MONDAY ECONOMIC REPORT

Supply Chain Disruptions and the Delta Variant Slow GDP Growth

By Chad Moutray – November 1, 2021

The Weekly Toplines

- The U.S. economy grew 2.0% at the annual rate in the third quarter, the slowest pace of growth since the pandemic began, down from 6.7% in the second quarter. The deceleration in economic growth stemmed from supply chain disruptions and the spread of the delta variant, with consumer and business spending easing significantly in the quarter.

- In the latest GDP data, durable goods purchases fell for the first time since the second quarter of 2020, led by sizable declines in spending for motor vehicles and parts due to the ongoing chip shortage. Nonresidential fixed investment and net exports were also notable drags on growth in the third quarter.

- Overall, real GDP should rebound in the fourth quarter, with 4.0% growth expected, and for 2021, the forecast is for 5.5% growth. For 2022, the current estimate is for 3.6% growth. Real GDP in the third quarter was 1.4% above the pace seen before the COVID-19 pandemic began.

- New orders for durable goods pulled back 0.4% in September, but excluding transportation equipment, new durable goods orders increased 0.4%. Nondefense capital goods excluding aircraft—a proxy for capital spending—rose 0.8% to a record $77.7 billion in September.

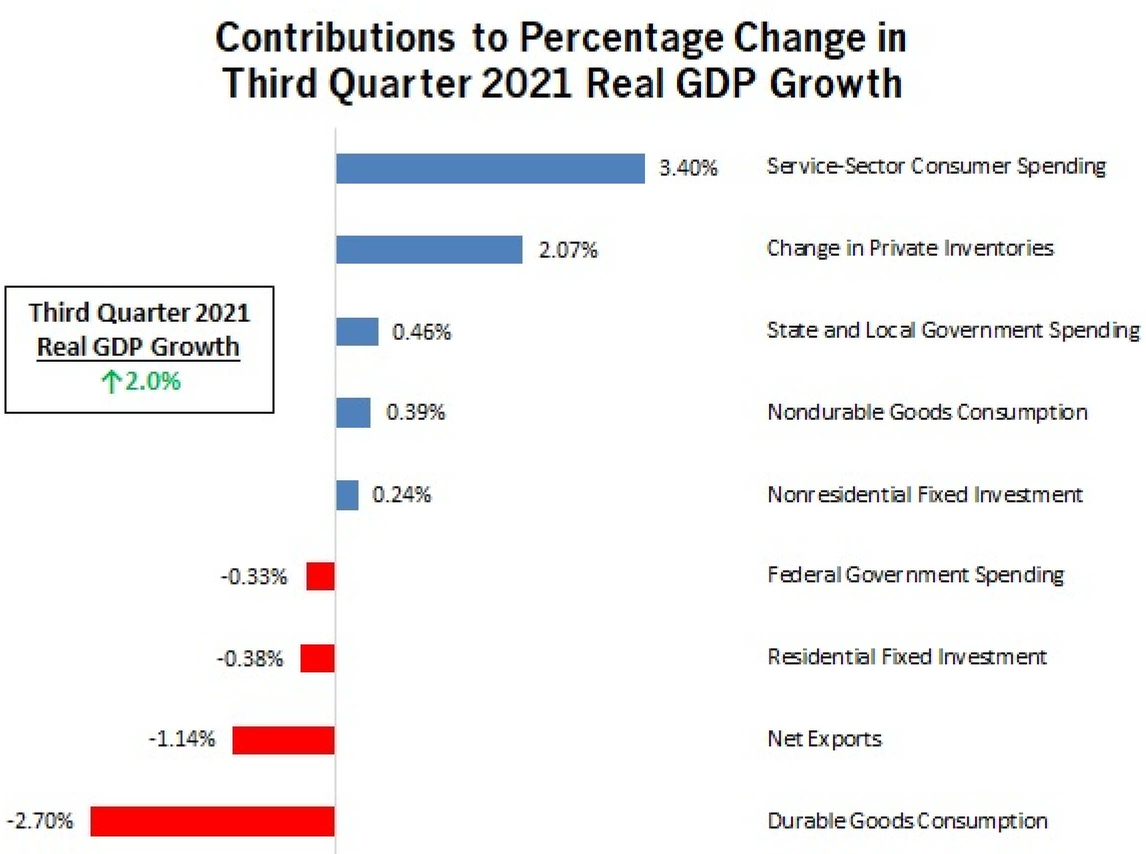
- Even as manufacturers struggle with supply chain bottlenecks, worker shortages and soaring costs, new durable goods orders have risen 10.0% year to date.

- Manufacturing activity strengthened in October in surveys from the Dallas, Kansas City and Richmond Federal Reserve Banks. Firms continued to cite ongoing challenges with supply chain disruptions, workforce shortages and soaring input prices, but the outlook remained positive.

- Personal consumption expenditures increased 0.6% in September. Nondurable goods spending rose 0.9% for the month, but durable goods purchases fell for the fourth time in five months, down 0.2% in September. Service-sector expenditures increased 0.6% in September, continuing to improve as more Americans get out and about.

- Meanwhile, personal income fell 1.0% in September, but with 4.2% growth year-over-year. Wages and salaries increased 0.8% for the month, with total manufacturing wages and salaries rising 0.2% from $976.8 billion in August to $978.9 billion in September.

- More importantly, total wages and salaries have increased 9.3% year-over-year, with manufacturing data up 10.1% since September 2020.
- In the personal income data, total unemployment insurance dropped from $352.3 billion in August to $97.7 billion in September, the lowest since March 2020. Meanwhile, initial and continuing unemployment insurance claims both fell to post-pandemic lows in the latest figures.
- The Index of Consumer Sentiment declined from 72.8 in September to 71.7 in October, but edging up from the previous estimate of 71.4, according to preliminary data from the University of Michigan and Thomson Reuters. Consumers continued to cite inflation as a key concern.
- The PCE deflator rose 0.3% in September, with food and energy prices up 1.1% and 1.3%, respectively. Excluding food and energy prices, the PCE deflator increased 0.2% in September, the slowest monthly pace of growth since February.
- Nonetheless, the PCE deflator has risen 4.4% year-over-year, the greatest increase since January 1991. Core inflation has increased 3.6% since September 2020, remaining the fastest pace of inflation since May 1991.
- I expect the Federal Open Market Committee to announce that it will start tapering its asset purchases at its Nov. 2–3 meeting (this week), with a possible interest rate hike in mid-2022.



Last Week's Indicators:
(Summaries Appear Below)

Monday, October 25
Chicago Fed National Activity Index
Dallas Fed Manufacturing Survey

Tuesday, October 26
Conference Board Consumer Confidence
New Home Sales
Richmond Fed Manufacturing Survey

Wednesday, October 27
Durable Goods Orders and Shipments
International Trade in Goods (Preliminary)

Thursday, October 28
Gross Domestic Product
Kansas City Fed Manufacturing Survey
Weekly Initial Unemployment Claims

Friday, October 29
Employment Cost Index
Personal Consumption Expenditures Deflator
Personal Income and Spending
University of Michigan Consumer Sentiment (Revision)

This Week's Indicators:

Monday, November 1
Construction Spending
ISM® Manufacturing Purchasing Managers' Index®

Tuesday, November 2
None

Wednesday, November 3
ADP National Employment Report
Factory Orders and Shipments
FOMC Monetary Policy Statement

Thursday, November 4
International Trade Report
Productivity and Costs
Weekly Initial Unemployment Claims

Friday, November 5
BLS National Employment Report

Deeper Dive

- **Chicago Fed National Activity Index:** The U.S. economy contracted in September, declining for the first time since April, according to the Chicago Federal Reserve Bank. The National Activity Index fell from 0.05 in August to -0.13 in September, and the three-month moving average declined from 0.38 to 0.25. Positive index readings suggest that the U.S. economy is growing above trend, and as such, the three-month moving average suggests that the national economy continues to expand overall despite pulling back in September.

  The weaker data stemmed largely from decreases in production-related indicators, which subtracted 0.37 in September after being a drag of 0.08 in August. Manufacturing production fell 0.7% in September, decreasing on supply chain and workforce challenges, including a large decline in motor vehicles and parts due to the ongoing chip shortage. At the same time, indicators for employment, personal consumption and housing were positive contributors to the NAI in September.

- **Conference Board Consumer Confidence:** Consumer confidence ticked higher in the latest data, rising from 109.8 in September to 113.8 in October, according to the Conference Board. Americans felt more upbeat about the current and future economy, with consumers more willing to make purchases and travel. With that said, consumer confidence remains lower today than in June, dampened by recent concerns about the spread of the delta variant and on inflationary worries.

Nonetheless, the underlying data in October were encouraging. The percentage of respondents suggesting that business conditions were "good" edged up from 18.6% to 19.1%, while the percentage feeling that conditions were "bad" dipped from 25.3% to 24.9%. At the same time, the percentage of respondents suggesting jobs were "plentiful" fell from 56.5% to 55.6%, while those saying jobs were "hard to get" dropped from 13.0% to 10.6%.

Regarding the outlook, the percentage of consumers anticipating better business conditions over the next six months improved from 21.7% to 24.3%, while those predicting a worsening of conditions increased from 17.6% to 21.1%. Meanwhile, the percentage of respondents expecting more jobs in the next six months jumped from 21.3% to 25.4%, while those expecting fewer jobs decreased from 19.9% to 18.3%. Along those lines, 18.7% of consumers predicted higher incomes in the months ahead, up from 16.9%, with the percentage anticipating reduced incomes inching down from 11.4% to 11.3%.

- **Dallas Fed Manufacturing Survey:** Manufacturing activity rebounded in October after slowing materially in September. The composite index of general business conditions rose from 4.6 in September to 14.6 in October, buoyed by improvements in new orders, employment, wages and capital expenditures. At the same time, shipments, capacity utilization and hours worked eased somewhat in October, and the sample comments continued to note ongoing challenges with supply chain disruptions, workforce shortages and soaring input prices. The index for raw material costs decelerated somewhat in October but remained not far from the record high. Meanwhile, the index for finished goods jumped from 44.0 to 49.8, an all-time high.

  Looking ahead, manufacturers in the Texas district remained positive in their outlook for the next six months, with the forward-looking composite measure increasing from 11.5 to 15.0. Optimism about growth in new orders, production and shipments strengthened in the latest data, but hiring and capital spending expectations softened a little. Respondents anticipated wages and benefits to jump at the second-fastest pace in the survey's history, following August's reading (60.6), with that index up from 50.4 to 60.3.

- **Durable Goods Orders and Shipments:** New orders for durable goods pulled back 0.4% from a record $262.3 billion in August to $261.3 billion in September. Nondefense aircraft and parts orders, which can be highly volatile from month to month, fell 27.9% in September after jumping 63.9% in August. In addition, motor vehicles and parts sales dropped 2.9% for the month, with the chip shortage and supply chain issues continuing to challenge that sector. Excluding transportation equipment, new durable goods orders increased 0.4% in September.

  Demand strengthened in September for machinery (up 1.1%), fabricated metal products (up 0.7%), primary metals (up 0.6%) and other durable goods (up 0.3%). In addition to automobiles and nondefense aircraft, other segments with declining orders in September included electrical equipment, appliances and components (down 0.5%) and computers and electronic products (down 0.3%), both of which have also struggled with chip shortages and supply chain disruptions. Nondefense capital goods excluding aircraft—a proxy for capital spending in the U.S. economy—rose 0.8% from $77.1 billion in August to a record $77.7 billion in September.

  Despite some weaknesses in the transportation equipment sector, the durable goods data continue to reflect a strong upward trend overall, even as manufacturers struggle with supply chain bottlenecks, worker shortages and soaring costs. Orders rose 10.0% year to date, or 9.6% with transportation equipment excluded. Similarly, core capital goods orders have grown 8.5% through the first three quarters of 2021.

Meanwhile, durable goods shipments rose 0.4% in September, bouncing back from the 0.5% decline in August. Shipments of motor vehicles and parts fell 2.3% for the month. With transportation equipment excluded, shipments of durable goods increased 1.0% in September to a new all-time high ($184.5 billion). So far this year, durable goods shipments have risen 5.2%, or 10.1% excluding transportation equipment. In addition, core capital goods shipments increased 1.4% from $74.9 billion to $75.9 billion, an all-time high, with 8.4% growth year to date.

Even with sizable challenges, manufacturers remain upbeat in their assessments of the coming months, and these data are consistent with that, especially the phenomenal growth year to date and the new records set for core capital goods orders and shipments. This suggests broad-based growth in the durable goods sector outside of transportation equipment and in spite of lingering supply chain and workforce issues that have plagued the sector all year.

- **Employment Cost Index:** Private manufacturing wages and salaries rose 1.2% in the third quarter, extending the 1.3% gain in the second quarter. That translated into 3.7% growth over the past 12 months, the fastest pace since the first quarter of 2001 (3.8%). For all private-sector employees, wages and salaries increased 1.6% in the third quarter, up from 1.0% in the second quarter, with 4.6% growth year-over-year, an all-time high for a series dating to the beginning of 2001.

  Benefits costs for manufacturing employees increased 1.6% in the third quarter, a four-year high and up from 0.4% in the prior quarter. On a year-over-year basis, benefits have risen 3.1%, the highest since the second quarter of 2018. Overall, total manufacturing compensation rose 1.4% for the quarter, or 3.6% year-over-year, the highest since the second quarter of 2005.

- **Gross Domestic Product:** The U.S. economy grew 2.0% at the annual rate in the third quarter, the slowest pace of growth since the pandemic began, down from 6.7% in the second quarter. The deceleration in economic growth stemmed from supply chain disruptions and the spread of the delta variant, with consumer and business spending easing significantly in the quarter. Durable goods purchases fell for the first time since the second quarter of 2020, led by sizable declines in spending for motor vehicles and parts due to the ongoing chip shortage. Nonresidential fixed investment and net exports were also notable drags on growth in the third quarter.

  Overall, real GDP should rebound in the fourth quarter, with 4.0% growth expected, and for 2021, the forecast is for 5.5% growth. For 2022, the current estimate is for 3.6% growth. At $19.465 billion, real GDP in the third quarter was 1.4% above the pace seen at the end of 2019, or before the COVID-19 pandemic began.

  Here is a breakdown of the major categories:

  - Personal consumption expenditures: Goods spending plummeted 9.2% at the annual rate in the third quarter, the first decline of the year and down from 13.0% growth in the second quarter. Durable goods spending fell 26.2% in the third quarter, the largest quarterly decrease since the fourth quarter of 2008, led by motor vehicles and parts declines. In contrast, nondurable goods and service-sector spending rose 2.6% and 7.9%, respectively, albeit also with easing from the second quarter.

Overall, personal consumption expenditures added 1.09 percentage points to top-line growth in the third quarter, with nondurable goods and services adding 3.79 percentage points but durable goods dragging down the headline number by 2.70 percentage points.

- Gross private domestic investment: Nonresidential fixed investment rose 1.8% at the annual rate in the third quarter, slowing from 9.2% growth in the second quarter. Investments in intellectual property products were a bright spot, rising 12.2%, which should assist with productivity growth moving forward. In contrast, businesses spent less on equipment and structures, declining 3.2% and 7.3% in the quarter, respectively. Residential spending fell for the second consecutive quarter, down 7.7% in the third quarter. Overall, nonresidential fixed investment contributed 0.24 percentage points to real GDP growth in the quarter, but residential spending subtracted 0.38 percentage points.

  After declining in the first and second quarters, inventory spending rebounded in the third quarter, adding 2.07 percentage points to headline growth.

- Net exports: Exports of goods and services fell 2.5% at the annual rate in the third quarter, with goods exports down 5.1% and service-sector exports up 3.8%. At the same time, imports of goods and services jumped 6.1% in the third quarter, led by a 44.4% rebound in service-sector imports but with goods imports edging down 0.1%. In total, net exports subtracted 1.14 percentage points in the third quarter, serving as a drag on economic activity for the fifth straight quarter.

  Year to date, goods exports have inched down 0.1%, but goods imports have increased a modest 3.6%, as the U.S. economy has recovered faster than some of its international peers. Along those lines, goods imports have risen 9.5% since the end of 2019 (or before the pandemic), with goods exports declining 4.6%.

- Government spending: Federal government spending decreased 4.7% at the annual rate in the third quarter, extending the 5.3% decline in the second quarter and subtracting 0.33 percentage points from real GDP. At the same time, state and local government spending increased 4.4% in the third quarter, the strongest reading since the first quarter of 2020, adding 0.46 percentage points to headline growth.

- **International Trade in Goods (Preliminary):** The goods trade deficit rose from $88.16 billion in August to a record $96.25 billion in September. This deficit has averaged nearly $90 billion year to date in 2021, up from the annual averages of $71.79 billion and $76.84 billion in 2019 and 2020, respectively. In September, goods exports plummeted from a record $149.11 billion to $142.15 billion, which was more than enough to outweigh the increase in goods imports from $237.28 billion to $238.40 billion.

In the latest data, the decrease in goods exports was led by significant reductions for industrial supplies (down $5.69 billion) and capital goods (down $1.56 billion). Meanwhile, stronger imports for capital goods (up $2.27 billion), other goods (up $807 million) and industrial supplies (up $703 million) were enough to offset declines for automotive vehicles (down $2.15 billion) and consumer goods (down $436 million). Final data, which will also include the service-sector trade surplus, will be released Nov. 4.

- **Kansas City Fed Manufacturing Survey:** Manufacturing activity continued to expand solidly, with the composite index of general business conditions rising from 22 in September to 31 in October, the best reading since April. New orders, production, shipments, employment, the average employee workweek and exports each strengthened in October, which was encouraging. Yet, the sample comments once again noted supply chain and logistics constraints, workforce shortages and rising input costs. At the same time, the index for raw material prices jumped from 80 to 87, a new record high.

  In special questions, 95% of respondents said they were facing challenges with supply chain disruptions, with more firms delaying projects, raising prices, increasing inventories and turning away businesses. Nearly 70% said they were diversifying suppliers. Fifty-six percent of firms anticipated rising material costs and supply chain issues to linger for at least 6 to 12 months, with 36% seeing them not improving until at least 12 months from now.

  Meanwhile, respondents continued to feel very upbeat about additional growth over the next six months, but with the forward-looking composite index edging down from 35 in September to 34 in October. It remained not far from the record 37 in June. Respondents expected input prices to remain very elevated, with the forward-looking measure rising from 79 to 85, an all-time high. Respondents anticipated supplier delivery times to rise at the fastest pace on record. More favorably, respondents predicted capital expenditures to increase at the strongest rate since September 2018.

- **New Home Sales:** New single-family home sales soared 14.0% from 702,000 units at the annual rate in August to 800,000 units in September, the best pace since March. In the latest figures, sales increased in every region of the country except for the Midwest. Despite the uptick, these data have trended lower since peaking at 993,000 units in January, which was the strongest pace since December 2006, largely on affordability issues, supply chain challenges and workforce shortages. With weaker data since January, new single-family home sales declined 17.6% year-over-year, down from 971,000 units in September 2020.

  There were 5.7 months of supply on the market in September, down from 6.5 months in August but up from just 3.6 months in January. The median sales price for new homes was $408,800, a new record and up 18.7% from $344,400 one year ago.

- **Personal Consumption Expenditures Deflator:** The PCE deflator rose 0.3% in September, mirroring the gain in August. Food and energy prices increased 1.1% and 1.3% for the month, respectively. Excluding food and energy prices, the PCE deflator increased 0.2% in September, the slowest monthly pace of growth since February. Nonetheless, the PCE deflator has risen 4.4% year-over-year, the greatest increase since January 1991. Core inflation has increased 3.6% since September 2020, the same year-over-year pace as in June, July and August, remaining the fastest pace of inflation since May 1991.

Rising raw material costs continue to be a major concern for manufacturers, especially with supply chain disruptions and soaring pent-up demand in the marketplace. Indeed, core inflation is likely to remain elevated, even if there is some stabilization by early 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 expect the Federal Open Market Committee to announce that it will start tapering its asset purchases at its Nov. 2–3 meeting, with a possible interest rate hike in mid-2022.

- **Personal Income and Spending:** Personal consumption expenditures increased 0.6% in September, extending the 1.0% gain in August. Nondurable goods spending rose 0.9% for the month, but durable goods purchases fell for the fourth time in five months, down 0.2% in September. Service-sector expenditures increased 0.6% in September, continuing to improve as more Americans get out and about. On a year-over-year basis, personal spending has increased a solid 10.9%, with durable and nondurable goods soaring 11.8% and 12.7%, respectively, and with service-sector purchases up 10.1% since September 2020.

  Meanwhile, personal income fell 1.0% in September, falling for the first time since May. Over the past 12 months, personal income has risen 4.2%. Wages and salaries increased 0.8% for the month, with total manufacturing wages and salaries rising 0.2% from $976.8 billion in August to $978.9 billion in September. More importantly, total wages and salaries have increased 9.3% year-over-year, with manufacturing data up 10.1% since September 2020. Of note in the latest data, total unemployment insurance dropped from $352.3 billion in August to $97.7 billion in September, the lowest since March 2020.

  The personal saving rate decreased from 9.2% in August to 7.5% in September, the lowest since December 2019. As such, the saving rate—after peaking at 33.8% in April 2020—has drifted down closer to the annual average in 2019 (7.6%), or before the COVID-19 pandemic.

- **Richmond Fed Manufacturing Survey:** After contracting in September for the first time since May 2020, manufacturing activity in the Richmond Federal Reserve Bank's district rebounded in October. The composite index of general business activity rose from -3 in September to 12 in October, with new orders, shipments and capacity utilization bouncing back for the month. In addition, employment, the average workweek and capital spending strengthened. Supplier challenges continued to keep the backlog of orders and vendor lead times growing, with the latter rising to a new all-time high. Wage growth pulled back for the second straight month from August's record pace but remained very elevated. 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 soared 13.04% in October, slipping slightly from 14.01% in September. Firms reported that the prices received for their goods and services increased 9.42% in October, up from 9.13% in September. Likewise, respondents anticipated an annualized 6.49% increase in costs six months from now, up from 6.24% in the prior release. Manufacturers in the district expected prices received increasing 5.73%, or slightly below the 5.82% predicted in the September report.

- **University of Michigan Consumer Sentiment (Revision):** The Index of Consumer Sentiment declined from 72.8 in September to 71.7 in October, but edging up from the previous estimate of 71.4, according to preliminary data from the University of Michigan and Thomson Reuters. This remains not far from August's reading (70.3), which was the lowest since December 2011. Americans felt slightly less upbeat about current and future economic conditions in October. Consumers continued to cite inflation as a key concern, offsetting improvements in the delta variant and with the economic outlook overall. The statement reads, "Declining living standards due to inflation were spontaneously mentioned by one of every five households, concentrated among older and poorer households."

- **Weekly Initial Unemployment Claims:** Initial unemployment claims totaled 281,000 for the week ending Oct. 23, down from 291,000 for the week ending Oct. 16 and the lowest since the week of March 14, 2020. Meanwhile, continuing claims declined from 2,480,000 for the week ending Oct. 9 to 2,243,000 for the week ending Oct. 16, also a post-pandemic low. Continuing claims were consistent with 1.7% of the workforce, down from 1.8% in the previous report.

  At the same time, 2,830,661 Americans received some form of unemployment insurance benefit (including state and federal programs) for the week ending Oct. 9. That figure was down from 3,279,047 for the week ending Oct. 2. The decrease in the latest figures stemmed from sizable declines in pandemic and state unemployment assistance and extended benefits.