ISM: Manufacturing Springs Into Production

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Economic activity in the manufacturing sector expanded in March for the 10th consecutive month, and the overall economy grew for the 58th consecutive month, say the nation's supply executives in the latest Manufacturing ISM *Report On Business*.

Manufacturing expanded in March as the PMI registered 53.7 percent, an increase of 0.5 percentage points when compared to February's reading of 53.2 percent. A reading above 50 percent indicates that the manufacturing economy is generally expanding, below 50 percent indicates that it is generally contracting.

"The March ISM report confirms that the fundamentals of manufacturing activity are positive," noted Daniel J. Meckstroth, Chief Economist for the Manufacturers Alliance for Productivity and Innovation (MAPI). "The index of 53.7 in March is slightly better than 53.2 in February, and both are above the 50 percent level that separates growth from decline. Over the last 20 years, the ISM index has equaled or been higher than 53.7 only 39 percent of the time. Of particular importance in the March report is that the production index surged 7.7 points to 55.9, new orders growth accelerated, and the backlog indicator jumped sharply. These indicators tend to confirm the suspicion that weather probably played a major part in the flattening of manufacturing industrial production growth in the first quarter of 2014 compared to the fourth quarter of last year."

A PMI in excess of 43.2 percent, over a period of time, generally indicates an expansion of the overall economy. Therefore, the March PMI indicates growth for the 58th consecutive month in the overall economy, and indicates expansion in the manufacturing sector for the 10th 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 average PMI for January through March (52.7 percent) corresponds to a 3.1 percent increase in real gross domestic product (GDP) on an annualized basis. In addition, if the PMI for March (53.7 percent) is annualized, it corresponds to a 3.5 percent increase in real GDP annually."

Orders, Production and Inventory

ISM's New Orders Index registered 55.1 percent in March, an increase of 0.6 percentage point when compared to the February reading of 54.5 percent. This represents growth in new orders for the 10th 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 55.9 percent in March, which is an increase of 7.7 percentage points when compared to the 48.2 percent reported in February. This represents the largest month-over-month increase in production since June 2009 when the increase was 12.7 percentage points. It also indicates a return to growth in production following only one month of contraction in the last 19 months. An index above 51.1 percent, over time, is generally consistent with an increase in the Federal Reserve Board's Industrial Production figures.

"The New Orders Index being up is reflective of 11 of our 18 categories showing broad-based growth in new orders," adds Holcomb. "Again it shows that the underlying demand is solid. Production certainly relates to that, but also notice the backlog of orders is up 5.5 points. So there are a lot of old orders that still need attention in terms of production as well."

ISM's Backlog of Orders Index registered 57.5 percent in March, which is 5.5 percentage points higher than the 52 percent reported in February, indicating notable growth in order backlogs relative to February. Of the 86 percent of respondents who reported their backlog of orders, 28 percent reported greater backlogs, 13 percent reported smaller backlogs, and 59 percent reported no change from February.

The Inventories Index registered 52.5 percent in March, the same reading as reported in February, and indicates that inventories are growing for the second consecutive month, following two consecutive months of contraction. 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).

"Inventory levels are good and I think the mix is improved from a couple of months ago when it was probably dragging down production," explains Holcomb. "The fact that production is up suggests that the inventories balance is right. The index at 52.5 is a good number in an environment of continuing growth."

Exports, Imports and Prices

ISM's New Export Orders Index registered 55.5 percent in March, which is 2 percentage points higher than the 53.5 percent reported in February. March's reading reflects growth in the level of exports for the 16th consecutive month.

ISM's Imports Index registered 54.5 percent in March, which is 1 percentage point higher than the 53.5 percent reported in February. This month's reading represents 14 consecutive months of growth in imports.

"I like the two point uptick in the Exports Index," says Holcomb. "It shows a really solid and growing demand for U.S. exports of finished products and reflects that the world likes our products in terms of price, quality and availability. Imports is raw materials and the number shows we like everyone's raw materials as well. That combination indicates that the world economy is flowing nicely across the oceans and appears to be in good shape."

The ISM Prices Index registered 59 percent in March, which is a decrease of 1 percentage point compared to the February reading of 60 percent. In March, 28 percent of respondents reported paying higher prices, 10 percent reported paying lower prices, and 62 percent of supply executives reported paying the same prices as in February. 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 number is pretty nominal,”explains Holcomb. “Again, the first quarter is generally the time when suppliers come in to negotiate and sign contracts for the year ahead. Plus or minus a point here is nothing. I think that overall we’re going to see pretty nominal price increases throughout the year.”

Employment

ISM’s Employment Index registered 51.1 percent in March, which is a decrease of 1.2 percentage points when compared February’s reading of 52.3 percentage points, and represents the ninth 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.

“I think the Employment Index number is a bit of a red herring or an anomaly — perhaps some sort of weather impact on employers making it difficult to get, find or signup new employees,” says Holcomb. “The fact that production is strong, new orders is strong and there’s a heavy backlog — I have a sense that employment has to go up from there in the next few months.”

Overall Results

“The March ISM report should allay fears of an industrial slowdown,” Meckstroth added. “Manufacturing production is never smooth and we expect a strong rebound in production activity over the next three quarters. Now that economic policy uncertainty has receded because of a federal budget agreement, we expect business investment to accelerate both this year and next and be the principal driver of an accelerating growth rate in manufacturing. There is still some pent-up demand for motor vehicles, although the greatest opportunity is in the resurrection of the housing supply chain. Manufacturing production increased 2.2 percent in 2013 and MAPI forecasts 3.2 percent growth this year.”

Overall, Holcomb feels this month’s report is very well structured in terms of all of the supporting indexes being over 50 and the PMI continuing to increase. “I think it’s a very nice report, which I think bodes well for the future,” concludes Holcomb.

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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