ISM: Extreme Weather Cools Down Manufacturing

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Economic activity in the manufacturing sector expanded in January for the eighth consecutive month, and the overall economy grew for the 56th consecutive month, say the nation’s supply executives in the latest Manufacturing ISM *Report On Business*.

“While U.S. manufacturing continued its growth into the new year, survey data from the Institute for Supply Management (ISM) showed that the pace of factory activity slowed considerably,” says Cliff Waldman, senior economist for the Manufacturers Alliance for Productivity and Innovation (MAPI). “The overall Index fell by 5.2 percentage points from 56.5 in December to 51.3 in January, still signaling overall output advances but at a far more muted pace.

“A number of survey components were worrisome in suggesting a dramatic halting to the acceleration of output growth that manufacturing appeared to be enjoying in the final months of 2013,” he added. “Most notably, the new orders index tumbled by 13.2 percentage points from an unsustainable 64.4 percent in December to 51.2 percent in January, and the production component fell by 6.9 percentage points from 61.7 percent in December to 54.8 percent in January. Further, the backlog of orders, an indicator of the near-term pressure on production, fell below the 50 percent mark, indicating a contraction. This is a decidedly negative sign for near-term manufacturing output gains.”

A PMI in excess of 43.2 percent, over a period of time, generally indicates an expansion of the overall economy. Therefore, the January PMI indicates growth for the 56th consecutive month in the overall economy, and indicates expansion in the manufacturing sector for the eighth consecutive month. The past relationship between the PMI and the overall economyindicates that the PMI for January (51.3 percent) corresponds to a 2.7 percent increase in real gross domestic product (GDP) on an annualized basis.

“We’re still growing, but manufacturing seems to have been impacted to some degree by the very severe weather in January,” says Bradley J. Holcomb, CPSM, CPSD, chair of the ISM Business Survey Committee. “All of the negative comments we received this month talk about the poor weather conditions impacting shipments, transportation and also very possibly new orders because certain companies were shut down for snow days and just couldn't function normally. On the other hand the remaining comments are quite positive and covers a number of sectors. I think we just consider this as one month of data and certainly not a trend. We’ll see what happens next month, but we continue to believe that this would be a good year for the economy.”

Orders, Production and Inventory

ISM’s New Orders Index registered 51.2 percent in January, a significant decrease of 13.2 percentage points when compared to the December seasonally adjusted reading of 64.4 percent. This represents growth in new orders for the eighth consecutive month, but is also the largest decline in new orders in the last four years. A New Orders Index above 52.1 percent, over time, is generally consistent with an increase in the Census Bureau’s series on manufacturing orders (in constant 2000 dollars).

ISM’s Production Index registered 54.8 percent in January, which is a decrease of 6.9 percentage points when compared to the seasonally adjusted 61.7 percent reported in December. This month’s reading indicates growth in production for the 17th consecutive month, but at a significantly slower rate than in December. An index above 51.1 percent, over time, is generally consistent with an increase in the Federal Reserve Board’s Industrial Production figures.

“New orders is off quite a bit,” adds Holcomb. “Down 13.2 points is certainly the biggest drop in the last four or five years since we started this economic recovery, but nevertheless new orders is still growing. You can still see the list of companies that are growing, especially ones related to the auto, housing and food/beverage industries. Again, we'll see what echoes next time, but production being down I think was impacted by weather because of the lack of raw materials get to facilities.”

The Inventories Index registered 44 percent in January, which is 3 percentage points lower than the 47 percent reported in December. This month’s reading indicates that respondents are reporting inventories are contracting for the second consecutive month, following two consecutive months of growth in raw materials inventories. An Inventories Index greater than 42.8 percent, over time, is generally consistent with expansion in the Bureau of Economic Analysis’ (BEA) figures on overall manufacturing inventories (in chained 2000 dollars).

"When it comes to inventory levels, if you don't have the right raw materials then you can't produce your products and that was definitely affected by the weather to some degree in January," explains Holcomb. "It's all kind of connected and inventories levels being down to 44 definitely pulls down the PMI number."

ISM's Backlog of Orders Index registered 48 percent in January, which is 3.5 percentage points lower than the 51.5 percent reported in December, indicating a contraction of order backlogs following three consecutive months of expanding order backlogs. Of the 83 percent of respondents who reported their backlog of orders, 19 percent reported greater backlogs, 23 percent reported smaller backlogs and 58 percent reported no change from December.

Exports, Imports and Prices

ISM's New Export Orders Index registered 54.5 percent in January, which is 0.5 percentage point lower than the 55 percent reported in December. January's reading reflects growth in the level of exports for the 14th consecutive month.

ISM's Imports Index registered 53.5 percent in January, which is 1.5 percentage points lower than the 55 percent reported in December. This month's reading represents the 14th consecutive month that the Imports Index has registered at or above 50 percent.

"Exports is largely of finished goods and imports is of raw materials," says Holcomb. "So on the export side it shows that the international community has again supported our finished products and the fact that exports is strong further suggests that domestic new orders was impacted by our cold weather. I think the imports and exports numbers are both pretty good numbers suggesting once again that the international economy is flowing pretty well despite headlines and news."

The ISM Prices Index registered 60.5 percent in January, which is an increase of 7 percentage points compared to the December reading of 53.5 percent. This month's reading indicates an increase in raw materials prices for the sixth consecutive month. In January, 28 percent of respondents reported paying higher prices, 7 percent reported paying lower prices, and 65 percent of supply executives reported paying the same prices as in December. A Prices Index above 49.7 percent, over time, is generally consistent with an increase in the Bureau of Labor Statistics (BLS) Index of Manufacturers Prices.

"The Prices Index is very normal for this time of year," explains Holcomb. "I spent time as a chief procurement officer for 20 years and know that suppliers always spend the first two to three months of the year loading up their price increases for raw materials, locking down price contracts for the year. I think this is very normal and very nominal, so it's totally within bounds."

Employment

ISM's Employment Index registered 52.3 percent in January, which is 3.5 percentage points lower than the seasonally adjusted 55.8 percent reported in December, and represents the seventh consecutive month of growth in employment, but at a slower rate than in December. An Employment Index above 50.6 percent, over time, is generally consistent with an increase in the Bureau of Labor Statistics (BLS) data on manufacturing employment.

“I think we had a pretty good number and reasonable at 52.3 percent,” says Holcomb. “There’s a lot of speculation as to what we’re going to see you later this week from the Bureau of Labor Statistics. This would suggest that it would be a good report, but I don't read too much into it right now.”

Overall Results

“The recent acceleration in U.S. economic growth along with the slow recovery in the global economy suggest that the most likely path for U.S. manufacturing during 2014 is one of moderate growth,” Waldman concluded. “Nonetheless, the January ISM report is a reminder that risks remain in a post-crisis environment. The recovery in the Eurozone is fragile and potentially flirting with deflationary pressures. China’s slowdown is wider and deeper than many expected. And the turmoil in emerging markets needs to be watched for its potential global impacts.”

This month’s report shows that manufacturing is continuing to grow for the eighth consecutive month while the overall economy is continuing to grow for the 56th consecutive month. Even though January had a lower-than-expected PMI, we’ll have to wait to see a trend develop before reading any further into the number.

“Aside from the 13 percent drop in new orders, there were no real surprises this month,” adds Holcomb. “The weather was clearly a contributing factor. We’ll see where we go from here, but the panel continues to be optimistic about a good 2014.”

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.