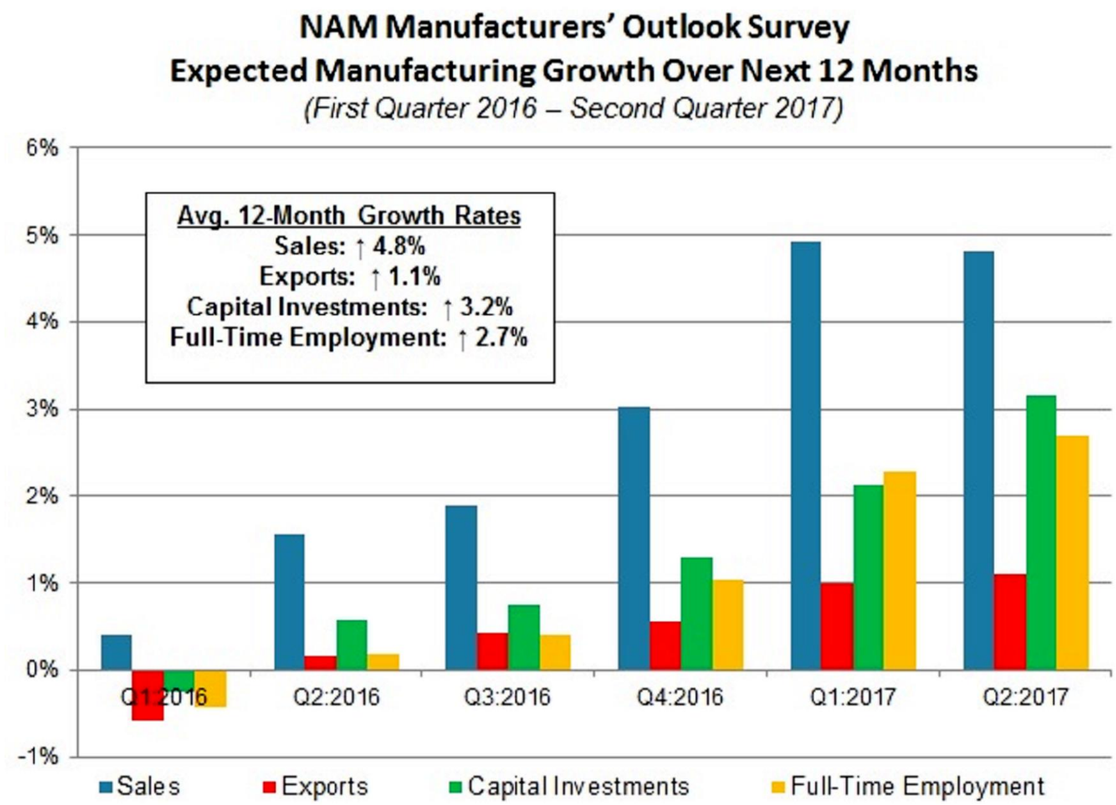

In March, the Manufacturers' Outlook Survey from the NAM rose to an all-time high in the survey's 20-year history, with 93.3 percent of respondents positive about their own company outlook. Three months later, manufacturers remain very upbeat. In the latest report, 89.5 percent were either somewhat or very positive about their own company outlook. This pullback in confidence mirrors easing in other sentiment surveys, even as they continue to present an encouraging assessment of overall conditions. In this case, the percentage of manufacturers, positive in their outlook, has averaged 91.4 percent over the first and second quarters of 2017, the highest consecutive two-quarter average in the survey's history.

Recent improvements in sentiment have corresponded with stronger manufacturing activity-another sign that the sector is trending in the right direction. This is especially the case with hiring and capital spending plans, both of which are a good proxy of a firm's willingness to invest for the future. For instance, respondents predict that full-time employment will grow an average of 2.7 percent over the next 12 months, the fastest pace in the survey's history, up from 2.3 percent in the prior survey. Similarly, firms forecast 3.2 percent growth in capital spending over the next 12 months, a six-year high and up from 2.1 percent in March. Much of this optimism stems from strong sales growth, which changed little in this survey. Respondents predict sales growth of 4.8 percent (on average) over the next 12 months, off slightly from the 4.9 percent expected growth in the prior release, which was the fastest pace in six years.

Turning to regional analysis for the sector, manufacturing activity continued to expand in both the New Yorkand Philadelphia Federal Reserve Bank districts, even as both surveys slowed somewhat in July. Each report found modest growth in new orders, shipments and employment for the month, and encouragingly, manufacturers remain upbeat about the next six months. Nearly 47 percent and 53.2 percent of respondents predicted higher sales moving forward in the New York and Philly Fed releases, respectively, with the latter survey expecting a sharp increase in capital spending over the coming months. Beyond those measures, business leaders also anticipate decelerating-but still elevated-pricing pressures for raw materials in the second half of this year.

In addition, new housing starts rebounded in June after a soft spring. New residential construction rose from an annualized 1,122,000 units in May, an eight-month low, to 1,215,000 in June. Since reaching 1,288,000 units in February, housing starts have pulled back; however, this is the first time activity has exceeded 1.2 million since then, which is promising. In a similar way, homebuilder optimism remains strong despite slipping once again, with respondents to that survey predicting healthy gains in activity over the next six months (see below). I forecast a growth of 1.28 million starts by year's end. On a year-over-year basis, housing starts rose 2.1 percent from June 2016's pace of 1,190,000, with single-family starts jumping 10.3 percent over the past 12 months. Housing permits also increased strongly, up 7.4 percent from 1,168,000 units at the annual rate in May to 1,254,000 in June. It was the best reading since March.

Manufacturers will get the first read on real GDP growth for the second quarter on Friday. After GDP grew just 1.4 percent in the first quarter, we anticipate that the second quarter data are likely to show the U.S. economy expanding at about 3 percent. Meanwhile, according to new data from the Bureau of Economic Analysis, real value-added manufacturing output bounced back in the first quarter, up 4.7 percent after falling by 2.9 percent in the fourth quarter. As a result, manufacturers contributed 0.54 percentage points to headline growth in the first quarter, a notable improvement from the 0.39 percentage point drag seen in the fourth quarter. Indeed, it was the largest industrial contributor to real GDP growth in the release. Overall, manufacturing value-added output rose from $2.194 trillion in the fourth quarter to $2.209 trillion in the first quarter, a new all-time high. The bottom line is that manufacturing accounted for 11.6 percent of real GDP in the first quarter, unchanged from the fourth quarter but down from 11.8 percent one year ago.

Several releases this week will highlight the current health of the manufacturing sector, including regional surveys from the Kansas City and Richmond Federal Reserve Banks and national data for the United States and Eurozone from IHS Markit. The Census Bureau will report on durable goods orders and shipments. These data points will hopefully show continued progress, with Europe seeking to build on its strongest growth in more than six years. The Federal Open Market Committee will meet next week, but it is not expected to raise short-term interest rates until its September meeting. Other highlights next week include new figures for consumer sentiment, employment costs, existing and new home sales and international trade in goods.

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Summaries for Last Week's Economic Indicators

Conference Board Leading Indicators

The Conference Board's Leading Economic Index (LEI) increased 0.6 percent in June, its fastest growth since January. Over the past six months, the LEI rose 2.5 percent, signaling modest growth in the months ahead. New orders in the manufacturing sector added 0.19 percentage points to headline growth, accelerating from softer data in both April and May. Other positive contributions in June came from building permits, consumer confidence, stock prices, the interest rate spread and overall lending conditions. In contrast, there was a slight drag on the LEI in June from average weekly unemployment claims.

Meanwhile, the Coincident Economic Index (CEI), which assesses current conditions, rose by 0.2 percent in June, down from 0.3 percent in May. Each of the components of the CEI-industrial production, nonfarm payrolls, personal income and manufacturing and trade sales-positively contributed to the index for the month. Manufacturing production rebounded in June, up 0.2 percent, after falling in two of the three prior months, and total industrial production-which also adds in mining and utilities-jumped 0.4 percent in June, rising for the fifth straight month.

Gross Domestic Product by Industry

Real GDP grew 1.4 percent in the first quarter, pulled lower by weak inventory spending and softer-than-desired consumer spending. At the same time, business investment was a bright spot in the report, and, according to new data from the Bureau of Economic Analysis, so was manufacturing. Real value-added output rebounded in the first quarter, up 4.7 percent after falling by 2.9 percent in the fourth quarter. As a result, manufacturers contributed 0.54 percentage points to headline growth in the first quarter, a notable improvement from the 0.39 percentage point drag seen in the fourth quarter. Indeed, it was the largest industrial contributor to real GDP growth in the release.

Other top contributors were mining (0.32 percent), construction (0.23 percent), wholesale trade (0.21 percent) and finance, insurance, real estate, rental and leasing (0.19 percent). In contrast, there were notable drags to growth from agriculture, forestry, fishing and hunting (-0.41 percent), retail trade (-0.21 percent), utilities (-10 percent) and arts, entertainment, health care and social assistance (-0.04 percent).

Overall, manufacturing gross output increased from $5.903 trillion in the fourth quarter to $6.002 trillion in the first quarter, up for the fourth straight report and exceeding $6 trillion for the first time since the fourth quarter of 2014. After struggling with a number of global challenges over the past couple years, these findings help to illustrate recent improvements. Gross output from manufacturers have stabilized since bottoming out at $5.689 in the first quarter of 2016. In addition, gross output from both durable (up from $3.017 trillion to $3.047 trillion) and nondurable (up from $2.886 trillion to $2.956 trillion) goods was higher in the first quarter.

These findings closely mirror the value-added data for manufacturing, which rose from $2.194 trillion in the fourth quarter to $2.209 trillion in the first quarter, a new all-time high. Value-added output for durable goods increased from $1.196 trillion to $1.207 trillion, with nondurable goods value-added rising from $0.998 trillion to $1.002 trillion.
The bottom line is that manufacturing accounted for 11.6 percent of real GDP in the first quarter, unchanged from the fourth quarter but down from 11.8 percent one year ago.

Housing Starts and Permits

The Census Bureau and the Department of Housing and Urban Development reported that new housing starts rebounded in June after a soft spring. New residential construction rose from an annualized 1,122,000 units in May, an eight-month low, to 1,215,000 in June. Since reaching 1,288,000 units in February, housing starts have pulled back; however, on the positive side, this is the first time that activity has exceeded 1.2 million since then and this is encouraging. Homebuilder optimism remains strong despite slipping once again, with respondents to that survey predicting healthy gains in activity over the next six months (see below). I forecast a growth of 1.28 million starts by year's end.

Looking at the June data, single-family (up from 799,000 to 849,000) and multifamily (up from 323,000 to 366,000) starts increased in the month, with both at their fastest rate since February, mirroring the headline number. The Midwest and Northeast saw the strongest growth, with only marginal gains in the West, whereas activity slipped in the South. On a year-over-year basis, housing starts rose 2.1 percent from June 2016's pace of 1,190,000. Single-family starts have jumped 10.3 percent over the past 12 months, up from 770,000 one year ago. In contrast, multifamily starts, which can be highly volatile from month to month, fell

12.9 percent over the same time frame.

Meanwhile, housing permits also increased strongly, up 7.4 percent from 1,168,000 units at the annual rate in May to 1,254,000 in June. It was the best reading since March. Permits have now exceeded 1.2 million units in 10 of the past 11 months. Permits are a proxy of future activity, so the data suggest strong growth moving forward. Much like above, single-family (up from 779,000 to 811,000) and multifamily (up from 389,000 to 443,000) permitting rose in this release. Overall, new residential construction permits have increased 5.1 percent since June 2016, up from 1,193,000 units last year. Nonetheless, single-family permits grew 9.2 percent year-over-year, with multifamily activity down 1.6 percent.

NAHB Housing Market Index

The National Association of Home Builders (NAHB) and Wells Fargo reported that the Housing Market Index continued to reflect strength despite slipping once again in July to its lowest level since the election. The index decreased from 66 in June to 64 in July, its weakest pace since October. NAHB Chief Economist Robert Dietz attributed much of the decline to "increasing supply-side costs," which are dampening sentiment among builders and pushing up prices.

To be fair, index values greater than 50 indicate strong builder confidence and readings of 60 or more indicate very strong expectations for activity; the data continue to indicate healthy growth and improvements over the longer term. Indeed, the survey results remained quite elevated even after easing from March's reading of 71, which was the highest level since June 2005.

Along those lines, homebuilders have healthy assessments about single-family home sales over the next six months. The index for expected sales dropped from 75 to 73-still a very healthy figure. In the July data, sentiment ticked higher in the Northeast and the West but dropped slightly in the Midwest and South.

NAM Manufacturers' Outlook Survey

In March, the Manufacturers' Outlook Survey from the NAM rose to an all-time high in the survey's 20-year history, with 93.3 percent of respondents positive about their own company outlook. Three months later, manufacturers remain very upbeat. In the latest report, 89.5 percent were either somewhat or very positive about their own company outlook. This pullback in confidence mirrors easing in other sentiment surveys, even as these surveys continue to present an encouraging assessment of overall conditions. In this case, the percentage who are positive in their outlook has averaged 91.4 percent over the first and second quarters of 2017, the highest consecutive two-quarter average in the survey's history.

Recent improvements in sentiment have corresponded with stronger manufacturing activity- another sign that the sector is trending in the right direction. This is especially the case with hiring and capital spending plans, both of which are a good proxy of a firm's willingness to invest for the future. For instance, respondents predict that full-time employment will grow 2.7 percent on average over the next 12 months, the fastest pace in the survey's history, up from 2.3 percent in the prior survey. Similarly, firms forecast 3.2 percent growth in capital spending over the next 12 months, a six-year high and up from 2.1 percent in March. Much of this optimism stems from strong sales growth, which changed little in this survey. Respondents predict sales growth of 4.8 percent (on average) over the next 12 months, off slightly from 4.9 percent expected growth in the prior release, which was the fastest pace in six years.

Respondents again cited rising health insurance costs as a major concern, noted as a top business challenge by roughly three-quarters of manufacturers. They see these costs increasing 8.4 percent over the next year. Respondents also listed attracting and retaining a quality workforce as a top worry, with 64.4 percent noting it as a primary challenge. At the same time, the business environment fell to third place in the previous survey, which is where it remains in this one. In this survey, 55.7 percent cited an unfavorable business climate, down from 71.2 percent and 58.2 percent in the past two releases, respectively. The likely reason for this drop is manufacturers' optimism that the new administration will continue to provide regulatory relief and make progress on regulatory and tax reform.

Along those lines, 8 in 10 manufacturers approved of President Trump's actions to reduce regulatory burdens, and to the extent those moves lead to reduced regulatory compliance costs for firms, 62.9 percent said they would use those dollars for increased capital investment and expenditures.

In addition, nearly 87 percent of respondents said they supported a comprehensive tax reform plan that matched the NAM's top priorities: a corporate tax rate of 15 percent; comparable lower rates for pass-through businesses; a strong, permanent research and development (R&D) incentive; robust capital cost-recovery rules; and a modern international tax system. Nearly 70 percent of respondents said comprehensive business tax reform would encourage their company to increase capital spending. In addition, two-thirds suggested that it would enable them to expand their businesses, with 57.7 percent saying they would hire more workers.

New York Fed Manufacturing Survey

The Empire State Manufacturing Survey reported that growth in manufacturing activity softened in July after rebounding in June. The composite index of general business conditions declined from 19.8 in June-its fastest pace since September 2014-to 9.8 in July. It was the second straight monthly expansion, but the underlying data indicated slower growth in July across the board than in the prior survey. This included new orders (down from 18.1 to 13.3), shipments (down from 22.3 to 10.5), employment (down from 7.7 to 3.9) and the average employee workweek (down from 8.5 to 0.0). More than 35 percent of respondents said that orders were higher in both June and July, but the difference maker in this month's data was the jump in those saying sales were lower, up from 17.0 percent to 22.3 percent. Yet, even with some easing, the manufacturing sector in the New York Federal Reserve Bank's district is stronger today than at this point last year, with modest expansions in most measures.

In a similar way, manufacturers in the region remained upbeat about the next six months despite most of the forward-looking measures pulling back in this release. The expectations composite index decreased from 41.7 to 34.9 but continued to suggest strong growth for the months ahead. Nearly 47 percent of those completing the survey predict increased new orders and shipments over the next six months (down from more than half), and at least 22 percent anticipate increased hiring and capital spending. On the positive side, predicted technology spending for the coming months accelerated slightly in July (up from 11.5 to 11.8), with pricing pressures decelerating once again but at still highly elevated rates (down from 33.1 to 30.7).

Philadelphia Fed Manufacturing Survey

The Federal Reserve Bank of Philadelphia reported that manufacturing activity continued to expand strongly in July. With that said, the composite index of general business activity decreased from 27.6 in June to 19.5 in July. Even with some easing for the second straight month, the headline index has averaged 29.7 year to date, illustrating the much-improved performance so far in 2017. The composite measure peaked at 43.3 in February, its best reading since November 1983. In July, manufacturers reported positive growth across the board, but many of the underlying data points decelerated, including new orders (down from 25.9 to 2.1), shipments (down from 28.5 to 12.2), employment (down from 16.1 to 10.9) and the average workweek (down from 20.5 to 3.8). To illustrate the slower growth in this survey, the percentage of respondents saying that orders had increased in the month dropped from 44.8 percent in June to 30.5 percent in July, with those suggesting a decrease rising from 18.9 percent to 28.4 percent.

Meanwhile, manufacturers in the Philadelphia region remained quite optimistic about the next six months. The forward-looking composite index increased from 31.3 to 36.9, and 53.2 percent felt that the number of new orders would rise in the coming months. Capital spending (up from 28.6 to 42.0) is expected to jump sharply, with that measure at levels not seen since April 1984. Other future-oriented data points also showed encouraging signs, even with some easing in the indices, such as shipments (down from 38.7 to 25.9), employment (down from 30.0 to 27.0) and the average workweek (down from 8.4 to 4.3). On the other hand, business leaders in the district see pricing pressures for raw materials continuing to accelerate strongly in the next six months (up from 28.7 to 29.7).

State Employment Report

Texas created the most net new manufacturing jobs in June, according to the Bureau of Labor Statistics, adding 4,600 workers in the month. Ohio (up 4,000), Minnesota (up 2,100), Florida (up 1,800), Iowa (up 1,600) and South Carolina (up 1,600) also topped the list of manufacturing employment gains in June. In addition, Texas also saw the greatest job gains over the past 12 months, with manufacturing employment in the state up 27,300 since June 2016. Other states with the fastest manufacturing job growth year-over-year included Florida (up 10,900), South Carolina (up 8,500), Wisconsin (up 7,900) and Michigan (up 5,800).

The national unemployment rate ticked up from 4.3 percent in May, a 10-year low, to 4.4 percent. Colorado and North Dakota had the lowest unemployment rates in the country, with both at 2.3 percent. A number of states were not far behind, including Hawaii (2.7 percent), Nebraska (2.9 percent), New Hampshire (2.9 percent), Indiana (3.0 percent) and South Dakota (3.0 percent). In contrast, Alaska (6.8 percent), New Mexico (6.4 percent), the District of Columbia (6.2 percent) and Louisiana (5.5 percent) had the highest unemployment rates.

Questions or comments?

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NATIONAL ASSOCIATION OF Manufacturers