


Manufacturing Report December 2009:
Creating Jobs and the Long Road to Recovery

National Association of Manufacturers

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The Current State of the Economy
The 2008-2009 recession is likely over. Will it be followed by a strong recovery or a sluggish upturn? Historically, deep recessions have been followed by robust growth, as a look at the last four recessionary cycles clearly shows (see Chart 1). Following the deep recessions in the mid-1970s and the early 1980s, the U.S. economy recovered vigorously. Conversely, following the milder declines in the early 1990s and again in 2001, the initial recoveries were sluggish.

However, history does not always repeat itself. While the federal government has enacted robust fiscal and monetary policies to confront the deepest and longest recession in the post World War II era, the U.S. economy still faces significant headwinds.

A recent survey of over 400 members of the National Association of Manufacturers (NAM) shows that most companies do not expect an upturn in their production to begin until sometime in 2010. Moreover, increases in sales, investment and employment over the coming year are expected to be weak.

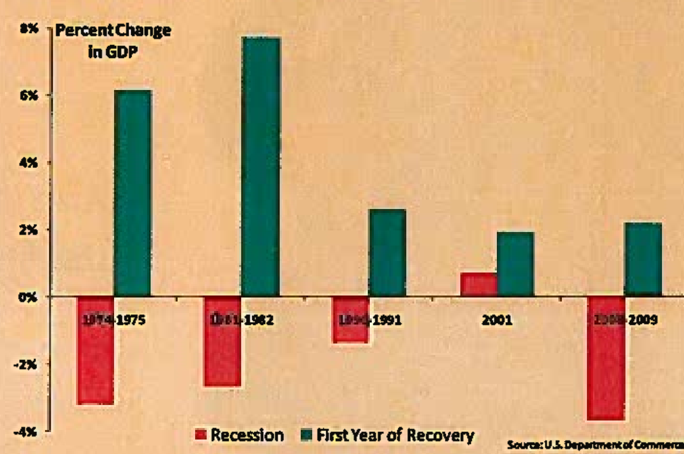
In addition to the troubling economic fundamentals described later in this report, the potential negative impacts of major policy initiatives currently being considered in Washington, D.C., including health care, climate change and the Employee Free Choice Act, would create additional burdens on manufacturers in the United States and the overall economy if enacted.

Any future policy changes that increase costs on U.S. manufacturers will likely result in a significantly weaker economic outlook.

Any cost increase, such as higher energy prices or surtaxes to pay for health care, would reduce U.S. manufacturers' ability to compete globally, produce, export, conduct research and development, and employ skilled and highly-paid workers.

Summary View

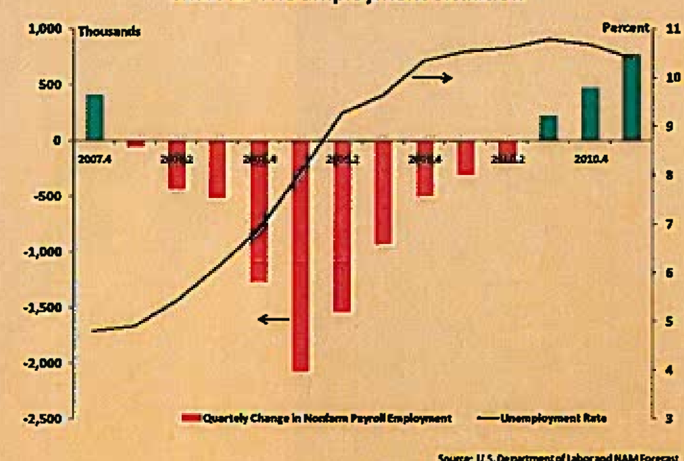
Chart 1. Recent Recessionary Cycles



The Economic Outlook. The 2008-2009 recession, which was both the longest and the deepest in the post World War II era, appears to be over. However, the likelihood of a strong cyclical rebound, such as those that followed the 1974-1975 and 1981-1982 recessions, is not promising (see Chart 1 above).

After falling 3.7 percent from the fourth quarter of 2007 to the second quarter of 2009, GDP is expected to rise a modest 2.2 percent during the first year of recovery. This is 68 percent slower than the first-year expansion following the most recent deep recessions mentioned above and nearly identical to the initial lackluster upturns immediately following the most recent mild recessions (1990-1991 and 2001).

Chart 2. The Employment Situation



Employment. An initial jobless recovery: After losing 6.8 million jobs from the fourth quarter of 2007 to the third quarter of 2009, an additional 1 million jobs are expected to be lost over the next three quarters, with the unemployment rate likely topping 11 percent mid-year 2010. Pre-recession levels of employment will not return until late 2012.

The recent 2.8-percent (SAAR) gain in third-quarter GDP underperformed the average 3.6-percent initial quarterly gain in GDP growth following the prior four recessions. However, recoveries have not always continued to accelerate.

First-Year Recoveries Following the 1974-1975 and 1981-1982 Recessions. After increasing by 4.1 percent in the initial quarter of the recovery, there was very strong GDP growth during the first year of recovery (6.2 percent after the 1974-1975 recession and 7.7 percent after the 1981-1982 recession). Both of these strong cyclical rebounds led to immediate gains in employment.

First-Year Recoveries Following the 1990-1991 and 2001 Recessions. After increasing by 3.1 percent in the initial quarter of the recovery, there was only modest GDP growth during the first year of economic recovery (2.6 percent after the 1990-1991 recession and 1.9 percent after the 2001 recession). A durable recovery in employment was delayed by at least a year in both of these recoveries.

The Current Recovery. Nearly half of the upturn in third quarter GDP was in consumer purchases of motor vehicles and residential investment, both of which were spurred by temporary government programs, namely "Cash for Clunkers" and homebuyer tax credits, the latter of which have been extended through April 2010. With the effects of these stimulus provisions likely to reverse (in the case of Cash for Clunkers) or moderate (in the case of the homebuyer tax credit) in coming quarters, determining whether the recovery will accelerate or decelerate will be driven more by underlying fundamentals.

Assessing the Fundamentals

The key for a self-sustaining expansion is for businesses to be confident enough to expand operations and hire workers. Unfortunately, there is little sign that this is taking place.

The current employment situation is far worse compared to the same period during the prior four business cycles. During the third quarter of 2009, overall nonfarm payroll employment fell by nearly 900,000, a 0.7-percent decline. This is more than twice as large as the average decline in the first quarter of recovery following the past four recessions.

At 10.2 percent, the unemployment rate is at its highest level since March 1983. While this is gloomy, the true state of the labor market is even darker. When discouraged workers and those who are employed on a part-time basis for economic reasons are included as unemployed, the current unemployment rate stands at a record 17.5 percent, equal to one in six workers.

The weak labor market has also put significant constraints on wage growth. Despite a 14-percent rise in government transfer payments, flagging wages have constrained the growth in overall real disposable income to just 1.1 percent during the year ending in the third quarter of 2009. This pace is less than half the average increase during comparable periods of the past four business cycles.

Unfortunately, signs of a turnaround in employment anytime soon are hard to find. Average weekly hours worked in the private sector, where an upturn is typically a precursor to actual increases in employment, remain at an all-time low.

While initial weekly claims for unemployment insurance have come down from the peak of over 650,000 earlier this year, they remain stubbornly above 500,000 and are not currently on pace to dip below 350,000, a level consistent with actual increases in employment, until mid-year 2010.

In addition, consumer confidence is very low. In the third quarter, consumer confidence was 37 percent below the level of the first quarter of growth during the past four recoveries. Also, consumer debt obligations are presently 28 percent higher compared to the last four recoveries, signaling that consumer demand, especially for big-ticket items, will be constrained.

So, with a struggling labor market, sluggish income growth, historically low confidence and historically high debt levels, a jobless recovery will continue to constrain consumer spending into the middle of next year.

With respect to business investment, signs of a robust upturn have not yet appeared. While conditions have improved, banks continue to have tight lending standards. At the same time, demand for commercial and industrial loans remains weak, showing that businesses have not become confident enough to begin investing. And given the fact that manufacturing's capacity utilization rate was at 67 percent in the third quarter, an upturn in business investment in the next several quarters is unlikely.

With respect to the housing market, conditions have improved compared to a year ago. Home prices have come down, and the excess supply of homes on the market has started to moderate. However, residential construction activity as well as the closely-watched National Association of Home Builders (NAHB) housing market index have basically come to a plateau during the past few months, signaling that momentum for a strong upturn in residential investment is not likely in the near term.

The one bright spot that has emerged in 2009 has been on the trade front. During the global recession, weak demand abroad caused exports to collapse. This decline especially hurt the manufacturing sector because nearly two-thirds of all U.S. exports are manufactured products.

However, after bottoming out in the first quarter of 2009, the major global economies have rebounded faster than the U.S. economy.
A global economic recovery, along with a competitive dollar, are positive developments that will help U.S. manufacturers going forward.

However, since exports are less than 13 percent of the U.S. economy and about a quarter of manufacturing output, continued growth in exports will only partially offset sluggish growth in other areas of the economy. Going forward, policymakers can increase U.S. manufacturers' ability to export by moving forward on the free trade agreements awaiting congressional approval as well as modernizing export controls.

The Current Outlook for Manufacturers

Results of the 2009 third quarter NAM/Industry Week Manufacturing Index, based on responses of NAM members, show that manufacturers expect only a modest uptick in their business activity during the coming year. Companies recorded their business outlook as well as their 12-month expectation for sales, prices, capital investment, inventories, employment and wages. Highlights of the third quarter results include:

- 65 percent of survey respondents do not expect an upturn in their company's production until sometime in 2010.

Looking ahead 12 months:

- Sales are expected to increase by 1.6 percent.
- Capital investment expenditures are anticipated to edge up just 0.2 percent.
- Employment is expected to remain essentially flat, rising just 0.1 percent.

While manufacturers' business outlook has improved compared to the worst parts of the recession, the fact that most companies do not anticipate an upturn in production to begin until sometime next year, along with the fact that expectations for growth over the next 12 months are muted, supports the expectation that the developing recovery remains fragile and will be sluggish over the coming year.

Prospects for the U.S. Economy

Consumer Spending. After increasing at an annual rate of 2.9 percent in the third quarter, consumer spending will decelerate over the next few quarters and edge up just 0.1 percent (SAAR) in both the fourth quarter of 2009 and the first quarter of 2010. Then, as the labor market begins to recover, consumer spending will gradually accelerate to 2-percent growth in the fourth quarter of next year. Consumer spending is not expected to improve to 3-percent growth until the first quarter of 2011.

Business Investment. Investment spending by businesses is expected to be restrained over next year, with spending on equipment expanding in the 1.5 to 2 percent range through the second quarter of 2010. By the fourth quarter of next year, business investment in equipment will be growing at an annual rate above 5 percent for the first time in three and a half years.

Housing. The recovery in residential investment will continue. However, the pace will decelerate to under 4-percent growth in the next several quarters due to spillovers from the weak labor market. Starting in the second quarter of next year, a more robust upturn will emerge.

International Trade. Over the next year, the dollar is expected to remain fairly stable, falling another 1 percent, as a gradually improving U.S. economy begins to catch up with recoveries abroad. U.S. exports will have a solid rebound and grow by 7.2 percent next year, faster than the 5-percent rise in imports.

Outlook for GDP and Manufacturing Production. With consumer spending and business investment remaining tepid in the near term, the overall economy will decelerate to 2.3-percent growth in the fourth quarter and average just 1.8-percent growth during the first half of 2010. Thus, the current recovery will be more like the sluggish upturns following the last two recessions.

As the labor market begins to improve in the middle of next year, more solid growth in consumer spending and business investment will join upturns in housing and exports, and a self-sustaining recovery will finally begin to emerge.

After increasing by a more solid 2.7 percent in the third quarter of next year, the economy will accelerate to 3.1-percent growth in the fourth quarter. Still, the economy is not expected to reach its pre-recessionary level before the first half of 2011.

Driven by modest consumer spending and business investment, overall manufacturing production will increase at an annual rate of just 1.6 percent through the first half of 2010 before accelerating to a stronger 4.3-percent rate of growth in the second half of next year and 4.6 percent in 2011.

Employment Expectations

With the economy expanding below its potential at just 2.4 percent next year, the labor market will remain weak and job losses will continue into mid-2010.

After falling by 6.8 million from the fourth quarter of 2007 through the third quarter of 2009, another 1 million jobs are currently forecast to be lost by the middle of next year.

Since the recession began, manufacturing has been hit harder than any other sector, with employment losses totaling over 2 million, or 29 percent of total jobs lost to date. This relationship is expected to hold going forward. Of the 1 million jobs expected to be lost during the next three quarters, nearly 300,000, or 29 percent, will be in manufacturing.

The unemployment rate is expected to continue to increase to peak at 10.8 percent in the third quarter of next year, though an individual monthly rate of at least 11 percent is likely. While net employment gains will begin in the second half of next year, the initial increases will be rather mild and just large enough to offset the decreases in the first half of the year.

Overall nonfarm employment is not expected to reach its pre-recessionary level of 138 million until the third quarter of 2012, at which time the unemployment rate will have moderated to 7.2 percent. During this time, manufacturing employment is expected to increase by 440,000 to a level of close to 12 million, still 1.9 million below the level at the start of the recession.

David Huether, NAM Chief Economist

The NAM Economic Outlook, December 2009

	GDP annualized (% change, SAAR)										Q4/Q4 (% change)			
	2008	2009				2010				2011				
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	2008	2009	2010	2011
Gross Domestic Product	-5.4	-6.4	-0.7	2.8	2.3	1.8	1.8	2.7	3.1	4.0	-1.9	-0.5	2.4	5
Private Domestic Final Sales*	-5.5	-6.2	-2.3	2.1	-0.7	0.0	1.1	2.3	2.8	4.1	-2.7	-1.8	1.6	4
Manufacturing Production	-18.4	-21.7	-8.1	8.4	1.5	2.2	1.2	4.5	4.1	4.6	-8.7	-5.0	3.0	4.6
Consumption														
Total	-3.1	0.6	-0.9	2.9	0.1	0.1	0.7	1.6	2.0	3.2	-1.8	0.7	1.1	4.2
Durable Goods	-20.3	3.9	-5.6	20.1	-6.1	0.6	0.3	2.5	3.5	4.8	-11.8	3.1	1.7	6.6
Nondurable Goods	-4.9	1.9	-1.9	1.7	1.7	-0.4	0.9	1.9	2.6	2.8	-2.9	0.8	1.3	3.2
Services	0.5	-0.3	0.2	1.0	0.8	0.1	0.7	1.3	1.5	3.0	0.3	0.4	0.9	4.1
Investment														
Total Fixed	-20.2	-39.0	-12.5	0.3	-2.2	-0.3	3.0	6.5	7.6	9.4	-9.6	-13.4	4.2	11.9
Nonresidential	-19.4	-39.2	-9.6	-4.1	-3.9	-1.4	0.6	3.0	4.9	6.8	-6	-14.2	1.8	8
Structures	-7.2	-43.6	-17.3	-15.1	-16.4	-8.2	-1.6	1.5	4.5	9.6	3.2	-23.1	-1.0	13.2
Equipment & Software	-25.9	-36.4	-4.9	2.3	2.0	1.6	1.5	3.7	5.2	5.8	-10.7	-9.2	3.0	6
Residential	-23.2	-38.2	-23.2	19.5	3.8	3.6	11.7	18.5	16.3	17.6	-21	-9.5	12.5	23.9
Imports & Exports														
Net exports*	-470.9	-386.5	-330.4	-358.0	-352.1	-348.3	-350.2	-342.3	-336.9	-327.7	-494.3	-356.7	-344.4	-311.4
Exports	-19.5	-29.9	-4.1	17.0	2.5	5.4	7.0	7.8	8.6	10.7	-6.8	-3.6	7.2	8.1
Imports	-16.7	-36.4	-14.7	20.8	2.9	3.5	6.1	4.6	5.8	6.8	-3.4	-6.9	5.0	12.5
Government - Nominal														
Total	-4.7	-3.7	7.2	3.1	4.1	3.5	3.8	3.3	3.1	2.6	3	2.7	3.4	1.1
Federal	2.1	-2.7	11.9	8.3	3.8	3.2	4.2	3.7	4.2	3.8	8.9	5.3	3.8	2.2
State & Local	-8.7	-4.3	4.3	-0.1	4.3	3.7	3.6	2.9	2.4	1.8	-0.3	1.1	3.2	0.6

* GDP less inventories change, net exports and government spending
** Billions 2005 dollars

	Labor Market (quarterly change in thousands)										Q4/Q4 (change in thousands)			
	2008	2009				2010				2011				
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	2008	2009	2010	2011
Total nonfarm payroll employment	-1,270	-2,070	-1,540	-930	-500	-300	-200	220	470	770	-2,270	-5,040	190	3,760
Total Private	-1,270	-2,070	-1,580	-800	-560	-330	-370	420	540	760	-2,480	-5,010	260	3,510
Manufacturing	-330	-590	-460	-240	-130	-80	-80	0	20	50	-720	-1,420	-140	220
Unemployment Rate	6.9	8.1	9.3	9.6	10.3	10.5	10.6	10.8	10.7	10.4	5.8	9.3	10.7	9.6

Source: U.S. Departments of Commerce and Labor and NAM forecast based on Economy.com's Macro Model