



Manufacturing's Multiplier Effect

Indirect Economic Activity Generated by \$1 of Sector GDP



January 17, 2012

In the Beige Book released last week, the Federal Reserve Board observed "modest to moderate" growth in economic activity over the past month. That trend extends to all facets of the domestic economy, with notable improvements in confidence and manufacturing activity in a number of indicators and regions of the country.

Respondents to the Manufacturers Alliance for Productivity and Innovation's (MAPI) outlook survey were strongly positive about production, new orders, employment and capital spending (even as there was some easing in MAPI's findings from the past survey). The sector is expected to experience moderate growth this year.

Perhaps because of these measures, businesses and consumers have become more positive, as well. The University of Michigan's Survey of Consumer Sentiment indicated a rebound in confidence to levels seen earlier in the year, with Americans more optimistic about both the current and future outlook. Likewise, the National Federation of Independent Business noted much-improved sentiment among small business owners, and more of these individuals said that the next three months might be a "good time to expand." While these sentiment surveys still have sub-par readings, the improvements of late show a trend that is headed in the right direction.

With that said, not all of the economic news released last week was good. Retail sales in December were disappointing, up just 0.1 percent. Despite much of the hype over larger Christmas sales – particularly around Black Friday and just before the holiday – overall sales growth was weak, and excluding auto sales, retail sales were negative for the month. In addition, the trade deficit widened in November. Global economic weaknesses, particularly in Europe, are having an impact on growth prospects. On Friday, Standard & Poor's downgraded several European countries' debt ratings, with France and Austria losing their AAA rating. Such moves help to reinforce economic anxieties, but they also highlight the reality that Europe's problems are having a real impact. Forty-five percent of the MAPI respondents said that their exports to Europe have been negatively affected by Europe's weaknesses.

When discussing the latest economic trends, there is a split between the U.S. domestic economy and the rest of the world. While U.S. economic activity has seen noticeable improvements recently, weaknesses abound elsewhere. This is particularly true in manufacturing, as seen in [this table](#) of world-wide factory activity. The worry – at least among those who closely follow the European crisis – is that those problems will spill over into domestic concerns.

This week, we will gain further insights into the U.S. market, with new industrial production numbers out tomorrow. Some regional production figures from the New York and Philadelphia Federal Reserve Banks and Chapman University (regarding California) also will be released this week. In addition to manufacturing activity, other data highlights for the week include consumer and producer price indices and new housing starts.

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Economic Indicators

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Summaries of Last Week's Economic Indicators

Business Inventories (November)

[The Census Bureau released business inventory data for November, with manufacturers experiencing a 0.5 percent increase in inventories for the month.](#) This represents a slower pace than the 0.9 percent growth rate of October. Manufacturers' sales were unchanged in November, with the inventory-to-sales ratio edging slightly higher to 1.34 from 1.33. Overall, though, businesses have done an excellent job of inventory control recently.

For the larger economy, both sales and inventories were up 0.3 percent in November. The motor vehicle sector had the largest increase in inventories, up 0.6 percent.

Consumer Credit (November)

[The Federal Reserve Board observed a steep increase in U.S. consumer credit in November, particularly for nonrevolving accounts.](#) There was \$14.8 billion in additional borrowing among nonrevolving debt – an annualized increase of 10.7 percent – which now totals \$1.68 trillion. Revolving debt, meanwhile, increased \$5.6 billion, or 9.5 percent, to \$789.3 billion. Overall debt levels are now just shy of \$2.5 trillion and increased in every month in 2011 except August.

Individual interest rates remain low, with the average rate for a 48-month new car loan at 5.45 percent. This is down from the 5.90 percent average in the third quarter of 2011. For credit cards, the average rate in November was 12.36 percent.

Commercial banks remain the largest holders of consumer credit, with \$1.08 trillion in credit outstanding. Finance companies and the federal government follow with

\$502.5 billion and \$416.3 billion, respectively. The largest increase occurred among student loans outstanding (e.g., the federal government), which grew from \$409.9 billion to \$416.3 billion.

Federal Reserve Beige Book (January)

Mirroring other economic indicators, [the Federal Reserve Board's Beige Book highlights "modest to moderate" growth in activity in recent months](#). It says, "Compared with prior summaries, the reports on balance suggest ongoing improvement in economic conditions in recent months, with most Districts highlighting more favorable conditions than identified in reports from the late spring to early fall."

The report says manufacturing activity has picked up in most districts. According to the analysis, "The strongest reports came from subsectors such as heavy equipment manufacturing and steel, for which demand has been boosted by robust growth in the energy, agricultural, and auto manufacturing sectors." Another positive for manufacturers has been the increase in consumer spending, which was driven largely by holiday sales. Export growth for manufactured goods has also been largely positive.

There were exceptions to the trend of higher manufacturing activity, though, including some districts that were "stable" (Cleveland, Richmond and Dallas) or slightly declining (Kansas City). Lower demand continues to be a challenge for manufacturers tied to the housing sector, and supply issues persist for some sectors because of the recent flooding in Thailand.

Pricing pressures, which have been a major challenge for manufacturers over the past year due to elevated energy and raw material costs, have eased somewhat. Price and wage increases have been limited. With that said, higher health benefit costs were cited as one compensation cost that was squeezing many employers.

This report is largely consistent with the [last Beige Book release](#). While economic growth remains sub-par overall, a number of modest improvements lately indicate that the domestic environment is getting better. Still, the Fed continues to watch the developments in Europe and domestically very closely, as a number of potential risks could derail what progress has been made.

International Trade (November)

[The Bureau of Economic Analysis and the Census Bureau reported that the U.S. trade balance in November widened to \\$47.8 billion from \\$43.3 billion in October](#). Americans imported \$225.6 billion in goods and services for the month (up from \$222.6 billion the previous month) and exported \$177.8 billion (down from \$179.4 billion).

A widening of the deficits for goods and petroleum led to this month's larger overall deficit. Exports of industrial supplies and materials fell from \$43.1 billion to \$41.4 billion, with smaller declines observed in the export of food products, automobiles

and capital goods. There was, however, a net gain in exports for consumer goods. The trade balance for petroleum, meanwhile, fell from \$24.2 billion to \$27.6 billion, largely on higher imports.

Looking geographically, exports to Europe have slowed somewhat, as one might expect given challenges in the Eurozone area. Exports of goods and services to Europe fell from \$28.4 billion in October to \$26.8 billion in November. Europe accounts for over 20 percent of U.S. manufactured goods exports, so any stalling in the region for sales of U.S. products can have an impact. Nonetheless, slower exports were not just a European phenomenon, as few exports were observed across the board in other regions, as well.

The value of U.S. manufactured goods exported in November was \$81.9 billion, down from \$86.2 billion in October. Still, there were \$889.3 billion in manufactured goods exports year-to-date in 2011 (through November), which represents an 11.8 percent increase on the \$795.4 billion at the same point in 2010. Note that these numbers are not seasonally adjusted.

Manufactured goods account for 60 percent of total U.S. exports. With that in mind, the U.S. will depend heavily on the manufacturing sector to make the President's goal of doubling exports by 2015. Hopefully, global economic growth can pick up in the coming months, helping to boost trade numbers. Economic weaknesses in Europe and elsewhere, though, could hinder this goal.

Job Openings and Labor Turnover Survey (November)

The Bureau of Labor Statistics, in releasing new [Job Openings and Labor Turnover Survey \(JOLTS\) data](#), found that manufacturing job openings and hires were little changed in November from October. Manufacturers hired 237,000 workers in November, up from 235,000 the previous month. Job openings, on the other hand, were down from 232,000 to 227,000.

Manufacturing separations increased from 216,000 to 220,000 for the month. As a result, net hiring for the sector was positive, with 17,000 net new manufacturing jobs added in November. This is the second consecutive month of net positive hiring; however, the rate of hiring as a percentage of total sector employment fell from 2.4 percent in November 2010 to 2.0 percent in November 2011. This suggests that hiring levels are still subpar. ([We learned that 23,000 net new jobs were added in manufacturing in December](#), but those figures have not been broken out by labor turnover yet.)

The story for the larger economy was similar, with fewer job openings and hires in the private sector and slightly more separations. Net hiring was positive, with 169,000 more workers added than separated. Sectors adding the most employees in November included retail trade and leisure and hospitality; the education and health services sector could be added to that list when discussing industries that posted the most new job openings.

Overall, these latest JOLTS data do not change the larger storyline that hiring remains a challenge. This is true despite improvements in the unemployment rate. While recent indicators suggest that hiring intentions moving into 2012 are positive, it is also clear that businesses are being cautious in bringing on new workers. With clear signs of stronger growth and fewer uncertainties in the marketplace, this could all change.

Manufacturers Alliance/MAPI Survey (Fourth Quarter)

[The Manufacturers Alliance for Productivity and Innovation \(MAPI\) announced that its composite index of manufacturing activity edged slightly lower from 67 in the third quarter of 2011 to 66 in the fourth quarter.](#) Similar to the Institute for Supply Management's surveys, readings over 50 suggest that the sector is expanding. Therefore, the senior financial executives from the manufacturing sector responding to this survey still suggest strong growth overall for the manufacturing industry, with slight easing in some of the numbers only reflecting a slightly lower growth rate. The index has grown now for nine consecutive quarters.

Looking at the various components of the index, each of them suggests strong growth moving forward, even though some of figures were lower than in the previous quarter. Illustrating the mixed nature of these results are shipments, which grew from 81 to 83 for the quarter, and new orders, which fell from 79 to 70. It is hard to get upset over either reading, despite the lower growth rate for new orders. Nonetheless, several indicators did mirror the easing observed in the new orders figure, including the level of exports, capital investments, profit margins and capacity utilization.

The survey asked a series of questions about uncertainties related to the European sovereign debt crisis. Almost all (97 percent) of the respondents felt that Europe would experience a recession in 2012, and 45 percent of them said that their exports to Europe have slowed as a result. Nonetheless, three-quarters of them anticipate no changes in the European strategies moving forward, at least at this time.

Overall, this survey continues to represent much stronger sentiment than many of its industry peers, yet other surveys also indicate an improved economic environment for manufacturers. Highlighting this, Donald Norman, a key MAPI economist responsible for this survey, says, "Barring a meltdown in the Eurozone, the U.S. manufacturing sector should continue growing at a moderate pace heading into 2012."

NFIB Small Business Survey (December)

[The National Federation of Independent Business \(NFIB\) released its monthly Small Business Economic Trends, with small business optimism rising from 92.0 in November to 93.8 in December.](#) It was the fifth consecutive monthly gain, up from 88.1 in August.

Along with the gain in confidence, the net percentage of respondents saying that the next three months are a "good time to expand" increased to 10, its highest level since before the recession. Likewise, small business owners are also more optimistic

about future sales, employment and capital spending.

Nonetheless, it is important to note that small businesses remain anxious despite these improvements. Traditionally, small businesses are experiencing strong growth once the optimism index exceeds 100 – a threshold that it has not been surpassed since 2006. Those suggesting that now is not a good time for expansion cited poor economic conditions and an unsettling political climate. The single most important problem continues to be "poor sales" followed by taxes and government regulations.

Retail Sales (December)

[The Census Bureau reported that retail sales grew by 0.1 percent in December, their slowest pace since May.](#) This suggests that holiday sales – despite strong Black Friday and Christmas week sales – were weaker than many might have preferred. In fact, excluding auto sales, retail sales would have fallen 0.2 percent. Nonetheless, retail sales in 2011 were 7.7 percent higher than in 2010.

Areas of strong growth in December included building materials (up 1.6 percent), motor vehicles and parts (up 1.5 percent), furniture and home furnishings (up 1 percent), clothing and accessories (up 0.7 percent) and food service and drinking places (up 0.7 percent). These were offset by declines in electronics and appliances (down 3.9 percent), gasoline stations (down 1.6 percent due to lower petroleum prices) and general merchandisers (down 0.8 percent).

These numbers suggest that Americans continue to be cautious in their spending despite rising confidence and improving labor market conditions. It also shows the public is willing to open its pocketbook selectively on big-ticket items such as automobiles and home improvements. Non-store retailers (up 10.6 percent) experienced the fastest year-over-year growth in retail sales, followed by auto dealers (up 9.5 percent), clothing, building materials and furnishings.

University of Michigan Consumer Sentiment (January)

[Consumers have become more optimistic over the past few months, according to the Survey of Consumer Sentiment from the University of Michigan and Thomson Reuters.](#) After bottoming out in August at 55.7, the consumer sentiment index rose to 69.9 in December and 74.0 in January. It is now at its highest point since May, when the index stood at 74.3.

The public is becoming more confident about the current and future economic environment, with both components rising for the month. Anxieties about expected growth had led the index lower in past months, so the economic recovery has been a key to the increase. The expectations components increased from 47.4 in August to 68.4 in January – a significant improvement. The index for present conditions, meanwhile, rose from 68.7 to 82.6 over the same time period.

Inflationary expectations remain mostly unchanged, with prices expected to rise 3.2 percent in 2012.

Wholesale Trade (November)

[The Census Bureau reported a 0.6 percent gain in sales from wholesalers in November, slightly lower than the 0.8 percent gain in October.](#) Durable goods led the increase, up 0.9 percent, reversing the previous month's decline. Professional equipment (up 3.8 percent including computers, which gained 2.8 percent), miscellaneous nondurables (up 2.6 percent), miscellaneous durables (up 2 percent), hardware (up 2 percent) and metals (up 1.6 percent) experienced the fastest gains. Automotive sales at the wholesale level were down 1.5 percent for the month. Nondurable goods grew 0.3 percent, much slower than the 1.7 percent increase in October.

Wholesalers' inventories rose a modest 0.1 percent. This essentially means that inventories changed little after their strong 1.2 percent gain in October. The inventory-to-sales ratio was also unchanged from the previous month at 1.15.

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Questions or Comments?
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