ISM: Orders Rise, Production Drops amid Extreme Weather

Jon Minnick, Associate Editor, Manufacturing Business Technology

Economic activity in the manufacturing sector expanded in February for the ninth consecutive month, and the overall economy grew for the 57th consecutive month, say the nation's supply executives in the latest Manufacturing ISM [1] *Report On Business*.

Manufacturing expanded in February as the PMI registered 53.2 percent, an increase of 1.9 percentage points compared to January's reading of 51.3 percent. A reading above 50 percent indicates that the manufacturing economy is generally expanding; below 50 percent indicates that it is generally contracting.

A PMI in excess of 43.2 percent, over a period of time, generally indicates an expansion of the overall economy. Therefore, the February PMI indicates growth for the 57th consecutive month in the overall economy, and indicates expansion in the manufacturing sector for the ninth consecutive month.

Bradley J. Holcomb, CPSM, CPSD, chair of the ISM Business Survey Committee says, "The past relationship between the PMI and the overall economyindicates that the PMI for January and February (52.3 percent) corresponds to a three percent increase in real gross domestic product (GDP) on an annualized basis. In addition, if the PMI for February (53.2 percent) is annualized, it corresponds to a 3.3 percent increase in real GDP annually."

Orders, Production and Inventory

ISM's New Orders Index registered 54.5 percent in February, an increase of 3.3 percentage points when compared to the January reading of 51.2 percent. This represents growth in new orders for the ninth consecutive month. 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 48.2 percent in February, which is a decrease of 6.6 percentage points compared to the 54.8 percent reported in January, and is the lowest production reading since May 2009 when the index registered 42.7 percent. It also indicates contraction in production following 17 consecutive months of growth. An index above 51.1 percent, over time, is generally consistent with an increase in the Federal Reserve Board's Industrial Production figures.

"The impact of extreme weather shows up this month mostly in production, which is down 6.6 and that looks very unusual in view of solid new orders, and a backlog of orders which is growing," adds Holcomb. "I think production was impacted by perhaps plant closings, the inability to get all of your workers available, plus the late shipments of certain raw materials. Backups in ports, hampered logistics and things of that sort is reflected in February's production numbers. Other than that, I think it's positive and will work its way out once spring shows up."

The Inventories Index registered 52.5 percent in February, which is 8.5 percentage points higher than the 44 percent reported in January, and indicates that inventories are growing, following two consecutive months of contraction. February's reading reflects the largest month over month inventory increase since April 1988 when the percentage of growth was 9.1 percent over March 1988. 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).

"Inventories is interesting because it's up 8.5 percentage points — which is a modern era record," explains Holcomb. "I think you have to go back to 1988 to find a bigger month-over-month increase. I attribute that to two things and it's interactive. First, production is down when new orders and backlog are both up, so you're clearly going to pile up inventories in that scenario. Second, it also is very probably a mix problem where producers didn't get the right raw materials and so you've got other materials building up. Let's take automobile manufacturing for example. You need a certain set of parts to build a car. If you don't get certain ones, then you can't build anything at all, so inventories pile up. Again, it's weather related, as well as a consequence of production being down."

ISM's Backlog of Orders Index registered 52 percent in February, which is four percentage points higher than the 48 percent reported in January, indicating growth in order backlogs following one month of contraction in the last five months. Of the 85 percent of respondents who reported their backlog of orders, 22 percent reported greater backlogs, 18 percent reported smaller backlogs, and 60 percent reported no change from January.

Exports, Imports and Prices

ISM's New Export Orders Index registered 53.5 percent in February, which is one percentage point lower than the 54.5 percent reported in January. February's reading reflects growth in the level of exports for the 15th consecutive month.

ISM's Imports Index registered 53.5 percent in February, which is the same percentage that was reported in January. This month's reading represents 13 consecutive months of growth in imports.

"At 53.5 each, both imports and exports are growing over the prior month," says Holcomb. "I think that's the first thing to recognize that both imports and exports — exports being finished goods and imports being raw materials — are largely both growing and reflective of a healthy global economy despite the fact that China's manufacturing PMI is down and the Eurozone PMI is up this month. So all is balanced and things are flowing fairly well."

The ISM Prices Index registered 60 percent in February, which is a slight decrease of 0.5 percentage point compared to the January reading of 60.5 percent. In February, 27 percent of respondents reported paying higher prices, seven percent reported paying lower prices, and 66 percent of supply executives reported paying the same prices as in January. 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.

"It's really normal for the first two to four months of the year for suppliers to come into companies and negotiate their pricing contracts for the year," explains Holcomb. "It always happens the early part of the year. This is very normal and nominal so there's no real story there."

Employment

ISM's Employment Index registered 52.3 percent in February, which is the same percentage that was reported in January, and represents the eighth consecutive month of growth in employment. 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.

"The Employment Index is flat, but at the same time it's growing," says Holcomb. "It's growing at the same rate as January and I'm not at all concerned about it. It's just maybe a reflection of the weather as well. I think it's just kind of nominal and there's no really big mystery there."

Overall Results

Overall, Holcomb sees this month's report as being well-balanced and moving in the right direction. "I think it obviously shows growth over January — and you have to remember that January showed growth over December, but just not as fast," concludes Holcomb. "We're on a good enough trend here and I think that's particularly the case in view of all of this bad weather which is certainly having an

impact on manufacturing."

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.

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