

## State of Manufacturing

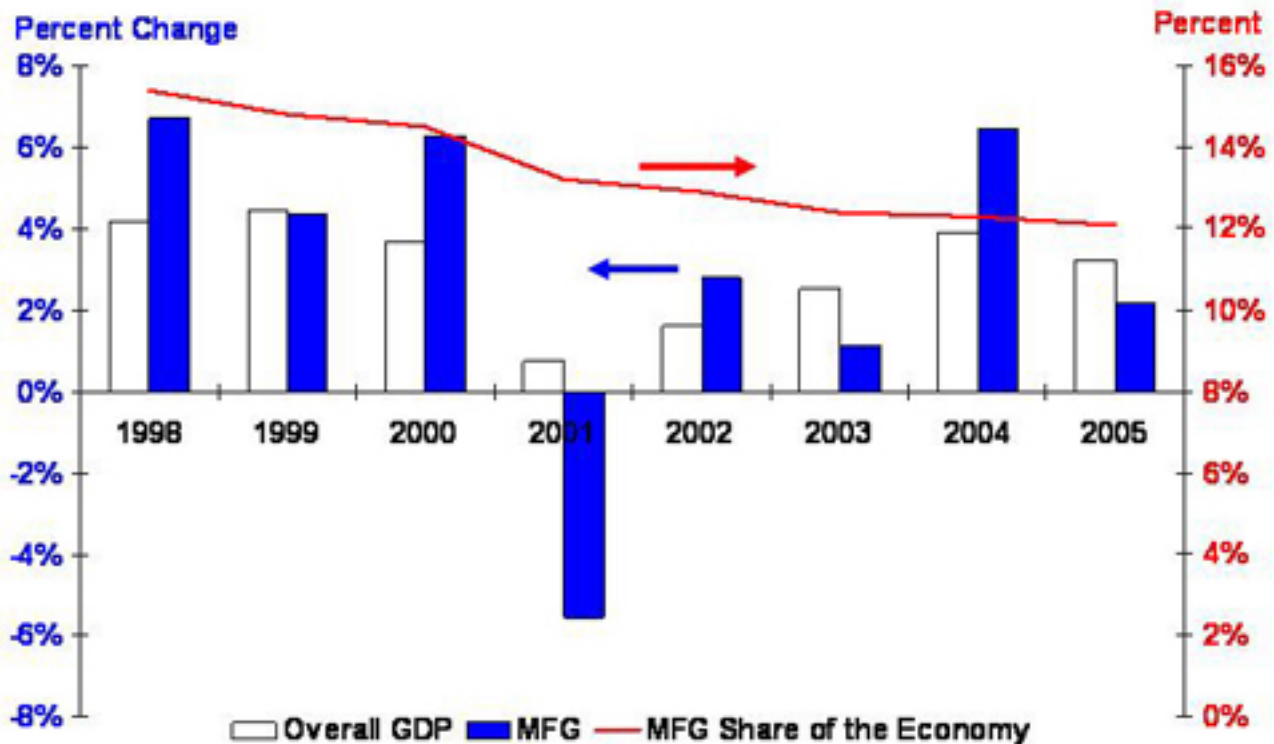
### Manufacturing and the Economy (GDP)

After surging 6.5 percent in 2004, Manufacturing GDP slowed to 2.2 percent growth in 2005, slower than the 3.2 percent rise in overall GDP. Within manufacturing, durable goods sector GDP increased by 4.9 percent in 2005, while nondurable manufacturing GDP declined 1.3 percent.

At \$1.5 trillion, manufacturing made up 12 percent of the economy last year, virtually the same as 2004. This is the first time in 7 years that there was not significant erosion in manufacturing's share of the economy.

One of the reasons that manufacturing stabilized as a share of GDP last year is that for the first time in a decade, inflation in the manufactured sector did not decline in 2005, and instead rose by 3.2 percent – slightly faster than the overall 3 percent rise in overall inflation last year.

### Manufacturing and the U.S. Economy



Source: Commerce Department

## Manufacturing Employment

Manufacturing employment fell by 14,000 in February to a level of 14,115,000. This marks the 8<sup>th</sup> consecutive monthly decline. After rising by 56,000 between September of 2005 and June of 2006, manufacturing employment has declined by 123,000 since mid-2006. Half of this decline has been in motor-vehicles. Another 44 percent of the loss has been in wood products and furniture manufacturing, sectors that have been hit hard by the housing downturn. Eleven other sectors had modest declines in +employment since last June, while 8 manufacturing sectors added employees over this time frame, led by machinery, which has increased employment rolls by 31,000 since last June.



## **PMI Index**

After declining 5 out of the prior 6 months, the most recent report on manufacturing activity by Institute for Supply Management shows that the closely watched PMI Index rose back above 50 to a level of 52.3 in February (a reading over 50 indicates a growth manufacturing sector).

### **Top Performing Industries**

The 13 industries reporting growth in February — listed in order — are: Apparel, Leather & Allied Products; Petroleum & Coal Products; Plastics & Rubber Products; Miscellaneous Manufacturing; Computer & Electronic Products; Chemical Products; Wood Products; Textile Mills; Electrical Equipment, Appliances & Components; Transportation Equipment; Paper Products; Food, Beverage & Tobacco Products; and Machinery.

What respondents were saying:

"Business is booming in the fertilizer business." (Chemical Products)

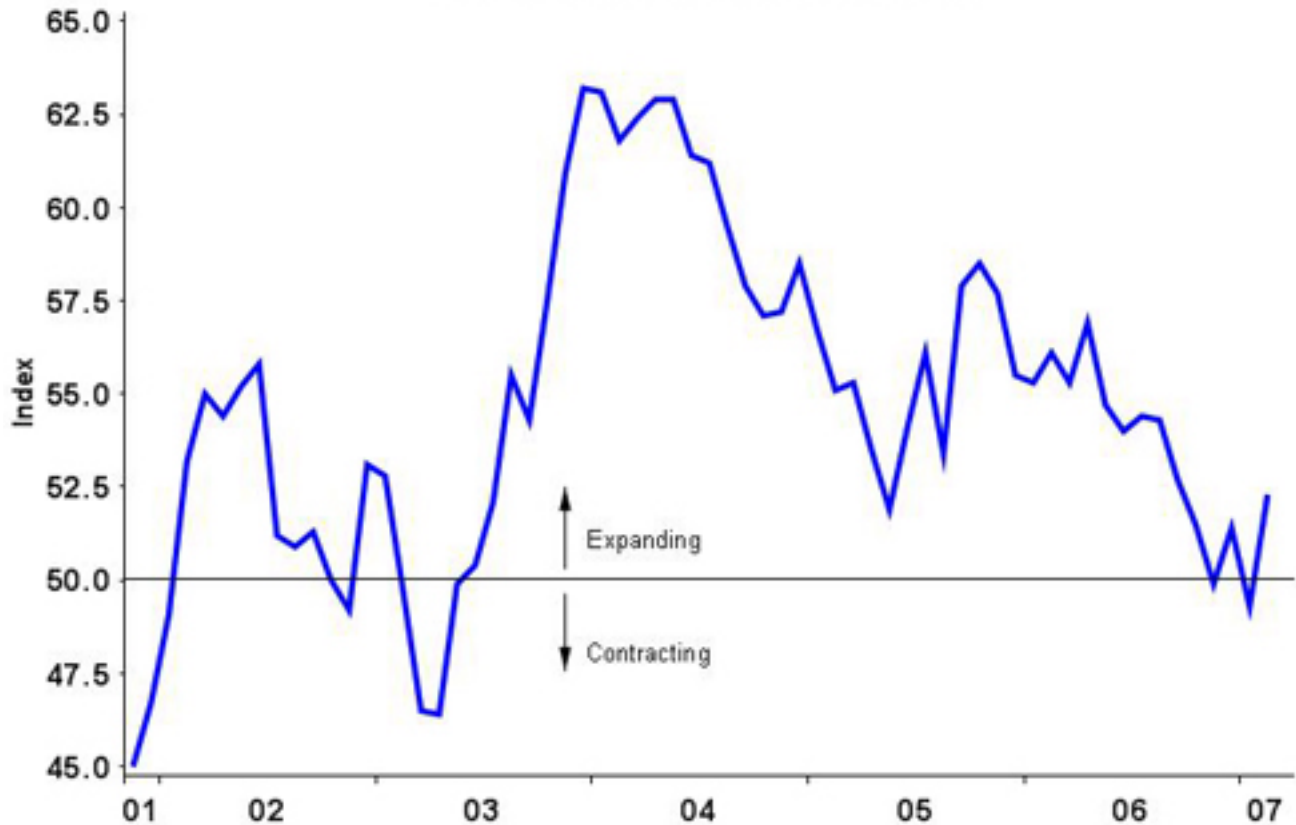
"Business continues to be strong but flat. Goals were all met for the month except inventory is too high according to budget." (Fabricated Metal Products)

"Our business has continued at a fairly level pace since September 2006." (Computer & Electronic Products)

"Although our business is still depressed, we are seeing increased order activity for single pieces of equipment compared to complete system solutions as in the past." (Machinery)

"Business has slowed a little. Lead times for MRO parts are still longer than a year ago." (Nonmetallic Mineral Products)

## ISM Manufacturing PMI Index



Source: Reuters EcoWin

### Manufacturing Production

The Federal Reserve's monthly report on industrial production showed that manufacturing output rose by 0.3 percent in February. This is just the second rise in the past six months (See chart). The rise in February was driven by a 2.2 percent increase in computer and electronic products as well as a 3.1 percent upturn in motor vehicle production, after a 6 percent drop the previous month. Outside of high-tech and motor vehicles, manufacturing production in February was stagnant.

The pace of manufacturing production decelerated throughout 2006: after increasing at an annual rate of 5.5% in the first and second quarters, output grew by 4.4% in the third and then declined by 1.7% in the fourth quarter (the 1st quarter of negative growth since the second quarter of 2003.) The slowdown has been driven by downturns in motor vehicle production as well as in sectors impacted by ongoing correction in housing (wood products, nonmetallic minerals, textile products, and furniture.) In addition excess inventory investment in the latter half of 2006 has put downward pressure on production as well.

Despite the deceleration, manufacturing production rose by 3.5 percent in 2006, outpacing the economy for a third consecutive year.

Fastest growing sectors: Q4 05 to Q4 06 (% change)

Computers and electronics	18.4
Aerospace	14.8
Machinery	5.3
Printing	5.1

Slowest growing sectors: Q4 05 to Q4 06 (% change)

Wood products	-14.8%
Textile & product mills	-7.8
Motor vehicles	-3.7



Source: Reuters EcoWin

## **Manufacturing Orders**

After recovering in November and December, new orders for manufacturing products plummeted 5.6 percent in January – the biggest monthly decline since July 2000. The January decline was led by durable goods where orders fell by 8.7 percent. Nondurable orders fell by 2 percent. Fueled by a 40 percent drop in construction equipment, overall machinery orders fell by 10 percent. In addition, transportation equipment fell by 19 percent, mainly due to a drop in the volatile aircraft sector.

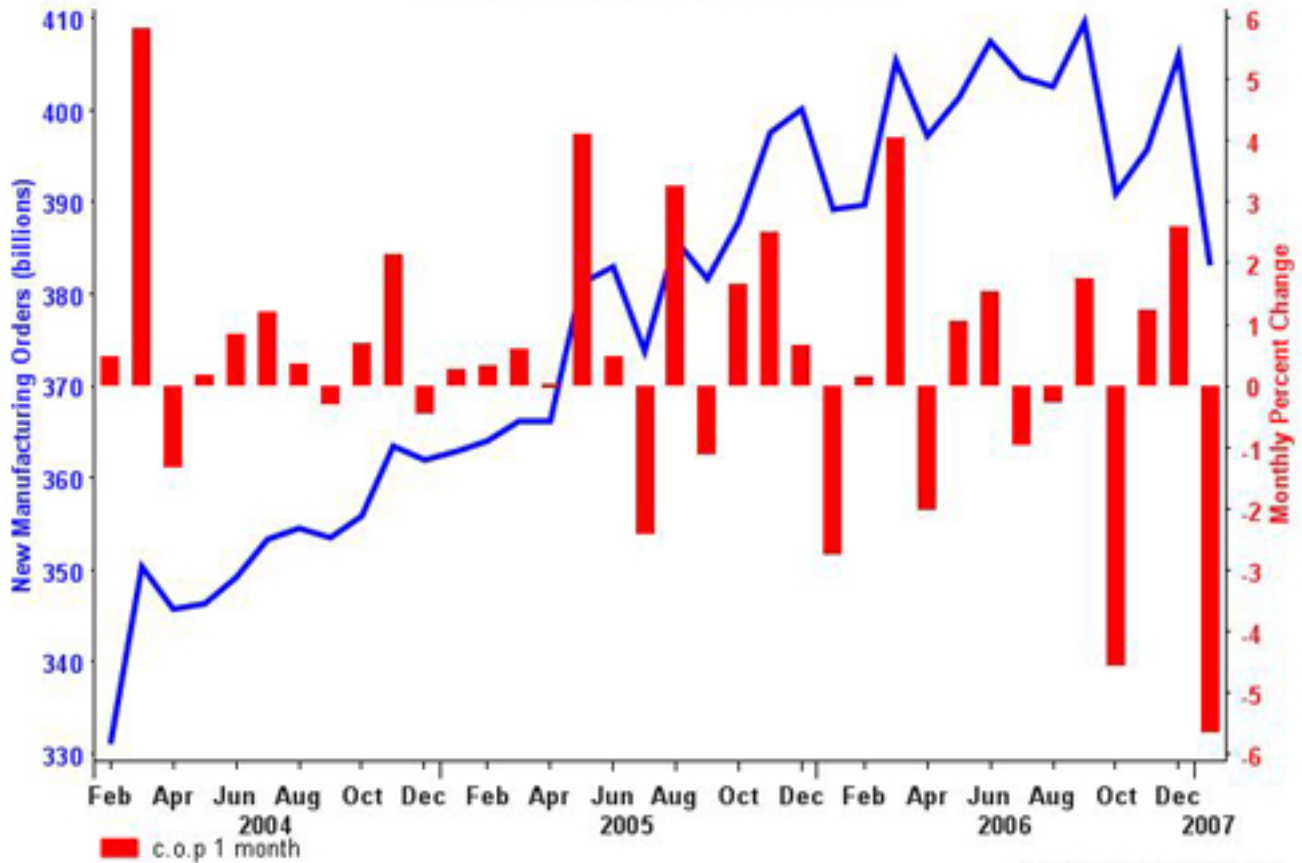
### **Largest January Increases**

Electrical equipment (9.1%), leather products (4.7%), textile mills (4.3%), beverage and tobacco products (2.9%), textile products (2.3%), and fabricated metal products (1.3%),

### **Largest January Decreases**

Transportation equipment (-19%), machinery (-9.9%), computers and electronic products (-9.5%), petroleum products (-9.2%), and paper products (-6.4%).

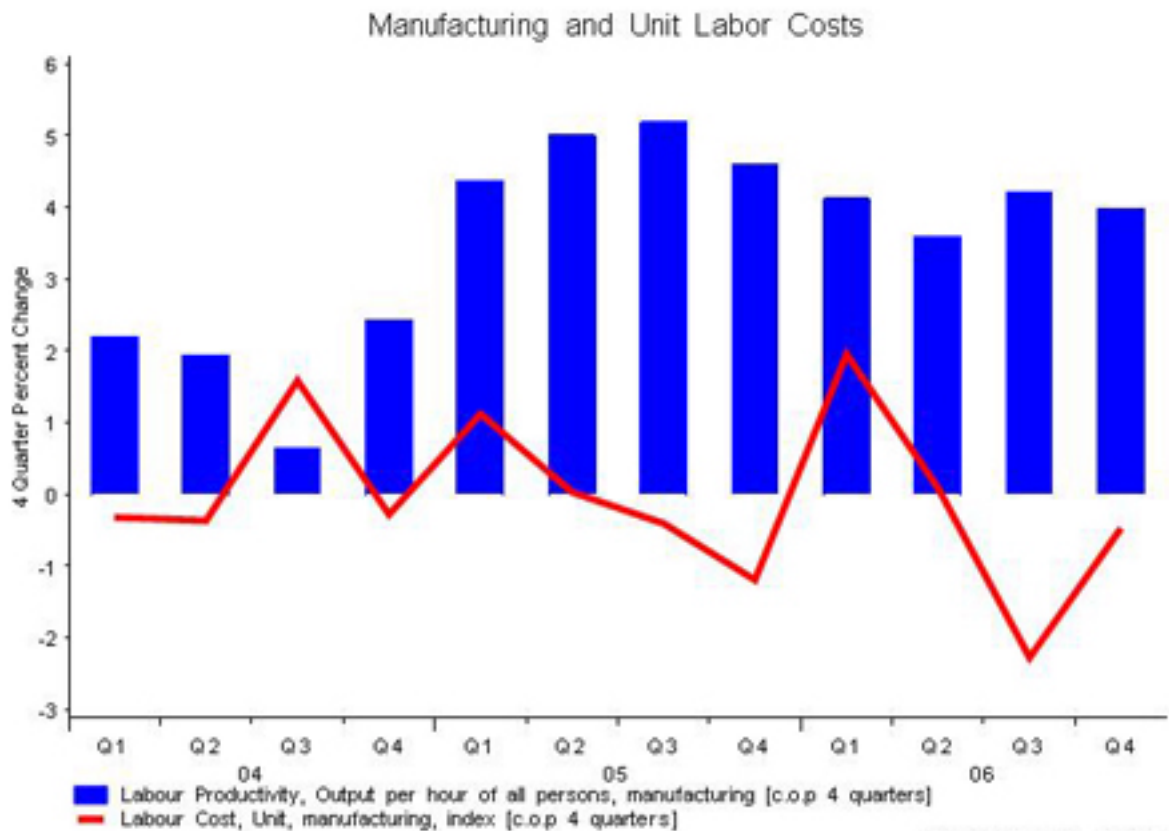
## Manufacturers New Orders



Source: Reuters EcoWin

## Productivity and Labor Costs

Over the 4 quarters of 2006, manufacturing productivity increased 4 percent (see chart below). This is modestly slower than the 4.6 percent in 2005. At the same time, manufacturing hourly compensation increased by 3.5 percent, nearly identical the 3.4 percent in 2005. As a result, unit labor costs (ULCs) fell by 0.5 percent last year. Continued high levels of productivity have kept a lid on wage-inflation in manufacturing.



## Manufacturing Trade

One of the sources of growth that has kept manufacturing growing in spite of the downturn in housing has been the improving trade picture. During the 12 months ending in January 2007, manufactured exports increased by 13.3 percent – more than double the 5.1 percent rise in imports.

From Africa, to Asia, to Eastern Europe, to Western Europe, to North American to Latin America and the Caribbean, manufactured exports outpaced imports across the globe in 2006.

The largest export increases (in terms of percent change) in 2006 were: petroleum and coal products (32%), primary metals (29%), transportation equipment (27) and electrical equipment and appliances (16)

In terms of contribution to the overall 13 percent rise in manufacturing exports in 2006, the largest contributors were: transportation equipment (42% of the rise), chemicals (16) and machinery (11). Together, these 3 sectors accounted for more than two-thirds of the overall rise in manufacturing exports

in 2006.

