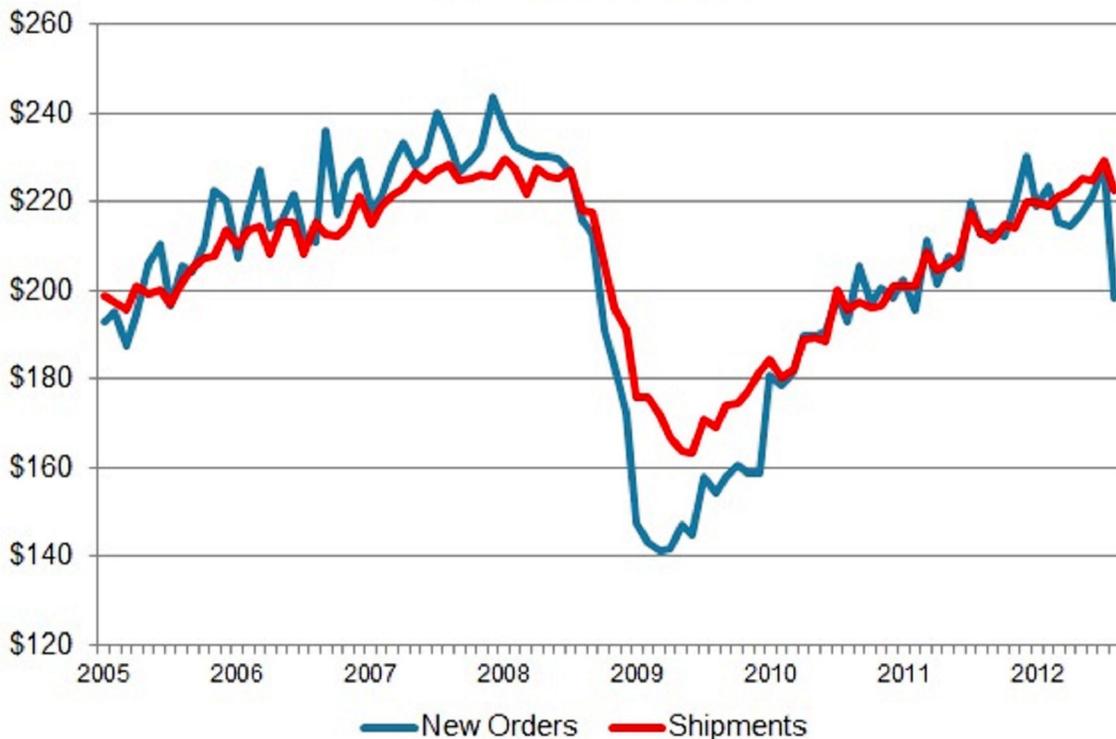




October 1, 2012

## Manufactured Durable Goods (in Billions of Dollars)



Several indicators released last week show slowing sales continuing to hurt manufacturers. The large decline in durable goods orders was the biggest eye-opener. According to advance data from the Census Bureau, durable goods fell by 13.2 percent in August. While fewer new orders in the transportation sector, especially for nondefense aircraft, can mostly explain this decrease, the declines in sales were fairly broad-based. In addition, the Bureau of Economic Analysis revised its estimate of real gross domestic product (GDP) for the second quarter from 1.70 percent to 1.25 percent. As noted in earlier iterations of this figure, the contribution of manufacturing to real output was negligible— a significant turnaround from earlier quarters.

Reduced manufacturing activity largely contributed to the Chicago Federal Reserve Bank's National Activity Index declining from -0.12 in July to -0.87 in August. Values under zero suggest that the macroeconomy is growing below its historical average, and the latest data indicate considerable weaknesses in the current economic environment. Regional Federal Reserve Bank surveys back this up. Weak sales, slowing global growth, the fiscal abyss and upcoming elections all fueled manufacturers' uncertainty, which the latest regional data from ISM-Chicago noted. The Chicago Business Barometer indicated a contraction for the first time since September 2009, with new orders dragging the index lower.

Despite these headwinds, consumer sentiment improved in both of the major confidence surveys out last week. Both the Conference Board and the University of Michigan data indicate that Americans' perceptions regarding future economic growth improved in the past month. This might seem at odds with other surveys. For instance, in the recent [small business survey](#) from the NAM and the National Federation of Independent Business, 55

percent of respondents feel that the national economy is worse today than three years ago. Yet, these types of sentiment surveys tend to move with current pocketbook issues, and it is not entirely clear that the average individual perceives the economic threats (e.g., fiscal abyss, budget sequestration) as real, and not just political gamesmanship.

Of course, the real test of consumer sentiment is how it impacts spending. Americans increased their personal spending by 0.5 percent in August, building on July's strong gains. Higher gasoline prices, however, contributed to much of this increase. Real spending rose just 0.1 percent. Moreover, consumers spent more than they earned, reducing the savings rate from 4.1 percent to 3.7 percent. Personal incomes increased 0.1 percent overall, but for manufacturers, wages and salaries dropped, reflecting recent weaknesses in the sector. One area where spending has been decidedly higher is in the housing sector, with new single-family residential home sales up nearly 28 percent year-over-year. In August, however, new home sales were off slightly.

This week, the two big releases will be the latest Institute for Supply Management (ISM) manufacturing data, which will be released this morning, and the jobs numbers out on Friday. Expect disappointing results for both, with the ISM Purchasing Managers Index potentially showing a contraction for four straight months. Likewise, employment growth is expected to be in-line with past months, but hopefully, an improvement from the 15,000 lost manufacturing jobs observed in August.

**Chad Moutray**  
*Chief Economist*  
*National Association of Manufacturers*

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## Economic Indicators

### Last Week's Indicators:

*(Summaries Appear Below)*

#### Monday, September 24

*Chicago Fed National Activity Index*  
*Texas Manufacturing Outlook Survey*

#### Tuesday, September 25

*Conference Board Consumer Confidence*  
*Richmond Fed Manufacturing Survey*

#### Wednesday, September 26

*New Home Sales*

#### Thursday, September 27

*Chicago Fed Midwest Manufacturing Index*  
*Durable Goods*  
*Gross Domestic Product (Second Revision)*  
*Kansas City Fed Manufacturing Survey*

#### Friday, September 28

*ISM-Chicago*  
*Personal Income and Spending*  
*University of Michigan Consumer Sentiment (Revision)*

### This Week's Indicators:

#### Monday, October 1

*Construction Spending*  
*ISM Manufacturing Index*

#### Tuesday, October 2

*Motor Vehicle Sales*

#### Wednesday, October 3

*ADP Employment Report*

#### Thursday, October 4

*Factory Orders*

#### Friday, October 5

*BLS Employment Report*  
*California Manufacturing Survey*  
*Consumer Credit*

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## Summaries of Last Week's Economic Indicators

### Chicago Fed Midwest Manufacturing Index

The Chicago Federal Reserve Bank reported that its Midwest Manufacturing Index (MMI) fell 1.2 percent from 95.3 in July to 94.1 in August. Slower auto production pulled the index lower, with motor vehicles activity off 4 percent for the month in the region. Even with August's decline, the auto sector remains a net positive on a

year-over-year basis, with production up 21.7 percent since August 2011. The motor vehicle segment has helped to lift the MMI more than 10 percent over the past year.

Outside of autos, manufacturing activity was mixed in the Chicago Fed region in August. Steel output declined 0.5 percent, but both machinery and resource production rose 0.1 percent each. The Midwest has seen stronger growth than the national average, with industrial production rising 4 percent over the past 12 months. In addition to motor vehicles, strong annual output gains were seen in the machinery (up 9.4 percent) and steel (up 8.6 percent) industries.

In summary, growth in the Midwest has slowed. We are seeing similar trends in other indicators. With global growth slowing and pervasive doubts about the political and fiscal environment heading into 2013, economic expansion has dropped off considerably. It will be important for us to reverse this course to get manufacturing to expand and hire once again.

### **Chicago Fed National Activity Index**

The Chicago Federal Reserve Bank reported that the U.S. economy weakened significantly in August. Its National Activity Index declined from -0.12 in July to -0.87 in August. The three-month moving average fell from -0.27 to -0.47, its lowest level since June 2011. Negative values suggest that the U.S. economy is growing below its historical average, and when the three-month moving average falls below -0.70, the risk of a recession increases. Therefore, the lower index values this month suggest an economy that is moving in the wrong direction, but not quite in recession territory yet.

As with the Conference Board's Leading Economic Index which was released last week, reduced manufacturing activity contributed significantly to this month's decline. Production-related components reduced the measure, with its contribution down from 0.08 to -0.58. The 1.2 percent decline in industrial production, in addition to lower capacity utilization, was an important factor.

Consumption, housing and employment factors also contributed negatively to the index. While housing starts were higher, permits were lower. Sales have also been an issue, particularly for manufacturers.

### **Conference Board Consumer Confidence**

The Conference Board reported that its Consumer Confidence Index rose from 61.3 in August to 70.3 in September. This suggests that Americans were more optimistic, with the gain larger than expected. Growth in the index stemmed from consumers' perceptions about the current economic environment and their expectations for the next six months. The largest gains were in the latter, with the forward-looking measure up from 71.1 to 83.7.

This survey tends to react to pocketbook issues, and respondents were more positive about both job prospects and income growth. This translated into improved buying plans for automobiles and appliances, with home purchasing plans slightly lower.

The improved assessments for the next six months— both for consumers in the Conference Board survey and manufacturers in the Richmond one— seem to diverge from other reports showing concerns about the fiscal abyss, budget sequestration, slowing global growth and other anxieties. As the NAM/*IndustryWeek* Survey of Manufacturers shows, nearly 79 percent of respondents are worried about the political and fiscal environment.

I still view that these uncertainties are hampering economic growth, and the impacts of the fiscal abyss and sequestration are already having real negative impacts on the economy.

### **Durable Goods**

The Census Bureau reported that durable goods orders fell by a whopping 13.2 percent in August, well below the 3.3 percent gain in July. To be fair, the bulk of this decline stemmed from the transportation sectors, especially for airplanes. The nondefense aircraft and parts sector did not have any new orders in August, which obviously impacted the results. At the same time, defense aircraft and parts orders were off 8.1 percent, and motor vehicle and parts orders dropped 10.9 percent. Excluding the transportation sector, new durable goods orders would have been down 1.6 percent.

Outside of transportation, sales were down across-the-board. Sectors with the largest declines in new orders included machinery (down 4.7 percent), computers and electronic products (down 2.9 percent), primary metals (down 1.7 percent) and fabricated metal products (down 0.4 percent). The electrical equipment and appliances sector, on the other hand, bucked this trend, up 3.8 percent. In addition, core capital goods— which are nondefense capital goods excluding aircraft— rose 1.1 percent.

Meanwhile, shipments of durable goods were also lower, down 3.0 percent. Excluding the transportation sector, shipments were off 0.9 percent. As with new orders, the declines were fairly broad-based. Significant declines

were seen in automotive (down 11.2 percent), computers and related products (down 7.7 percent) and nondefense aircraft (down 6.4 percent).

### **Gross Domestic Product (Second Revision)**

The Bureau of Economic Analysis reported that real GDP in the second quarter was up just 1.25 percent instead of the 1.7 percent gain estimated earlier. Reduced inventory, spending on services and exports contributed to the lower figure. The drought, in particular, was a factor in lowering farm inventories more than what was estimated previously.

The largest driver of growth in the second quarter was the consumption of services, adding 0.99 percentage points to the 1.25 percent growth in real GDP. For manufacturers, spending on goods had a negligible contribution, adding just 0.08 percent. Nondurables consumption- primarily from gasoline and other energy goods- accounted for the bulk of this increase. Durable goods spending was lower on reduced motor vehicle purchases in the quarter.

Fixed investment and goods exports were positives for manufacturers. Residential and nonresidential spending added 0.56 percentage points to growth, a sign that both housing and capital spending continue to move in the right direction. Likewise, the net export of goods contributed 0.25 percentage points to real GDP, with growth in exports outstripping imports.

Government spending continues to hinder growth, subtracting 0.14 percentage points. With the looming fiscal abyss and impending budget cuts slated for the start of 2013, this will no doubt continue to be the case.

### **ISM-Chicago**

The Chicago Business Barometer from ISM-Chicago and Deutsche Börse declined from 53.0 in August to 49.7 in September. This is the first time the ISM-Chicago composite index has fallen below 50- its threshold for contracting activity- since September 2009. The barometer has declined steadily since February, when it peaked at 64.

As with many other regional manufacturing surveys, falling sales lowered the index. The index for new orders dropped from 54.8 in August to 47.4 in September. The order backlog also contracted. Meanwhile, production continues to grow modestly, but the growth rate has eased; the production index declined from 57.4 to 55.4. Employment growth also slowed, with capital spending plans decelerating as well.

Similar to other sentiment surveys, the ISM-Chicago is often looked to as a precursor to the ISM's larger Purchasing Managers' Index. The ISM figure will be released on Monday, and it is expected to remain below 50. If true, it would be the fourth consecutive month of contraction nationally. Either way, the manufacturing sector continues to struggle with reduced new orders, slowing global economies and uncertainties related to the U.S. election and economic future.

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

The Kansas City Federal Reserve Bank reported that its monthly composite index dropped from 8 in August to 2 in September. This suggests that manufacturers in its region grew more slowly this month.

Several components were consistent with other Fed regions that have noted contracting activity. The Kansas City Fed's previous survey bucked the trend somewhat with stronger levels of production and new orders, but this month, global and national weaknesses appeared to take their toll.

For instance, the index for new orders dropped from 11 to -2, with similar negative values observed for production, shipments, the average workweek and exports. Job creation slowed to a near standstill, with the employment index down from 2 to 1.

Meanwhile, pricing pressures picked up, with raw material prices beginning to creep higher. The index for raw material prices rose from 7 in June to 26 in August to 30 in September. Looking ahead six months, most manufacturers expect for these costs to increase, with the forward-looking index for raw material prices at 60 in September, up from 49 in August.

Despite the slower growth figures, manufacturers in the Kansas City region are cautiously optimistic about growth moving forward, albeit with less enthusiasm than observed last month. The composite index for business activity for six months from now decreased from 18 to 11, indicating modest growth is expected in production and new orders. Employment and capital spending intentions, however, indicate that manufacturers plan to hire more workers and invest in their businesses, even with potential headwinds facing them.

### **New Home Sales**

[The Census Bureau and the U.S. Department of Housing and Urban Development reported that new single-family home sales remained mostly unchanged in August, down from 374,000 to 373,000 annualized units for the month.](#) Large gains were seen in the Northeast, with slight increases in both the Midwest and West. However, new home sales declined in the South.

The larger trend in housing remains positive. This includes new home sales, which have risen 27.7 percent in the past 12 months. These increases have been in every region, with the greatest gains observed in the Northeast and West.

There are 4.5 months of new single-family houses on the market, unchanged from July but an improvement from earlier in the year.

### **Personal Income and Spending**

[Americans increased their spending for the second month in a row, according to data from the Bureau of Economic Analysis.](#) Personal spending rose 0.5 percent in August, building on the 0.4 percent growth observed in July. However,, spending rose by 0.1 percent when adjusted for inflation. Higher energy costs accounted for the bulk of August's increase in consumer prices, with energy costs up 5.8 percent. It is important to note, however, that energy costs in August were the same as they were in August 2011, with a year-over-year rate of 0 percent.

Higher energy costs in August also contributed significantly to higher consumer spending. Nondurable goods consumption- which includes gasoline- rose \$42.2 billion at the annual rate, or an increase of 1.7 percent. Durable goods consumption, in contrast, was up just \$4 billion, or 0.3 percent. For durables, this was the fastest growth rate in spending since February.

Meanwhile, personal income increased 0.1 percent in August, the same growth rate as in July. Much of the increase came from rental and dividend income. For manufacturers, wages and salary compensation were lower, down from \$731.8 billion to \$726.6 billion. The longer-term trend for manufacturers remains positive year-to-date, as wages and salaries in the sector began the year at \$716.4 billion.

With spending outstripping income growth, the savings rate fell from 4.1 percent in July to 3.7 percent in August.

### **Richmond Fed Manufacturing Survey**

[The Richmond Federal Reserve Bank reported that manufacturing activity expanded in September.](#) This reflects some progress from the contractions observed in the previous three months, with the composite index of general business conditions up from -9 to 4. Increased sales boosted the new orders index from -20 to 7. The growth rate of shipments was also higher.

On the other hand, manufacturers in the region have not increased their hiring to match the better sales figures yet. Overall employment continues to contract, with the index for the number of employees remaining unchanged in September at -5. The average workweek was also lower, with the contraction easing somewhat.

As we have seen in other surveys, raw material prices have picked up a little. Input prices were up 1.42 percent, higher than August's 1.32 percent gain. The longer-term trend reflects significant easing in producer prices, with the latest data showing an uptick. The prices received for final goods, however, grew by just 0.44 percent, suggesting some pricing pressures.

The forward-looking measures improved slightly, with shipments, new orders and capacity utilization expected to grow strongly six months from now. However, the data also reflect some possible tentativeness in that assessment, as the growth rate for hiring and capital expenditures slowed. The expected employment index, for instance, dropped from 8 to 1, indicating almost no change in job growth over the course of the next six months.

### **Texas Manufacturing Outlook Survey**

[The Federal Reserve Bank of Dallas continues to provide a mostly mixed picture on manufacturing for Texas.](#) On the one hand, several measures of activity picked up steam in September. For instance, the index for new orders rose from 0.2 in August to 5.3 in September. Roughly 26 percent of respondents said new sales were rising, with about 53 percent suggesting no change. Production, capacity utilization, shipments, hours worked and capital expenditures also rose slightly. The data suggest some improvement for manufacturers in the region.

Yet, there were also some concerns. Manufacturers said that their business outlook was growing at a slower rate, with the index down from 4.1 to 2.4. Sixty-two percent said that their outlook had not changed. Meanwhile, their perceptions about the overall economy remain negative, up from -1.6 to -0.9. Nearly 21 percent of respondents said that the general business activity worsened, with 59.1 saying it was unchanged.

Job hiring continues to be positive, but has eased in the past month. The employment index declined from 14.2 to 5.9, with almost three-fourths of respondents saying that their worker levels were unchanged. Another challenge is increased pricing pressures. The index for raw material prices jumped from 10.9 to 22.5, with 27.8 percent of manufacturers indicating that their costs rose during the past month. Almost 67 percent reported no change in raw material prices. Meanwhile, the prices received for finished goods contracted, suggesting some deflation.

Moving forward, manufacturers remain cautiously optimistic. The forward-looking measures for their business outlook and the regional macroeconomy showed some modest gains, even as 6 out of 10 respondents predict no change. Forecasts for production, new orders, shipments, employment and capital spending for the next six months remain strong, even as some of these measures eased from August's values. Pricing pressures should also grow strongly, according to these responses.

Even with these more positive forecasts, manufacturers in the Texas region are concerned about possible headwinds. As one chemical manufacturer put it, "The outlook six months from now will depend on the outcome of the elections. Anxieties remain high related to the fiscal abyss as well, with a fabricated metal manufacturer saying, "The significant uncertainties related to the U.S. government's tax changes, debt, etc., appear to be front and center on our customers' minds. Indeed, slowing global growth and political uncertainties appear to be hampering growth in the region, even with modest gains seen in this month's survey."

### University of Michigan Consumer Sentiment (Revision)

The University of Michigan and Thomson Reuters downwardly revised its September Consumer Sentiment Index from its earlier estimate of 79.2 to 78.3. Still, this represents an increase from August, as noted [before](#), when consumer sentiment stood at 74.3. This improvement was similar to the increases in optimism observed in the Conference Board's survey (see above).

August's gains in sentiment stemmed mostly from improved perceptions related to the future economy. The forward-looking component of this index increased from 65.1 to 73.4 for the month. The opinion of the current economic environment slipped just marginally, but was mostly unchanged.

These surveys tend to react to pocketbook issues. Some observers have suggested that recent gains could be related to higher equity values, with this benefiting especially those earning more than \$75,000. Ellen Hughes-Cromwick, the chief economist at Ford Motor Company, made reference to this when she addressed the National Economists Club in D.C. last week.

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Questions or comments? Please contact Chad Moutray at [cmoutray@nam.org](mailto:cmoutray@nam.org)



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