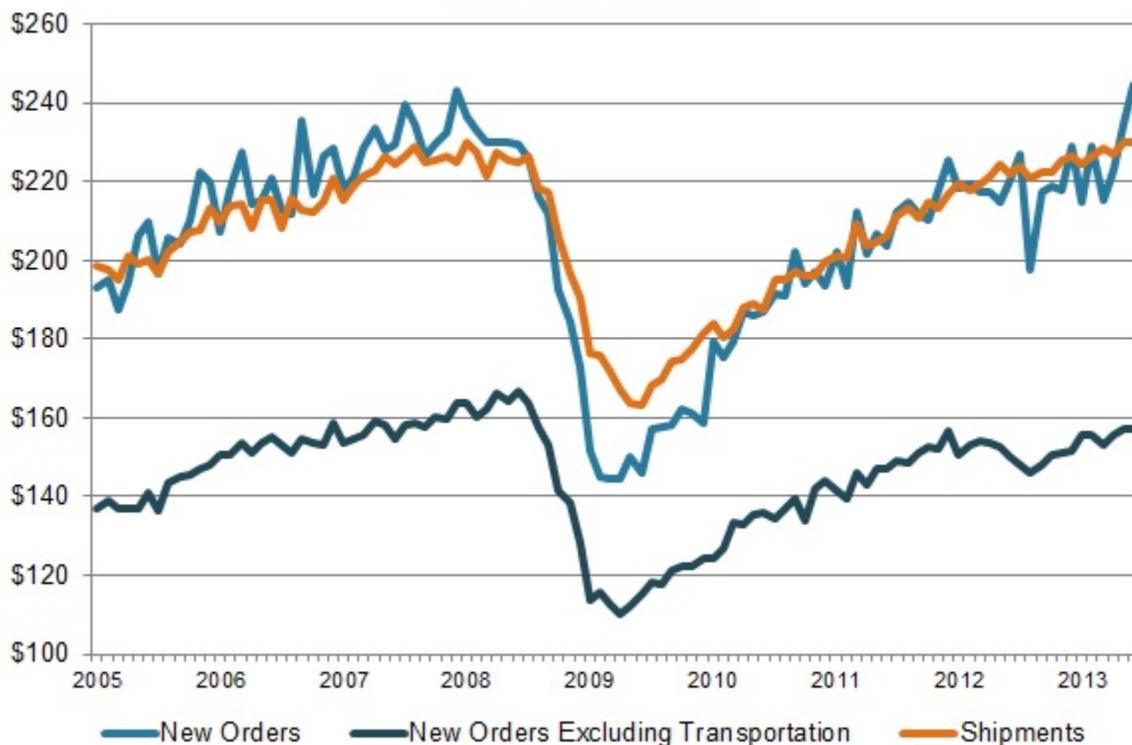




July 29, 2013

## Manufactured Durable Goods (in Billions of Dollars)



For the most part, manufacturing activity continues to improve from weaknesses during the spring. The [Markit Flash U.S. Manufacturing Purchasing Managers' Index \(PMI\)](#) increased from 51.9 in June to 53.2 in July, suggesting modest growth overall and increases in new orders, output and employment. This included export sales, which contracted in June and have been slow so far in 2013. Meanwhile, the [Kansas City Federal Reserve Bank's](#) composite index was up from -5 to 6, echoing similar improvements in the [New York](#) and [Philadelphia](#) districts. Of the regional Fed manufacturing surveys for July released so far, only the [Richmond Fed's](#) respondents noted weaknesses, with surprisingly sharp declines in sales for that district. All of the surveys, however, reflect cautious optimism for the second half of the year. Similarly, the latest [consumer confidence](#) figures from the University of Michigan suggest sentiment has reached a six-year high.

The Census Bureau's advance estimates of [new durable goods orders](#) provided mixed comfort on the current state of that sector's sales environment. Strong demand for aircraft orders lifted the volume of new orders to an all-time high. Yet, when you exclude transportation from the analysis (which would also include higher auto sales), weaknesses persist in the broader industry. Without transportation, new orders would have been unchanged, and they have edged up just 1.0 percent since January. The latest National Association for Business

Economics (NABE) [Industry Survey](#) gives further credence to this, with respondents noting slower sales and earnings in the goods-producing sectors (which include manufacturing) in the second quarter. Nonetheless, business economists anticipate a pickup in activity over the next year, with 70 percent of respondents expecting real GDP growth of between 2.1 and 3.0 across the next 12 months.

In international markets, exports have been slow in the early months of 2013, with particular weaknesses in Europe. The good news last week was the surprisingly positive [Markit Flash Eurozone Manufacturing PMI](#) report, with its composite index for July measuring 50.1. This was its first reading above 50—the threshold for expansion—since June 2011. While Europe still has significant issues to work through, the increase in demand and uptick in output were welcome developments and perhaps indicate some stabilization. The PMI data gave markets a huge psychological boost, with many analysts suggesting that Europe might have turned the corner. In contrast, China's economy continues to decelerate. The [HSBC Flash China Manufacturing PMI](#) declined to 47.7 in July and has now contracted for three straight months.

This week will be a big one on the economic front. The key headline to watch will come on Wednesday with the release of second-quarter real GDP, with economists revising their estimates lower in the past few weeks to 1 percent or less. If the Bureau of Economic Analysis confirms this, it would suggest extremely sluggish growth in the first half of 2013, with [first-quarter growth](#) recently revised down to 1.8 percent. In addition to output, we will also get the latest PMI data from the Institute for Supply Management (ISM) and employment numbers for July. Hopefully, the ISM data will mirror the progress seen in the Markit data discussed above. The jobs figures will be watched closely to see if the manufacturing sector can reverse its recent declines in hiring.

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## Economic Indicators

### Last Week's Indicators:

*(Summaries Appear Below)*

#### Monday, July 22

*Chicago Fed National Activity Index  
NABE Industry Survey*

#### Tuesday, July 23

*Richmond Fed Manufacturing Survey*

#### Wednesday, July 24

*Markit Flash PMIs for the United States, China  
and Eurozone*

#### Thursday, July 25

*Durable Goods Orders and Shipments  
Kansas City Fed Manufacturing Survey*

#### Friday, July 26

*University of Michigan Consumer Sentiment  
(Revised)*

### This Week's Indicators:

#### Monday, July 29

*Chicago Fed Midwest Manufacturing Index  
Dallas Fed Manufacturing Survey*

#### Tuesday, July 30

*Conference Board Consumer Confidence*

#### Wednesday, July 31

*ADP National Employment Report  
FOMC Monetary Policy Statement  
Gross Domestic Product  
(Second-Quarter Estimate)  
ISM-Chicago*

#### Thursday, August 1

*Construction Spending  
ISM Purchasing Managers' Index*

#### Friday, August 2

*BLS National Employment Data*

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## Summaries of Last Week's Economic Indicators

### Chicago Fed National Activity Index

The Chicago Federal Reserve Bank reported that its National Activity Index (NAI) increased from -0.29 in May to -0.13 in June. This was the third consecutive month of progress, as the NAI has risen from -0.45 in March. Still, it is the fourth straight month with the index below zero. Negative numbers indicate that the U.S. economy is below its historical growth trend, and when the three-month moving average falls below -0.70, the risk of recession is increased. The three-month moving average improved from -0.37 to -0.26 for the month, suggesting that a recession is not likely at this point.

Manufacturing provided a slight positive for the June NAI, adding 0.04 points to the index. [Industrial production](#) rose 0.3 percent in June, and manufacturing capacity utilization edged marginally higher. We have also seen progress in many regional sentiment surveys, as noted in the Federal Reserve's most recent [Beige Book](#). Likewise, employment measures contributed another 0.06 points to the NAI, with [nonfarm payroll](#) growth of 195,000 in June. At the same time, however, manufacturing employment was down for the fourth straight month, suggesting some continued sluggishness to hire.

Housing and consumption variables were a drag on growth. [Retail sales](#) have been weak, particularly when you exclude autos and gasoline from the analysis, and many sentiment surveys show slow growth in new orders. Likewise, we saw significant declines in [housing starts](#) and permits data, particularly in the multifamily segment. On the positive side, single-family permits were slightly higher for the month.

### Durable Goods Orders and Shipments

The Census Bureau reported that new durable goods orders rose 4.2 percent in June, lifting it to an all-time high. The \$244.5 billion in new orders in June surpassed the past high of \$243.0 billion in December 2007. In essence, this brings durable goods sales back to where they were prior to the Great Recession. Yet, the jump in new orders in June was mainly attributable to increased aircraft sales. New orders in the transportation sector soared during the month, up 12.8 percent. In addition to airplanes, auto sales were also higher, up 1.3 percent.

If you exclude transportation from the analysis, new durable goods orders were unchanged, which somewhat dampens the enthusiasm for reaching a new all-time high. It suggests that outside of aircraft and autos, the broader sector experienced some significant weaknesses. New durable goods excluding transportation have edged up just 1.0 percent since January, but more positively, they have risen 4.9 percent year-over-year. (Total new durable goods orders are up 10.9 percent over the past 12 months, illustrating how much transportation sales have pushed the top-line figure higher.)

Machinery was one of the larger non-transportation strengths in the new orders data, up 2.4 percent. Fabricated metal products and miscellaneous durable goods sectors also saw small gains, both up 0.1 percent. On the negative side, sales were lower for computers and electronics (down 2.6 percent), electrical equipment and appliances (down 1.8 percent) and primary metals (down 0.2 percent).

Meanwhile, durable goods shipments were unchanged in June, pulling back from May's 1.3 percent gain. Shipments have risen 1.5 percent year-to-date, with year-over-year growth of 3.4 percent. This suggests decent, but not robust, growth over the past 12 months. With a flat shipments number, sector breakdowns were mixed. Declines in machinery (down 1.2 percent) and electrical equipment and appliances (down 1.0 percent) offset gains in primary metals (up 2.2 percent), motor vehicles (up 1.3 percent) and computers and electronics (up 0.8

percent).

### **Kansas City Fed Manufacturing Survey**

The Federal Reserve Board's most recent [Beige Book](#) showed manufacturing activity in the Kansas City district weakened in June. Severe weather disruptions mainly contributed to last month's decrease, reversing May's modest gain.

With that as a background, July's manufacturing survey was destined to be watched closely, looking for progress. Indeed, [the Kansas City Fed found that manufacturing activity rebounded this month, with its composite index improving from -5 to 6](#). Chad Wilkerson, a vice president and economist at the Kansas City Fed, said, "We saw several positive things in this month's survey. Production and shipments rebounded after being disrupted by storms last month, [and] while some firms remain hesitant to expand, overall capital spending and hiring plans remain positive."

Various subcomponents show progress since the past survey, with the index for new orders up from -10 to 5 and the production index up from -17 to 21. This suggests a fairly healthy turnaround in activity. Export orders also turned positive, up from -5 to 2. Still, roughly half of respondents suggest that sales and output activity remained unchanged between June and July, with three-fourths noting flat export orders.

Employment remained negative for the month (down from -1 to -2), and the average workweek continued to shorten (up from -13 to -6). Companies are hesitant to bring on new workers right now.

The good news, however, is that manufacturers are cautiously optimistic about future growth, with higher levels of new orders, production, capital spending and employment expected. The index for expected employment six months from now was unchanged at 7, indicating moderate growth in hiring moving forward. Behind this figure are higher anticipated sales, with 38 percent of respondents expecting orders to increase during the second half of the year. The more positive perception of possible growth in the coming months is one that we have seen in other sentiment surveys.

### **Markit Flash PMIs for the United States, China and Eurozone**

[After contracting for 23 straight months, manufacturing activity in the Eurozone grew \(barely\) in July, according to preliminary data from Markit](#). The Markit Flash Eurozone Manufacturing PMI rose from 48.8 in June to 50.1 in July, just above the all-important threshold of 50, which signifies expansion in the sector on net. The last time the manufacturing PMI figure was greater than 50 was June 2011. While Europe continues to have political and economic issues, we have seen the pace of the decline slow in recent months. July's increase is the culmination of gains made since March's 46.7 reading and the 44.0 value observed in June 2012.

Increased output was the main driver of this month's higher figure, with the production index up from 49.5 to 52.3. Demand rose both in the Eurozone and for exports, with the new orders index up from 49.1 to 50.4 and exports up from 49.0 to 50.9. This should bode well for manufacturing activity moving forward, but weaknesses persist. While there are small gains in output and sales, employment remains negative, albeit less so, up from 47.5 to 49.0. Similarly, sellers continue to lower their prices to sell their goods. Nonetheless, many perceive the shift from contraction to growth as a sign that Europe might be starting to turn the corner.

In contrast to Europe's gains, China's manufacturing activity appears to be slipping. [The HSBC Flash China Manufacturing PMI declined from 48.2 in June to 47.7 in July](#). Growth in China has been decelerating for much of the year, spilling over into production and demand. This was the third straight month of sub-50 PMI readings for the manufacturing sector. Index values were lower for output (down from 48.8 to 48.2), new orders (down from 47.1 to 46.6) and employment (down from 47.9 to 47.3). On a somewhat positive note, new export sales decreased at a slower rate (up from 44.0 to 47.7). Moreover, output price declines also eased for the month (up from 42.9 to 47.2), even as sellers continue to reduce their prices to sell goods.

Meanwhile, manufacturing activity in the United States appears to be picking up, which other economic indicators have shown. [The Markit Flash U.S. Manufacturing PMI increased from 51.9 in June to 53.2 in July](#). This was the fastest pace since February's 54.9 reading, perhaps a sign that the sector has returned to modest growth after

pervasive softness in the market during the spring. The improvements in July's data stem largely from a faster pace of growth for new orders (up from 53.7 to 55.1), with gains in export orders as well (up from 47.5 to 52.3). The international piece is key, particularly given weaknesses in manufacturing goods exports so far in 2013.

In addition, employment, which was relatively flat in June, edged slightly higher in July (up from 50.4 to 52.6). Despite the uptick in new orders, the index for output was virtually unchanged for the month (up from 53.9 to 54.0), but still reflects modest gains. The news about increased sales, however, should push production higher in coming months, particularly as stockpiles of finished goods remain low. The inventory index contracted in July (down from 51.0 to 47.0) and has had sub-50 readings in 9 of the past 12 months.

Flash data use most, but not all, of the survey responses. Markit reports that it usually includes 85 percent of the incoming data for its Flash releases. The final data will include all information, with the PMI releases for each data point scheduled for August 1.

### **NABE Industry Survey**

[The NABE released its latest Industry Survey, which found that sales and earnings decelerated somewhat in the second quarter.](#) A net of 20 percent said their sales were rising in the second quarter, down from 47 percent in the first quarter. This brings it back to levels seen in the third and fourth quarters of 2012. In the goods-producing sector (which includes manufacturing), 43 percent said their sales were increasing during the second quarter, down from 73 percent in the first quarter.

The data mirror other indicators showing softness in the second quarter. Timothy Gill, chair of the NABE Industry Survey Committee and vice president of business information & statistics for the Aluminum Association (an NAM member), said these results "possibly [reflected] increased headwinds from a weak global economic environment and tighter domestic fiscal policy in the latest period."

The slowing pace of sales growth has reduced profit margins. In goods-producing industries, 29 percent of respondents said their profits declined over the past three months, with half reporting no change. That represents deterioration in profits from the first quarter, where no one in the goods-producing sectors had declining sales (relative to the fourth quarter of 2012). In the larger economy, the results were similar, with the net percentage of those reporting higher profits down from 16 percent in the first quarter to -3 percent in the second quarter.

The news on employment was more positive. Overall, hiring picked up in this latest survey. While 60 percent of respondents said they had not changed their employment levels, 29 percent noted an increase in hiring during the second quarter. That is up from 22 percent reporting increased hiring in the first quarter. This carried through to the goods-producing sectors as well, with 29 percent of respondents saying they had hired new workers in the second quarter, up from 18 percent three months ago. Goods-producing industries include construction and mining, both of which have seen employment gains of late, in contrast to manufacturing.

In terms of forecasts, business economists surveyed tend to be cautiously optimistic about the next 12 months. Seventy percent think that real GDP will grow 2.1 percent to 3.0 percent between the second quarter of 2013 and the second quarter of 2014. That is up from 60 percent who said the same in the last survey and 47 percent six months ago. As such, expectations about the future economic environment have been upgraded overall.

However, several other economic forecasts for 2014, including the one from the [Federal Reserve](#), predict real GDP growth rates of 3.0 percent or more, and as such, these numbers appear to be slightly more subdued. For instance, nearly one-fifth of respondents felt that growth would be from 1.1 percent to 2.0 percent, although that was down from 26 percent three months ago.

### **Richmond Fed Manufacturing Survey**

[The Richmond Federal Reserve Bank observed contracting manufacturing activity levels in July.](#) This bucked the trend that we saw in other Fed surveys, which have noted improvements this month. The composite index of general business assessment declined from 7 in June to -11 in July, its first decline since May and the fourth so far in 2013.

Reduced new orders, shipments and capacity utilization weakened sentiment in the Richmond district, reversing June's progress. For instance, the index for new orders dropped from 9 in June to -15 in July, a surprisingly sharp decline in sales, particularly given other national indicators showing the opposite. The average workweek grew at a slower pace (down from 11 to 2). Meanwhile, hiring in the region has stalled, with the index for employment unchanged at zero.

Despite the current softness in the marketplace, respondents continued to be cautiously optimistic about the second half of 2013. In fact, data indicate manufacturers anticipate decent growth in new orders and shipments (both up from 21 to 24) over the next six months. At the same time, they expect to see modest gains in employment (down from 9 to 5) and capital expenditures (up from 9 to 11), suggesting that business leaders plan to add workers and increase their investments on the basis of possibly higher prospects in the coming months. Still, hiring remains more sluggish than other perceived improvements in activity moving forward, as evidenced by the easing in this month's reading.

Pricing pressures, meanwhile, have picked up, but are still not at elevated levels. Input prices increased 1.60 percent at the annual rate in July, up from 1.13 percent in June and 1.00 percent in May. Manufacturers anticipate some acceleration in raw material costs, but not much changed from last month. Input costs are anticipated to grow 2.06 percent on average six months from now, just marginally higher than the 2.01 percent predicted in June's survey.

#### **University of Michigan Consumer Sentiment (Revised)**

[Consumer confidence increased to a six-year high in July, according to the University of Michigan and Thomson Reuters](#). The Consumer Sentiment Survey originally had been estimated to decline slightly in preliminary figures, but instead, the final report suggests a gain of 1.0 point. The overall index rose from 84.1 in June to 85.1 in July, its highest level since July 2007. In general, Americans are more confident in the economy, with the index improving from December's 72.9 reading.

The index for current conditions rose from 93.8 to 98.6. The average for the past three months has been 96.8. This compares to the average of 88.7 in the first four months of 2013 and indicates a pickup in confidence. Similarly, the public also has become more optimistic about the future, with the average in the forward-looking component rising from an average of 68.9 in the first four months of the year to an average of 76.7 in the months since then.

Surveys such as this one tend to react to pocketbook issues. The improvements so far in 2013 can be attributed largely to rising home and equity values, which have allowed Americans to feel a little wealthier. At the same time, we have seen modest gains in incomes. Earlier this year, higher payroll taxes and persistent headwinds in the domestic and global economy reduced confidence measures. While these issues have not gone away, larger positive forces in the macro environment have counteracted those negatives. Still, Americans are also keenly aware of the challenges, too, including elevated unemployment rates and frustrations with slow growth.

Moving forward, it will be interesting to see how higher interest rates and gasoline prices impact consumer sentiment. History tells us they tend to be a drag on confidence. In the end, however, the value in these types of surveys is in how they predict consumer behavior. So far, we have seen modest gains in consumer spending, helping to lift output figures.

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