NAM Manufacturers' Outlook Survey

NAM Manufacturing Outlook Index

45.6

(Down from 51.8 in March)

Small Manufacturers: 43.7 (Down from 55.0)

Medium-Sized Manufacturers: 47.4 (Down from 51.4)

Large Manufacturers: 43.9 (Down from 49.8)

Expected Growth Rate Over the Next 12 Months

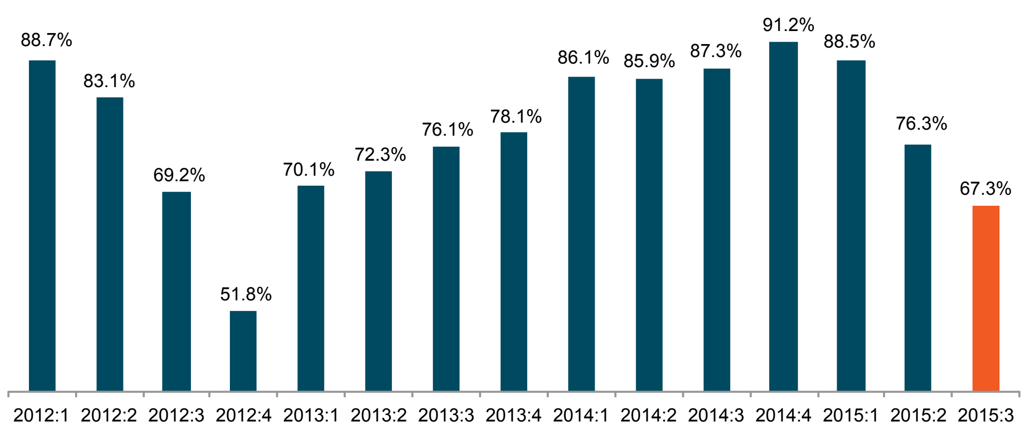
67.3%	**Percentage of Respondents Positive in Their Own Company's Outlook** (Down from 76.3% in June)
↑ 2.0%	**SALES** (Down from 2.7% in June)
↑ 2.0%	**PRODUCTION** (Down from 2.8% in June)
↓ 0.1%	**EXPORTS** (Down from a gain of 0.4% in June)
↑ 0.7%	**CAPITAL INVESTMENT** (Down from 1.9% in June)
↑ 0.5%	**PRICES** (Down from 0.8% in June)
↑ 0.3%	**FULL-TIME EMPLOYMENT** (Down from 0.8% in June)
↓ 0.7%	**INVENTORIES** (Down from a decline of 0.1% in June)
↑ 1.5%	**EMPLOYEE WAGES** (Down from 1.6% in June)
↑ 8.7%	**HEALTH INSURANCE COSTS** (Up from 7.9% in June)

Summary

Six years after the recovery began, we continue to live in a nuanced economic environment. There are signs of encouragement that help lift our perceptions of growth moving forward, including rebounds in housing, consumer spending and the labor market. It is these strengths in the U.S. economy—including a 5.3 percent unemployment rate, its lowest level since August 2008—that provide fodder for those wanting the Federal Reserve to begin raising short-term rates before the end of the year. Along those lines, manufacturing leaders are generally more positive than negative in their outlook, even as we have seen some of that optimism diminish year to date.

Such positive feelings, however, are paired with nagging worries about the global economy, and since last year, business leaders in the manufacturing sector have grappled with a number of significant headwinds that have held back demand and production, particularly for exports. These challenges include a stronger U.S. dollar, lower crude oil prices and weaker economic growth in key international markets. Activity in the sector has clearly decelerated as a result. While other sectors have begun to rebound from a softer start at the beginning of the year, we have yet to see a significant boost among manufacturers, which has been frustrating. As an illustration of this, manufacturing production has downshifted from a robust year-over-year pace of 6.0 percent in January to just 1.5 percent in July. The Institute for Supply Management's manufacturing purchasing managers' index has also decelerated, falling to its lowest level in two years in August.

Figure 1: Manufacturing Business Outlook by Quarter, 2013–2015



Percentage of respondents who characterized the current business outlook as somewhat or very positive.

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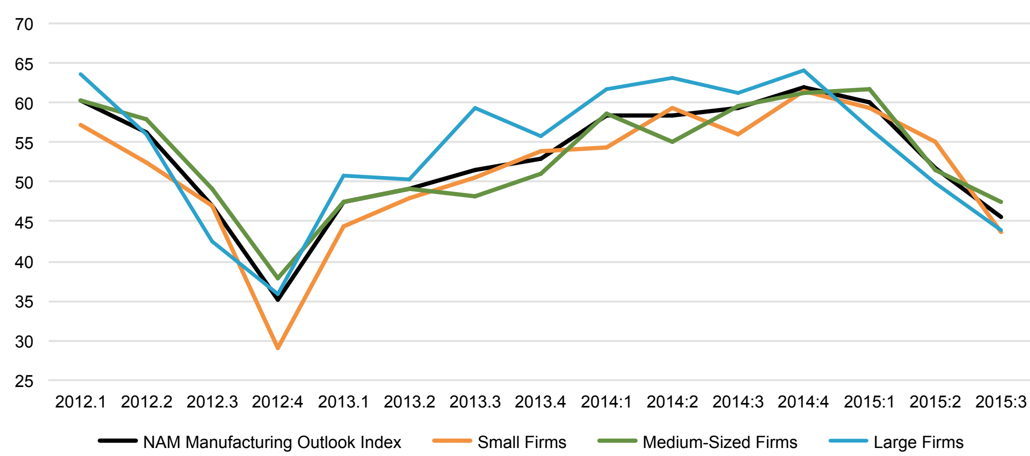
These headwinds have clearly been top-of-mind for manufacturers responding to the National Association of Manufacturers (NAM) quarterly survey. In December, 91.2 percent of manufacturers were either somewhat or very positive about their own company's outlook. Since then, that figure fell to 88.5 percent in March, 76.3 percent in June and 67.3 percent today (Figure 1). That represents a significant decline in sentiment over a short period of time. The September reading of this measure marks the lowest since the fourth quarter of 2012, when manufacturers were worried about the fiscal cliff. It is worth noting that manufacturers were surveyed in the current report during the last two months of August, with anxieties about Chinese growth and the correction in the U.S. stock market likely having a negative impact on these responses.

To help make sense of this outlook measure, we introduced a new index starting in the last report: the NAM Manufacturing Outlook Index (Figure 2). Numbers greater than 50 suggest the manufacturing outlook is above average, coinciding with an expanding sector. The index has fallen from 61.7 in December to 59.9 in March to 51.7 in June to 45.6 in this report. As such, this figure indicates the manufacturing outlook is currently below its historical average – a statement that is true at all firm size levels. Medium-sized manufacturers (e.g., those with between 50 and 499 employees) were slightly more upbeat in their assessments, with an index reading of 47.4, but this remains a subpar reading.

Large firms (e.g., those with 500 or more employees) had negative index values for the second straight survey, likely the result of increased export challenges. In fact, manufacturers expect exports to decline by 0.1 percent on average over the next 12 months, down from a gain of 0.4 percent in the last survey. Medium-sized and large manufactures anticipate 0.3 percent and 0.5 percent decreases in exports over the next year, respectively, with small firms (e.g., those with less than 50 employees) expecting a slight increase of 0.2 percent. This shows the negative effects of the dollar and softer growth abroad on the overall outlook.

Figure 2: NAM Manufacturing Outlook Index, 2013–2015



Source: National Association of Manufacturers.

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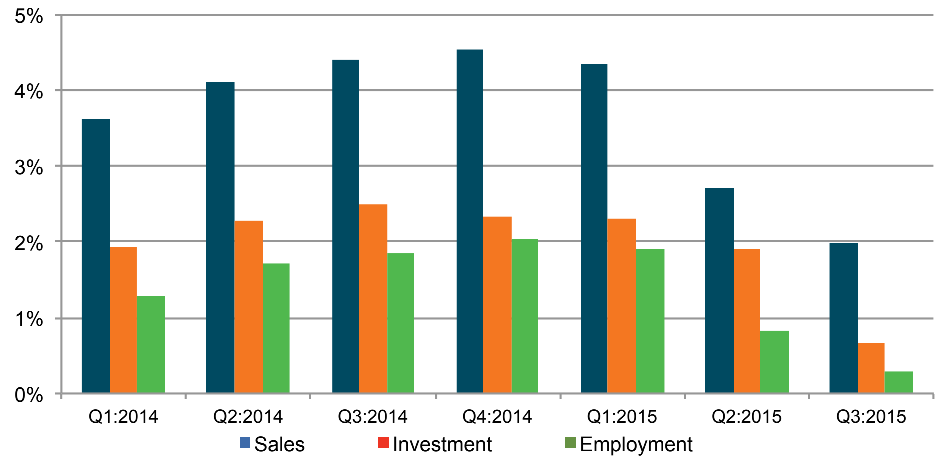
Other measures have also eased significantly over the course of this year. For instance, manufacturers expect sales to grow by 2.0 percent over the next 12 months, down from 4.5 percent in December and 2.7 percent in June (Figure 3). To illustrate the easing in the sales outlook, 30.3 percent of those taking the survey anticipate growth in sales of 5 percent or more over the next year, down from 50.9 percent six months ago. Small and medium-sized firms were more optimistic about demand over the coming year than their larger counterparts, anticipating 2.3 percent growth in sales versus 1.0 percent, respectively. As stated earlier, exports were likely a factor in this result.

Production numbers were similar, with 2.0 percent growth predicted over the next four quarters. This was down from 2.8 percent in the last survey. The percent anticipating production increases of 5 percent or more declined from 35.1 percent to 29.8 percent, and those expecting falling production rose from 12.9 percent to 19.7 percent. As with sales, small and medium-sized entities had a better outlook for output, forecasting 2.3 percent growth in production, with large manufacturers seeing just 1.1 percent growth over the next year.

Employment growth has also slowed significantly, down from 2.0 percent in December to 0.8 percent in the last survey to 0.3 percent now. Roughly half of all respondents do not plan to change their employment levels over the next year, with one-fifth seeing declines. Small and medium-sized manufacturers predict 0.5 percent growth in hiring over the next 12 months on average, but large firms anticipate job losses of 0.3 percent. Regarding compensation, those completing the survey expect wages to increase 1.5 percent over the next year, down just slightly from 1.6 percent in the previous report.

Figure 3: Expected Growth of Manufacturing Sales, Investment and Employment, 2014–2015



Note: Expected growth rates are annual averages.

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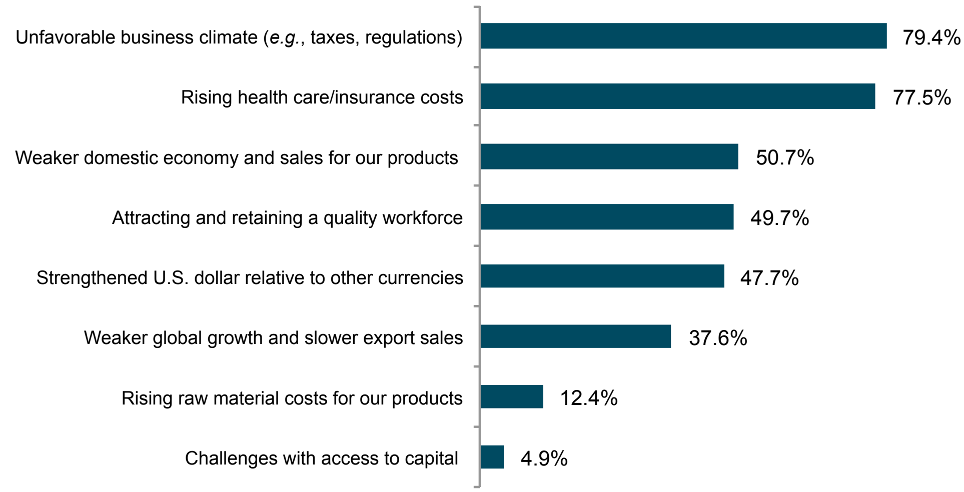
Interestingly, the capital spending plans did indicate growth. Large manufacturers expect 1.2 percent growth on average in capital expenditures over the next 12 months, with small and medium-sized firms planning 0.5 percent. This would indicate that larger businesses are still planning to make investments in their firms despite the current headwinds. Yet, investment spending has decelerated much like the other indicators, down from 2.5 percent one year ago to a more-paltry 0.7 percent in this latest survey. Looking at all the responses, 18.7 percent said they see at least 5 percent growth in capital investments over the next year, down from 25.6 percent who said the same thing in June.

Meanwhile, manufacturers expect their inventories to decrease by 0.7 percent over the next 12 months, declining for the second straight quarter. Nearly 30 percent anticipate declining inventory stocks, with 18.3 percent predicting increases. Just over one-half of the respondents predict inventory levels to remain unchanged. There is a silver lining from declining inventory stocks, of course. If new orders pick up significantly, production would have to accelerate significantly to match the increased demand.

The top business challenge was an unfavorable business climate, cited by 79.4 percent of manufacturing respondents (Figure 4). Indeed, manufacturers continue to be frustrated with the lack of comprehensive tax reform and with a perceived regulatory assault on their businesses. Many of those taking the survey noted their concerns on these issues, with some highlights shown in the sample comments below. Along those lines, 79.0 percent of respondents said the United States was on the wrong track, up from 73.4 who said the same thing three months ago, with just 6.2 percent feeling that we are headed in the right direction. The remainder were unsure.

Figure 4: Primary Current Business Challenges, Third Quarter, 2015



Note: Respondents were able to check more than one response. Therefore, responses exceed 100 percent.

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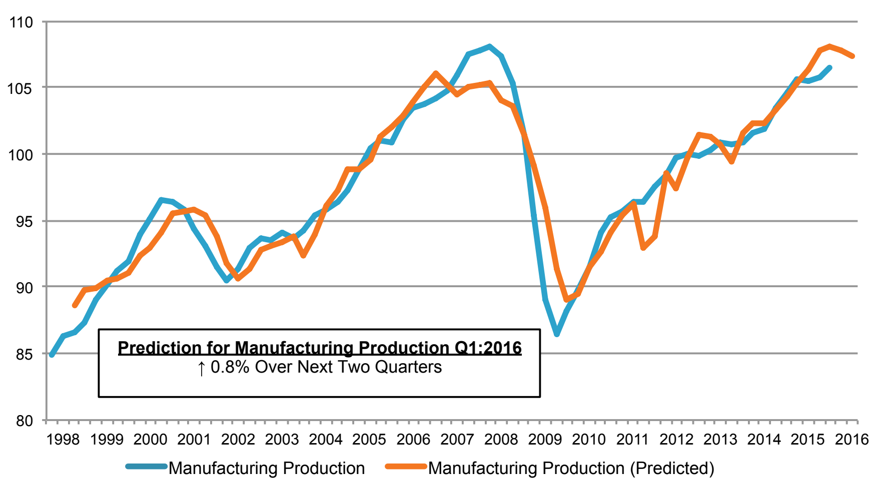
Figure 5: Predicted Manufacturing Production (North American Industry Classification System)



Note: Industrial production is predicted two quarters in advance by regressing NAM/IndustryWeek Survey of Manufacturers data as one of the independent variables, with data stretching back to Q4:1997. Other explanatory variables include current values for housing permits, the interest rate spread, personal consumption and the S&P 500.

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Health insurance costs were also a major concern, cited by 77.5 percent as a primary challenge. Manufacturers see health insurance costs increasing 8.7 percent over the next 12 months. This figure has continued to trend upward, up from 7.2 percent in March and 7.9 percent in June. More specifically, nearly 80 percent expect their premiums to increase by at least 5 percent on average in the next year, with 42.3 percent predicting cost to rise by at least 10 percent. Small and medium-sized firms anticipate premiums to jump faster in the next year than large manufacturers do, at 9.5 percent and 6.7 percent respectively.

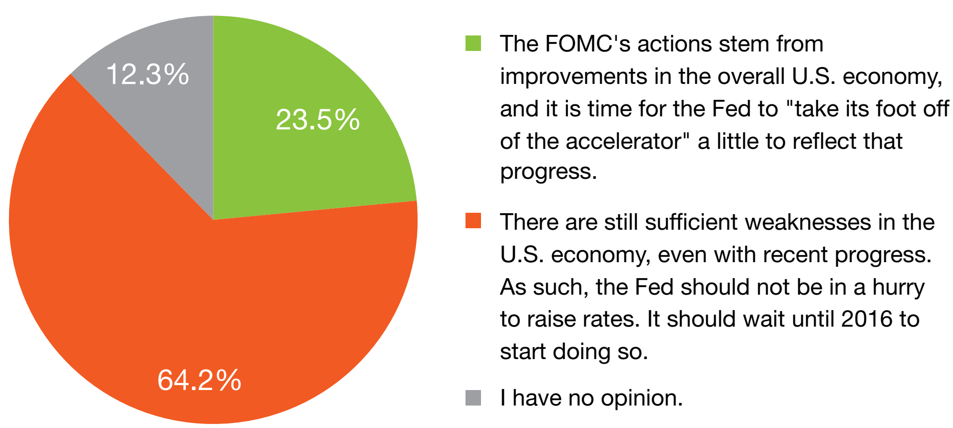
To end this discussion on a somewhat positive note, it is important to note that two-thirds of manufacturers remain positive, even with the number of headwinds mentioned earlier. That suggests at least some degree of cautious optimism moving forward. Indeed, the current data are consistent with an increase in 0.8 percent in manufacturing production over the next two quarters (Figure 5). While this is less-than-ideal in terms of anticipated growth, it does suggest some progress by the beginning of the new year. In addition to the business outlook figure from the NAM Manufacturers' Outlook Survey, this model includes current values for housing permits, the interest rate spread, personal consumption and the S&P 500. Historically, this regression explains 90 percent of the variation since the data began in the fourth quarter of 1997.

Special Questions

Monetary Policy

One of the larger guessing games in economic circles of late has been when the Federal Reserve will begin to normalize monetary policy. More specifically, the Federal Open Market Committee (FOMC) ended its quantitative easing program last fall, and the next step will be for it to start raising short-term rates. The federal funds rate has been essentially zero since the beginning of the financial crisis, and with improvements in the economy, there has been increased pressure on the Fed to "take its foot off of the accelerator" a little in order to reflect that economic progress. Along those lines, Federal Reserve Chair Janet Yellen has said that the FOMC would like to begin the process of raising rates – likely by 25 basis points – by year's end.

Figure 6: Which of the Following Statements Regarding the Federal Reserve's Possible Normalization of Rates Would Be True for Your Firm?"



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With that as context, we asked manufacturers what they thought that the Federal Reserve should do. Given the current headwinds in the economy, 64.2 percent of those completing the NAM survey said that they felt that the FOMC should be patient when it comes to raising short-term rates, with the FOMC waiting until 2016 to increase the federal funds rate. That would give the Fed more time to evaluate incoming data to ensure sufficient progress. In contrast, 23.5 percent said that it was time for the Fed to adjust rates given recent improvements in the U.S. economy. The survey did not ask whether that would be the September or December meeting, but it does suggest that this group wants the Fed to act sooner rather than later.

Capital Spending

Earlier, we discussed how growth in capital spending has decelerated over the course of the past few surveys, largely on a weakened economic outlook. Another factor that might be contributing to this slower growth might be the expiration of key investment incentives at the end of 2014. These tax extenders, including enhanced Section 179 expensing and the ability to expense 50 percent of capital expenditures in the first year, are important tools for manufacturers and small businesses, because they encourage additional investment. Indeed, 35.4 percent of those completing the survey said that their company had delayed making capital investments due to the expiration of these incentives.

Moreover, just over 60 percent of respondents felt that enhanced Section 179 and/or 50 percent first-year expensing were either mildly important or extremely important to their company's investment decisions.

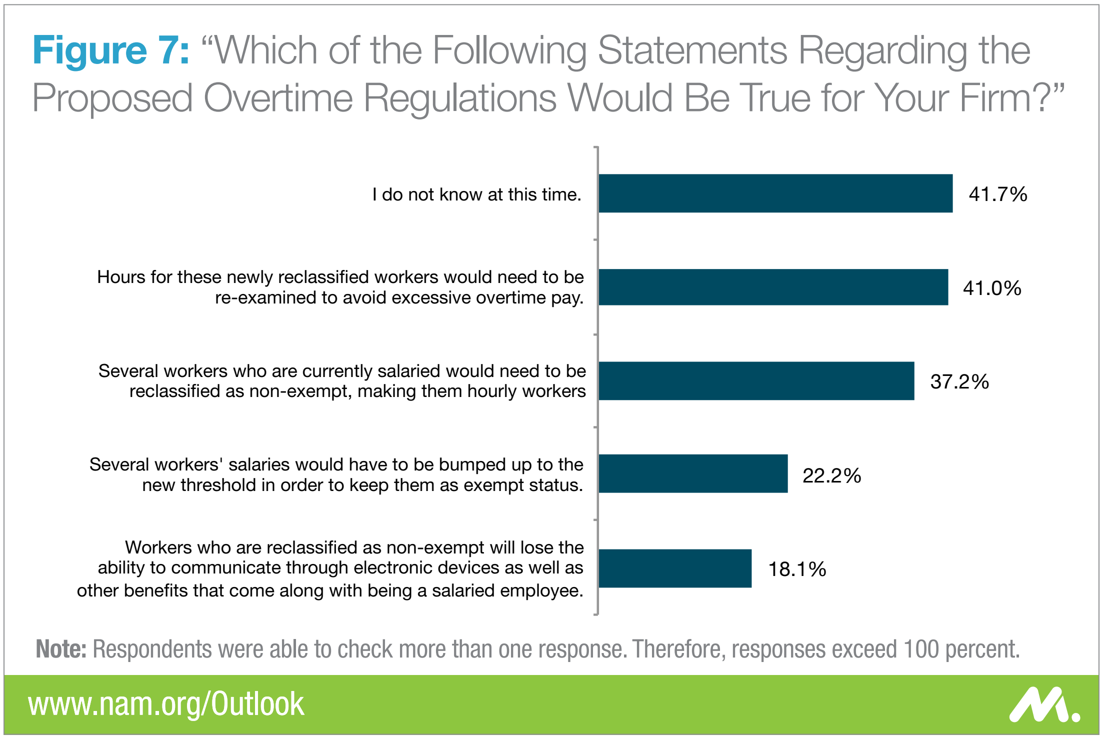
Overtime Regulations

The U.S. Department of Labor (DOL) has proposed to more than double the salary threshold for employees who are exempt from overtime pay. The current salary test is $23,660, and the Administration wants to increase this to $50,440 as of 2016. This new rule would mean that employers may have to reclassify those employees who fall in between these two levels and have been classified as exempt. We asked manufacturers about this new rule, and 59.7 percent of them said that they were concerned about the impact that the proposed overtime regulations would have on their business. One-third noted that they were not concerned.

We were also interested in learning how manufacturers might react if these rules were implemented as currently drafted (Figure 7), with respondents selecting all of the answers that applied to their situation. First of all, many businesses are still uncertain about how these rules might impact them, with 41.7 percent suggesting that they do not know at this point. The comment period for the proposed regulation has yet to close and the agency has indicated there may be additional changes made prior to the rule being made final, which adds to uncertainty at this time.

Still, a number of manufacturers have explored what they might do. For instance, 41.0 percent noted that they would need to reclassify their exempt employees to avoid excessive overtime pay, with 37.2 percent suggesting that their firm would need to adjust hours. This regulation will also negatively impact individuals who are now classified as exempt employees, with 18.1 percent of employers stating that newly reclassified workers would lose their ability to communicate via electronic devices as well as other workplace flexibilities not available to non-exempt employees.

Meanwhile, 22.2 percent of those completing the survey said that they would need to bump up some salaried workers to keep them at an exempt status.

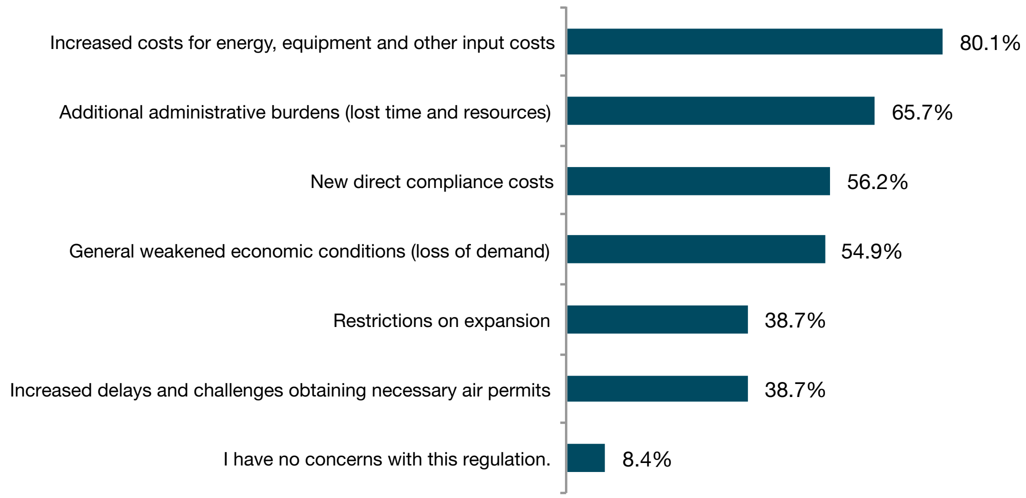


Ozone Regulations

In October, the Environmental Protection Agency (EPA) will issue a stricter federal ground-level air quality standard. EPA and independent analyses indicate that this could be one of the most expensive regulations in U.S. history. This issue has garnered a lot of attention. Indeed, in the last NAM Manufacturers' Outlook Survey, almost two-thirds of respondents said that they were concerned about the impact that these new EPA regulations might have on their businesses. Indeed, nearly 80 percent of manufacturers in that report noted that they were not likely or uncertain to continue with new construction or major modifications projects as a result.

In this survey, we wanted to dig a little deeper to gauge exactly what it was that concerned manufactures about this proposed regulation (Figure 8). Note that respondents were able to select as many options as they wanted for this question. Just over 80 percent felt that this new rule would increase their overall costs for energy, equipment and other input costs. Moreover, 65.7 percent were troubled by additional administrative burdens, with 56.2 percent disturbed by new direct compliance costs. The NAM has suggested that this regulation will restrict economic growth and economic development, and 54.9 percent said that they believed that this rule would weaken the economy. In addition, 38.7 percent felt that it would restrict expansion, and the same percentage believed that it would increase the number of delays and challenges necessary to obtain air permits.

Figure 8: "What Concerns You About the New Ozone Regulation?"



Note: Respondents were able to check more than one response. Therefore, responses exceed 100 percent.

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Note

This survey has been conducted quarterly since 1997, with the NAM membership submitting this quarter's responses between August 14 and 28, 2015. In total, 309 manufacturers from all parts of the country, in a wide variety of manufacturing sectors and in varying size classifications, responded this quarter. Aggregated survey responses appear below. The next survey is expected to be released Wednesday, December 9, 2015.

Sample Comments on Primary Challenges Facing Manufacturers

"Aging and retiring workforce and the loss of critical knowledge." (Fabricated metal products)

"Closure of the Export-Import Bank." (Other - Wire insulating manufacturing)

"Competition importing cheaper goods from China." (Machinery)

"Competition in the marketplace. They have more money to spend than we do, so we need to spend smarter." (Food manufacturing)

"Congress not doing their job and relying on short-term extensions instead of fixing problems." (Other – Manufacturing products for construction sector)

"Depressed oil prices." (Fabricated metal products)

"Dumping and unfair trade practices." (Primary metals)

"Government is doing all it can to eliminate small manufacturing businesses." (Plastics and rubber products)

"Increased, and ever-increasing regulation." (Chemicals)

"Interest rates are artificially too low, perverting the allocation of capital." (Electrical equipment and appliances)

"Over-regulation from all government agencies – local, state and federal levels." (Wood products)

"Out of control EPA regulations hammering the energy sector." (Electrical equipment and appliances)

"The time it takes to get permits." (Machinery)

"We need R&D and investment tax incentives!" (Other - Power electronics manufacturing)

Survey Responses

1. How would you characterize the business outlook for your firm right now?

a. Very positive – 10.8%
b. Somewhat positive – 56.5%
c. Somewhat negative – 27.5%
d. Very negative – 5.2%

Percentage that is either somewhat or very positive in their outlook = 67.3%

2. Over the next year, what do you expect to happen with your company's overall sales?

a. Increase more than 10 percent – 7.8%
b. Increase 5 to 10 percent – 22.5%
c. Increase up to 5 percent – 26.4%
d. Stay about the same – 22.8%
e. Decrease up to 5 percent – 9.8%
f. Decrease 5 to 10 percent – 6.8%
g. Decrease more than 10 percent – 3.9%

*Average expected increase in **sales** consistent with these responses = 2.0%*

3. Over the next year, what do you expect to happen with your company's overall production levels?

a. Increase more than 10 percent – 7.9%
b. Increase 5 to 10 percent – 22.0%
c. Increase up to 5 percent – 27.5%
d. Stay about the same – 23.0%

e. Decrease up to 5 percent – 9.5%
f. Decrease 5 to 10 percent – 5.9%
g. Decrease more than 10 percent – 4.3%

*Average expected increase in **production** consistent with these responses = 2.0%*

4. Over the next year, what do you expect to happen with the level of exports from your company?

a. Increase more than 5 percent – 9.4%
b. Increase 3 to 5 percent – 2.3%
c. Increase up to 3 percent – 8.7%
d. Stay about the same – 56.0%
e. Decrease up to 3 percent – 9.4%
f. Decrease 3 to 5 percent – 6.0%
g. Decrease more than 5 percent – 8.1%

*Average expected change in **exports** consistent with these responses = -0.1%*

5. Over the next year, what do you expect to happen with prices on your company's overall product line?

a. Increase more than 10 percent – 0.7%
b. Increase 5 to 10 percent – 4.3%
c. Increase up to 5 percent – 24.6%
d. Stay about the same – 56.7%
e. Decrease up to 5 percent – 10.8%
f. Decrease 5 to 10 percent – 2.6%
g. Decrease more than 10 percent – 0.3%

*Average expected increase in **prices** consistent with these responses = 0.5%*

6. Over the next year, what are your company's capital investment plans?

a. Increase more than 10 percent – 9.2%
b. Increase 5 to 10 percent – 9.5%
c. Increase up to 5 percent – 21.3%
d. Stay about the same – 37.4%
e. Decrease up to 5 percent – 8.9%
f. Decrease 5 to 10 percent – 3.9%
g. Decrease more than 10 percent – 9.8%

*Average expected increase in **capital expenditures** consistent with these responses = 0.7%*

7. Over the next year, what are your inventory plans?

a. Increase more than 10 percent – 1.0%
b. Increase 5 to 10 percent – 3.9%
c. Increase up to 5 percent – 13.4%
d. Stay about the same – 52.0%
e. Decrease up to 5 percent – 19.3%
f. Decrease 5 to 10 percent – 5.2%

g. Decrease more than 10 percent – 5.2%

Average expected change in ***inventories*** *consistent with these responses = -0.7%*

8. Over the next year, what do you expect in terms of full-time employment in your company?

a. Increase more than 10 percent – 2.0%
b. Increase 5 to 10 percent – 5.2%
c. Increase up to 5 percent – 26.1%
d. Stay about the same – 46.7%
e. Decrease up to 5 percent – 12.4%
f. Decrease 5 to 10 percent – 4.9%
g. Decrease more than 10 percent – 2.6%

Average expected increase in ***employment*** *consistent with these responses = 0.3%*

9. Over the next year, what do you expect to happen to employee wages (excluding nonwage compensation, such as benefits) in your company?

a. Increase more than 5 percent – 2.0%
b. Increase 3 to 5 percent – 12.1%
c. Increase up to 3 percent – 62.1%
d. Stay about the same – 22.9%
e. Decrease up to 3 percent – 0.3%
f. Decrease 3 to 5 percent – 0.3%
g. Decrease more than 5 percent – 0.3%

Average expected increase in ***employee wages*** *consistent with these responses = 1.5%*

10. Over the next year, what do you expect to happen to health insurance costs for your company?

a. Increase 15.0 percent or more – 16.6%
b. Increase 10.0 to 14.9 percent – 25.7%
c. Increase 5.0 to 9.9 percent – 37.1%
d. Increase less than 5.0 percent – 11.4%
e. No change – 5.5%
f. Decrease less than 5.0 percent – 0.7%
g. Decrease 5.0 percent or more – 0.3%
h. Uncertain – 2.6%

Average expected increase in ***health insurance costs*** *consistent with these responses = 8.7%*

11. Do you think the United States is headed in the right direction, or is our country on the wrong track?

a. Right direction – 6.2%
b. Wrong track – 79.0%
c. Unsure – 14.8%

12. What are the biggest challenges you are facing right now? (Check all that apply.)

a. Weaker domestic economy and sales for our products to U.S. customers – 50.7%
b. Weaker global growth and slower export sales – 37.6%
c. Strengthened U.S. dollar relative to other currencies – 47.7%
d. Challenges with access to capital or other forms of financing – 4.9%
e. Unfavorable business climate (e.g., taxes, regulations) – 79.4%
f. Increased raw material costs – 12.4%
g. Rising health care/insurance costs – 77.5%
h. Attracting and retaining a quality workforce – 49.7%

13. What is your company's primary industrial classification?

a. Chemicals – 5.6%
b. Computer and electronic products – 2.3%
c. Electrical equipment and appliances – 5.6%
d. Fabricated metal products – 31.8%
e. Food manufacturing – 2.6%
f. Furniture and related products – 2.0%
g. Machinery – 10.2%
h. Nonmetallic mineral products – 2.6%
i. Paper and paper products – 0.3%
j. Petroleum and coal products – 0.3%
k. Plastics and rubber products – 10.2%
l. Primary metals – 5.6%
m. Transportation equipment – 5.6%
n. Wood products – 3.0%
o. Other – 12.5%

14. What is your firm size (e.g., the parent company, not your establishment)?

a. Fewer than 50 employees – 25.3%
b. 50 to 499 employees – 51.2%
c. 500 or more employees – 23.6%

Special Questions

Monetary Policy

15. The Federal Open Market Committee (FOMC) of the Federal Reserve is likely to begin raising short-term interest rates by the end of this year. Which of the following statements would be true for your firm regarding this action?

a. The FOMC's actions stem from improvements in the overall U.S. economy, and it is time for the Fed to "take its foot off of the accelerator" a little to reflect that progress – 23.5%

b. There are still sufficient weaknesses in the U.S. economy, even with recent progress. As such, the Fed should not be in a hurry to raise rates. It should wait until 2016 to start doing so – 64.2%
c. I have no opinion – 12.3%

Capital Spending

16. Has your company delayed making capital investments due to the expiration of key investment incentives, and if so what provision needs to be extended?

a. Yes, enhanced Sec. 179 expensing – 5.6%
b. Yes, 50 percent first-year expensing – 5.0%
c. Yes, both – 24.8%
d. No – 61.7%
e. Other – 3.0%

17. How critical are enhanced Section 179 and/or 50 percent first-year expensing to your company?

a. Extremely important to our company's investment decisions – 23.1%
b. Mildly important to my company's investment decisions – 37.0%
c. No change in investment activity – 20.5%
d. Extremely important to our customers – 5.9%
e. Mildly important to our customers – 3.0%
f. No impact at all – 10.6%

Overtime Regulations

The U.S. Department of Labor (DOL) has proposed to more than double the salary threshold for employees who are exempt from overtime pay. The current salary test is $23,660, and the Administration wants to increase this to $50,440 as of 2016. This means you, as an employer, may have to reclassify those employees who fall in between these two levels and have been classified as exempt.

18. Are you concerned about the impact of the proposed overtime regulations on your business?

a. Yes – 59.7%%
b. No – 33.3%
c. Uncertain – 7.0%

19. Which of the following would be true for your firm assuming this regulation were to go into effect? (Check all that apply.)

a. Several workers who are currently salaried would need to be reclassified as non-exempt, making them hourly workers – 37.2%
b. Several workers' salaries would have to be bumped up to the new threshold in order to keep them as exempt status – 22.2%
c. Hours for these newly reclassified workers would need to be re-examined to avoid excessive overtime pay – 41.0%
d. Workers who are reclassified as non-exempt will lose the ability to communicate through electronic devices (smart phones/tablets) as well as other benefits that come with being a salaried employee – 18.1%
e. I do not know at this time – 41.7%

Ozone Regulations

In October, the Environmental Protection Agency (EPA) is expected to issue a stricter federal ground-level air quality standard. EPA and independent analyses indicate that this could be one of the most expensive regulations in U.S. history. For more information on this proposed rule, see www.nam.org/ozone.

20. What concerns you about this new ozone regulation? (Check all that apply.)

a. New direct compliance costs – 56.2%
b. Increased delays and challenges obtaining necessary air permits – 38.7%
c. Restrictions on expansion – 38.7%
d. Increased costs for energy, equipment and other input costs – 80.1%
e. General weakened economic conditions (loss of demand) – 54.9%
f. Additional administrative burdens (lost time and resources) – 65.7%
g. I have no concerns with this regulation – 8.4%