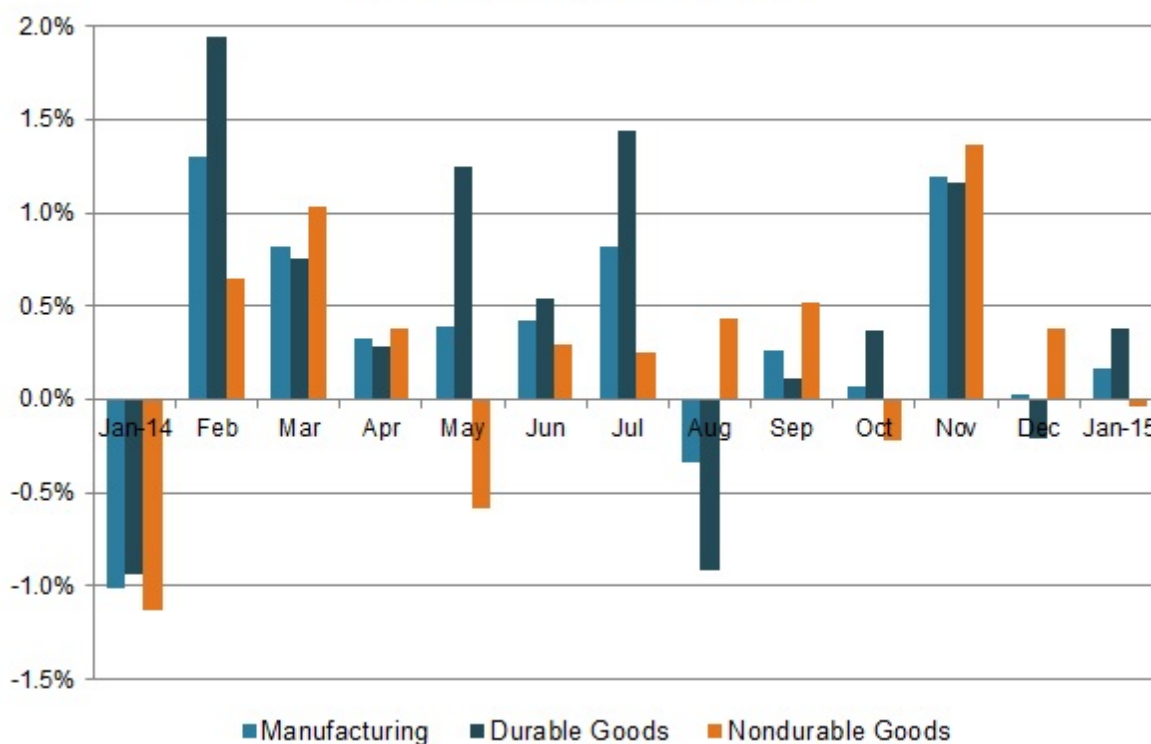


A Publication of the National Association of Manufacturers



February 23, 2015

Percentage Changes in Manufacturing Production, 2014–2015



In the [minutes](#) of its January 27–28 meeting, the Federal Open Market Committee (FOMC) provided a nuanced view of the economic outlook. Participants noted that “economic activity had been expanding at a solid pace,” and they were mostly optimistic about the “prospects for further improvement in 2015.” Yet, the FOMC also pointed to some significant headwinds in the U.S. economy, including sluggish global growth, a stronger U.S. dollar, federal government sequestration and reduced crude oil prices. Regarding the latter, the Federal Reserve said that it was concerned that “persistently low energy prices might prompt a larger retrenchment of employment [and capital investment] in these industries.”

Despite these challenges, the FOMC remains on track to begin normalizing rates later this year. While its January [statement](#) stressed its patience in doing so, conventional wisdom continues to hold that the Federal

Reserve will begin raising short-term rates in mid-2015. Of course, even when the Federal Reserve starts to ease up on its accommodative policies, they will continue to be stimulative for the foreseeable future. As such, the fact that pricing pressures have lessened considerably—with the [producer price index](#) falling for two straight months—frees the Federal Reserve to pursue such actions without worry about inflation, at least for now.

There were a number of reports released last week that examined the current state of manufacturing. [Manufacturing production](#) edged marginally higher in January, up 0.2 percent. This represented an improvement from being flat in December, but the data also suggest that output in the sector has been quite soft in both December and January. On the positive side, manufacturing production has risen a whopping 5.6 percent over the past 12 months. Of course, sharply reduced output in January 2014 due to a number of winter storms helped to buoy this year-over-year figure. Still, the year-over-year pace last month was 4.3 percent, illustrating decent growth in manufacturing output last year overall.

Survey data also show some easing in manufacturing activity, likely due to the headwinds discussed above, even as they continue to indicate modest growth overall. The [Markit Flash U.S. Manufacturing PMI](#) increased on stronger production growth; nonetheless, the pace of new orders, exports and hiring decelerated for the month. The export measures slowed to a crawl, highlighting the global challenges that currently exist. Similarly, the [New York](#) and [Philadelphia](#) Federal Reserve Banks both observed eased sentiment in their February surveys, particularly regarding demand. The good news was that manufacturers in both districts remained mostly positive in their outlook for the next six months. Indeed, this helps to explain the intent to bring on more workers and increase capital investments, which were relative strengths noted in the Philadelphia Federal Reserve report.

Looking abroad, [European manufacturing activity](#) edged ever so slightly higher in February on better sales and production figures. Employment growth in the sectors was unchanged, but still somewhat positive. At the same time, these figures vary from country to country, with [France](#) and [Germany](#) moving in opposite directions. French manufacturers have reported contracting activity levels for 10 straight months, whereas demand was slightly stronger in Germany. Despite some signs of marginal improvement, the European economy remains sluggish, with the European Central Bank attempting to stimulate growth, and market watchers continue to follow developments in Greece.

Meanwhile, the housing market has made incremental progress over much of the past year. However, both [housing starts and permits](#) were lower in January, with single-family starts down sharply. With that said, December's activity levels were quite robust, and the longer-term trend is more encouraging. Housing starts have exceeded 1 million for five consecutive months, and I still expect them to stabilize around 1.1 million units in the coming months. For their part, [homebuilders](#) are also more positive than negative, albeit with less optimism than the month before. Heavy snow could be a factor, according to the National Association of Home Builders, in some of the reduced sentiment in the latest report, particularly in the Midwest and Northeast.

This week, there will be a number of reports released on the manufacturing sector, including regional surveys from the Dallas, Richmond and Kansas City Federal Reserve Banks. In addition, we will get preliminary durable goods orders and shipments data on Thursday from the Census Bureau. Beyond these reports, the biggest headline will come on Friday, with the first revision for fourth-quarter real GDP growth. Other highlights include the latest data on consumer confidence, consumer prices and existing and new home sales.

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*P.S.: If you have not already done so, please take a moment to complete the latest **NAM/IndustryWeek Survey of Manufacturers**. This 20-question survey helps us to gauge how manufacturing sentiment has changed since December's [survey](#). It also includes some special questions on the direction of the country, the estate tax, shareholder activism and the employee benefits tax. To complete the survey, click [here](#). Responses are due by **Friday, February 27**. As always, all responses are anonymous.*



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(Revision)

Summaries for Last Week's Economic Indicators

Conference Board Leading Indicators

[The Conference Board reported that the Leading Economic Index \(LEI\) rose 0.2 percent in January, growing more slowly than the 0.4 percent rate in December.](#) It was the slowest pace in five months. Since July, the LEI has increased 2.3 percent. This represents a modest pace, and yet, it has also eased somewhat from the 3.3 percent six-month growth rate experienced last month. Softer manufacturing data helped to explain some of the easing in January, with expansion of [new orders](#) decelerating, according to the Institute for Supply Management (ISM). Indeed, the ISM's index for new orders slowed to its lowest level in 12 months, with exports contracting on global weaknesses.

Other challenging aspects in the LEI included softer building permits, initial unemployment claims and stock market data. In contrast, consumer confidence, favorable credit conditions and the interest rate spread were positive elements in this month's LEI.

Meanwhile, the Coincident Economic Index (CEI), which assesses current conditions, was also up 0.2 percent in January. This was the same pace as in December. All four subcomponents to the CEI made positive contributions to growth, including industrial production (*see below*), nonfarm payrolls, personal income and manufacturing and trade sales.

Housing Starts and Permits

[The Census Bureau and the U.S. Department of Housing and Urban Development reported that residential construction activity pulled back slightly in January](#). New housing starts declined from an annualized 1,087,000 in December to 1,065,000 in January. The good news was that starts have exceeded 1 million for five straight months, averaging 1,057,400 over that time period. Yet, the numbers for January were also somewhat softer than expected.

This was particularly true for single-family starts, which fell 6.7 percent for the month, down from 727,000 to 678,000. However, December's single-family starts represented the fastest pace since March 2008, and the January figure continues to reflect upward movement over the longer term. For instance, there were 583,000 single-family starts in January 2014 and 652,000 starts six months ago in July. In contrast, the highly volatile multifamily segment moved higher for the second straight month, up from 360,000 in December to 387,000 in January. This was the highest level since July's 446,000 pace.

Meanwhile, housing permits declined from 1,060,000 to 1,053,000. The data mirrored the trends seen in residential starts activity, with single-family permits lower (down from 675,000 to 654,000) and multifamily permits higher (up from 385,000 to 399,000). Housing permits have been at 1 million annualized units in 11 of the past 12 months, averaging nearly 1,040,000 over that time frame.

Overall, the housing market has made incremental progress over the past year. Housing starts should stabilize to around 1.1 million in the coming months, and yet, it is hard not to be disappointed by the easing seen in the January reports. This softness was evident in other indicators as well, suggesting a slower-than-desired start to the new year.

Industrial Production

[Manufacturing production edged marginally higher in January, up 0.2 percent, according to the Federal Reserve Board](#). This represented an improvement from being flat in December, and yet, the data also suggest that output in the sector has been quite soft in both December and January. On the positive side, manufacturing production has risen a whopping 5.6 percent over the past 12 months. Of course, sharply reduced output in January 2014 due to a number of winter storms helped to buoy this year-over-year figure. Still, the year-over-year pace last month was 4.3 percent, illustrating decent growth in manufacturing output last year overall.

Capacity utilization for manufacturers increased from 78.0 percent in December to 78.1 percent in January. December's utilization rate originally had been estimated to be 78.4 percent, so this revision marks that down somewhat.

Durable goods output was up 0.2 percent in January, with nondurable goods production unchanged. The fastest areas of manufacturing output growth for the month were in primary metals (up 1.7 percent), computer and electronic products (up 1.2 percent), apparel and leather (up 1.1 percent), machinery (up 0.7 percent), nonmetallic mineral products (up 0.7 percent) and plastics and rubber products (up 0.6 percent).

In contrast, the following categories had declining production levels in January: furniture and related products (down 1.1 percent), aerospace and miscellaneous transportation equipment (down 0.8 percent), petroleum and coal products (down 0.7 percent) and motor vehicles and parts (down 0.6 percent), among others.

Meanwhile, total industrial production also rose 0.2 percent in January, which was better than the 0.3 percent decline in December. In addition to the increase in manufacturing output, utilities also had improved production, up 2.3 percent. Mining activity was down 1.0 percent for the month, but up 8.5 percent year-over-year. On the other hand, output from utilities declined 6.6 percent over the past 12 months. Total industrial production was up 4.8 percent since January 2014. Overall capacity utilization was unchanged at 79.4 percent.

Markit Flash PMIs for the United States, Eurozone and Japan

[The Markit Flash Eurozone Manufacturing PMI edged ever so slightly higher, up from 51.0 in January to 51.1 in February](#). This suggests very modest growth in manufacturing activity in February, with better data for new orders (up from 50.6 to 50.9), output (up from 52.1 to 52.2) and exports (up from 50.7 to 51.8). Hiring in the Flash Eurozone Composite PMI, which includes all economic segments, rose to its highest level since August 2011, but this was primarily in the service sector. Indeed, for manufacturers, the pace of employment growth was unchanged in February at 50.6.

Markit also released preliminary manufacturing activity data for [France](#) (down from 49.1 to 47.0) and [Germany](#) (unchanged at 50.9), which continue to move in opposite directions. While the French economy saw improvements overall, its manufacturing sector has now contracted for 10 straight months. At the same time, demand was slightly stronger in Germany, with exports (up from 49.5 to 50.8) shifting positive again for the month. [German real GDP](#) increased 0.7 percent in the fourth quarter, larger than expected and higher than the 0.3 percent growth for the Eurozone as a whole. Still, the European economy remains sluggish, with the European Central Bank attempting to stimulate growth, and market watchers continue to follow developments in Greece.

Meanwhile, the [Markit Flash Japan Manufacturing PMI](#) declined from 52.2 to 51.5, its lowest level since July. This was largely due to a slower pace of growth for both new orders (down from 53.1 to 51.1) and employment (down from 51.4 to 50.7). Yet, output (up from 52.3 to 52.7) and exports (up from 51.5 to 52.8) were both higher, representing modest growth in both cases. Exports expanded at their fastest rate since August. Overall, the Japanese economy has begun to show some signs of recovery, with [real GDP](#) increasing 0.6 percent in the fourth quarter. This followed two consecutive quarters of declines.

Closer to home, the [Markit Flash U.S. Manufacturing PMI](#) increased from 53.9 to 54.3, with strong production growth (up from 55.7 to 56.0) helping to fuel the better activity numbers. Still, many of the other measures were weaker in February, with sluggish global growth, a stronger U.S. dollar, the West Coast ports slowdown and other factors dampening demand. New orders (down from 55.0 to 54.7), exports (down from 51.2 to 50.2) and employment (down from 53.4 to 51.7) decelerated somewhat for the month, with exports slowing to a crawl. However, sales and output continue to expand at relatively decent paces.

China will release Flash PMI numbers on Wednesday, February 25. Final data points for all of these measures, including China, will come out on Monday, March 2.

NAHB Housing Market Index

[The National Association of Home Builders \(NAHB\) and Wells Fargo reported that the Housing Market Index dropped from 57 in January to 55 in February](#). This is down from 58 in December, and it suggests a deceleration in homebuilders' optimism in the early months of 2015. NAHB attributes at least part of February's decrease to "unusually high snow levels across much of the nation," particularly in the Midwest and Northeast.

Still, the index has exceeded 50—the level at which more builders are positive than negative—for eight straight months. Indeed, homebuilders remain upbeat about the next six months, with the index of expected single-family sales unchanged at 60. This indicates relatively strong growth in sales moving forward, even as the traffic of potential buyers dipped somewhat this month.

NY Fed Empire State Manufacturing Survey

[The Empire State Manufacturing Survey noted expansion for the second straight month in the district, according to the New York Federal Reserve Bank.](#) The composite index of general business conditions declined from 10.0 in January to 7.8 in February, but this still represented modest growth overall for the region's manufacturers. However, the underlying data were mixed but mostly reflected some easing in February, much like the headline figure. The pace of shipments (up from 9.6 to 14.1) was higher; yet, many of the other data points were weaker, including new orders (down from 6.1 to 1.2) and employment (down from 13.7 to 10.1). In addition, the average workweek (up from -8.4 to -1.1) contracted by less than the month before.

As such, while manufacturers in the district remained optimistic, they were less upbeat than last month. Many of the forward-looking measures reflected this deceleration in attitudes, with indices for expected new orders (down from 41.4 to 28.6), shipments (down from 40.6 to 30.3), employment (down from 31.6 to 24.7) and the average workweek (down from 11.6 to 1.1) slowing. On the other hand, these data points also indicate relatively strong growth over the next six months, albeit with less enthusiasm than before. For instance, 44 percent of respondents anticipate increased new orders in the months ahead, down from 54 percent who said the same thing in January's report.

Indeed, it is that relatively strong economic outlook that helps to explain bringing on more workers and increasing capital investments. In this latest survey, 28.1 percent of manufacturers plan to hire additional employees over the next six months, and 39.3 percent expect more capital expenditures. Indices for capital spending (up from 14.7 to 32.6) and technology spending (up from 12.6 to 19.1) were two areas where attitudes improved strongly this month.

Philadelphia Fed Manufacturing Survey

[The Federal Reserve Bank of Philadelphia reported that manufacturing activity expanded at a slightly slower pace in February than in January.](#) The composite index of general business activity declined from 6.3 to 5.2. Overall activity was softer in both January and February than in prior months, with the headline index averaging 21.5 over the 10-month period from March through December. Nonetheless, the Manufacturing Business Outlook Survey continues to reflect mostly positive attitudes about the economy, with 55.0 percent of respondents suggesting that demand had increased so far in 2015 relative to the last quarter of 2014.

Despite this finding, the index for new orders decreased from 8.5 in January to 5.4 in February, with the percentage of respondents saying that sales had declined increasing from 22.3 percent to 28.0 percent. On the other hand, shipments (up from -6.9 to 8.1) improved for the month, with nearly 35 percent saying they shipped more in February, up from 22.4 percent in January. At the same time, labor market indicators were also mixed. Net hiring (up from -2.0 to 3.9) was positive, whereas the average number of hours worked (up from -6.7 to -6.0) remained in negative territory.

The good news is that manufacturers in the district remain overwhelmingly upbeat about the next six months. The forward-looking composite measure rose from 29.7 to 50.9. In fact, 55.5 percent of respondents anticipate increased new orders in the months ahead, with just more than half seeing higher shipment levels. Regarding employment, 37.0 percent expect to add new workers over the next six months, with just 10.2 percent indicating possible declines. Capital spending was also expected to increase at healthy rates.

Producer Price Index

[The Bureau of Labor Statistics reported that producer prices for final demand goods and services declined](#)

[0.8 percent in January, falling for the fifth time in the past six months](#). Looking just at final demand goods, producer prices plummeted in January, down 2.1 percent and off for the seventh consecutive month. Reduced energy prices have contributed to the sharp decline in producer prices, with final demand energy goods down 10.3 percent in January alone. Indeed, West Texas Intermediate crude sold for an average of \$47.22 a barrel in January, down from the monthly average of \$59.29 in December.

Such significant declines in energy costs have helped to reduce overall pricing pressures in the economy. In addition, food prices were also lower for the second straight month, down 1.1 percent in January. There were reduced prices for bakery products, beef, cooking oils, dairy products, eggs, fruits, grains and poultry in January. Nonetheless, even with some easing over the past few months, final demand food goods cost 3.2 percent more than they did at the end of 2013.

On a year-over-year basis, producer prices for final demand goods and services fell 0.1 percent. This reflects significant easing in raw material costs since the 2.2 percent pace in May, and it was down from the 1.0 percent year-over-year pace in December.

Meanwhile, core inflation—which excludes food and energy costs—has also decelerated a bit, with year-over-year producer prices down from 2.1 percent in December to 1.7 percent in January. This suggests that overall prices remain largely under control and in line with the Federal Reserve's stated goal of 2 percent. Conventional wisdom holds that the Federal Reserve will start to normalize rates in mid-2015, and yet, monetary policy will continue to be stimulative for the foreseeable future. Reports like these free the Federal Reserve to pursue these types of easy money policies without inflation worries, at least for now.

If anything, there will be some who worry about deflation. Excluding food and energy, producer prices for final demand goods decreased 0.2 percent in January, the second such decline in the past four months. Producer prices for industrial chemicals, light motor trucks, mining equipment, oil field and gas field machinery, pumps and compressors, transformers and power regulators, railroad equipment and ships were all lower for the month..

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Questions or comments?

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