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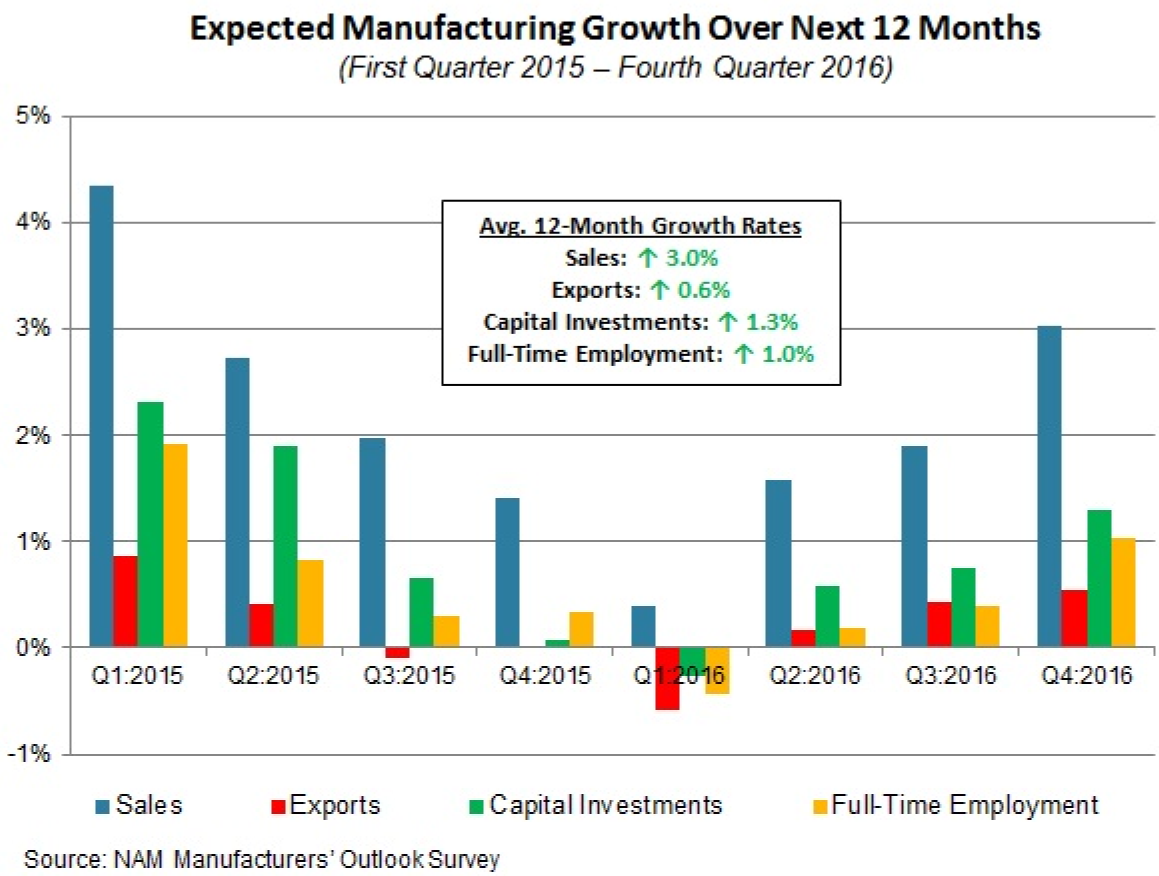

After a burst of post-election enthusiasm, several reports out last week reminded us that the economy continues to have some challenges, despite recent progress. For instance, new manufacturing production data, down 0.1 percent in November, were disappointing following two months of gains. Moreover, output in the sector has risen just 0.1 percent on a year-over-year basis, suggesting essentially stagnant growth over the past 12 months. Meanwhile, total industrial production declined 0.4 percent in November, falling for the third time in the past four months. In addition to manufacturing, utilities production was also lower, down 4.4 percent, whereas mining output increased for the second straight month, up 1.1 percent. On a positive note, we would expect manufacturing production growth to accelerate moving forward, especially if more upbeat sentiment surveys (see below) prove accurate. I anticipate manufacturing output to increase roughly 1.5 percent in 2017.

There were similarly discouraging numbers in the housing and retail markets. While Americans have generally been more willing to open their pocketbooks in recent months, retail sales pulled back in November from the strong gain in October. Retail spending rose 0.1 percent in November, off from the consensus estimate of 0.3 percent and down from the 0.6 percent gain in October. This was softer than desired, largely due to weakness in the motor vehicle and parts segment, which declined 0.5 percent for the month. Excluding automobiles, retail sales increased 0.2 percent. Nonetheless, retail sales have risen 3.8 percent over the past 12 months, representing a healthy pace overall. Turning to residential construction, new housing starts declined 18.7 percent in November, falling from its fastest pace in more than nine years in October. The decline in November, however, stemmed mostly from a drop of activity in the highly volatile multifamily segment. While also easing in this report, single-family starts have been more encouraging, up 5.3 percent year-over-year.

As noted earlier, consumers and businesses have been very optimistic since the election, and this has been reflected in a number of surveys. Last week, this included homebuilders, who sent the Housing Market Index up to the highest level of confidence since July 2005, and small business owners, who pushed the Small Business Optimism Index to a 23-month high. The NAM Manufacturers' Outlook Survey echoed these gains, with respondents cautiously upbeat about better business conditions and stronger growth. Indeed, 77.8 percent of manufacturers are either somewhat or very positive about their own company's outlook in the latest survey, up from 61.0 percent in September. This was the highest level since the March 2015 survey and ended the five-quarter streak with this headline measure being below its historical average of 73.1 percent. Moreover, manufacturers completing the latest survey anticipated 3.0 percent growth in sales over the next year, up from 1.9 percent in September.

Other manufacturing surveys were also quite heartening. Regional data from the New York and Philadelphia Federal Reserve Banks both indicated strong gains in December. In both reports, more than 55 percent of survey respondents expected new orders and shipments to increase over the next six months. Meanwhile, the Markit Flash U.S. Manufacturing PMI rose to a 21-month high, mirroring assessments about growth in new orders, which also expanded at the fastest pace over that time frame. It was a similar story at year's end in Europe. The Markit Flash Eurozone Manufacturing PMI increased to a level not seen since April 2011. As such, the continent's economy continues to move in the right direction, with activity accelerating at a decent rate. In addition, manufacturers in France and Germany were also more upbeat, with French manufacturing activity expanding at its fastest pace in 67 months, an impressive accomplishment given that the data were in contraction territory as recently as September.

Of course, the bigger headlines last week came from financial markets—with the Dow Jones Industrial Average flirting with 20,000 for the first time ever—and the Federal Reserve. Along those lines, the Federal Open Market Committee (FOMC) opted to raise short-term rates for the first time in 2016 at the conclusion of its December 13–14 meeting. The target of the federal funds rate was increased by 25 basis points, with the range now between 0.50 and 0.75 percent. This move was widely expected. Moving into 2017, FOMC participants appear to be more hawkish than three months ago, with economic projections appearing to forecast three rate hikes next year. That is up from a median prediction of two rate hikes at the September meeting. Beyond next year, Federal Reserve participants also see three increases in both 2018 and 2019. The Federal Reserve does not anticipate core inflation exceeding 2 percent over that time frame. Both consumer and producer prices picked up in November, but inflationary pressures remain mostly modest overall.

This week will be another busy one leading up to the holiday. There will be new surveys on consumer confidence and on manufacturing sentiment from the Kansas City Federal Reserve Bank as well as the latest figures on durable goods orders. In addition, we will get another revision for third-quarter real GDP growth, which should not shift much from the current annual rate of 3.2 percent. Other numbers to watch include new data on leading indicators, new home sales and personal income and spending.

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P.S.: Due to the holidays, the Monday Economic Report will not be published on December 26. The next issue will be released on **Tuesday, January 3**.

Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, December 12
None

Tuesday, December 13
NAM Manufacturers’ Outlook Survey
NFIB Small Business Survey

Wednesday, December 14
FOMC Monetary Policy Statement
Industrial Production
Producer Price Index
Retail Sales

Thursday, December 15
Consumer Price Index
Markit Flash Manufacturing PMIs for the United States and Eurozone
NAHB Housing Market Index
New York Fed Manufacturing Survey
Philadelphia Fed Manufacturing Survey

Friday, December 16
Housing Starts and Permits

This Week's Indicators:

Monday, December 19
None

Tuesday, December 20
None

Wednesday, December 21
Existing Home Sales

Thursday, December 22
Chicago Fed National Activity Index
Conference Board Leading Indicators
Durable Goods Orders and Shipments
Gross Domestic Product (Second Revision)
Kansas City Fed Manufacturing Survey
Personal Income and Spending

Friday, December 23
New Home Sales
University of Michigan Consumer Sentiment

Summaries for Last Week`s Economic Indicators

Consumer Price Index
The Bureau of Labor Statistics reported that consumer prices rose 0.2 percent in November, slowing from the 0.4 percent gain in October. It was the fourth straight monthly increase. The slight uptick in consumer inflation in November stemmed from higher energy costs, up 1.2 percent, with gasoline prices up 2.7 percent. Nonetheless, energy prices, which can be quite volatile from month to month, were up 1.1 percent over the past 12 months. At the same time, food prices were unchanged for the fifth consecutive month, with a decline of 0.3 percent since November 2015. Overall, the consumer price index increased 1.7 percent year-over-year in November, up from 0.9 percent in July and the highest level since September 2014.

Core consumer prices were also up 0.2 percent in November. There were higher prices for medical care services, transportation services, used cars and trucks and shelter, but lower costs for apparel, household furnishings, medical care commodities and new vehicles. Excluding food and energy costs, consumer prices have risen 2.1 percent over the past 12 months, down from 2.2 percent in the prior report. Even though core consumer price inflation has exceeded the Federal Reserve’s stated goal of 2 percent for 13 consecutive months, overall pricing pressures remain modest and under control for now.

Housing Starts and Permits

The Census Bureau and the U.S. Department of Housing and Urban Development reported that new housing starts declined 18.7 percent in November. This was disappointing following the 27.4 percent surge in October. New residential construction dropped from an annualized 1,340,000 in October, its fastest monthly pace since July 2007, to 1,090,000 in November. The jump in starts appears to be an outlier, largely from volatility in the multifamily segment. Indeed, here are the multifamily starts data for the past four reports: August (440,000), September (271,000), October (477,000) and November (262,000). Multifamily residential construction starts have averaged 381,455 units year to date in 2016, down from 395,333 in all of 2015.

At the same time, single-family starts also decreased in November, down from 863,000 to 828,000, but remain elevated relative to prior months. Through the first 11 months of this year, single-family starts have averaged 781,818 units, up from 712,833 for last year as a whole. In addition, starts in the single-family segment have risen 5.3 percent since November 2015, up from 786,000 units. As such, new residential construction data were perhaps more encouraging than the headline number suggests, especially for single-family activity.

That more upbeat assessment can also be seen in the housing permits figures, despite some easing in this latest release. Permitting for new residential units declined from 1,260,000 units at the annual rate to 1,201,000. It was the third straight month with permitting data exceeding 1.2 million, which was reassuring, particularly since permits serve as a proxy for future activity. Single-family permitting increased for the fourth consecutive month, up from 774,000 to 778,000, its highest level since November 2007. In contrast, multifamily activity dropped from 486,000 to 423,000. Across the past 12 months, housing permits have decreased 6.6 percent, with single-family activity up 5.9 percent but permits for multifamily down 23.2 percent year-over-year.

Industrial Production

The Federal Reserve reported that manufacturing production edged down slightly in November, off 0.1 percent, after experiencing gains in both September and October. Manufacturers have struggled to increase demand over the past few years, with a strong dollar and global headwinds dampening overall activity, but recent sentiment surveys, including the most recent one from the NAM (see below), have reflected a rebound in activity. In that light, the latest production data are disappointing, continuing to highlight ongoing struggles for the sector, even as other segments have seen progress. Along those lines, manufacturing production has risen just 0.1 percent on a year-over-year basis, suggesting essentially stagnant growth over the past 12 months. Manufacturing capacity utilization was also lower for the month, down from 74.9 percent to 74.8 percent. That was off from the 75.3 percent rate from one year ago.

Looking more closely at the November manufacturing data, nondurable goods production increased by 0.3 percent, but output from durable goods manufacturers decreased 0.2 percent. The largest increases for the month were in petroleum and coal products (up 3.3 percent), primary metals (up 2.3 percent), miscellaneous durable goods (up 1.1 percent) and nonmetallic mineral products (up 1.1 percent). In contrast, motor vehicles and parts (down 2.3 percent), machinery (down 1.5 percent), plastics and rubber products (down 1.4 percent) and electrical equipment and appliances (down 1.1 percent) saw declining production in November.

Meanwhile, total industrial production declined 0.4 percent in November, falling for the third time in the past four months. In addition to manufacturing, utilities production was also lower, down 4.4 percent, whereas mining output increased for the second straight month, up 1.1 percent. Over the past 12 months, mining and utilities production have decreased 4.6 percent and 1.9 percent, respectively. Overall, total industrial production fell 0.6 percent year-over-year, remaining in negative territory for the 15th straight month largely on the drag from mining activity. Capacity utilization was down as well, from 75.4 percent in October to 75.0 percent in November.

Markit Flash Manufacturing PMIs for the United States and Eurozone

The Markit Flash U.S. Manufacturing PMI edged up from 54.1 in November to 54.2 in December, a 21-month high. This mostly mirrored assessments about new orders growth (up from 55.5 to 55.6), which also expanded at the fastest pace over that time frame. Other indicators were mixed but encouraging. Employment expanded at its highest rate in 18 months (up from 52.4 to 54.1), whereas output grew modestly but pulled back a little in December (down from 56.0 to 55.1). On a more disappointing note, exports slowed to a near crawl but were positive for the sixth time in the past seven months (down from 51.0 to 50.3). Softer international demand, however, should not be surprising given the strong U.S. dollar. Overall, this report provides some encouragement for manufacturers, many of whom have been rather cautious in their economic outlook for much of the past two years.

Meanwhile, it was a similar story at year's end in Europe. The Markit Flash Eurozone Manufacturing PMI increased from 53.7 in November to 54.9 in December, a level not seen since April 2011. As such, the continent's economy continues to move in the right direction, with activity accelerating at a decent rate. The headline PMI has trended higher since bottoming out at 51.2 in February. The underlying data were higher across the board in December, including new orders (up from 54.4 to 56.1), output (up from 54.1 to 56.1), exports (up from 54.1 to 54.7) and hiring (up from 53.4 to 53.7). In addition, manufacturers in France (up from 51.7 to 53.5) and Germany (up from 54.8 to 56.8) were also more upbeat. In particular, French manufacturing activity expanded at its fastest pace in 67 months, an impressive accomplishment given that the data were in contraction territory as recently as September.

NAHB Housing Market Index

The National Association of Home Builders (NAHB) and Wells Fargo reported that the Housing Market Index rose strongly, up from 63 in November to 70 in December. It was the highest level of confidence since July 2005, reflecting strong optimism among homebuilders in their economic outlook after the election. Index values greater than 50 indicate builders are more confident in their outlook than not, with numbers greater than 60 suggesting strong expectations for activity. Respondents were more upbeat in every region.

Builders continue to report healthy assessments about single-family home sales over the next six months. The index for expected sales jumped from 69 in November to 78 in December. Still, NAHB Chief Economist Robert Dietz cautioned that "builders remain sensitive to rising mortgage rates and continue to deal with shortages of lots and labor."

NAM Manufacturers' Outlook Survey

There is a sense of optimism in the air as we end 2016, especially since the election. Americans appear to be cautiously upbeat about growth moving forward, and equity markets have reached all-time highs, largely on a belief that the new administration will bring needed tax and regulatory reforms and a significant infrastructure package. At the same time, there are also lingering headwinds for many manufacturers, including still-soft demand for exports, largely due to the strong U.S. dollar. Yet, there were signs of stabilization in the second half of 2016. Surveys have largely reported improved sentiment in recent months, with better demand and output data as well as modest growth.

This includes the NAM Manufacturers' Outlook Survey, with the percentage of respondents who are positive about their own company's performance at a nearly two-year high. Indeed, 77.8 percent of manufacturers are either somewhat or very positive about their own company's outlook in the latest survey, up from 61.0 percent in September. This was the highest level since the March 2015 survey and ended the five-quarter streak with this headline measure being below its historical average of 73.1 percent. However, the outlook figure remains below its recent peak—achieved in December 2014—of 91.2 percent of respondents being positive.

The answers to the question about whether the country is headed in the right direction serve as one piece of evidence that manufacturing leaders remain anxious, particularly in the aftermath of the election results. More manufacturers think the country is headed in the right direction (up from 6.8 percent to 25.7 percent), which is encouraging. However, the "unsure" response jumped significantly (up from 16.6 percent to 47.3 percent), with many of those responses moving from those who might have marked "wrong track" (down from 76.6 percent to 27.0 percent) expressing a more uncertain assessment of things. That will likely settle out in the coming months, particularly as the new administration's plans take shape.

Manufacturers completing the latest survey anticipated 3.0 percent growth in sales over the next year, up from 1.9 percent in September. To illustrate this shift since the previous survey, the percentage feeling that sales would increase by at least 5 percent over the next 12 months grew from 26.6 percent in the third quarter to 36.2 percent in this release. In addition, capital spending and hiring plans also improved in this survey, with respondents seeing 1.3 percent and 1.0 percent growth, respectively, over the next 12 months.

Rising health insurance costs were once again cited as a top business challenge, noted by 77.5 percent of respondents. They see these costs increasing 8.0 percent over the next 12 months. Respondents also listed an unfavorable business climate as a top worry, with 71.2 percent noting it as a primary challenge, right behind health care costs. Moreover, leaders continue to note ongoing challenges with attracting and retaining a quality workforce, mentioned by 58.1 percent of survey respondents.

New York Fed Manufacturing Survey

The Empire State Manufacturing Survey reported that manufacturing activity grew at its fastest pace in eight months in December, expanding for the second straight month. The composite index of general business conditions increased from 1.5 in November to 9.0 in December. As such, sentiment among manufacturers in the New York Federal Reserve Bank's district has jumped post-election, expanding modestly and improving from weaknesses in the autumn months. This can be seen in some of the underlying data points as well, especially new orders (up from 3.1 to 11.4). Indeed, the percentage of respondents suggesting that their sales rose in the month increased from 29.4 percent in November to 38.5 percent in December. Shipments figures were also encouraging (unchanged at 8.5).

At the same time, employment continued to lag behind, with indices for the number of employees (down from -10.9 to -12.2) and the average workweek (up from -10.9 to -7.0) still in contraction territory. Note that hiring declined at a faster rate in this release, with the percentage reporting increased employment down from 10.9 percent to 6.1 percent. That suggests that firms remain quite cautious for now, even with better demand figures.

Despite some lingering weaknesses in the labor market, manufacturers in the New York region were very upbeat about the next six months. The forward-looking composite index jumped from 29.9 in November to 50.2 in December, its highest level since January 2012. In fact, more than 55 percent of respondents anticipate stronger growth for new orders and shipments in the months ahead, with 35.7 percent and 33.9 percent expecting increased hiring and capital spending, respectively. Technology spending is seen growing more modestly, with 23.5 percent of respondents predicting an increase.

NFIB Small Business Survey

The National Federation of Independent Business reported that sentiment among small business owners jumped in November post-election. The Small Business Optimism Index increased from 94.9 in October to 98.4 in November, its highest level since reaching a post-recessionary high of 100.3 in December 2014. As noted in the commentary, small business owners in this survey were hopeful for better tax and regulatory policies as a result of the election, boosting overall sentiment. This can be seen in the data as well. The percentage of respondents suggesting that the next three months would be a "good time to expand" increased from 9 percent to 11 percent, a 12-month high. In addition, the percentage expecting sales to increase over the next three months soared from 1 percent to 11 percent, the largest level since March 2015.

This rise flowed through to other variables as well. While actual employment changes remained weak in November, the net percentage planning to add workers in the next three months rose from 10 percent to 15 percent, its highest level so far this year. Moreover, 31 percent of small business owners said they had positions they could not fill right now, up from 28 percent in October. With that said, capital expenditure plans pulled back somewhat in this report, down from 27 percent to 24 percent.

The top "single most important problem" was taxes (19 percent), highlighting the need for comprehensive tax reform. Government regulations (18 percent), the quality of labor (16 percent), poor sales (12 percent) and the cost and availability of insurance (10 percent) also topped the list.

Philadelphia Fed Manufacturing Survey

The Federal Reserve Bank of Philadelphia reported that manufacturing activity expanded at its fastest pace in 25 months, expressing post-election optimism in its latest survey. The composite index of general business activity soared from 7.6 in November to 21.5 in December, its highest level since November 2014. In addition, sentiment has now expanded for five consecutive months, improving from weaker data earlier in the year. With that said, the underlying data were mixed, but still encouraging. Growth in new orders eased somewhat (down from 18.6 to 13.9), whereas shipments accelerated (up from 19.5 to 22.0), with both variables expressing relatively strong expansions.

The labor market variables were both positive. Most importantly, hiring increased for the first time in 12 months (up from -2.6 to 6.4). At the same time, the average employee workweek widened for the third straight month (up from 7.4 to 9.8), indicating definite progress after narrowing in 11 of the 13 prior months.

Moving forward, manufacturers in the Philadelphia Federal Reserve district were extremely optimistic. The forward-looking index jumped from 29.3 to 52.6, the most since August 2014. More than 55 percent of respondents predict higher levels of new orders and shipments over the next six months, with 34.5 percent expecting more hiring and 42.8 percent planning for higher capital expenditures.

Producer Price Index

Producer prices increased 0.4 percent in November, bouncing back from being unchanged in October and growing at its fastest monthly pace since June. Digging into the data, producer prices for final demand goods rose for the third straight month, up 0.2 percent in November. A large jump in food costs, up 0.6 percent, helped to explain much of this boost, with energy prices edging down 0.3 percent. Still, food costs have been on a downward trend over the longer term, down 2.6 percent over the past 12 months. On the other hand, energy prices were virtually flat year-over-year, up just 0.2 percent. Excluding food and energy, final demand goods prices for producers increased 0.2 percent in November.

Overall, producer prices for final demand goods and services have increased 1.2 percent since November 2015, its highest year-over-year rate in two years and a notable pickup in inflationary pressures after being unchanged in August. Meanwhile, core producer prices, which exclude food and energy, grew 1.5 percent year-over-year in November, up from 1.2 percent in October and the most since January 2015. The year-over-year pace of core inflation for producers has moved gradually higher across the past 12 months, up from 0.3 percent one year ago.

The bottom line is that pricing pressures have continued to accelerate, even as they remain largely in check—at least for now. Core inflation on a year-over-year basis has remained below the Federal Reserve's stated goal of 2 percent for 30 straight months (since May 2014). Prices are likely to accelerate somewhat moving forward and should exceed the 2 percent threshold in the coming months. Nonetheless, it should remain in an acceptable range for the Federal Open Market Committee, which continues to balance the need for accommodation in its monetary policy with a desire to normalize rates on the basis of economic progress.

Retail Sales

The Census Bureau reported that retail sales pulled back in November from the strong gain in October. Americans increased their retail spending by 0.1 percent in November, off from the consensus estimate of 0.3 percent and down from the 0.6 percent gain in October. This was softer than desired, largely due to weakness in the motor vehicle and parts segment, which declined 0.5 percent for the month. Excluding automobiles, retail sales increased 0.2 percent. Even with a less-than-stellar figure in this latest release, Americans have continued to increase their spending relative to the more cautious approach to purchases earlier in the year. Over the past 12 months, retail sales have risen 3.8 percent. That represents a healthy rebound from the 1.7 percent pace in March. Still, it was down from 4.2 percent in October, which had been the fastest year-over-year rate in nearly two years.

The underlying November data were mixed but mostly higher. Retail segments with increased spending for the month included food services and drinking places (up 0.8 percent), furniture and home furnishings (up 0.7 percent), food and beverage stores (up 0.4 percent), building material and supplies dealers (up 0.3

percent) and gasoline stations (up 0.3 percent), among others. In contrast, some of the categories with weaknesses beyond automobiles in November included sporting goods and hobby stores (down 1.0 percent), miscellaneous store retailers (down 0.8 percent) and department stores (down 0.2 percent).

Since November 2015, the largest gains in retail spending included nonstore retailers (up 11.9 percent), health and personal care stores (up 6.2 percent), miscellaneous store retailers (up 5.8 percent), food services and drinking places (up 4.9 percent), building material and supplies dealers (up 4.3 percent), furniture and home furnishing stores (up 4.1 percent), gasoline stations (up 4.0 percent) and motor vehicle and parts dealers (up 3.3 percent).

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Questions or comments?

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