Research

# State of the Economic Recovery: 5 Economic Indicators to Watch

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Last month the Bureau of Economic Analysis (BEA) released its first estimate of the growth in real Gross Domestic Product (GDP) during the first quarter of 2015. According to the report, real GDP's annualized growth rate was only a dismal 0.2 percent. So what exactly caused this slow growth in the first three months of the year? Some argue that this low estimate is due to an underlying methodological issue that results in a significant underestimate for the first quarter. However, several economic indicators have decelerated or declined over the last few months, indicating tepid growth in the first quarter. Given the questions surrounding the validity of the last GDP estimate, it is particularly important to examine economic metrics from a variety of sources and analyze their implications for growth.

What exactly is the debate over the recent GDP report? At issue are the BEA's seasonal adjusting methods. Almost every economic raw estimate features significant variation throughout the year due to typical changes in weather and holiday breaks. As a result, the raw estimate tells us very little about the underlying trend that is impacting people's well-being. So, in order to uncover those trends throughout the year, officials publish seasonally adjusted estimates, which account for these variations and generally are the headline figures in any report. The real GDP growth rate estimates are no different. However, economists have puzzlingly noted that even after seasonal adjustment, over several years the BEA's first quarter GDP growth estimates have been consistently lower than the rest of the year. This might suggest that the BEA does not adequately adjust for seasonal factors in the first quarter, which could result in "residual seasonality" and underestimating first quarter growth. To almost ensure confusion for the casual follower, within a few days of each other researchers at the Federal Reserve Board in Washington reported finding no evidence that the latest GDP estimate was impacted by this data problem and researchers at the Federal Reserve Bank of San Francisco found that this statistical issue did indeed impact the estimated figure. This debate makes it all the more important to understand what other economic indicators have been telling us.

## RETAIL SALES

The Census Bureau's report on retail sales reveals significant trends in consumer spending, which makes up roughly two-thirds of GDP.

The shaded region in Graph 1 represents the first quarter of 2015. After rising throughout the most of 2014, total retail sales began to fall at the end of the year. The decline continued into 2015 and hit bottom in February, right in the middle of the first quarter.

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While this is not a good sign, this chart alone does not illustrate weakening in spending because it could be due to declines in vehicle and gas sales, which are highly volatile and do not represent the underlying trends in retail sales.

Graph 2 illustrates the trend in total retail sales after stripping out automobile and gasoline station sales, which we can call “core retail sales.”

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While not as exaggerated as in Graph 1, there was significant growth in core retail sales throughout most of last year and a noticeable deceleration at the end of the year. This weakening was then followed by a slight decline during the first quarter. So even when excluding volatile portions of retail sales, the measure indicates that the first quarter featured a significant slowdown in spending that likely hampered economic growth.

## CONSUMER CONFIDENCE

Paralleling the weakening in retail sales was a decline in consumer confidence during the beginning of the year.

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After rising throughout all of 2014, consumer confidence began declining during the first quarter of 2015 and continued declining afterword. Changes in consumer confidence reflect households’ willingness to buy goods or make investments. As a result, the decline in confidence during the first quarter could be another indication that consumers were less willing to spend during the first quarter and a signal that they were also less willing to invest.

## MANUFACTURING

Perhaps one of the most significant drags on the U.S. economy in recent months has been the stark decline in manufacturing. One common way to measure performance in manufacturing is to examine purchases of durable goods, which are long lasting manufactured products like machinery. After excluding defense equipment and aircraft orders, volatile goods that do not represent underlying trends in durable goods, it is clear that capital goods orders have been suffering for quite some time.

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Durable goods orders excluding defense and aircraft have been falling since last summer and continued to decline into the first quarter of 2015. While some may argue the decline in durable goods is due to a harsh winter, it is clear that weather cannot be the main cause because the decline started during the summer.

Mirroring the decline in durable goods orders is a noticeable deceleration in another common metric of the manufacturing sector.

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Every month, the Institute for Supply Management (ISM) estimates a series of indices that measure growth in both manufacturing and non-manufacturing sectors. ISM’s composite index of manufacturing growth, the PMI, has fallen significantly since last summer and continued to fall through the first quarter of 2015. While the measure remained above 50 and indicates that manufacturing still grew during this period, the sharp decline in the index reveals a significant deceleration in manufacturing growth. This likely contributed to the slowdown in overall economic growth during the first quarter.

When manufacturing began to stall last year, growth in manufacturing employment decelerated as well.

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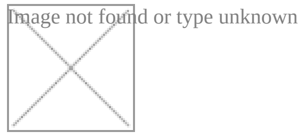
ISM’s index for manufacturing employment coincides directly with the fall in the PMI. However, while the PMI has remained above 50, the employment index hit 50 in March and fell below 50 in April. This indicates that manufacturing employment did not grow in March and it actually decreased in April.

## NON-MANUFACTURING

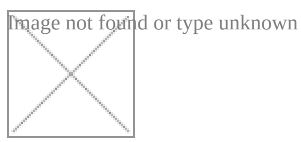
Even though ISM indicators suggest non-manufacturing is in better shape than manufacturing, non-manufacturing was still growing at a decelerated rate at the beginning of 2015.




ISM's composite index for non-manufacturing growth, the NMI, fell slightly at the end of 2014 and remained at that lower level through the first quarter of 2015. While the index did not continue to fall and remained only a few points below its peak in 2014, it does indicate that the slight deceleration persisted into 2015's first quarter and is yet another indicator that growth slowed last quarter. Fortunately there was a slight increase in the index in April (the beginning of the second quarter). Hopefully this suggests that the deceleration was temporary and non-manufacturing will bounce back the rest of the year.

## INTERNATIONAL TRADE DEFICIT

Finally, the latest data on international trade is a further indication that economic growth during the first quarter was fairly weak.




*After* the BEA released its advanced first quarter GDP estimate, the Census Bureau reported that in March the trade deficit spiked to $51.4 billion, as imports surged by the largest margin on record ($17.1 billion) and exports barley rose. Illustrated in Graph 8, this was way above any estimated trade deficit over the past year. The surge in imports came after the West Coast ports settled its months long labor dispute and began processing its backlog of imported items. Meanwhile this abrupt expansion in the trade deficit provides further evidence first quarter economic growth was weak. In fact, the high trade deficit in March has led to many analysts now projecting that the BEA's first quarter estimate will be revised down to show that the economy actually contracted at the beginning of the year.

## CONCLUSION

While questions remain regarding the validity of the latest GDP report on the first quarter of 2015, declines in retail sales, consumer confidence, durable goods orders, manufacturing, non-manufacturing, and relative exports all point to weak growth. Harsh weather during the winter likely played a role in slowing the first quarter's growth, but many of the slowing trends began occurring months before cold weather. The fact that cold weather could be all it takes to completely derail economic growth indicates that the US economy still has a long way to go to recover from the Great Recession.