for existing homes has jumped 17.8% year-over-year, up to $359,900 and not far from June's record high ($362,800).

- **Gross Domestic Product (Revision):** The U.S. economy grew 6.6% at the annual rate in the second quarter, building on the 6.3% gain in the first quarter. Real GDP growth in the second quarter was revised marginally higher, up from the previous estimate of 6.5% growth, on upward revisions to exports, goods consumption and nonresidential fixed investment that were enough to offset reduced estimates for government spending, inventories, residential investment and service-sector spending.

  Overall, second quarter real GDP was buoyed by consumer spending and nonresidential fixed investment, with both continuing to rebound solidly. At the same time, faster growth was held back by federal government spending, net exports, residential investment and spending on inventories. More importantly, real GDP is now 0.8% above the pre-pandemic levels seen at the end of 2019, a relatively quick turnaround given the magnitude of the decline in activity seen in the recession in February to April 2020. The current forecast is for 6.0% growth in 2021 overall, with real GDP rising 4.1% in 2022.

  Breaking down the details in this report:

  - **Personal consumption expenditures** increased an annualized 11.9% in the second quarter, extending the 11.4% gain in the first quarter. Goods spending has soared 27.4% and 12.8% at annual rates in the first and second quarters, respectively, and with more Americans getting out and about, service-sector spending rose 11.3% in the second quarter, rising for the fourth straight report. Goods consumption contributed 2.95% to headline growth in real GDP, with spending on services adding another 4.85% (for a total of 7.80% from personal consumption expenditures overall).

  - **Business investment** data provided mixed results in the second quarter. Nonresidential fixed investment grew 9.3% at the annual rate in the latest data, rising for the fourth consecutive quarter and buoyed by strong growth in spending on equipment and intellectual property products, up 11.6% and 14.6%, respectively. On the other hand, investment in structures fell 5.4% for the quarter, and residential spending pulled back 11.5% following very solid gains in the prior three quarters. Overall, business fixed investment added 0.63% to topline GDP growth in the second quarter, but spending on inventories remained weak, subtracting 1.30% from headline growth. As a result, gross private domestic investment subtracted 0.67% from real GDP in the quarter.
  - **Net exports of goods and services** subtracted 0.24% from topline growth in the second quarter, dragging down real GDP for the fourth consecutive quarter. Imports have continued to recover faster than exports, particularly for services in the latest data. At the same time, real goods exports rose 6.3% at the annual rate in the second quarter, with real goods imports up 4.1%. With that said, real goods imports have increased 9.5% since the fourth quarter of 2019 (before the pandemic), whereas real goods exports remain down 3.4% over that time frame.
  - **Government spending** subtracted 0.33% from real GDP growth in the second quarter, pulling lower in the aftermath of large government stimulus payments in the first quarter. Federal government spending declined 5.2% at the annual rate in the second quarter after jumping by 11.3% in the first quarter. At the same time, state and local government spending rose 0.3% in the latest quarter.

- **IHS Markit Flash U.S. Manufacturing PMI:** After expanding at a record pace in July, manufacturing activity slowed a bit in August but continued to grow robustly, with the IHS Markit Flash U.S. Manufacturing PMI declining from 63.4 in July to 61.2 in August. It was the fifth straight month with the index exceeding 60—a threshold which would signal very solid expansions. Growth for new orders (down from 64.6 to 61.9), output (down from 59.7 to 56.3), exports (down from 54.8 to 53.6) and employment (down from 55.0 to 52.8) decelerated in August, but the index for future output (up from 74.1 to 75.9) strengthened, indicating a very optimistic outlook for production over the next six months.

  Supply chain disruptions continue to challenge manufacturers, but the data also indicate that the rapid increase in the delta variant is having some dampening impacts, especially in the service sector. The IHS Markit Flash U.S. Services PMI dropped from 59.9 to 55.2, easing for the third straight month from the record high in May and the lowest since December. In manufacturing, the index for delivery times (down from 16.5 to 15.9) fell to the slowest on record, and raw material costs (up from 86.7 to 88.4) and output prices (up from 86.7 to 88.4) both soared once again at all-time-high rates.

  Meanwhile, the IHS Markit Flash Eurozone Manufacturing PMI continued to expand strongly despite declining from 62.8 in July to 61.5 in August, a six-month low. The headline index has exceeded 60 for six consecutive months—a sign that the manufacturing sector is growing very strongly—even as firms continue to be challenged by supply chain and COVID-19 issues. The underlying data fell across the board, including for new orders, output, exports and hiring. While employment softened slightly for manufacturers, the labor market remained robust for the Eurozone overall, with the composite measure for hiring remaining at an all-time high. Indices for input prices (down from 88.5 to 87.3) and output prices (down from 71.0 to 69.0) edged down for the month, but cost pressures remained very elevated and not far from record paces. Moving forward, manufacturers remained optimistic about production over the next six months.

Manufacturing activity also slowed in August for France, Germany and, outside the Eurozone, in the United Kingdom. Despite some softening, the expansions were solid in each of these countries, with an upbeat outlook. In Germany, input costs jumped in August once again at the fastest rate on record, with some easing in raw material prices there and in the United Kingdom.

- **International Trade in Goods (Preliminary):** After being just shy of an all-time high, the goods trade deficit declined in the latest advance statistics, down from $92.05 billion in June to $86.38 billion in July. (The June reading was originally reported to be a record high at $93.17 billion but was revised lower. The current record was $92.86 billion in March.) In July, the reduction in trade deficit was the result of increased goods exports to a new record (up from $145.31 billion to $147.56 billion) and corresponding with a decrease in goods imports (down from $237.37 billion to $233.94 billion).

  In July, the increase in goods exports was led by strength in capital goods (up $949 million), consumer goods (up $849 million) and automotive vehicles (up $595 million). Meanwhile, sharply lower goods imports occurred for consumer goods (down $2.65 billion) and industrial supplies (down $1.96 billion) in July. Final data will be released Sept. 2, which will also include the service-sector trade surplus.

- **Kansas City Fed Manufacturing Survey:** Manufacturing activity continued to expand rapidly, albeit with the composite index of general business conditions edging down from 30 in July to 29 in August. The underlying data provided mixed results. New orders and employment strengthened in August, with both growing just shy of a record pace. At the same time, production, shipments, the average employee workweek and exports softened for the month. The sample comments noted ongoing supply chain and logistics constraints, workforce shortages and rising raw material costs. In addition, respondents cited the challenges posed by the continued spread of the delta variant of COVID-19.

  On the topic of costs, the index for raw materials prices rose from 78 in July to 80 in August. While this is below the record reading of 86 in May, input costs continue to expand robustly. Similarly, the index for prices received for finished products soared from 52 to 61, an all-time high.

  Meanwhile, respondents continued to feel very upbeat about additional growth over the next six months, with the forward-looking composite index rising from 33 in July to 36 in August, just shy of the record 37 in June.

- **New Home Sales:** After declining for three straight months, new single-family home sales rose 1.0% from 701,000 units at the annual rate in June, a 14-month low, to 708,000 units in July. Overall, new home sales have slipped since peaking at 993,000 units in January, which was the strongest pace since December 2006, as affordability has dampened demand for single-family sales. In July, sales rose in the South and West but remained weak in the Midwest and Northeast. With weaker data since

January, new single-family home sales declined 27.2% year-over-year, down from 972,000 units in July 2020.

There were 6.2 months of supply on the market in July, with inventories rising year to date, up from 3.6 months in January. The median sales price for new homes jumped to $390,500 in July, a new record and up 18.4% from $329,800 one year ago.

- **Personal Consumption Expenditures Deflator:** The PCE deflator rose 0.4% in July, down from gains of 0.5% in both May and June and the slowest monthly gain since February. Food prices increased 0.6% for the month, with energy costs up 1.6%. Excluding food and energy prices, the PCE deflator increased 0.3% in July, down from 0.5% in June and the weakest gain since February.

  Overall, the PCE deflator has risen 4.2% year-over-year, the most since January 1991, and core inflation has increased 3.6% since July 2020, the same year-over-year pace as in June and the fastest pace of inflation since May 1991.

  Rising raw material costs continue to be a major concern for manufacturers, and these data are 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 highly elevated, even if there is some stabilization in the coming months or moving into 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 would expect the Federal Open Market Committee to start the process of tapering its asset purchases at its next meeting in September, with a possible interest rate hike in mid-2022.

- **Personal Income and Spending:** Personal income rose 1.1% in July, up from 0.2% in June and the strongest monthly gain in four months. Over the past 12 months, personal income has risen 2.7%. It might be better to make this comparison relative to pre-pandemic levels. Under that assumption, personal income has increased more sharply, up 8.7% since February 2020.

  Wages and salaries increased 1.0% for the month, with total manufacturing wages and salaries rising 1.2% from $959.7 billion in June to $971.0 billion in July. On a year-over-year basis, total wages and salaries in the economy jumped 10.1%, with a gain of 7.6% since July 2020 in the manufacturing sector. Since February 2020, total wages and salaries have increased 5.3%, with manufacturing data up 4.1% over the past 17 months.

  In July, many Americans began to benefit from advance childcare tax credit payments, which helped boost income. Indeed, “other government social benefits” rose from $735.6 billion in June to $907.1 billion in July, a three-month high. At the same time, total unemployment insurance payments declined from $433.0 billion in June to $380.5 billion in July, the lowest level since December.

  Meanwhile, personal consumption expenditures increased 0.3% in July, slowing from a gain of 1.1% in June. The data show some weakening in spending for the month, likely on ongoing supply chain challenges and rising COVID-19 cases. Along those lines, durable and nondurable goods spending fell 2.3% and 0.4% in July, respectively, even as service-sector purchases rose 1.0% for the month as more Americans get out and about. Since February 2020, personal spending has increased a solid 7.1%, with durable and nondurable goods soaring 29.7% and 15.2%, respectively, and with service-sector purchases up 1.3% over that time frame.

With income growth exceeding spending, the personal saving rate increased from 8.8% in June to 9.6% in July. Overall, the saving rate remains elevated, even as it has decelerated from record highs during the worst of the pandemic. For comparison purposes, the saving rate averaged 7.6% in 2019 before COVID-19. This suggests that Americans remain somewhat cautious about spending despite economic progress year to date.

- **Richmond Fed Manufacturing Survey:** Manufacturing activity in the Richmond Federal Reserve Bank's district expanded at the slowest pace in 13 months, with the composite index of general business activity dropping from 27 in July to 9 in August. The underlying data softened across the board, including for new orders, shipments, capacity utilization, hiring and capital spending. Inventories continued to deteriorate, albeit a slower rate of decline in August. Supplier challenges continued to keep lead times highly elevated, but the backlog of orders narrowed. Wage growth was the strongest on record. 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 edged down from growth of 11.16% in July to 11.05% in August—a rate that remains extremely robust. Firms reported that the prices received for their goods and services increased 9.25% in August, up from 6.93% in the previous survey. Likewise, respondents anticipate an annualized 6.20% increase in costs six months from now, accelerating from 5.63% in the prior release. Manufacturers in the district see expected prices received increasing 5.03%, or little changed from 4.98% in the July report.

- **University of Michigan Consumer Sentiment (Revision):** Consumer confidence dropped from 81.2 in July to 70.3 in August, the lowest level since December 2011, according to the University of Michigan and Thomson Reuters. This was little changed from the previous estimate, which was 70.2. Americans felt more concerned about the current and future economic outlook, particularly as the delta variant of COVID-19 has continued to spread so rapidly around the country. Inflation also remains a worry for many of the respondents.

- **Weekly Initial Unemployment Claims:** Initial unemployment claims totaled 353,000 for the week ending Aug. 21, little changed from 349,000 for the week ending Aug. 14. Meanwhile, continuing claims edged down from 2,865,000 for the week ending Aug. 7 to 2,862,000 for the week ending Aug. 14—the lowest figure since the COVID-19 pandemic began. Continuing claims remained consistent with 2.1% of the workforce.

  At the same time, 12,007,632 Americans received some form of unemployment insurance benefit (including state and federal programs) for the week ending Aug. 7. That figure rose from 11,825,467 for the week ending July 31, largely on increased pandemic and extended benefits assistance.

- If you have not already done so, please take a moment to complete the latest NAM Manufacturers' Outlook Survey. This survey will help gauge how manufacturing sentiment has changed since the second-quarter survey . In addition, there are some special questions on the economic outlook, COVID-19 mitigation strategies, tax policy and infrastructure spending, among others. Small and medium-sized manufacturers will also have some additional questions about the "new normal" following COVID-19 and impacts on the workforce. To complete the survey, click here. Responses are due by Monday, Aug. 30, at 5:00 p.m. EDT. As always, all responses are anonymous.

- The Manufacturing Institute—the workforce development and education partner of the NAM—is working on a new research study, funded by AARP, on multigenerational teams, demographic changes in the workplace and recruiting and maintaining adequate workforces. As such, we are looking to collect information regarding current practices and attitudes related to multigenerational teams to establish a baseline of the current state of age diversity in our industry. If you have not already done so, please click here to take a brief survey. Your responses are strictly confidential and will only be used in aggregate to benchmark the entire industry. Responses are due by Tuesday, Aug. 31, at 5:00 p.m. EDT.

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