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MONDAY ECONOMIC REPORT

Relief at the Pump: Lower Energy Costs Help Moderate Inflation

August 15, 2022

The Weekly Toplines

- According to the U.S. Energy Information Administration, the average cost of regular gasoline nationally was $4.038 per gallon on Aug. 8, the lowest price since Feb. 28. A similar measure from AAA reported that gasoline prices averaged $3.978 per gallon nationally last week, falling below $4 for the first time since early March.

- Lower energy prices helped moderate inflation measures in July. After soaring 1.3% in June, the fastest monthly increase since September 2005, consumer prices were flat in July. Declining energy costs, which fell 4.6% in July, helped provide some welcome relief, with gasoline prices off 7.7%. At the same time, food prices continued to grow solidly, up 1.1% for the month.

- The Consumer Price Index has risen 8.5% over the past 12 months, pulling back from 9.1% in June, which was the fastest since November 1981. Core inflation (which excludes food and energy) increased 5.9% year-over-year in July, the same pace as in June. Core inflation has decelerated since March (6.5%), which was the highest since August 1982, but continues to rise at a very strong pace.

- Overall, price pressures for consumers are likely to remain elevated over the coming months, but these data offered some comfort, with signs of possible cooling in inflationary pressures. With more favorable comparison months moving forward, core price growth on a year-over-year basis should continue to moderate somewhat, albeit at still-high rates. The current forecast is for year-over-year growth in the CPI to be 6.5% at year’s end, with core inflation at 5.0%.

- Likewise, producer prices for final demand goods and services fell 0.5% in July, pulling back from the 1.0% gain in June and declining for the first time since April 2020. Over the past 12 months, producer prices for final demand goods and services have risen 9.8%, down from 11.3% in June and the lowest year-over-year rate since October. Meanwhile, core producer prices increased 5.8% year-over-year, continuing to decelerate since hitting a record 7.1% in March but remaining highly elevated.

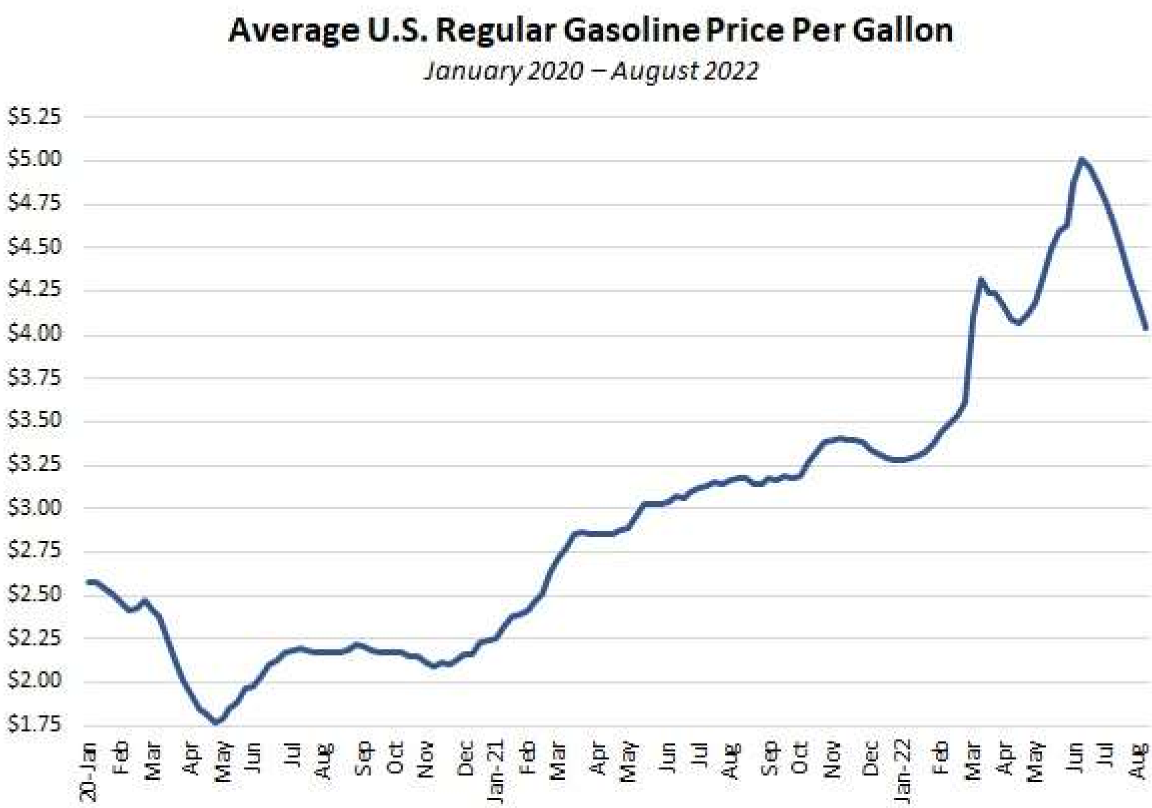
- These data will likely provide mixed comfort. On the one hand, it is encouraging to see some deceleration in these measures, but even with some easing, prices continue to rise at very elevated levels. For their part, manufacturers continue to cite rising raw material costs as their top challenge, followed closely by supply chain and workforce challenges.

- The Federal Open Market Committee might increase the federal funds rate by 50 basis points at its Sept. 20–21 meeting instead of the 75 basis-point hike that some were calling for after the strong labor market numbers the week before.

- Incoming data will help to frame the size of the rate hike not only in September, but also for the Nov. 1–2 and Dec. 13–14 meetings. My current view is that there will be 25 basis-point federal funds rate hikes at each of the final two FOMC meetings this year.

- Another complication for the Federal Reserve is falling labor productivity for nonfarm businesses, with soaring compensation and unit labor costs. With that said, manufacturing labor productivity jumped 5.5% at the annual rate in the second quarter, bouncing back strongly after declining in the three previous quarters on stronger output.

- 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 55.1 in August, according to preliminary data from the University of Michigan and Thomson Reuters. Inasmuch as these data are highly correlated with falling gasoline prices, the increase should not be a surprise.



Source: *U.S. Energy Information Administration*

Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, August 8
None

This Week's Indicators:

Monday, August 15
NAHB Housing Market Index
New York Fed Manufacturing Survey

Tuesday, August 9
NFIB Small Business Survey
Productivity and Costs

Wednesday, August 10
Consumer Price Index

Thursday, August 11
Producer Price Index
Weekly Initial Unemployment Claims

Friday, August 12
University of Michigan Consumer Sentiment

Tuesday, August 16
Housing Starts and Permits
Industrial Production

Wednesday, August 17
Retail Sales

Thursday, August 18
Conference Board Leading Indicators
Existing Home Sales
Philadelphia Fed Manufacturing Survey
Weekly Initial Unemployment Claims

Friday, August 19
State Employment Report

Deeper Dive

- **Consumer Price Index**: After soaring 1.3% in June, the fastest monthly increase since September 2005, consumer prices were flat in July. Declining energy costs, which fell 4.6% in July, helped provide some welcome relief, with gasoline prices off 7.7%. At the same time, food prices continued to grow solidly, up 1.1% for the month.

  Excluding food and energy, core consumer prices rose 0.3% in July, easing from 0.7% growth in June and the slowest pace since March. Prices for household furnishings and supplies (up 0.6%), medical care commodities (up 0.6%), new vehicles (up 0.6%), shelter (up 0.5%) and medical care services (up 0.4%) were notably higher in July, but these cost increases were mitigated somewhat by reduced prices for transportation services (down 0.5%), used cars and trucks (down 0.4%) and apparel (down 0.1%).

  The Consumer Price Index has risen 8.5% over the past 12 months, pulling back from 9.1% in June, which was the fastest since November 1981. At the same time, core inflation (which excludes food and energy) increased 5.9% year-over-year in July, the same pace as in June. Core inflation has decelerated since March (6.5%), which was the highest since August 1982, but continues to rise at a very strong pace.

  Overall, price pressures for consumers are likely to remain elevated over the coming months, but these data offered some comfort, with signs of possible cooling in inflationary pressures. With more favorable comparison months moving forward, core price growth on a year-over-year basis should continue to moderate somewhat, albeit at still-high rates. The current forecast is for year-over-year growth in the CPI to be 6.5% at year’s end, with core inflation at 5.0%.

  While these data will continue to put pressure on the Federal Reserve to act aggressively and decisively on inflation, signs of possible cooling in pricing pressures might offer some flexibility on monetary policy. Indeed, the Federal Open Market Committee might increase the federal funds rate by 50 basis points at its Sept. 20–21 meeting instead of the 75 basis-point hike that some were calling for after the strong labor market numbers the week before.

- **NFIB Small Business Survey**: The National Federation of Independent Business reported that the Small Business Optimism Index, which fell to the lowest level since

March 2013 in June, was little changed in July, up from 89.5 to 89.9. Supply chain disruptions, workforce shortages and inflation continued to challenge small business owners. The net percentage of respondents saying general business conditions would be better six months from now improved from -61%, a record low in the 48-year history of the survey, to -52%. In addition, the net percentage of firms expecting sales to rise over the next three months declined from -28% to -29%, the worst reading since April 2020.

Respondents cited inflation as the top “single most important problem,” followed by difficulties in obtaining enough qualified labor. Inflationary pressures have decelerated but remain elevated. In July, the net percentage of respondents reporting higher prices today than three months ago pulled back from 63% to 56%. At the same time, the net percentage planning a price increase over the next three months eased from 49% to 37%.

The labor market remained tight. The percentage of respondents suggesting they had job openings they were unable to fill edged down from 50% to 49%, remaining near a record pace (51%). In addition, the percentage of respondents citing few or no qualified applicants for job openings inched down from 60% to 57%. Finally, the net percentage of respondents planning to increase hiring over the next three months ticked up from 19% to 20%.

- **Producer Price Index**: Producer prices for final demand goods and services fell 0.5% in July, pulling back from the 1.0% gain in June and declining for the first time since April 2020. At the same time, producer prices for final demand goods dropped 1.8% in July following very solid increases in the prior six months. Energy prices plummeted 9.0% in July, pulling the headline number lower. Food costs rose 1.0% for the month. Food and energy costs have soared 15.0% and 36.7% year-over-year, respectively, despite the decrease in energy prices in July. Excluding food and energy, producer prices for final demand goods increased 0.2% in July, slowing from the 0.4% gain in June.

  Over the past 12 months, producer prices for final demand goods and services have risen 9.8%, down from 11.3% in June and the lowest year-over-year rate since October. Meanwhile, core producer prices increased 5.8% year-over-year, continuing to decelerate since hitting a record 7.1% in March but remaining highly elevated.

  These data will likely provide mixed comfort. On the one hand, it is encouraging to see some deceleration in these measures, but even with some easing, raw material costs continue to rise at very elevated levels. Indeed, manufacturers cite rising raw material costs as their top challenge, followed closely by supply chain and workforce challenges, with the very significant pace of price growth in this data over the past year helping to explain why.

- **Productivity and Costs**: Manufacturing labor productivity jumped 5.5% at the annual rate in the second quarter, bouncing back strongly after declining in the three previous quarters. Output in the sector rose 4.3% in the second quarter, building on the 3.9% gain in the first quarter. This reflects resilient growth in demand for goods despite ongoing challenges with supply chain, workforce, inflationary and geopolitical issues. With that said, the number of hours worked declined 1.1% in the second quarter, but with hourly compensation up 4.9%. Unit labor costs among manufacturers decreased 0.5%.

  Labor productivity for durable goods increased 6.1% in the second quarter, with output jumping 6.0%. The number of hours worked edged down 0.1%, with hourly compensation soaring 5.3% and unit labor costs decreasing 0.7% in the second quarter. At the same time, labor productivity for nondurable goods rose 5.4% in the second quarter, with output up 2.6%. The number of hours worked fell 2.6%, with hourly compensation up 4.0%. Unit labor costs for nondurable goods manufacturers decreased 1.3%.

Meanwhile, nonfarm business labor productivity fell 4.6% in the second quarter at the annual rate, extending the 7.4% decline in the first quarter. Output decreased 2.1%, but with the number of hours worked rising 2.6% and hourly compensation up 5.7%. As a result, unit labor costs soared 10.8%.

- **University of Michigan Consumer Sentiment (Preliminary):** 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 55.1 in August, according to preliminary data from the University of Michigan and Thomson Reuters. 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 future conditions. Yet, consumers also felt less upbeat in their views of the current economic environment, and overall, the sentiment remains not far from the lowest in the survey's history. The release noted, "… high income consumers, who generate a disproportionate share of spending, registered large declines in both their current personal finances as well as buying conditions for durables." Overall, Americans continued to worry about inflation, particularly as higher prices dampen their purchasing power and overall household finances. Final data will be released on Aug. 26.

- **Weekly Initial Unemployment Claims:** The week ending Aug. 6 saw 262,000 initial unemployment claims, up from 248,000 for the week ending July 30 and the highest since the week ending Nov. 13, 2021. These data have trended gradually higher since reaching 166,000 claims for the week ending March 19, which was the second-lowest reading in the history of the series and the lowest since the week ending Nov. 30, 1968.

  At the same time, the week ending July 30 saw 1,428,000 continuing claims, up from 1,420,000 for the week ending July 23 and the highest since the week ending April 2. These data have trended somewhat higher since falling to 1,306,000 claims for the week ending May 21, which was the lowest since the week ending Dec. 27, 1969.

Take Action

Register Today: Compensation and Labor Market Competitiveness Webinar
On Thursday, Aug. 18, from 2:00 p.m. to 3:00 p.m. EDT, The Manufacturing Institute—the workforce development and education partner of the NAM—will host a webinar focusing on how companies have competed for talent in a very tight labor market, highlighting the findings of a recent paper with Colonial Life. Manufacturers continue to recount the difficulties that they are having with attracting and retaining workers, and compensation practices have needed to adapt. In addition, companies have had to differentiate themselves from other competitors for workers. For more information and to register, click here.

Be Part of Manufacturing's Premier Workforce Event
The MI 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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