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What's Up With Manufacturing?

The most recent signposts on recession recovery offer some good news and mixed emotions. The good news is that, for one segment of our economy, 2009 will be a year of record profits. The mixed emotions are that this blessed sector is the same group of Wall Street companies that were largely to blame for the crash.

For the rest of us, the continuing sluggishness in housing, the bad news on employment and a host of other signals – some positive, some negative – show that recovery will not be swift.

A few of the glimmers of hope were in the manufacturing sector. Factory production ran at 70.7 percent of capacity in October, a very tepid number, but still up from June's record low of 68.3 percent. Manufacturing output fell 0.1 percent, but that decline was largely attributable to the end of the cash for clunkers program, which caused automotive production to decline by 1.7 percent last month.

Other positive signs came from the report for October by the Institute for Supply Management:

- The Purchasing Manager's Index (PMI) was the highest level since April, 2006. The PMI is a composite of five economic indicators.
- The new order index was up for the fourth month in a row.
- The production index was up significantly, with only two of thirteen industries reporting a decline.
- The employment index showed growth for the first time in fourteen months.

All of these good signs are welcome but still must be considered to be fragile. And, even if they continue, they do not portend a vigorous recovery, but a slow return to normalcy.

The government has started to become interested in assisting manufacturing industries. In August, the White House announced an agenda to partner with the private sector to "spur innovation", to "invest in the skills of American workers", and to promote exports. These objectives are too general to offer an idea of the specifics, but at least attention is now focused on manufacturing.

Waiting around for the government to develop the specifics would, we believe, be a mistake. Industry would be much better served by taking a proactive stand – communicating with congressional representatives and administration officials to suggest and promote ideas that could assist in bringing back this critical sector.

It is likely that a main prong of the government's effort will be in providing assistance for R&D on new approaches to manufacturing, particularly in energy conservation and perhaps in developing new or better products. These might be positive initiatives, but a good deal of help could also come from other measures, particularly those that would relieve the burdens and competitive disadvantages American manufacturers now face.

We have spoken of some of these measures previously. They include vigorous enforcement of laws prohibiting unfair trade practices, an end to subsidies paid by states and localities to attract foreign companies, a remediation of the health care system problems that would reduce the costs of our companies, a stabilization of higher education costs and fees, and careful attention to the effects of legislative proposals on the ability of manufacturers to make and sell their products.

Manufacturing was the backbone of the American economy for much of our history. The economic storm that we now are navigating should show to any doubters that our fortunes cannot be left solely to the services sector – the banks, the lawyers and the technicians. It is not too late to put our citizens back to work making things.

Turning to some of the cost factors for our products:

- <u>Scrap and Pig Iron</u> The prices for #1 dealer bundles and #1 busheling were down this month, to $260 and $265 per mt, respectively. After a three month run-up, we have seen a three month decline, bringing current prices to the levels of last summer. The spot price for Brazilian pig iron (cif New Orleans) is $300 per mt, down for the second month in a row.

- <u>Natural Gas</u> The Nymex contract price was fairly steady, down 16¢ (4%) to $3.76 per mcf. No doubt you have seen the recent publicity given to enhanced techniques for capturing natural gas supplies, as well as the increased efforts to market the product as a clean energy source. For the time being, the former should prevail as a price governor, but the long-term prospects are for increased demand and, hence, increased prices.

- <u>Ocean Freight</u> The Baltic Capesize Index jumped almost 75%, to 6113. The increase seems to reflect greater Chinese requirements for coal and ore imports.

- <u>Foreign Exchange</u> The dollar has stabilized some, at least for a time. Since last month, the euro is unchanged at $1.49; however, the pound's value increased 4 cents, to $1.67. The Canadian dollar was up two cents to $0.94.

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