

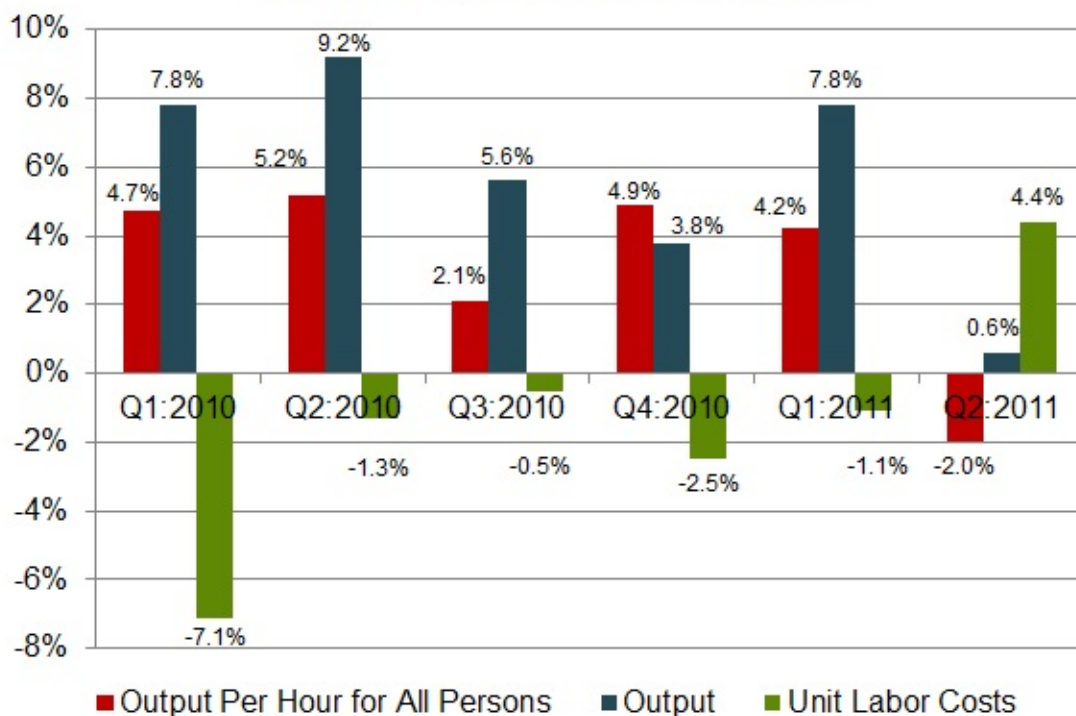
## Monday Economic Report



A Publication of the National Association of Manufacturers



### Percentage Changes in Manufacturing Productivity & Unit Labor Costs



August 15, 2011

For many Americans who might not follow the ups and downs of economic trends, the wild gyrations of the stock market have captured their attention and brought the larger challenges of the domestic and global macroeconomy to the forefront of their minds.

Much of the anxiety is international in nature. The downgrading of the U.S. government's debt by Standard & Poor's will not bring about any positives in terms of borrowing costs, economic growth, or national prestige. In the short-term, though, the demand for U.S. securities remains strong, and so long as the other ratings agencies continue to rate our debt as AAA, the impacts will be muted. The market turbulence of the last week had more to do with financial struggles in Europe — particularly the speculation that France, too, might see a debt downgrade — and with concerns about a slowdown in global growth.

This uncertainty has weighed heavily on businesses and consumers. The University of Michigan's consumer sentiment survey found on Friday that the public is extremely pessimistic about future economic growth, with its expectations index at its lowest point since 1980. Meanwhile, the National Federation of Independent

Business (NFIB) reported that small businesses remain worried about poor sales, resulting in greater hesitancy for these owners to hire additional workers, invest in new capital equipment, or expand their businesses. The Job Openings and Labor Turnover (JOLTS) data show that job creation in the U.S. remains virtually stagnant.

In addition to these reports, the trade gap widened and productivity fell (mostly due to decreases in output). While business inventories and retail sales rose, it is clear that consumers are being much more careful with their purchases, particularly as they balance higher prices with increased economic anxieties. The good news – particularly for those who closely monitor the motor vehicle sector – is that sales of automobiles have begun to recover from the supply chain disruptions earlier in the spring.

In light of the recent deterioration in economic conditions (and mostly as a reaction to the dramatic slide in financial markets earlier last week), the Federal Reserve Board's Federal Open Market Committee (FOMC) voted to keep the federal funds rate as near-zero for the next two years. This suggests that the FOMC is more worried about economic growth than about pricing pressures. Nonetheless, it is notable for the fact that three individuals dissented, primarily out of concern that keeping interest rates so low for so long might promote inflation. Manufacturers have worried about rising energy and raw material prices for much of the past year, so while they might benefit from reduced borrowing costs, the possibility of increased pricing pressures must bring at least some trepidation, at least in [my view](#).

This week, we will get a sense of the current inflationary trends with the release of new data on consumer and producer prices. In addition, industrial production and two regional Federal Reserve Bank surveys (New York and Philadelphia) will gauge recent manufacturing activity. Hopefully, the economic news this week will be less stressful.

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## Economic Indicators

### Last Week's Indicators:

(Summaries Appear Below)

Monday, August 8

*None*

Tuesday, August 9

Federal Reserve FOMC Statement

NFIB Small Business Survey

Productivity and Costs

Wednesday, August 10

Job Openings and Labor Turnover Survey

*Wholesale Trade*

Thursday, August 11

International Trade

Friday, August 12

Business Inventories

Retail Sales

Univ. of Michigan Consumer Sentiment

### This Week's Indicators:

Monday, August 15

*Empire State Manufacturing Survey*

NAHB Housing Market Index

Federal Reserve Sr. Loan Officer Survey

Tuesday, August 16

Import and Export Prices

Industrial Production

New Residential Construction

Wednesday, August 17

Producer Price Index

Thursday, August 18

Consumer Price Index

Existing Home Sales

Index of Leading Indicators

Philadelphia Fed Manufacturing Survey

Friday, August 19

Regional and State Employment

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## Summaries of Last Week's Economic Indicators

### Business Inventories (June)

The Census Bureau said that inventories grew 0.3 percent in June, slower than in earlier months this year. For manufacturers, both sales and inventories rose 0.2 percent from the previous month. This is a steep dropoff from April and May, which saw inventories growing at 1.5 and 0.8 percent, respectively. In essence, sales and inventories have been keeping pace with one another – a statement that is also true for retailers and wholesalers. A further sign of this: the inventory-to-sales ratio has remained relatively constant for manufacturers at 1.34.

### Federal Reserve Board's Federal Open Market Committee Statement

The Federal Reserve Board's Federal Open Market Committee (FOMC) has decided to keep interest rates exceptionally low, with the target federal funds rate at between 0 and 0.25 percentage points.

In its [statement](#), the Fed wrote:

“The Committee currently anticipates that economic conditions – including low rates of resource utilization and a subdued outlook for inflation over the medium run – are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013.”

It is notable that this decision was not unanimous. Presidents of the three regional Federal Reserve Banks: Richard Fisher (Dallas), Narayana Kocherlakota (Minneapolis), and Charles Plosser (Philadelphia) all voted against the decision. The other notable feature of this statement is that interest rates are expected to stay in place for the next two years. Many economists – including myself – had predicted that rates would go up later this year. This decision reflects the general weaknesses in the economy and need to keep rates lower longer to stimulate growth.

Reflecting this weakness, the Fed wrote about it in very stark terms:

“Indicators suggest a deterioration in overall labor market conditions in recent months, and the unemployment rate has moved up. Household spending has flattened out, investment in nonresidential structures is still weak, and the housing sector remains depressed. However, business investment in equipment and software continues to expand. Temporary factors, including the damping effect of higher food and energy prices on consumer purchasing power and spending as well as supply chain disruptions associated with the tragic events in Japan, appear to account for only some of the recent weakness in economic activity. Inflation picked up earlier in the year, mainly reflecting higher prices for some commodities and imported goods, as well as the supply chain disruptions. More recently, inflation has moderated as prices of energy and some commodities have declined from their earlier peaks. Longer-term inflation expectations have remained stable.”

For manufacturers, this means that interest rates will remain low, but it also suggests that the Federal Reserve remains worried about economic growth moving forward. As such, it will keep its October 2008 policy of maintaining a low federal funds rate in place for two more years.

### International Trade (June)

[Petroleum and manufactured goods dominated the U.S. trade deficit during the first half of 2011 according to data released today by the Commerce Department.](#) Of the \$288 billion goods and services deficit accumulated so far this year, the deficit in petroleum was \$169 billion and in manufactured goods was \$213 billion – together they account for more than the entire deficit. Partially offsetting these deficits were surpluses in services and agricultural commodities. The petroleum deficit in the first half of 2011 was \$32 billion larger than in the first half of 2010, and the manufactured goods deficit was up \$38 billion.

Total U.S. exports of goods and services were up 16 percent over the first half of 2010, staying ahead of the 15 percent annual rate necessary to reach the goal of doubling exports by the end of 2014. Manufactured goods exports, however, slipped below this target rate, rising 12.8 percent over the first half of 2010. Manufactures outperformed services, which grew only 9.9 percent. Overall export growth was spurred by agricultural goods and mineral fuel exports.

Manufactured goods imports for the first half of the year grew more rapidly than exports, up 15.1 percent over the first half of 2010. The growth was fastest in capital goods, where imports were up 17 percent. Consumer goods imports rose 10 percent and automotive imports were up 13 percent. Fully 70 percent of the manufactured goods deficit in the first half of the year was in the consumer goods category.

On a monthly basis, June exports of goods and services fell slightly from May, marking the second straight month of decline. Manufactured goods exports, seasonally-adjusted, dropped 1.5 percent from May, the second straight month of decline. Of particular concern is that exports of capital goods, the largest U.S. export category, fell 3.6 percent in June – putting capital goods exports back to the level of December 2010. While this could be a one-month aberration, the decline was widespread with two-thirds of capital goods export groups showing declines. The only major growth was in exports of civilian aircraft.

While U.S. exports are being aided by the competitive range of the U.S. dollar, industrial machinery and other capital goods exports are being hampered by slower-than-expected growth in traditional U.S. markets, such as Europe and increasing competition from foreign firms.

#### Job Openings and Labor Turnover Survey (JOLTS, June)

Reflecting general weaknesses in the economy in June, [the level of job hirings and separations declined somewhat from May, according to new data from the Bureau of Labor Statistics](#). While the rates of each to total employment did not change much, there were 78,000 fewer hires and 129,000 fewer separations in June than in May.

This reduction in employment activity was broad-based in almost every major sector except for leisure and hospitality, which experienced additional hiring and separations in the accommodation and food services sector.

For manufacturing, hiring fell from 263,000 new workers in May to 246,000 in June. At the same time, total separations for manufacturers dropped from 272,000 in May to 250,000 in June. These declines occurred in both durable and nondurable goods sectors, with greater reductions in the latter.

The bottom line is that separations in manufacturing exceeded hiring for the second month in a row. This time that difference is 5,000 workers, which is a marginal improvement from the 9,000 worker gap in May.

Meanwhile, job openings in manufacturing remained flat, with 211,000 new job postings in both May and June. This represents 1.8 percent of the total workforce in the sector for both months. Breaking this down using seasonally unadjusted data, however, the results are more mixed. There was an increase in job openings within durable goods industries (up from 151,000 in May to 164,000 in June); there were fewer postings for nondurables (down from 70,000 to 56,000).

These data confirm the weaknesses in the larger macro economy in June, which we already knew from employment and other data released in the past month. From the bigger picture, the JOLTS data continue to show the stagnant pace of growth for new job creation. While the pace of separations has slowed considerably (even with the more recent weaknesses), hires have remained more or less in the same range for much of the past couple of years. This is a challenge for policymakers, as they seek strategies that promote economic growth moving forward.

#### National Federation of Independent Business Small Business Optimism Index (July)

[Small businesses have become more pessimistic each month since February of this year, with the Index of Small Business Optimism falling in July to 89.9 from 90.8 in June](#). Of the respondents who said that the next three months were not a "good time to expand," the overwhelming reason (46 percent) was the economy. The second most-cited reason was the political climate, a reflection perhaps of the frustration many business leaders have with the political environment here in Washington. The single most important problem was "poor sales," a proxy for weak economic conditions, as it has been for the past couple of years.

Employment among small businesses was mixed. More firms decreased their employment in July than added to it, but that figure was still an improvement over June's. Looking toward the next three months, the net percentage of survey respondents who planned to hire was +2 percent, which is roughly equivalent to the average year-to-date statistic. Hence, small business hiring is not expected to pick up its pace over the coming months.

Overall, this report gives little good news. With small businesses less optimistic, they have been less willing to spend on capital equipment, hire additional workers, or expand their operations. Uncertainty about the

economy and lack of demand continue to be top concerns, hurting small firms' ability to expand and recover from the recession.

#### Productivity and Costs (Second Quarter)

The Bureau of Labor Statistics reported that nonfarm business labor productivity fell 0.3 percent in the second quarter, with unit labor costs rising 2.2 percent. (All percentages are in annual rates of growth.) For manufacturers, the drop was even steeper. After increasing by 4.2 percent in the first quarter (revised down from an earlier estimate of 6.1 percent), manufacturing productivity dropped 2 percent in the second quarter. Manufacturing output slowed significantly to a 0.6 percent growth rate in the first quarter.

Manufacturing unit labor costs, which had fallen in the first quarter, rose 4.4 percent in the second quarter. Despite these numbers, unit labor costs for manufacturers over the past year have been flat, and productivity has risen 2.3 percent.

Parsing through the manufacturing data, one clearly sees a split between durable and nondurable goods productivity. After growing by 6.9 percent in the first quarter, the output per hour for all persons from durable goods industries decreased 3.5 percent in the second quarter. Overall output increased by 1.4 percent, however, which was well off of the 13.8 percent growth from the previous quarter, reflecting the supply chain disruptions and other challenges in the sector in the spring.

Nondurable goods output, though, fell 0.2 percent in the second quarter, after growing by 2 percent in the first quarter. Nondurable manufacturing productivity rose by 1.2 percent, with unit labor costs up 1.8 percent for the quarter.

Overall, these numbers reflect weaknesses in the manufacturing sector in the second quarter. The slowdown can be seen in the lower growth rates for output, especially for durables but also for nondurables. As a result, unit labor costs, which fell throughout much of the past year and a half (a 4 percent decline in 2010, for instance), rose in the second quarter of this year.

To stay competitive with our international competitors, we will need a strong manufacturing sector, with renewed growth in output and continued gains in innovation and productivity to help keep those costs in check.

#### Retail Sales (July)

Retail sales were up 0.5 percent in July, the strongest gain since March, according to the Census Bureau. Year-over-year growth in retail sales was 8.5 percent. The auto sector has been hard-hit by supply chain disruptions this year, but it appears to be regaining some strength, increasing 0.4 percent between June and July. Even with these challenges, though, motor vehicle and parts sales have risen 8.1 percent over the past year.

Other sectors experiencing strong gains in retail sales in July included miscellaneous retail stores (up 2.4 percent), gasoline stations (up 1.6 percent) and electronics and appliance stores (up 1.4 percent). The improvement in gas station sales is notable as it had fallen in June with lower petroleum prices. Sectors with lower sales in July were sporting goods, hobby, book and music stores (down 1.5 percent), department stores (down 0.8 percent) and building material, garden equipment and supply dealers (down 0.4 percent).

Overall, these numbers suggest that consumers are picking up their spending somewhat, albeit not at the levels seen earlier this year. They also suggest that Americans are being careful with their purchases. While gas station sales and food and beverage store sales are up around 24 percent and 8 percent year-over-year, respectively, many other sectors have seen only slight growth over the past year, such as department stores (up 0.4 percent), electronics and appliance stores (up 0.4 percent) and furniture and home furnishings stores (up 1.1 percent). This reflects the trade-offs many people are making with their budgets.

#### University of Michigan/Reuters Consumer Sentiment Survey (August)

Consumer sentiment figures released today by the University of Michigan and Reuters show the public is increasing pessimistic. The Index of Consumer Expectations fell from 63.7 in July to 54.9 in August. Stock market volatility, weak employment growth, and political jockeying have clearly had an impact on individual attitudes about the economy. In May, the Index was 74.3; it has fallen by more than 19 points in just three months.

Consumer sentiment fell for both current and future economic conditions. However, expected conditions in the next few months fell the most, plunging to 45.7 from 56.0 in July and 71.6 in February. The expectations measure is the lowest it has been since 1980.

In terms of inflation, consumers expect to see 3.4 percent increases in prices over the next year, which is unchanged from the previous survey.

#### Wholesale Trade (June)

The U.S. Census Bureau announced that wholesale sales and inventories both rose by 0.6 percent between May and June (all percentages are seasonally adjusted at annual rates of growth). Wholesale durable goods sales rose by 1.6 percent in June, reversing the 0.5 percent decline in May. This increase in sales was led by the automotive sector, which was up 8.7 percent. This is a strong signal that motor vehicle sales are starting to recover from the supply chain disruptions of the spring.

Nondurable goods sales, though, fell by 0.2 percent but were still up nearly 20 percent year-over-year. Aside from automobiles, other sectors with sales increases included alcohol (up 4.0 percent), chemicals (up 2.3 percent), machinery (up 2.1 percent) and groceries (up 1.8 percent). The largest declines in sales came from the petroleum sector (down 2.9 percent), reflecting lower energy prices.

Wholesale inventories mirrored the sales figures for the most part, with durable goods inventories up 1.3 percent for the month and 12.1 percent for the year. Wholesale nondurable goods inventories were off 0.4 percent in June, but they were 21.4 percent higher than this time last year. The sectors with the strongest inventory gains were automotive (up 4.3 percent), computer equipment (up 3.5 percent), metals (up 2.6 percent), apparel (up 2.4 percent) and chemicals (up 2.2 percent).

The inventory-to-sales ratio remained unchanged at 1.16. This measures how many months it would take to deplete current inventories at the current rate of sales. The rates for durable and nondurable goods in June were 1.52 and 0.87, respectively.

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Questions or Comments?

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