Machining

Hype or Reality: Is Manufacturing Really Doing This Well in 2017?

Don Sears & Julie Sullivan | Nov 22, 2017

What You Need to Know:

The trend lines in manufacturing show expansion and confidence in 2017.
Manufacturing grew despite natural disasters such as Hurricane Irma and the floods in Houston, though companies are worried about health insurance costs.
To help widen the perspective on the manufacturing economy, it helps to know what investment economists and financial analysts think: They like what they see.
After a decade of little activity, capital goods investment is a positive sign of an uptick in business confidence and will help the manufacturing industry.

Will 2017 go down as a strong year in the manufacturing industry? Third-quarter and year-over-year trend lines suggest it will. The question is whether growth will expand in the fourth quarter and into 2018.

It has been a *positive* year for ***positive sentiment*** and activity in manufacturing, especially in the U.S. There is strong, measurable growth and confidence in cutting tool activity, purchasing manager indexes and capital and durable goods spending. The key economic trend lines for manufacturing show healthy business investment and activity in 2017, but has it peaked or will it keep momentum?

Preliminary ***GDP numbers*** show the economy is growing 3 percent for the year. The Purchasing Managers Index is ***expanding*** globally. ***Durable goods*** and capital ***goods activity*** through September are up, too. Manufacturing makes up about 12 percent of the U.S. economy and is being helped by continued replenishment of business inventories, and “business investment in equipment has contributed to GDP growth for four straight quarters,” says Reuters.

“Orders for non-defense capital goods excluding aircraft—seen as a measure of business spending plans—surged 1.7 percent in September instead of the 1.3 percent increase reported last month,” ***finds*** Reuters. “September’s increase in these so-called core capital goods orders was the largest since July 2016.”

From October 2016 to October 2017, the Institute for Supply Management’s PMI has averaged 57 percent. Anything over 50 percent in the PMI is considered a strong economic indicator.

"In these surveys—produced at huge cost and involving thousands of interviews in each country with real business people—a reading above 50 indicates an acceleration in activity," ***notes*** Paul Colgan, editor in chief of Business Insider Australia. "The more above 50 you are, the faster the expansion."

Most manufacturers are feeling good—with many economists and financial watchers giving a resounding "thumbs-up" to the indicators with limited trepidation. Where is there any trepidation? Exports, backlogs and peak rates of growth. The Gardner Business Index, which tracks metalworking industry activity closely, ***found signs*** of export contraction and a "slight lag" in backlog in August. A one-month change, however, does not necessarily bring the trend line down for the year.

"In the year-to-date and one year ago periods, the GBI is up 8.7 percent and 12.2 percent respectively," notes Michael Guckes, chief economist at Gardner Business Intelligence in an August report.

When looking at durable goods through the lens of 10-year Treasury note rates, ***Gardner believes*** durable goods reached peak growth in September. Still, ***metalworking*** industry activity has had positive growth news overall.

"Despite usual summer month volatility, year-to-date cutting tool shipments remain 7 percent above their 2016 levels," says Gregory Daco, chief U.S. economist at Oxford Economics in the US Cutting Tool Institute (USCTI) and AMT—The Association For Manufacturing Technology November ***press release***.

Despite Natural Disasters, Manufacturing Confidence Still Grew

So, where's the rub? Several tragic natural disasters briefly ***disrupted the supply chain*** this year and put a pause on some manufacturers' operations, which increased lead times for fulfillment and led to higher costs, relay respondents in the ***PMI report***. Some are worried about rising healthcare costs to impact the bottom line, according to the ***National Association of Manufacturers***. Others are concerned with changes to U.S. trade policies.

"Passage of a pro-growth tax cut package could further boost business activity and optimism, but the risk of protectionist measures still looms over the outlook," says Daco.

Nevertheless, there is continued confidence in the manufacturing industry itself. NAM ***forecasts*** production to grow by 3.6 percent between now and the first quarter of 2018, with the output growing 1.2 percent year over year. Smaller companies with 50 employees or less expect sales to rise 3.8 percent on average over the next year.

"[T]his year we have seen the highest consecutive three-quarter average—90.9 percent having a positive outlook for their company—in the survey's history," reports ***NAM*** in its Third Quarter Outlook report, which has been published for 20 years.

Has 2017 Really Been *That* Good for Manufacturing?

It may be easy to dismiss manufacturing association sentiment whose job it is to promote the industry. But when examining the pure economic data, it's really hard to argue 2017 has not been a strong one to date. Take a look at how economists and financial analysts view the data.

"You know what's good for the economy, and a sign of a healthy business environment?" ***asks*** Stephen Guilfoyle, founder and president of Sarge986, and a former chief market economist for Stuart Frankel & Co. "Core capital goods orders, that's what, and that line does not get enough media attention when durable goods orders are reported by the Census Bureau each month. Headline: Durable goods crushed expectations in September. Ex-transportation? Ex-defense? Crushed it."

Guilfoyle is not alone. Others see similar trend lines and positive growth. The question, as always with leading versus lagging economic indicators, is whether the growth will be sustained.

"For the third quarter, non-residential fixed investment—a measure for business investment—accelerated to a 5.8 percent year-over-year growth rate," ***notes*** Seeking Alpha, an investor and financial analysis tracker.

Why care what economists and investor analysts think of manufacturing data? Because manufacturing continues to be a major contributor to the overall U.S. economy.

"Manufacturing generates $1.40 in economic activity for every dollar put in, according to the U.S. Bureau of Economic Analysis, far greater than the multiplier generated by business services, information, retail trade or finance," says Joel Kotkin, executive director of the Center for Opportunity Urbanism and a professor at Chapman University, in an ***article for Forbes***.

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Current Problems in the Manufacturing Industry

As the ***NAM*** survey reported, 32 percent (over one-third) of respondents said they were "unsure" whether the United States was headed in the right direction. In the past four surveys, however, far more respondents questioned the government's decisions.

What's more, rising health insurance costs are also cause for concern with many organizations. A hefty 72 percent of manufacturers cited insurance costs as a top business challenge, with many anticipating costs to increase into 2018. A larger 76 percent of survey respondents believed that their premiums would increase by at least 5 percent by this time next year.

"What could screw this up?" asks Guilfoyle. "[M]aybe interest rates that rise too fast … It is also possible that fears of tighter monetary conditions are bringing activity forward to some degree. That could hurt later."

What Are Expectations for Manufacturing in 2018?

The good news is these concerns are not necessarily keeping companies from investing back in themselves in the kinds of durable and capital purchases they had been delaying in less than ideal economic conditions.

"It only seems like yesterday that American businesses spent nearly a decade finding ways to not invest in themselves other than through payouts to shareholders," says Guilfoyle. "American business is back, and the economy is clearly strengthening."

What do manufacturers themselves believe will happen next year? The NAM report sheds some additional light in these specific areas:

- Medium-sized businesses expect to increase hiring by 2.6 percent.
- Less than 3 percent (2.7) expect capital spending growth (down from 3.2 percent in 2Q).
- More than 32 percent expect capital expenditures to rise by at least 5 percent.
- Three percent average growth is expected in capital spending for medium-sized manufacturers.
- Inventories are expected to grow by 1 percent (for the third consecutive increase after seven straight quarters of declines, the fastest pace in 19 years).

Time will tell if growth continues. There is still data to be collected in the remainder of the calendar year for the fourth quarter. Seeking Alpha may sum it up best:

“Though we do not expect neither business investment nor domestic growth to be ‘off to the races’ from here, we are closely monitoring key economic indicators to determine the sustainability of the upturn.”

How does your business feel about the current state of manufacturing? Tell us in the comments.

