Slowing Down

The March rebound in the index continued in April, although at a slightly reduced pace. The national economy, as expected in our previous reports, expanded in the first quarter of 2011 at exactly 1% lower rate than in the second half of 2010 (BEA). This slowdown affected our regional manufacturing as well. We observed a sharp pullback in manufacturing activity in February, but then a rebound occurred in March. The March rebound continued into April but at a slightly decreasing rate. The current performance suggests that the March rebound returned us to the pre-February levels of growth and in April the economy just slowed a little in growth but remained near the March levels of expansion. However, given the rise in commodity prices it is difficult to argue that the March –April levels will continue. Historically, April is a month of season rebound, and we failed to see that effect this year.

The region’s seasonally adjusted PMI edged down from 60.9 in March to 60.8 in April. This is still a solid performance for our index, as it has now remained above 60 for two consecutive months. The last time we saw the region’s PMI remain above 60 for two consecutive months was in July – August of 2008. These levels are consistent with the manufacturing sector expansion and the expansion of the overall regional economy. However, the index failed to continue to go higher in April. The non-seasonally adjusted PMI increased by 2.5 points and in light of a declining seasonally adjusted PMI this suggested that the seasonal boost this year was weaker than the historical norm.

After reaching the highest level since August of 2008, the region’s seasonally adjusted production indicator declined slightly in April (67.5, down from 68.6 in March). But the individual responses continued to show strong optimism. The index decline was not contributed to more responders reporting lower production levels but to the seasonal factors. The non-seasonally adjusted indicator did continue to climb up in April. April is a month of rebound in production, and the rebound seen in 2011 fell short of what the historical seasonality implied for our region.

The seasonally adjusted New Orders indicator advanced slightly in April to 57.2 from 57.1 in March. The number of responders indicating higher new orders increased by 6.1%, while the number of responders indicating reduced new orders activity declined by 4.6%. This continued to paint a positive short-term outlook for our region’s manufacturing.

The negativity is seen in Employment and Commodity Price indicators.

Although our non-seasonally adjusted employment indicator remained flat at 50 in April, the seasonally adjusted indicator posted a 1.8 point decline to 48.6 in April. We continued to see more than half of our survey responders indicating constant employment levels. This suggests that the output recovery does not translate into a substantial job growth.

Commodity prices continued to remain a serious concern, as nearly 77% of our survey responders indicated higher commodity prices in April. Our seasonally adjusted Commodity Price indicator reached 88.5, a level not seen since June of 2008, the time when the oil price hovered near its all time high.

There have been several factors feeding into the model and affecting the economic performance. One of these has been the meltdown in the value of the USD. This helps revive the manufacturing sector across the country and helps reduce the competitive pressure imposed by foreign manufacturers. For our region, the closely watched USD/CAD rate has been in our favor in 2011, as the USD posted significant declines against its Canadian counterpart. But this is a double-edged sword, as a declining USD also helped push up the prices of commodities. The declining USD, the budget deficits, the ongoing monetary expansion (all, characteristics of one problem – budget deficits) all helped push up commodity prices as the starting point of this wave of inflation. This inflation is primarily caused by government economic policies and as a result it has originated in commodities. But at this point in time it has already started spreading into a broadly defined economy. Although the core inflation continues to remain low, the overall inflation as measured by the CPI advanced prices by 0.5% in February and March (BLS). This means that the US economy was running at above 6% annual inflation in February – March, and based on the behavior of food and gasoline prices it is difficult to argue that that rate softened in April. In fact, we are probably yet to see the peak of inflation at some point this summer.

Inflation, coupled with high unemployment will make it difficult for businesses to pass their costs increases onto consumers in the form of higher prices. At least this will be an issue in the domestic market. Based on recent earnings releases we see that our businesses are experiencing these difficulties in the US market, but of course the weaker USD helps offset it with the foreign exposure. However, this inflation will likely cause reduced employment growth, and that could help further weaken the pace of this expansion. This is not likely to be a repetition of the summer of 2008 as the Fed policies are different today and the housing bubble is no longer there, plus the stock market bubble appears to be supported by the printing press and inflationary pressure. But, the second quarter expansion is likely to continue to be below the trend of the second half of 2010.

May 2, 2011

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