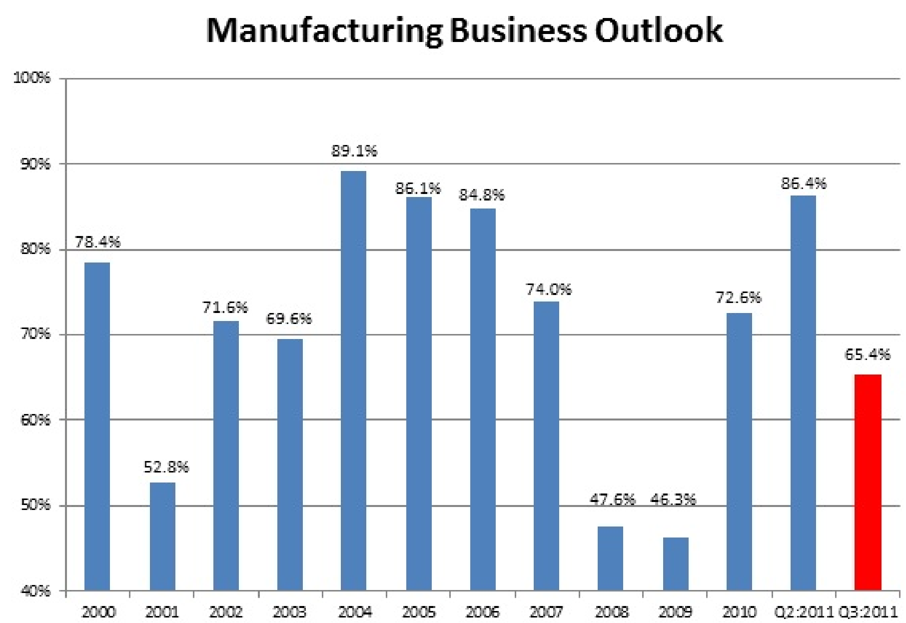
# Monday Economic Report



A Publication of the National Association of Manufacturers


***Note:*** *Percentage of respondents to the NAM/Industry Week Survey of Manufacturers who characterized the current business outlook as somewhat or very positive. Percentages are annual averages. Data for 2010 are through the third quarter.*

September 19, 2011

The current economic environment appears to be stuck in neutral. A number of economic indicators released last week varied little from the previous month, including data for retail sales and producer prices. At the same time, measures for manufacturing production were mixed. The Federal Reserve Board found that industrial production rose 0.2 percent in August, led by strong increases in durable goods sectors including motor vehicles and aerospace. Meanwhile, the New York and Philadelphia Federal Reserve Banks’ monthly surveys observed contracting new orders and production in their regions.

These regional bank surveys have clearly tapped into pessimism that spans both consumers and businesses. The University of Michigan reported a slightly higher level of consumer sentiment in September; yet, the American consumer remains quite pessimistic, particularly about the future. Small business optimism has also dipped lower, with the National Federation of Independent Business reporting another decline in its monthly index. Anxieties about economic growth are paramount to survey respondents, and given that we need increased consumer spending and business investment for future growth, this is worrisome.

Economists and manufacturers have both downgraded their expectations for growth over the coming year as a result. Business economists have lowered their real GDP growth estimates for 2011 and 2012 to 1.7 percent and 2.3 percent, respectively, according to the National Association for Business Economics. Likewise, the NAM/*IndustryWeek* Survey of Manufacturers estimated that manufacturing sales will grow by 3.2 percent on average over the next 12 months, a decline from the 5.5 percent estimate just three months ago. While manufacturers remain positive about the overall outlook for the next year, their level of optimism has diminished in a relatively short period of time.

Manufacturers expect for new orders, production, employment and capital spending to increase over the next six months. This finding is consistent in the NAM/*IndustryWeek* and regional Federal Reserve Bank surveys. Yet, some definite headwinds temper this optimism and threaten our economic recovery. At the top of this list is the worry about European financial markets and the possible ramifications to the global economy if this situation spins out of control. There are also domestic challenges -- such as the fiscal situation, housing, unemployment and the business climate -- that pose impediments to growth.

This week, we will receive new data on the still-struggling housing market. Today, the National Association of Home Builders will release its Housing Market Index, and tomorrow, the Census Bureau will release new housing starts numbers. It would be nice to see a turnaround over the coming months in the housing sector, with starts growing from the current rate of approximately 600,000 homes per year, given the importance of the housing sector to manufacturers and the overall economy.

**Chad Moutray**
*Chief Economist*
*National Association of Manufacturers*

## Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, September 12
*NABE Outlook Survey*

Tuesday, September 13

NFIB Small Business Survey

Wednesday, September 14

Business Inventories

NAM/IndustryWeek Survey of Manufacturers

Producer Price Index

Retail Sales

Thursday, September 15
Consumer Price Index

Empire State Manufacturing Survey

Industrial Production

Philadelphia Fed Manufacturing Survey

Friday, September 16
Regional and State Employment

University of Michigan Consumer Sentiment

This Week's Indicators:

Monday, September 19
*NAHB Housing Market Index*

Tuesday, September 20

New Residential Construction

Wednesday, September 21

Existing Home Sales

FOMC Monetary Policy Statement

Thursday, September 22
Conference Board Leading Indicators

Friday, September 23
None

## Summaries of Last Week's Economic Indicators

### Business Inventories

The Census Bureau reported that business inventories grew 0.4 percent in July, nearly matching similar growth in June. Manufacturing inventories rose 0.5 percent, led by increases from food and beverage stores (up 0.6 percent) and motor vehicle and parts dealers (up 0.4 percent). General merchandise, furniture and building materials stores experienced declining inventories for the month.

Manufactured sales increased 1.6 percent in July. Motor vehicles, home furnishings, food and beverages and general merchandise stores (not including department stores) helped lift these figures. The inventories-to-sales ratio remained virtually unchanged at 1.32 for the month.

### Consumer Price Index (August)

The Bureau of Labor Statistics reported that the consumer price index (CPI) rose 0.4 percent in August, building on last month's 0.5 percent increase. Once again, higher energy costs led the way, up 1.2 percent for the month. While gasoline prices fell in May and June, they remain elevated, with overall energy costs up 18.4 percent and gasoline prices up 32.4 percent since last year. Food costs also rose, up 0.5 percent for the month and 4.6 percent for the year. Grocery items for the home increased even more (0.6 percent and 6.0 percent). Core inflation -- which excludes food and energy costs -- rose 0.2 percent.

For the month, the largest price increases were in apparel, cereals, dairy products, fats and oils, gasoline, sugars and used cars and trucks. Those items with price declines included lodging, nonalcoholic beverages, personal care products, personal computers and peripheral equipment and video and audio products.

Overall, these numbers suggest that consumers are continuing to be squeezed by higher prices, particularly for energy and food. These higher costs are raising overall core inflation, which is up 2 percent year-over-year, albeit still to moderate levels.

Persistent inflation (even if moderate) will undoubtedly make the decisions of the Federal Reserve that much harder as it weighs whether to aggressively tackle inflation or unemployment. Given recent statements from the Fed, it appears to be considering new policies to pump up the economy ("Operation Twist") -- a sign that it continues to be more worried about a slowing economy than about inflation. Policymakers will closely watch the Fed's activities on September 20 and 21 to see what actions, if any, it will take.

### Empire State Manufacturing Survey (September)

The Empire State Manufacturing Survey from the Federal Reserve Bank of New York shows that manufacturing activity continues to contract in the state, with its index of general business conditions falling from -7.7 in August to -8.8 in September. This index had been 21.7 in April; the September figure represents the fourth consecutive month of declining activity.

The New York survey notes contracting new orders, shipments, inventories and employment. The index for prices paid ticked up somewhat, reflecting faster growth in raw material prices; yet, the index for prices received also edged higher. Respondents said that their selling prices rose 1.4 percent on average during the past 12 months, and they expect their prices to go up 1 percent over the next year. Nonetheless, pricing pressures remain elevated overall, especially as manufacturers are not able to pass along the bulk of the increases in raw material costs.

On the bright side, the respondents to this survey were more optimistic about the next six months than in the previous report, with higher rates of new orders, shipments and capital expenditures expected. Employment, though, is expected to remain unchanged overall, which is down from the slight growth estimate in the August survey.

### Industrial Production (August)

The Federal Reserve reported that industrial production was up 0.2 percent in August, its fourth straight month of positive growth. Since August 2010, industrial production has risen 3.4 percent. Likewise, manufacturing production rose 0.5 percent in August and 3.8 percent for the year. Manufacturers' capacity utilization also edged 0.4 percent higher in August.

Production at the sector level was more mixed, with 10 sectors experiencing gains in production and nine having declines. Durable goods sectors had the strongest increases and were up 0.4 percent for the month; nondurables rose 0.1 percent.

The sectors with the greatest increases included aerospace and miscellaneous transportation (up 2.2 percent), motor vehicles and parts (up 1.7 percent), computer and electronic products (up 1.3 percent), primary metals (up 1.2 percent) and furniture and related products (up 1.2 percent). The largest declines were in textile and product mills (down 1 percent), printing and support (down 0.9 percent) and wood products (down 0.8 percent).

This report shows that manufacturing production continues to rise, led by strong growth once again in the transportation sectors. A rebound in motor vehicle sales and production from the supply chain issues of the spring and strong aerospace numbers significantly added to rising production. The overall industrial production figure was weighed down by weakness in the utility sector, which fell 3 percent in August, reversing the 2.8 percent increase last month. Mining production continues to increase and is up 1.2 percent -- its sixth consecutive month of gains.

### NABE Outlook Survey (September)

The National Association of Business Economics (NABE) reported in its quarterly Outlook Survey that real GDP is expected to grow 1.7 percent this year, down from the earlier estimate of 2.8 percent made in May. Similarly, business economists foresee 2.3 percent growth in 2012 instead of 3.2 percent.

The reasons for the downgrade are multifaceted. First, the Bureau of Economic Analysis reported much slower growth in the first half of this year than many economists expected (0.4 percent in the first quarter and 1 percent in the second). Second, businesses have faced a number of significant headwinds this year, from supply chain disruptions to rising raw material prices to falling business and consumer confidence. Growth in spending has been flat as a result.

In addition, one cannot discount that this survey was conducted in August, so U.S. fiscal challenges and European financial market worries were no doubt at the forefront of economists' minds. At the NABE annual meeting in Dallas, the sentiment among many economists was that Europe's problems would likely get worse before they get better. With such an overhang of doubt regarding the euro, it is not hard to see how so many economists -- including me -- have downgraded their growth estimates of late.

### ***NAM/IndustryWeek*** Survey of Manufacturers (Third Quarter)

The NAM and *IndustryWeek* surveyed manufacturers in late August to gauge their current outlook on the economy. Manufacturers were generally positive, but they were significantly less optimistic than just three months ago *(see the graphic above)*. Whereas 86.4 percent of respondents were either very or somewhat positive in their business outlook in the June survey, only 65.4 percent said the same in the third quarter -- a drop of over 20 percentage points. Many responders shifted from "somewhat positive" to "somewhat negative." Nonetheless, it is important to note that nearly two-thirds of manufacturers had a positive outlook on the economy.

Even with an upbeat assessment for manufacturing activity, individuals responding to this survey clearly downgraded their expectations for growth moving forward. For example, in the June survey, nearly 80 percent of manufacturers predicted higher sales over the course of the next year, with the average expected increase being 5.5 percent. In August, almost 58 percent forecasted higher sales, with an average expected increase of 3.2 percent. Similar declines were also seen for hiring, capital spending and exports.

The economy dominated the top concerns of manufacturers, along with the regulatory climate and the rising cost of energy and raw materials.

### NFIB Small Business Survey (August)

Small businesses became more pessimistic in August, according to the National Federation of Independent Business (NFIB). Its Small Business Optimism Index fell from 94.1 in January and 89.9 in July to 88.1 in August. This nearly matches where the index was one year ago.

Economic concerns were behind this decline, with 53 percent saying that the economy is not good and 13 percent noting economic uncertainty. The single most important problem continues to be poor sales, as cited by 25 percent of respondents. On the other hand, if one were to add together regulatory and tax concerns, this would top sales at 37 percent.

Small business owners on average expect sales to fall in the coming months. Twelve percent more of these owners see their sales falling than those who expect increases in the next three months. Likewise, more small businesses shrank employment than expanded it over the last three months. Looking ahead, a net 5 percent expect to hire -- an improvement from July (which was a net +2 percent) but still not suggesting fast growth.

### Philadelphia Federal Reserve Bank Business Outlook Survey (September)

Mirroring the Empire State survey described above, the Philadelphia Federal Bank released a September update to its Business Outlook Survey, with its general business activity index improving from -30.7 in August to -17.5 in September. The Philly survey was by far the most pessimistic of any of the regional manufacturing reports last month, and this report shows that activity in the region remains very weak. New orders, shipments, unfilled orders, delivery times and the average workweek all contracted. Raw material prices grew, with the prices received for goods also increasing, much like what was found in the New York survey. The good news is that employment went from contracting last month (with an index of -5.2) to expanding somewhat this month (5.8).

Manufacturers in the Mid-Atlantic region tend to be more optimistic about the next six months, with the general business activity index for expected activity rising from 1.4 in August to 21.4 in September. Most measures of activity are expected to grow, including new orders, production and employment. Still, in a series of special questions, respondents were split regarding third-quarter production; about 41 percent expect production to fall, while another 41 percent expect increased production. In the fourth quarter, more expect to see declining production (49 percent) than increasing production (38 percent). This provides an interesting contrast, with the overall indices more optimistic than the special survey question responses.

### Producer Price Index (August)

The Bureau of Labor Statistics reported that producer prices were unchanged in August. Core inflation, which excludes food and energy costs, rose 0.1 percent. Behind these numbers, it is clear that food and energy price changes are mixed.

Food costs rose 1.1 percent in August, or 8.4 percent since last year. This contrasts with energy costs, which were down 1 percent for the month, led by decreases in gasoline and diesel fuels. Still, even with the recent declines in energy costs, energy prices are up 15.9 percent since last year.

For manufacturers, producer prices fell 0.5 percent, mainly from a decline in energy costs. Finished prices for petroleum and coal products manufacturing fell 4 percent, for instance, which was more than any other industry. Other declines included primary metals (down 0.4 percent), plastics and rubber (down 0.3 percent) and chemicals (down 0.2 percent).

With that said, producer prices remain elevated; the manufacturing producer price index (PPI) is up 8.7 percent since last year. For August, industries with the fastest growth in finished goods prices were food manufacturing (up 1 percent), textile mills (up 0.8 percent) and apparel (up 0.7 percent). The price of intermediate goods also fell 0.5 percent, mainly from lower energy costs (down 2.3 percent). Crude prices rose 0.2 percent.

Overall, this report is a welcome respite from pricing pressures that have dominated the concerns of manufacturers throughout this year. Nonetheless, raw material prices remain elevated, with the costs of some materials still rising, including food.

### University of Michigan Consumer Sentiment Survey (September)

The University of Michigan and Thomson Reuters reported that consumer confidence edged slightly higher, from 55.7 in August to 57.8 in September. While this is good news, it is important to note the survey of consumers still shows the public to be quite pessimistic; consumer sentiment in June, for instance, was 71.5.

This month's improvement stemmed from stronger perceptions about the current state of the economy, with the survey's index of present conditions rising from 68.7 last month to 74.5 this month. Future expectations, however, fell slightly from 47.4 to 47.0.

The overall downgrading of the short-term outlook is not positive for manufacturers. Consumer fears about future economic growth, high unemployment rates, global financial market volatility and U.S. fiscal health are clearly weighing these numbers down. To the extent that these figures hold down consumption, that is not a good sign. The Census Bureau also reported last week that retail sales were flat in August.

{Back to top}

Questions or Comments?
Please contact Chad Moutray at cmoutray@nam.org



## Archive