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MONDAY ECONOMIC REPORT

Inflation Moderated in January, but Prices Continue to Rise Steadily

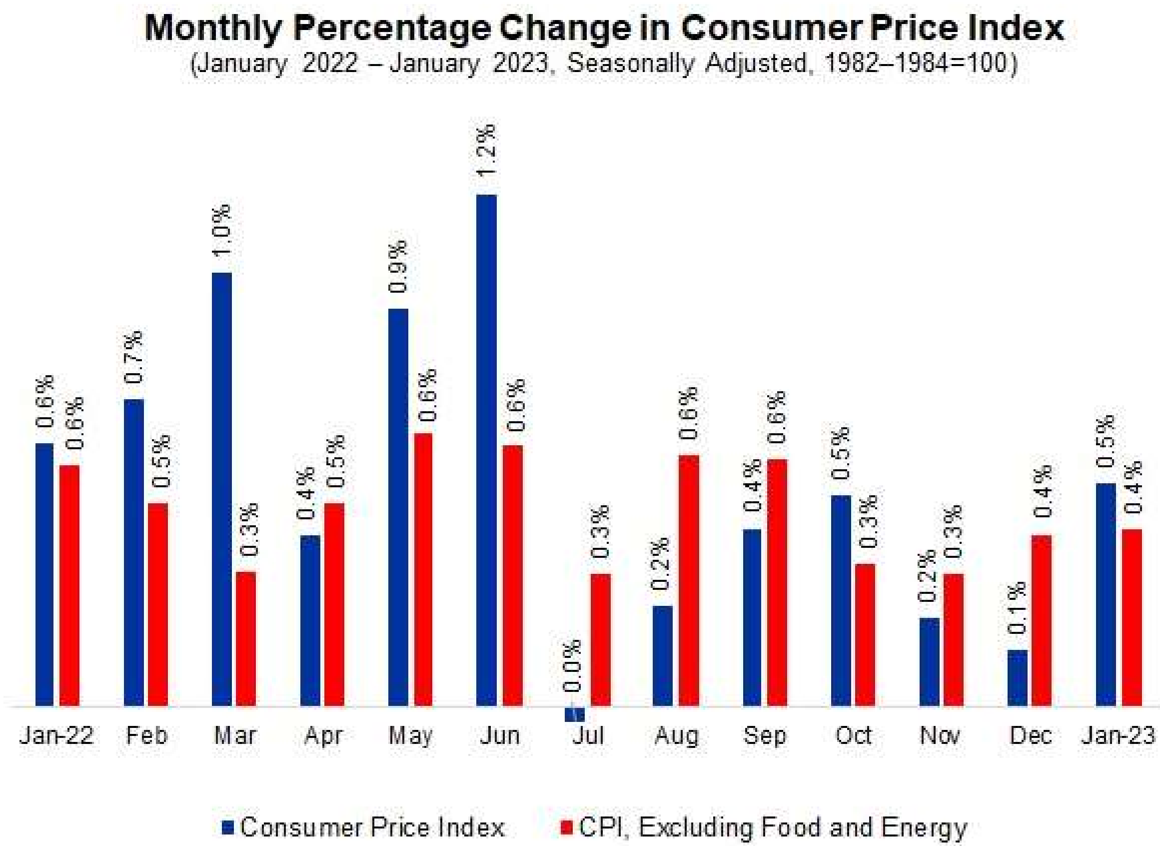
By Chad Moutray – February 21, 2023

The Weekly Toplines

- Consumer prices rose 0.5% in January, accelerating from the 0.2% and 0.1% gains in November and December, respectively. Excluding food and energy, core consumer prices rose 0.4% in both December and January. The Consumer Price Index has risen 6.4% over the past 12 months, the slowest rate since October 2021, albeit at a still elevated pace. Core inflation (which excludes food and energy) increased 5.6% year-over-year in January, the weakest reading in 13 months.
- Producer prices for final demand goods and services rose 0.7% in January, bouncing back after declining 0.2% in December and the largest monthly gain since June. Excluding food and energy, producer prices for final demand goods soared 0.6% in January, the fastest pace since May. Producer prices for final demand services increased 0.4% for the second consecutive month.
- Over the past 12 months, producer prices for final demand goods and services have risen 6.0%, the lowest since March 2021. Core producer prices increased 4.5% year-over-year, continuing to decelerate since hitting a record 7.1% in March. It was also the lowest in 22 months.
- Overall, pricing pressures for consumers remain very elevated, even with continued easing in the latest data. This will continue to put pressure on the Federal Open Market Committee, which now might look to do three 25-basis-point rate hikes at the next three meetings: March 21–22, May 2–3 and June 13–14. Assuming the incoming data allow the Federal Reserve to hit the pause button at that time, this would bring the "terminal rate"—or the rate at which the FOMC ceases increasing rates—to at least 5.50%.
- After declining sharply in November and December, manufacturing production bounced back somewhat in January. As such, manufacturing production once again proved its resilience despite struggles with weaker-than-desired global growth and ongoing geopolitical and economic uncertainties.
- Nonetheless, manufacturing production has risen just 0.3% over the past 12 months. At the same time, manufacturing capacity utilization rebounded from a 15-month low, increasing from 77.1% in December to 77.7% in January.
- Like manufacturing production, retail sales jumped 3.0% in January following disappointing data in November and December. As such, the consumer bounced

back, starting the new year with a burst of spending that should lift GDP estimates and is another sign of resilience in the U.S. economy.

- Excluding motor vehicles and gasoline station sales, retail spending increased by a solid 2.6% in January. Over the past 12 months, retail sales have risen 6.4%, or 7.4% with motor vehicles and gasoline station sales excluded.
- Despite better retail sales and production figures, manufacturing surveys from the New York and Philadelphia Federal Reserve Banks both reported contracting activity in their regions in February. However, manufacturers in both districts felt cautiously optimistic in the outlook for the next six months.
- Meanwhile, new residential construction activity declined 4.5% to 1,309,000 units at the annual rate in January, the slowest pace since June 2020. Single-family housing starts dropped 4.3% to 841,000 units. Issues of affordability and an uncertain economic outlook have impacted the housing market negatively, and on a year-over-year basis, new housing starts have dropped 21.4%. Single-family construction activity has plummeted 27.3% over the past 12 months.
- With that said, mortgage rates have stabilized somewhat more in the past few months, and that has brought some would-be homebuyers back into the market. Along those lines, the latest data on builder sentiment improved, with a more upbeat—although still negative—outlook, according to the National Association of Home Builders and Wells Fargo.



Monthly Percentage Change in Consumer Price Index
(January 2022 – January 2023, Seasonally Adjusted, 1982–1984=100)
0.6%
0.6%
0.7%
0.5%
1.0%
0.3%
0.4%
0.5%
0.9%
0.6%
1.2%
0.6%
0.0%
0.3%
0.2%
0.6%
0.4%
0.6%
0.5%
0.3%
0.2%
0.3%
0.1%
0.4%
0.5%
0.4%
Jan-22
Feb
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Jan-23
Consumer Price Index
CPI, Excluding Food and Energy

Manufacturers: Here's What You Should Look Out for in 2023
As international commerce evolves, Husch Blackwell's team of legal thought leaders is providing insight into what manufacturers can expect in the coming year. Download our Legal Insights for Manufacturing report to explore how the legal and regulatory framework is evolving to address manufacturing's large generational shifts. Topics include:

- Supply chain risk and reshoring;
- Cybersecurity and data protection;
- Heightened regulatory and enforcement risk;
- Product safety and associated liability; and
- Increased unionization and skilled labor scarcity.

The choices made during this era of transition will be crucial for manufacturers in the U.S. Download our Legal Insights for Manufacturing report to learn more.

Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, Feb. 13
None

Tuesday, Feb. 14

This Week's Indicators:

Monday, Feb. 20
PRESIDENTS DAY HOLIDAY

Tuesday, Feb. 21

Consumer Price Index
NFIB Small Business Survey

Wednesday, Feb. 15
Industrial Production
NAHB Housing Market Index
New York Fed Manufacturing Survey
Retail Sales

Thursday, Feb. 16
Housing Starts and Permits
Philadelphia Fed Manufacturing Survey
Producer Price Index
Weekly Initial Unemployment Claims

Friday, Feb. 17
Conference Board Leading Indicators

Existing Home Sales
S&P Global Flash U.S. Manufacturing PMI

Wednesday, Feb. 22
FOMC Meeting Minutes

Thursday, Feb. 23
Gross Domestic Product (Revision)
Kansas City Fed Manufacturing Survey
Weekly Initial Unemployment Claims

Friday, Feb. 24
New Home Sales
Personal Consumption Expenditures Deflator
Personal Income and Spending
University of Michigan Consumer Sentiment (Revision)

Deeper Dive

- **Conference Board Leading Indicators**: The Leading Economic Index decreased 0.3% in January, falling for the 11th straight month. Over the past six months, the LEI has declined 3.6%, suggesting weaker growth over the coming months as firms grapple with an uncertain economic outlook. The release notes that these data are consistent with a higher risk of recession in the near term. Nonetheless, the Coincident Economic Index edged up 0.2% in January, with 0.7% growth over the past six months.

- **Consumer Price Index**: Consumer prices rose 0.5% in January, accelerating from the 0.2% and 0.1% gains in November and December, respectively. After declining in each of the two prior releases, energy costs increased 2.0% in January. Food prices rose 0.5% in the latest data, continuing to rise solidly. Over the past 12 months, food and energy costs have increased 10.1% and 8.7%, respectively.

  Excluding food and energy, core consumer prices rose 0.4% in both December and January. Prices for medical care commodities (up 1.1%), transportation services (up 0.9%), apparel (up 0.8%), shelter (up 0.7%), household furnishings and supplies (up 0.5%) and new vehicles (up 0.2%) increased for the month. In contrast, prices for used cars and trucks (down 1.9%) and medical care services (down 0.7%) declined.

  The Consumer Price Index has risen 6.4% over the past 12 months, edging down from 6.5% in December and the slowest rate since October 2021, albeit at a still elevated pace. At the same time, core inflation (which excludes food and energy) increased 5.6% year-over-year in January, inching down from 5.7% in December and the weakest reading in 13 months.

  Overall, pricing pressures for consumers remain very elevated, even with continued easing in the latest data. This will continue to put pressure on the Federal Open Market Committee, which now might look to do three 25-basis-point rate hikes at the next three meetings: March 21–22, May 2–3 and June 13–14. Assuming the incoming data allow the Federal Reserve to hit the pause button at that time, this would bring the “terminal rate”—or the rate at which the FOMC ceases increasing rates—to at least 5.50%.

- **Housing Starts and Permits**: New residential construction activity declined 4.5% from 1,371,000 units at the annual rate in December to 1,309,000 units in January, the slowest pace since June 2020. Single-family housing starts dropped 4.3% from 879,000 units to 841,000 units, and multifamily starts fell 4.9% from 492,000 units to 468,000 units. Issues of affordability and an uncertain economic outlook have impacted the housing market negatively, and on a year-over-year basis, new housing starts have dropped 21.4%. Single-family construction activity has plummeted 27.3% over the past 12 months.

  Meanwhile, new housing permits—a proxy for future residential construction—edged up 0.1% from an annualized 1,337,000 units in December to 1,339,000 units in January. Yet, single-family permits declined 1.8% from 731,000 units to 718,000 units, the lowest level since April 2020. At the same time, multifamily activity rose 2.5% from 606,000 units to 621,000 units. On a year-over-year basis, housing permits have fallen 27.3% from 1,841,000 units in January 2022, with single-family permits tumbling 40.0% over the past 12 months.

  With that said, mortgage rates have stabilized somewhat more in the past few months, and that has brought some would-be homebuyers back into the market. Along those lines, the latest data on builder sentiment improved, with a more upbeat —although still negative—outlook, according to the National Association of Home Builders and Wells Fargo (see below).

- **Industrial Production**: After declining sharply in November and December, manufacturing production bounced back somewhat in January, rising 1.0%, with durable and nondurable goods output up 0.8% and 1.1%, respectively. As such, manufacturing production once again proved its resilience despite struggles with weaker-than-desired global growth and ongoing geopolitical and economic uncertainties. Nonetheless, manufacturing production has risen just 0.3% over the past 12 months. At the same time, manufacturing capacity utilization rebounded from a 15-month low, increasing from 77.1% in December to 77.7% in January.

  The manufacturing production data in January were mostly higher, led by sizable gains in apparel and leather goods (up 3.7%), nonmetallic mineral products (up 2.4%), other manufacturing (up 2.2%), textiles and product mills (up 2.2%), machinery (up 1.7%), food, beverage and tobacco products (up 1.7%) and chemicals (up 1.6%), among others. At the other end of the spectrum, plastics and rubber products (down 1.0%), wood products (down 1.0%), furniture and related products (down 0.7%), printing and related support activities (down 0.6%) and petroleum and coal products (down 0.2%) had reduced output for the month.

  Over the past 12 months, the largest increases in manufacturing production occurred in apparel and leather (up 13.4%), aerospace and miscellaneous transportation equipment (up 10.2%), nonmetallic mineral products (up 7.2%) and motor vehicles and parts (up 4.7%). In contrast, paper (down 8.5%), textile and product mills (down 6.5%), furniture and related products (down 5.8%) and wood products (down 5.8%) had the biggest declines in production over the past year.

  Meanwhile, total industrial production was flat in January following declines in both November and December. In addition to manufacturing, mining production grew 2.0%

in January, but output in the utilities sector dropped 9.9% on warmer temperatures. On a year-over-year basis, industrial production has increased 0.8%. Total capacity utilization inched down from 78.4% to 78.3%, the lowest rate in 16 months.

- **NAHB Housing Market Index**: Homebuilders felt negative in their assessments of the housing market for the seventh consecutive month, but with the Housing Market Index improving strongly from 35 in January to 42 in February, according to the National Association of Home Builders and Wells Fargo. Readings below 50 are consistent with more builders being negative than positive in their views of the housing market. While affordability and uncertainty in the economic outlook will continue to challenge the residential market, builders are more hopeful that housing activity has "stabilized." Indeed, improved mortgage rates and sales incentives have appeared to boost demand somewhat.

  In February, the index of current activity for single-family homes rose from 40 to 46, and the index for the traffic of potential buyers increased from 23 to 29. Meanwhile, the index for expected single-family sales in the next six months jumped from 37 to 48.

- **New York Fed Manufacturing Survey**: Manufacturing activity in the New York Federal Reserve Bank's district contracted for the third straight month in February, but at a slower rate. The composite index of general business conditions improved from the post-pandemic low of -32.9 in January to -5.8 in February. Shipments stabilized, and the decline in new orders slowed. Yet, labor market conditions worsened, with hiring decreasing for the first time since June 2020 and the average employee workweek narrowing further. Raw material costs accelerated once again, continuing to expand solidly.

  Manufacturers responding to the Empire State Manufacturing Survey felt more upbeat in their outlook for the next six months, with the forward-looking composite index rising from 8.0 to 14.7. With that said, growth expectations for new orders, shipments, employment, capital expenditures and technology spending eased somewhat in the latest survey, but the average employee workweek improved further. Manufacturers predicted input costs to continue rising sharply.

- **NFIB Small Business Survey**: The Small Business Optimism Index ticked up from 89.8 in December to 90.3 in January. Small business owners continued to be anxious about the economic outlook, with ongoing inflation and workforce issues. The net percentage of respondents saying general business conditions would be better six months from now rose from -51% in December to -45% in January, with just 7% suggesting that the next three months were a "good time to expand."

  Respondents cited inflation as the top "single most important problem," followed closely by difficulties in obtaining enough qualified labor. With that said, pricing pressures—while elevated—have moderated somewhat. The net percentage of respondents reporting higher prices today than three months ago edged down from 43% in December to 42% in January. Yet, the net percentage planning a price increase over the next three months rebounded from 24%, a two-year low, to 29%.

  The labor market remained solid overall. The percentage of respondents suggesting they had job openings they were unable to fill rose from 41% to 45%. In addition, the percentage of respondents citing few or no qualified applicants for job openings inched up from 51% to 52%. The net percentage of respondents planning to increase hiring over the next three months ticked up from 17% to 19%.

Meanwhile, the capital spending data were mixed. The percentage of respondents suggesting they made a capital expenditure in the past six months rose from 55% to 59%, the strongest pace since May 2021, but the net percentage saying they planned to make a capital expenditure in the next three to six months slipped from 23% to 21%, a 22-month low.

- **Philadelphia Fed Manufacturing Survey**: The Philadelphia Federal Reserve Bank's composite index of general business conditions contracted for the sixth straight month, with activity declining more sharply in February. The composite index of general business activity dropped from -8.9 in January to -24.3 in February. New orders declined at a faster rate, and shipments and employment softened. The average employee workweek narrowed, and input costs accelerated somewhat after expanding at the slowest pace since August 2020 in December.

  Meanwhile, manufacturers in the Philly Fed district felt only cautiously positive in their outlook for the next six months, with the forward-looking composite index slipping from 4.9 in January to 1.7 in February. Respondents saw new orders and hiring improving from the previous survey, but predicted shipments, capital expenditures and input costs rising at a somewhat slower pace.

  In special questions, respondents said that compensation costs should rise 4.8% over the next four quarters, down slightly from 5.0% in the November survey, and the prices received for their company's goods and services should rise 4.5%. Overall, they expected consumer prices to increase 4.0% between now and Q1 2024, with consumer inflation averaging 3.0% over the next decade.

- **Producer Price Index**: Producer prices for final demand goods and services rose 0.7% in January, bouncing back after declining 0.2% in December. It was the largest monthly gain since June. Similarly, producer prices for final demand goods increased 1.2% in January following the 1.4% decline in December. After declining sharply in both November and December, energy costs jumped 5.0% in January. In contrast, food prices fell for the second straight month, down 1.0% in the latest data. Over the past 12 months, food and energy costs have risen 11.5% and 10.3%, respectively.

  Excluding food and energy, producer prices for final demand goods soared 0.6% in January, up from 0.1% in December and the fastest pace since May. Meanwhile, producer prices for final demand services increased 0.4% for the second consecutive month.

  Over the past 12 months, producer prices for final demand goods and services have risen 6.0%, down from 6.5% in December and the lowest since March 2021. Core producer prices increased 4.5% year-over-year, edging down from 4.7% in December and continuing to decelerate since hitting a record 7.1% in March. It was also the lowest in 22 months.

  Overall, these data provide mixed comfort. On the one hand, there are signs of continuing moderation in wholesale inflation, particularly in the year-over-year data, which is encouraging. Yet, the data also show that input costs continue to rise steadily and at paces that are higher than preferred. This latter trend is likely to continue to put pressure on the Federal Reserve, both in terms of its aggressiveness and in the timing for pausing rate hikes (see the Consumer Price Index discussion above).

- **Retail Sales**: Following disappointing data in November and December, retail sales jumped 3.0% in January. As such, the consumer bounced back, starting the new year with a burst of spending that should lift GDP estimates and is another sign of resilience in the U.S. economy. Excluding motor vehicles and gasoline station sales, retail spending increased by a solid 2.6% in January. Over the past 12 months, retail sales have risen 6.4%, or 7.4% with motor vehicles and gasoline station sales excluded.

In January, the retail sales data strengthened across the board, with the largest gains in department stores (up 17.5%), food services and drinking places (up 7.2%), motor vehicle and parts dealers (up 5.9%), furniture and home furnishings stores (up 4.4%) and electronics and appliance stores (up 3.5%), among others. Gasoline station sales were flat for the month, with spending at food and beverage stores edging up just 0.1%.

On a year-over-year basis, retailers with the largest increases in spending over the past 12 months included food services and drinking places (up 25.2%), sporting goods and hobby stores (up 6.9%), miscellaneous store retailers (up 6.7%), clothing and accessories stores (up 6.3%), food and beverage stores (up 6.2%), gasoline stations (up 5.7%) and department stores (up 5.4%). Note that these are gains in nominal terms, so higher prices helped buoy these increases.

- **Weekly Initial Unemployment Claims**: The week ending Feb. 11 saw 194,000 initial unemployment claims, little changed from 195,000 for the week ending Feb. 4. In addition, the week ending Feb. 4 saw 1,696,000 continuing claims, up from 1,680,000 for the week ending Jan. 28. While continuing claims have trended higher in recent weeks, the labor market remained a bright spot in the economy overall.

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Over the past few years, manufacturers in the U.S. have faced extensive challenges, with ongoing conversations about another recession and fears around the 2023 debt ceiling. Planning for the future of manufacturing is crucial. On Tuesday, March 7, at 2:00 p.m. EST, NAM Chief Economist Chad Moutray will join Rob Sinfield, vice president of business cloud enterprise management at Sage, to discuss predictions for the economic outlook for 2023 and how technology will be an integral part of your manufacturing business this year and beyond. To register, click here.

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