ISM: Manufacturing Is Off to a Good Start

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U.S. manufacturing is off to a good start in 2013.

Economic activity in the manufacturing sector continued to expand in January 2013 for the second consecutive month, and the overall U.S. economy grew for the 44th consecutive month, say the nation's supply executives in the latest *Manufacturing ISM Report On Business*.

"A strong ISM report, combined with the employment numbers for January from the Bureau of Labor Statistics showing a modest 4,000 additional manufacturing jobs, is a good start to the year," notes Daniel J. Meckstroth, chief economist for the Manufacturers Alliance for Productivity and Innovation (MAPI). "Despite the political uncertainty over the debt ceiling, sequestration, and federal government shutdown deadlines all coming up in the first half of this year, industrial activity continues to grow. All households saw a tax increase in January with the expiration of the 2 percent payroll tax cut, and high income taxpayers faced higher marginal rates and new health care taxes. Despite the headwinds, the strong improvement in housing starts, solid growth in motor vehicle production and widespread modest gains across many industries are driving manufacturing activity."

The Purchasing Managers Index (PMI) registered 53.1 percent, an increase of 2.9 percentage points from December's seasonally adjusted reading of 50.2 percent, indicating expansion in manufacturing for the second consecutive month. Manufacturing is starting out the year on a positive note, with all five of the PMI's component indexes — new orders, production, employment, supplier deliveries and inventories — registering above 50 percent in January.

“I was surprised by the size of the increase in the PMI 2.9 percentage points,” says Bradley J. Holcomb, CPSM, CPSD, chair of the Institute for Supply Management Business Survey Committee. “It beat everybody’s estimates on the street and my expectations as well.

“Certainly the last few months of 2012 have definitely had a quieting effect on manufacturing, particularly with consumer spending low, which drives this whole system. Businesses have been holding back on investments, waiting to see what was going to happen with fiscal cliff deals and consumer spending. Now, in the new year, with the first part of the fiscal cliff apple bitten off, we’re seeing renewed January enthusiasm.”

New Orders

ISM’s New Orders Index registered 53.3 percent in January, an increase of 3.6 percentage points when compared to the seasonally adjusted December reading of 49.7 percent. This represents growth in new orders, following one month of contraction. A New Orders Index above 52.2 percent, over time, is generally consistent with an increase in the Census Bureau’s series on manufacturing orders (in constant 2000 dollars).

“Ten of the reporting industries are indicating new orders growth. I think that's good news, and I think we often see this January enthusiasm,” explains Holcomb. “If you go back to our 2008 data, you see that January has always been a better month with February being just a little lower.”

Inventories and Employment

The Inventories Index registered 51 percent in January, which is 8 percentage points higher than the 43 percent reported in December. This month’s reading indicates that respondents are reporting inventories are growing in January, following two consecutive months of contraction in inventories. An Inventories Index greater than 42.7 percent, over time, is generally consistent with expansion in the Bureau of Economic Analysis’ (BEA) figures on overall manufacturing inventories.

“At the end of each year, companies work very hard to reduce inventories so that their books look as good as possible,” explains Holcomb. “That is a cost reduction strategy, as well as a means to lower their capital investment. Seeing a January increase is quite normal, but 8 percentage points is probably above normal. This percentage increase is also a response to a solid new orders number, and not wanting to be caught short on inventories or employment for that matter.”

ISM’s Employment Index registered 54 percent in January, which is 2.1 percentage points higher than the seasonally adjusted 51.9 percent reported in December, and indicates growth in employment for the 40th consecutive month. An Employment Index above 50.5 percent, over time, is generally consistent with an increase in the Bureau of Labor Statistics (BLS) data on manufacturing employment.

The U.S. economy added 157,000 nonfarm payroll jobs in January, according to the Bureau of Labor Statistics (BLS) [1]. This is in line with the consensus estimate for the month. However, the unemployment rate edged higher from 7.8 percent in December to 7.9 percent in January. The BLS included a number of revisions for 2012 to reflect payroll counts and seasonal adjustments. Including these revisions, nonfarm payrolls rose 2.2 million in 2012, or roughly 180,000 per month.

“The report clearly illustrates the slow growth in the manufacturing sector since the beginning of 2012,” explains Chad Moutray, chief economist for the National Association of Manufacturers (NAM). “Last month’s estimate of 25,000 workers added in December has now been revised down to just 8,000. In January, the sector added 4,000 net new workers. This reflects the weaknesses that we saw over the second half of the year, and manufacturers have lost 7,000 workers since July overall.”

Imports and Exports

ISM’s New Export Orders Index registered 50.5 percent in January, which is 1 percentage point lower than the 51.5 percent reported in December, but still considered growing. This month’s reading represents only the second month of growth in the index since May 2012, when the index registered 53.5 percent. ISM’s New Export Orders Index registered 50.5 percent in January, which is 1 percentage point lower than the 51.5 percent reported in December.

“I'm actually a little bit concerned about imports and exports numbers,” cautions Holcomb. “If you go back a few months, we saw those indexes fewer than 50, and they came back to 51.5 points each in December. Fortunately, they're still in positive or neutral territory, but this is where we see the global activity having an effect on manufacturing.”

Moving Forward

The manufacturing sector expanding for the second consecutive month, after moving up, down and sideways the last several months, indicates a positive sign that things are going to move forward in the right direction.

“I think businesses should just be pleased that we’re off to a good start, but let's not get too carried away with the idea that all the global problems are behind us, because that's definitely not the case,” says Holcomb. “While the report itself and the numbers feel really good, some of the comments from our respondents remind us that there are still lingering issues like the fiscal cliff, Europe’s financial problems, and, not to mention the new one of consumer tax increases. I don't want to throw cold water on this report, but we remain in a slow growth environment that is hopefully better than the last couple of years.”

In his role as the chair of the Institute for Supply Management Manufacturing Business Survey Committee, Bradley J. Holcomb writes the monthly Manufacturing ISM Report on Business based on the survey results of approximately 350 professionals across 18 different industry sectors. The report is released on the first *business day of each month, and features the PMI Index as its key measure. For more information on the Institute of Supply Management, visit www.ism.ws [2].*

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