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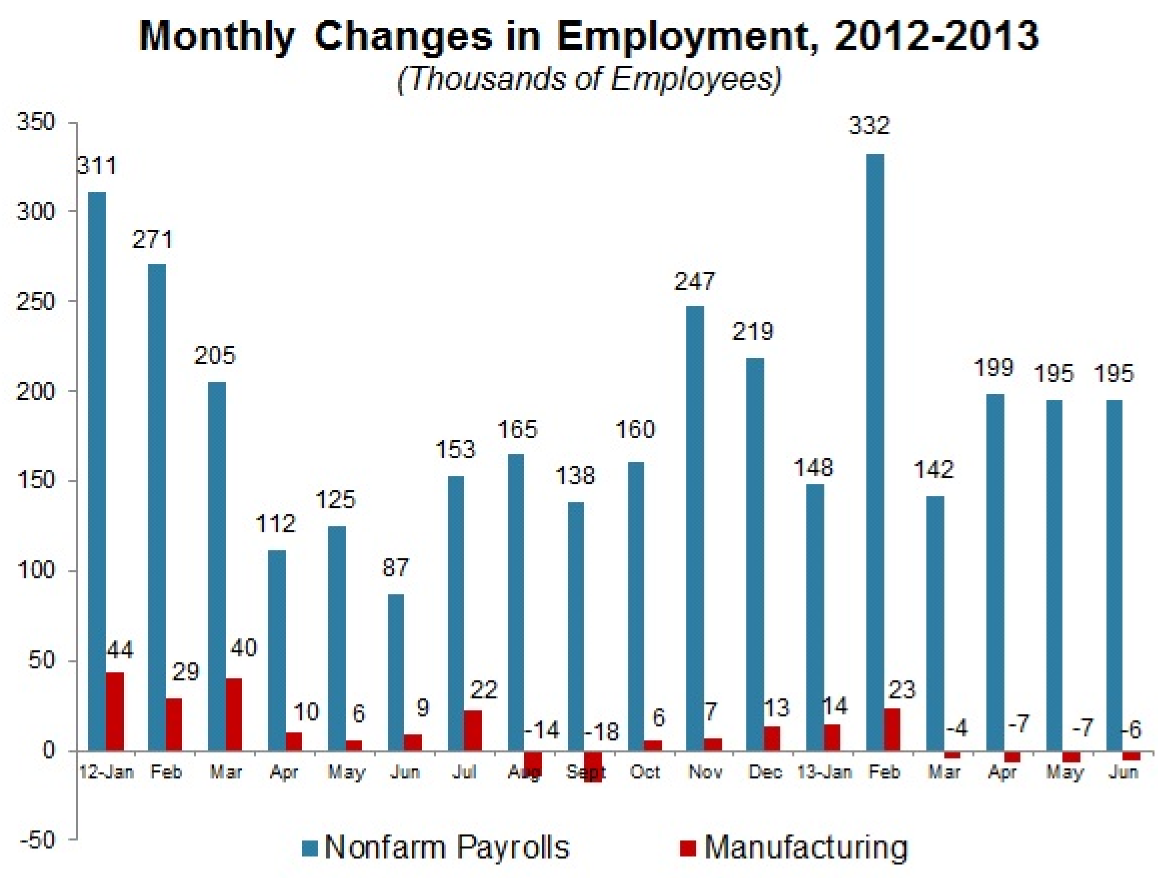
MONDAY ECONOMIC REPORT

July 8, 2013



As we saw in last week's report, there was modest progress in manufacturing activity in June. While the previous write-up discussed improvements in sales and output from regional sentiment surveys, the noted gains this time were found in the Institute for Supply Management's (ISM) Purchasing Managers' Index (PMI) report. The index rose from 49.0 in May to 50.9 in June, just barely expanding after contracting for the first time since November. Rebounds in new orders and production spurred the higher figure. Even with these gains, concerns remain, with sluggish (but positive) domestic and global sales dampening more robust growth. The one notable challenge was hiring, with the PMI measure for employment slightly negative.

Friday's jobs report from the Bureau of Labor Statistics confirmed this finding. Manufacturing employment declined by 6,000 in June, falling for the fourth consecutive month. The sector has added just 1 percent of all net new jobs over the past 12 months, a sluggish pace that suggests a continued hesitance to bring on new workers, particularly in light of softer demand.

In contrast, the larger macroeconomy has fared better, producing 195,000 net new nonfarm payroll workers for the month and significant revisions to both April and May of 70,000 workers total. Yet, the employment numbers also indicated an increase in part-time employees, helping to boost the "real" unemployment rate—which includes those who are marginally attached to the labor force—from 13.8 percent to 14.3 percent. (The more widely reported unemployment rate was unchanged at 7.6 percent.) Nonetheless, market observers saw the jobs report as a positive development, with an average of 201,833 new nonfarm workers added each month so far in 2013. This indicates a pickup in the hiring pace of 2011 and 2012, which averaged 175,000 and 182,500 each month, respectively.

On the trade front, the U.S. trade deficit rose from $40.1 billion in April to $45.0 billion in May. While goods exports were marginally lower for the month, goods imports increased by $4.2 billion. Manufactured goods exports have increased just 1 percent in the first five months of 2013 relative to the same time period in 2012. Such slow export growth is one reason that manufacturing demand has been soft this year. Reduced sales to the European Union are a large factor, with manufactured goods exports to the region down 6.2 percent in the year-to-date comparisons of 2012 and 2013. Beyond manufacturing, lackluster export growth also makes it harder for the United States to double exports by 2015, a priority the President outlined in his National Export Initiative.

This week, there will be two additional manufacturing surveys to analyze, including one from Chapman University in California and another from the Manufacturers Alliance for Productivity and Innovation (MAPI). Hopefully, they will show continued progress on new orders, output and overall sentiment. Beyond these reports, we will also get new data on consumer confidence, consumer credit, job openings, producer prices and wholesale trade.

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{Back to top}

Economic Indicators

Last Week's Indicators:
(Summaries Appear Below)

Monday, July 1
Construction Spending
ISM Purchasing Managers' Index

Tuesday, July 2
Factory Orders

Wednesday, July 3
ADP National Employment Report
International Trade

Thursday, July 4
INDEPENDENCE DAY

Friday, July 5
BLS National Employment Report

This Week's Indicators:

Monday, July 8
Consumer Credit

Tuesday, July 9
Job Openings and Labor Turnover Survey (JOLTS)
NFIB Small Business Survey

Wednesday, July 10
Wholesale Trade

Thursday, July 11
California Manufacturing Survey
MAPI Manufacturing Survey

Friday, July 12
Producer Price Index
University of Michigan Consumer Confidence Index

{Back to top}

Summaries of Last Week's Economic Indicators

ADP National Employment Report

Automatic Data Processing (ADP) estimated that 188,000 nonfarm payroll jobs were added in June. This was the fastest pace since February and higher than May's 134,000 additional workers. June's gains were primarily in the service sector (up 161,000), with the greatest increases in trade, transportation and utilities (up 43,000) and professional and business services (up 40,000). Construction jobs were also higher (up 21,000), boosted by the recovering housing sector.

At the same time, manufacturing employment remained weak, up just 1,000. On a year-to-date basis, the sector lost 14,000 workers in the first six months of 2013. These numbers differ from the official government data (*see next entry*), which show a gain of 13,000 manufacturing employees so far this year. Even with the difference, manufacturing hiring has stalled.

Similar to past reports, the majority of net new workers stemmed from small and medium-sized firms (e.g., those with fewer than 500 employees), adding nearly 74 percent of the total gains in net new employment for the month.

BLS National Employment Report

The Bureau of Labor Statistics reported that nonfarm payrolls increased by 195,000 in June, higher than the consensus estimate of around 165,000. The unemployment rate was unchanged at 7.6 percent, and revisions to the April and May data added 70,000 workers. While these were decent numbers, weaknesses remain. The number of people employed part time increased by 322,000, and the so-called "real" unemployment rate, which includes those marginally attached to the labor force, rose from 13.8 percent to 14.3 percent, erasing the gains in this measure since February.

As expected, manufacturing employment remains very soft, with 6,000 fewer workers in June than in May. This was the fourth straight month of declining manufacturing employment, continuing hiring weaknesses in the sector that we have seen since mid-2012. Over the course of the past 12 months, the sector has added just 29,000 net new workers, or 1.3 percent of the 2.3 million nonfarm jobs added during that time. Such a paltry rate of manufacturing job growth is a sign that we need pro-growth measures like those laid out in the NAM's *Growth Agenda*to boost the sector.

Looking specifically at June's manufacturing numbers, both the durable and nondurable goods sectors lost 3,000 workers. Total job losses in manufacturing would have been greater if it were not for the 5,100 additional workers in the motor vehicle sector, continuing its robust growth. Nonetheless, the largest declines were in electrical equipment and appliances (down 3,300), primary metals (down 2,800), wood products (down 1,700) and nonmetallic mineral products (down 1,500).

While the overall number of manufacturing workers fell on net, the average weekly hours edged slightly higher from 40.8 hours to 40.9 hours, and the average number of overtime hours stayed constant at 3.3 hours.

Job growth in the larger economy appears to be moving in the right direction, even as the unemployment rate remains elevated and challenges persist. The monthly average for nonfarm payroll gains in the first six months of 2013 was 201,833, which is faster than the 182,500 average for all of 2012. Yet, the manufacturing sector's weaknesses are notable. Weaker global growth and slower domestic demand have combined to reduce the need for additional hiring—something that needs to be turned around for the sector to flourish once again.

Construction Spending

The Census Bureau reported a 0.5 percent increase in construction spending in May. There were also year-over-year gains of 5.4 percent, suggesting modest growth overall during the past 12 months. The residential sector saw the bulk of the increase, with private housing construction up 1.2 percent for the month and 23.1 percent for the year. Non-housing construction activity has not fared as well. Private, nonresidential construction fell 1.4 percent in May and has declined 0.9 percent year-over-year.

Softness in manufacturing demand has dampened the enthusiasm for new building investment. Manufacturing construction activity decreased from $47.7 billion in April to $43.8 billion in May, a decline of 8.1 percent. This was the slowest pace since January 2012 and below the $45.7 billion average of 2012 as a whole.

Outside of manufacturing, the largest declines in construction spending in May included communications (down 6.3 percent), office space (down 1.9 percent) and commercial (down 1.6 percent) properties. In contrast, there were increases in religious (up 7.1 percent), amusement and recreation (up 2.2 percent) and power (up 2.1 percent) institutions.

Meanwhile, public construction spending has declined 4.7 percent over the past year, but it rose 1.8 percent for the month. Spending on commercial space was off significantly for the month (down 15.9 percent), but gains in power (up 7.9 percent), water supply (up 6.2 percent) and transportation (up 5.8 percent) projects more than offset the decline.

Factory Orders

The Census Bureau reported that factory orders rose 2.1 percent in May, building on April's 1.3 percent gain. However, a significant jump in nondefense aircraft sales skewed these increases. Excluding transportation equipment, new orders would have increased by a more modest 0.6 percent in May.

Manufactured goods orders were higher for both durable and nondurable goods sectors. We learned about durable goods activity a few weeks ago through an advance estimate. Among durable goods industries, the largest gains were among the computers and electronic products (up 2.4 percent), electrical equipment and appliances (up 1.7 percent), primary metals (up 0.8 percent) and machinery (up 0.7 percent). However, sales were lower for motor vehicles (down 2.0 percent), furniture and related products (down 1.4 percent) and fabricated metals (down 1.1 percent). This report adds nondurable goods sales, which rose 0.7 percent in May, offsetting April's 0.7 percent decline.

Meanwhile, manufactured goods shipments rose 1.0 percent, increasing for the first time since February. Durable goods shipments increased by 1.3 percent, with nondurable goods sales up 0.7 percent. As with the new orders data, higher nondefense aircraft deliveries influenced the figures. If you omit transportation numbers, shipments increased 0.5 percent.

International Trade

The Census Bureau and the Bureau of Economic Analysis reported that the U.S. trade deficit soared in May. The deficit rose from $37.1 billion in March to $40.1 billion in April to $45.0 billion in May. The shift occurred mainly from increased goods imports, jumping from $184.7 billion in March to $193.7 billion in May. (Despite the larger import deficit, it is only barely higher than the $191.9 billion average of 2012, illustrating recent volatility in the data.) Goods exports, on the other hand, declined from $131.1 billion in April to $130.3 billion in May, with weaker global sales hurting export growth.

The trade deficit widened from mostly nonpetroleum goods sources. The nonpetroleum trade deficit rose from $37.6 billion in April to $41.6 billion in May. The petroleum deficit increased as well, from $19.7 billion to $20.8 billion, but this is still better than the $24.3 billion observed in January (which was also the average for 2012). Lower energy costs and reduced petroleum imports have improved its trade balance.

The sector-by-sector breakdown of goods exports was mixed. Declines in consumer goods (down $1.2 billion), industrial supplies (down $917 million) and foods, feeds and beverages (down $146 million) offset increased exports from capital goods (up $817 million) and motor vehicles (up $320 million).

Manufactured goods exports have grown very slowly in 2013, up from $481.4 billion in the first five months of 2012 to $486.2 billion in 2013. This represents an increase of just 1 percent, which is one of the main reasons manufacturing demand has been soft this year. The year-to-date growth rate is well below the 5.5 percent increase in 2012 and the roughly 15 percent needed to double exports by 2015, as stated by the President's National Export Initiative.

Goods exports to the European Union account for much of this weakness (down from $114.0 billion year-to-date in 2012 to $106.9 billion in 2013), but there were modest gains in our largest trading partners of Canada (up from $122.4 billion to $125.0 billion), Mexico (up from $88.6 billion to $92.7 billion) and China (up from $44.4 billion to $45.9 billion). Elsewhere, goods exports to Japan have been softer this year (down from $28.7 billion to $26.6 billion), whereas South American exports have been marginally higher (up from $73.9 billion to $74.5 billion).

ISM Purchasing Managers' Index

The ISM reported that manufacturing activity improved in June, after contracting in May for the first time since November. The PMI rose from 49.0 in May to 50.9 in June, suggesting modest growth for the month. Still, manufacturers are not seeing robust growth in output and sales, a sign that weaknesses persist.

Nonetheless, both new orders and production shifted from declines in May to slight growth in June, with a pickup in exports. Production saw the largest change, as that index increased from 48.6 to 53.4. One of the commenters from the paper industry said, "June sales appear to have rebounded from what was a lackluster May." However, a chemical manufacturer cautioned, "Slow growth continues to choke the recovery. We are not out of the woods by any stretch of the imagination."

Perhaps with the latter comment in mind, the one notable area of weakness was hiring. The employment index declined from 50.1 (essentially neutral) to 48.7 (slightly negative). This suggests there continues to be some skittishness regarding manufacturing hiring, something the employment data discussed earlier show.

{Back to top}

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