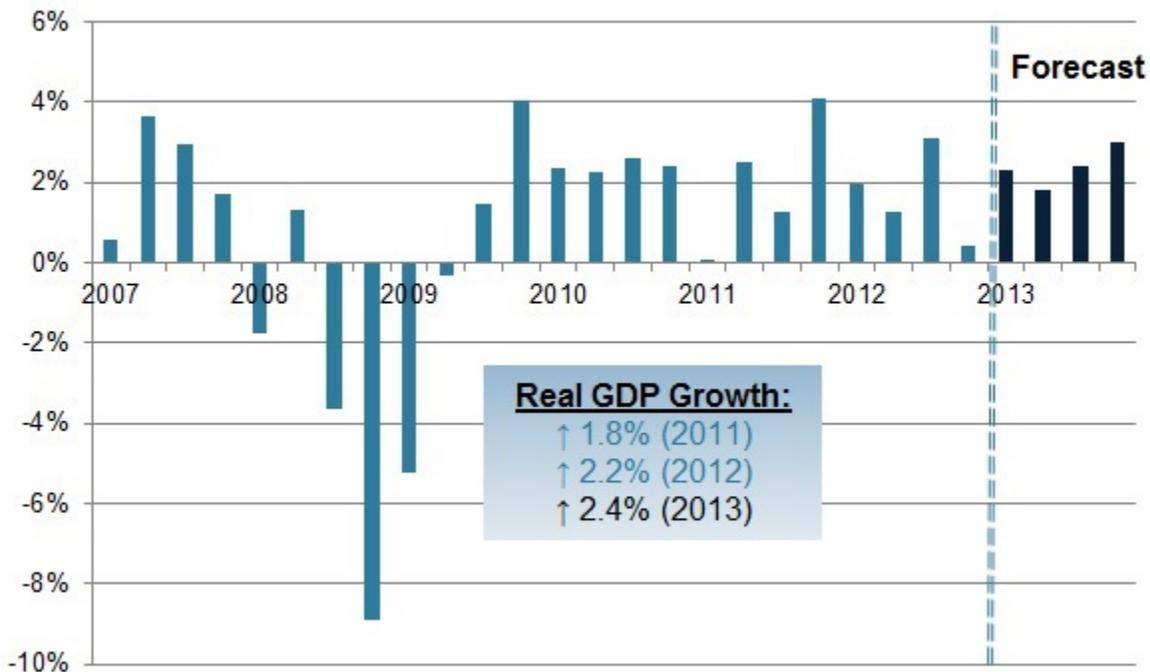




April 1, 2013

Real Gross Domestic Product (Chained 2005 Dollars)



Source: Bureau of Economic Analysis, NAM calculations using Moody's Analytics simulation model

According to the latest economic data, U.S. manufacturers are seeing slow-to-decent progress in their businesses. While there continue to be challenges, many of the regional Federal Reserve Bank surveys reported continued expansion, even if the pace of growth might have slowed. The Dallas Fed survey has grown for four straight months on higher sales and production data, and businesses in the region were overwhelmingly positive about future activity over the coming months. At the other end of the spectrum, the Kansas City Fed's composite index has contracted for six consecutive months. Both new orders and shipments were unchanged in February after falling sharply in January, and respondents tended to echo some of the frustrations of businesses in the area. Frequent concerns ranged from uncertainties about the economy to concerns about healthcare costs. Even in the Kansas City report, though, manufacturers expressed cautious optimism about the next six months – a constant sentiment across all the surveys.

This morning, we will get the latest read on the manufacturing sector from the Institute for Supply Management (ISM). The ISM purchasing managers' index is expected to show a very modest gain in activity in March, following the survey's uptick from 53.1 in January to 54.2 in February. Sales should drive the index higher, but other data show that these gains have been somewhat spotty lately. The Census Bureau's advance estimates

for new durable goods orders rose a very strong 3.6 percent in February, but this followed a 3.8 percent loss in January. Much of the volatility in that indicator has been due to the ups and downs in aircraft orders. Removing the transportation sector from of the analysis would have yielded a decline in new orders.

Motor vehicle demand appears in several of the indicators released last week. The durable goods report indicates that auto sales increased by a very robust 3.8 percent in February, and a rebounding motor vehicle sector helped to lift the Chicago Fed's Midwest Manufacturing Index. Year-over-year production in the auto industry in the Chicago Fed District was up 15.2 percent, a strong figure that helps explain why the Midwest has fared so well since the end of the recession. These indicators were also consistent with analysis from a couple weeks ago that showed retail sales gains largely due to increased auto purchases and higher gasoline prices.

On the consumer front, personal incomes were up 1.1 percent in February. Spending increased 0.7 percent. The nondurable goods sector benefited the most from the increased spending. The sector was up 1.9 for the month. Manufacturing employees, meanwhile, benefitted from the pickup in activity through higher total wages and salaries. At the same time, the two consumer sentiment surveys out last week moved in opposite directions. The Conference Board's report dropped significantly over jobs and income concerns. Respondents also cited across-the-board federal spending cuts as a factor. The University of Michigan's consumer confidence figure reversed an earlier estimate and found the public more positive than the month before, with its index rising for four straight months. The update from the initial report suggests that some of the concerns about the economy in many of the earlier responses might have dissipated as the month progressed.

Aside from the ISM report, other economic highlights due out this week include the latest figures on employment and international trade. Nonfarm payrolls are expected to increase by around 200,000 in March, indicating reasonable job growth last month just shy of the 236,000 net new workers added in February. Manufacturing hiring growth should also closely mirror the previous month's report. On the trade front, we will be looking to see whether recent improvements in many of our largest markets – with the notable exception of Europe – will lead to increases in exports of manufactured goods.

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Economic Indicators

Last Week's Indicators:

(Summaries Appear Below)

Monday, March 25

Chicago Fed Midwest Manufacturing Index
Chicago Fed National Activity Index
Dallas Fed Manufacturing Survey

Tuesday, March 26

Conference Board Consumer Confidence
Durable Goods
Richmond Fed Manufacturing Survey

Wednesday, March 27

None

Thursday, March 28

This Week's Indicators:

Monday, April 1

Construction Spending
ISM Manufacturing Purchasing Managers' Index

Tuesday, April 2

Factory Orders
Vehicle Sales

Wednesday, April 3

ADP National Employment Report

Thursday, April 4

None

Gross Domestic Product (Second Revision)
ISM-Chicago
Kansas City Fed Manufacturing Survey

Friday, April 5
BLS National Employment Report
International Trade

Friday, March 29

Personal Income and Spending
University of Michigan Consumer Sentiment Survey

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TOP 7 COST TRENDS IN 2013
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Summaries of Last Week's Economic Indicators

Chicago Fed Midwest Manufacturing Index

[The Chicago Federal Reserve Bank said that its Midwest Manufacturing Index edged slightly higher in January.](#) The index grew 0.1 percent in January to 97.0, up from 96.8 percent in December. This marked the third consecutive monthly increase (albeit a small one), and it continues a longer-term upward trend. Production in the Midwest has risen 6.4 percent over the past 12 months and 17.9 percent over the past 24 months, helping the sector recover from significant declines in the Great Recession.

The rebound in the auto sector largely contributed to these increases. Motor vehicle production rose 0.7 percent in January and 15.2 percent year-over-year. The Midwest Manufacturing Index tends to rise and fall largely on how the auto sector is performing, and strength in this sector has helped the Midwest outperform many of the nation's other regions. Machinery also performed well in January as production increased 0.4 percent and 2.8 percent year-over-year.

Of course, it was not all good news. There were weaknesses in the resource and steel sectors in January, down 0.3 percent and 0.5 percent, respectively. These declines counteracted the strengths in the auto and machinery sectors. Both sectors still experienced year-over-year gains – 1.5 percent for auto and 3.1 percent for machinery. Recent improvements in the U.S. economy and increases in overall production should allow these two sectors to experience growth in the coming months.

Chicago Fed National Activity Index

What a difference a month makes. [The Chicago Federal Reserve Bank said that it's National Activity Index \(NAI\) shifted from -0.49 in January to +0.44 in February.](#) January's data reflected a drop in industrial production and reduced housing starts, among other challenges. Negative numbers typically indicate economic growth below historical trends. When the three-month moving average falls below -0.70, the risk of recession increases. The January NAI therefore suggested that the macroeconomy was headed in the wrong direction.

The latest data, though, suggest that there was definite improvement in February, with manufacturing playing a key role. [Industrial production](#) rebounded in February, increasing 0.8 percent. That helped boost the manufacturing contribution to the NAI by 0.34 points, a significant swing from the 0.30 drag on the index the month before. Higher nonfarm payrolls, sales, and housing permits were also positive factors. With that said, the sector continues to have a negative contribution overall because housing data remains well below where it was a few years ago.

Despite the higher monthly NAI, the three-month moving average edged lower, from +0.28 in January to +0.09. The NAI value nevertheless indicates an economy that is growing above its historical average, even if it is not growing strongly.

This data is consistent with the Leading Economic Index report from the Conference Board. Overall, the U.S. economy is experiencing moderate growth, with manufacturers cautiously optimistic about increased activity moving forward. Still, there continue to be headwinds, and it will be interesting to see how across-the-board federal spending cuts impact growth moving forward, particularly as we move into the second quarter of 2013.

Conference Board Consumer Confidence

[The Consumer Confidence Index from the Conference Board dropped from 68.0 in February to 59.7 in March.](#) The decline essentially erases the rebound in sentiment observed in February. We are not far from the 58.4 value observed in January and still below the recent peak of 73.1 in October.

The Conference Board index slipped due to weakened perceptions about both current and future economic environments, with the forward-looking measure down the most from 72.4 to 60.9. At least part of the decline could stem from across-the-board federal budget cuts that went into effect March 1, the association's press release suggests. "The recent sequester has created uncertainty regarding the economic outlook and as a result, consumers are less confident," said Lynn Franco, the Conference Board's director of economic indicators.

The tempered sentiment transferred into pocketbook issues as well. The percentage of respondents feeling that jobs were more plentiful decreased marginally from the month before. Similarly, there was a drop in those expecting their incomes to increase.

The importance of these variables, of course, is how they translate into consumer spending patterns, and it appears that there were fewer people planning to purchase a motor vehicle (down from 11.1 to 10.1 percent) or appliances (down from 49.6 to 45.2 percent). On the positive side, those intending to purchase a home ticked higher (up from 3.8 to 5.6 percent). With that said, the most recent [retail sales](#) data tended to show higher – not lower – levels of purchases, but most of those purchases came from gasoline and auto sales. That data also pre-dates whatever impacts might come from fiscal sequestration.

Dallas Fed Manufacturing Survey

[The Federal Reserve Bank of Dallas said that manufacturing activity picked up in March.](#) The composite index of general business activity increased from 2.2 in February to 7.4 in March. This was the fourth consecutive month of higher overall sentiment, following seven out of eight months before that in which manufacturers were more pessimistic in their attitudes and data. The March report finds overall progress in the Texas district so far in 2013, mirroring what we have seen in several other regions.

Higher sales and production levels have been the principal driver of these improvements, albeit with modest growth overall and a significant number of firms with no growth. The index for new orders increased from 2.8 to 8.7 for the month. Looking at the raw data, just over one-quarter of respondents said that their orders had increased between February and March, with 55.9 percent saying that there was no change. Indeed, the majority of manufacturers reported no change in many of the key components. For instance, while the production index rose from 6.2 to 9.9, roughly two-thirds of those completing the survey reported unchanged production levels.

Although this suggests net progress for Texas manufacturers, but there is still some room for improvement. Hiring continues to lag behind. The employment index edged upward from 2.0 to 2.6 for the month. Within this measure, 16.2 percent said that their employment levels had increased, while 70.2 percent suggested that there was no change. The employment numbers tend to be consistent with other data points that have found hiring growth rising at a much slower pace than other variables. Capital spending, on the other hand, has tended to fair much better.

Manufacturers in the Dallas region expressed far more optimism about increased activity later this year, both for their own companies and for the macroeconomic environment. The forward-looking composite index grew from 10.8 in February to 15.5 in March. The new orders measure for six months from now, meanwhile, rose from 29.6

to 33.8, with 42.0 percent of respondents expecting their sales to increase. Roughly half anticipate them remaining the same. Production and shipments reflected similar data findings. The pace of capital investments and hiring are also predicted to pick up. In fact, 36.5 percent say that they expect employment to be higher six months from now, with 57.6 percent suggesting no change.

Durable Goods

[Large swings in aircraft orders over the past few months have resulted in a lot of volatility in durable goods orders data from the U.S. Census Bureau](#). In December, new durable goods orders increased 3.6 percent, followed by a 3.8 percent loss in January. In February, sales rose a sharp 5.7 percent in February. Demand for defense and nondefense aircraft plummeted in January but then rebounded strongly in February, driving the ups and downs. Demand for autos was also strong. In total, the transportation sector's new orders for the month rose 21.7 percent.

Excluding transportation from the analysis, new durable goods orders would have fallen 0.5 percent, suggesting continued weaknesses in the manufacturing sector beyond aircraft and motor vehicles. Core capital goods, or nondefense capital goods excluding aircraft, experienced a 2.7 percent decline in new orders in February, somewhat offsetting the 6.7 percent increase the month before.

Looking at all durable goods sales beyond aircraft, there was some strength in motor vehicles (up 3.8 percent), electronic equipment and appliances (up 2.9 percent), primary metals (up 1.7 percent), and computers and electronic products (up 1.3 percent). However, decreasing new orders in the fabricated metal products (down 4.4 percent) and machinery (down 2.2 percent) sectors offset the gains.

Shipments of durable goods increased 1.0 percent in February, bouncing back from a 0.7 percent loss in January. Gains were more broad-based on this measure. Weaknesses occurred only in the nondefense aircraft (down 10.5 percent), communications equipment (down 1.7 percent), and primary metals (down 0.5 percent) sectors. New orders of defense aircraft and parts (up 6.8 percent), motor vehicles and parts (up 3.8 percent), machinery (up 2.7 percent), and other durable goods (up 1.7 percent) grew at the fastest pace.

The headline number for durable goods orders increased at its fastest pace since September. If you peel back the layers, however, you quickly realize that new manufacturing orders are somewhat spotty, with the rebounds in auto aircraft and auto sales driving much of the data. Going forward, we would like to see broader strength in new orders, similar to the broad-based gains in durable goods. .

Gross Domestic Product (Second Revision)

[The Bureau of Economic Analysis boosted its real gross domestic product \(GDP\) estimates in its second revision of growth for the fourth quarter of 2012](#). The U.S. economy grew 0.4 percent in the fourth quarter, in line with consensus expectations, according to the latest data. In this analysis, real GDP improved from the [original estimate](#) of a 0.1 percent decline, and it also exceeded the 0.1 percent growth rate seen in the [first revision](#). The revised data reflect increased contributions from nonresidential fixed investments and exports.

For the most part, the overriding narrative has not changed much from the original estimate. Reduced spending on inventories and sharply lower defense spending figures represented the primary drags on growth. Defense spending alone subtracted 1.28 percentage points from real GDP in the quarter. Private inventories reduced output by another 1.52 percentage points. Real GDP growth could have exceeded 3 percent had it not been for these two factors.

Indeed, areas of strength – namely, higher consumer spending and business investment – counteracted drags on economic growth. Spending on goods and services rose 1.8 percent in the quarter, with the strongest growth coming from durable goods purchases. Purchases of goods added another 1.0 percentage point to real GDP. Large increases in fixed investment, both residential and nonresidential, contributed another 1.69 percentage points to real GDP.

The initial estimate of real GDP for the first quarter of 2013 will be released Friday, April 26. Several indicators have come in stronger than the consensus, and so we currently expect this figure to reflect 2.3 percent growth in

output – higher than originally anticipated.

However, there have also been some contracting forces in the economy, including higher taxes, across-the-board federal spending cuts, and economic challenges overseas, primarily in Europe. With sequestration slowly kicking in and FY 2014 budget discussion gaining traction in the second quarter of 2013, we might experience some slowed growth. We currently expect growth in the second quarter to be around 1.8 percent, with 2.4 percent real GDP growth for 2013 overall.

ISM-Chicago

[ISM-Chicago and Deutsche Börse reported that the Chicago Business Barometer declined from 56.8 in February to 52.4 in March.](#) This suggests slower growth in the Midwest region as the pace of sales and production eased down. The new orders index declined from 60.2 to 53.0, a shift more modest growth. Likewise, the production measure dropped from 60.2 to 51.8. Order backlogs contracted after slightly growing last month, contributing to this downturn.

Manufacturers in the Chicago region nevertheless continue to increase their hiring. Although the employment index decreased from 55.7 to 55.1, the sector's hiring growth has been positive for three straight months. This suggests a degree of cautious optimism moving forward. Inventories also declined significantly, down from 50.1 to 41.0. This could be a good proxy for future production, particularly if sales pick up. Capital investment data were also strong.

Kansas City Fed Manufacturing Survey

[The Kansas City Federal Reserve Bank said that manufacturing activity in its district contracted at a slower rate in March, but that activity has now contracted for six straight months.](#) The composite index improved from -10 in February to -5 in March. After sharp declines in new orders and shipments in February, the figures remained constant in March. That helped to slow the rate of decline in overall sentiment.

It is clear that manufacturers in this region tend to be more pessimistic about the current economic environment than reported in any of the other Fed regional surveys. Many of the key indicators were negative – some of them strongly so. The index for the number of employees swung from +2 (slight growth) to -15 (strong decline). The employment data have been negative four of the past six months, suggesting a high degree of skittishness toward hiring in the district. Other contracting figures included the orders backlog, the average employee workweek, export orders, and raw material inventories.

The survey's comments usually provide some context to the index data, and they reflect the negative perceptions of the numbers. Respondents noted some persistent macroeconomic uncertainties as well as higher costs. Healthcare proved to be worrisome. "Until the final rules of our cost for healthcare are known, we are not hiring," one respondent said. Another added, "Our customers are preparing for the increased healthcare costs and higher petroleum costs." The issue of how manufacturers will implement the Affordable Care Act has certainly risen to the forefront. Rising healthcare costs ranked the top concern in the [latest NAM/IndustryWeek Survey of Manufacturers](#).

Manufacturers in the Kansas City Fed District are more optimistic about the next six months than they are about the current macro situation, consistent with findings in other regions. The forward-looking composite index increased from 12 to 26, its highest level since September, and measures for new orders, shipments, capital spending, and employment are all expected to increase.

Personal Income and Spending

[The Bureau of Economic Analysis \(BEA\) said that personal income grew 1.1 percent in February – coincidentally the same pace experienced in November.](#) In between those months, tremendous volatility occurred in the data as several businesses chose to accelerate payouts due to the threat of the fiscal cliff. As a result, personal income experienced a 2.6 percent boost in December, followed by a 3.7 percent drop in January. Starting with the February numbers, we should be able to return to more normal trends.

Wages and salaries rose 0.6 percent in February, suggesting decent growth in employee compensation for the

month. For manufacturers, wages and salaries increased from \$749.8 billion in January to \$758.3 billion in February, continuing a steady rise in manufacturing compensation. Total manufacturing wages and salaries were \$723.1 billion in the first quarter of 2012 and \$708.3 billion in the first quarter of 2011.

Personal spending was up a relatively strong 0.7 percent in February, marking the fourth consecutive month of gains. This suggests – at least for now – that consumers have continued to make purchases even as consumer confidence data has waned on higher payroll taxes and other factors. The largest growth in spending came in the nondurable goods sector, which was up 1.9 percent.

The results are somewhat consistent with [retail sales](#) data for February from the Census Bureau, which found strong growth mainly attributable to higher gasoline prices and healthy auto sales. Perhaps one difference was unchanged durable goods spending in this latest report. Other sectors may have counteracted the robust motor vehicle sales. The personal spending data from BEA do not provide a breakdown for us to be able to make that determination.

With personal income growth outstripping personal spending, the savings rate rose from 2.2 percent in January (its lowest point since August 2007) to 2.6 percent in February. The savings rate was 6.5 percent in December, but accelerated dividends and other payouts made that month skewed that figure. The average savings rate in 2012 was 3.9, or 3.7 percent excluding December's outlying value.

Richmond Fed Manufacturing Survey

[The Richmond Federal Reserve Bank stated that the pace of manufacturing activity slowed somewhat in March.](#) The composite index of general business conditions declined from 6 in February to 3 in March. The new year began with a pretty steep contraction in January, with the index measuring -12, so the data for February and March suggest some degree of improvement, albeit with manufacturers in the region reporting slow growth.

The net decline in new orders in the district is one factor that could explain the deceleration in sentiment. Sales growth continues to be very weak, with zero or positive measures in the new orders index recorded just three times since May 2012. After sales declined sharply in January, they remained unchanged in February. The index stood at -4 in March. While the survey does not address across-the-board spending cuts, it would be interesting to know how sequestration has impacted the results, especially with Virginia being one of the [top states](#) affected.

Falling measures for the backlog of orders and capacity utilization accompanied declining new orders. Shipments data, though, continued to expand at a somewhat slower pace. The index for shipments decreased from 10 to 8 for the month, consistent with the modest growth in the average employee workweek. Unlike the findings of several other regional surveys, hiring appears to have picked up somewhat within the region. In the Richmond area, the employment index had been negative in January but grew from 8 in February to 9 in March.

Employment might be reacting to the cautious optimism for increased activity in the coming months. Measures of activity were generally higher. The index of new orders six months from now rose from 26 to 31, indicating that manufacturers in the Richmond Fed region and beyond tend to expect higher levels of sales, shipments, capital spending, and employment.

In terms of pricing pressures, respondents noted a deceleration in inflation from last month. The prices paid for input increased 1.28 percent at the annual rate in March, down from 2.04 percent in February. Looking ahead six months, manufacturers in the Richmond Fed District expect prices to rise 1.77 percent, down from 2.72 percent the month before.

University of Michigan Consumer Sentiment Survey

[The University of Michigan and Thomson Reuters found that optimism among consumers grew from 77.6 in February to 78.6 in March.](#) This marks a reversal from their [earlier estimate](#) that observed an unexpected drop in confidence for the month. With this update, the Consumer Sentiment Survey's key index has risen for four straight months, up from 72.9 in December. However, it still ranks below the 82.7 value observed in November. Ideally, we would like to see the index move closer to 100.

The improvement in the data mainly stemmed from perceptions about the current economic environment, with the index related to present conditions up from 89.0 to 90.7 for the month. The initial data had suggested that perhaps higher gasoline prices, increased payroll taxes, or discussions about across-the-board federal spending cuts might have had an impact. To some degree, those concerns must have dissipated. The survey also recorded marginally improved sentiment about future economic conditions, up from 70.2 to 70.8.

Consumers are currently anticipating 3.2 percent increases in prices over the next year, down slightly from the 3.3 percent forecast last month.

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