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MANUFACTURING FOCUS

Worst Year in Decades for Manufacturers...

...but Reason for Optimism in 2010

SCDigest Editorial Staff

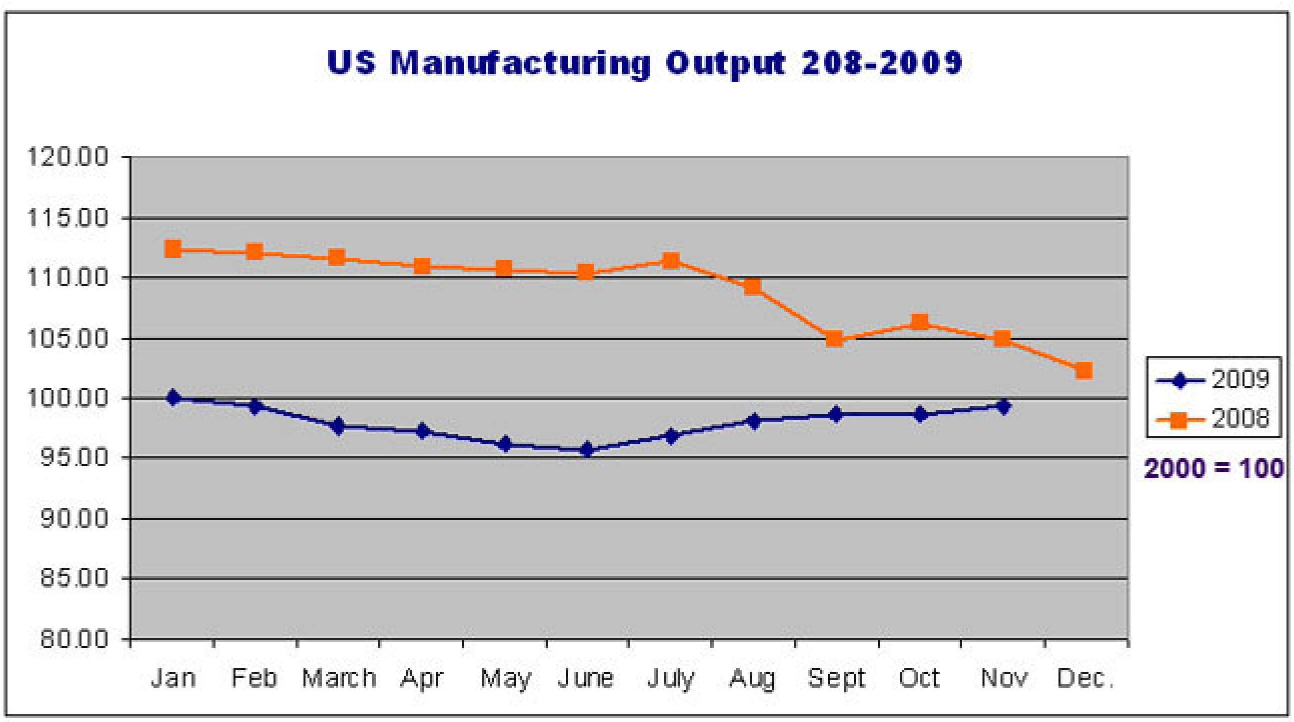
2009 will go down as a year manufacturers in the US and the world over will want to forget, with dramatically falling output and capacity utilization.

While the statistics show the sad but true tale, the good news is that overall the economic indicators are pointing up, in some cases strongly so, and 2010 could in fact be a year of relatively strong recovery for the manufacturing sector.

The recession in fact started sometime in 2008, and was simply taken to the next level by the dramatic collapse of the financial system in September of that year, leading to the dismal 2009.

As can be seen from the chart nearby, based on data from the Federal Reserve, US manufacturing output was already starting to drop dramatically from a peak in early 2008 through the rest of that year, and continued to remain at depressed levels for 2009.

The index uses manufacturing output in the year 2002 as its base, or value of 100. Thus, manufacturing output in January,



2008 was roughly 12% above 2002 levels. By the end of that year, it was just over that 100 level, and fell below 2002 levels in February, 2009, bottoming in June of last year with an index score of just 95.75.

While the number has stayed below 100 since then, there is a clear rising trend from June through November, the latest month for which data is available.

In a sense, the story was even worse in terms of factory utilization, which plummeted even below levels of the severe recession in 1981-82 to rates not seen since the Great Depression.

As shown in the chart below, US factory utilization remained below 70% for the entire year, versus an average of almost 80% for the period between 1972 and 2008.

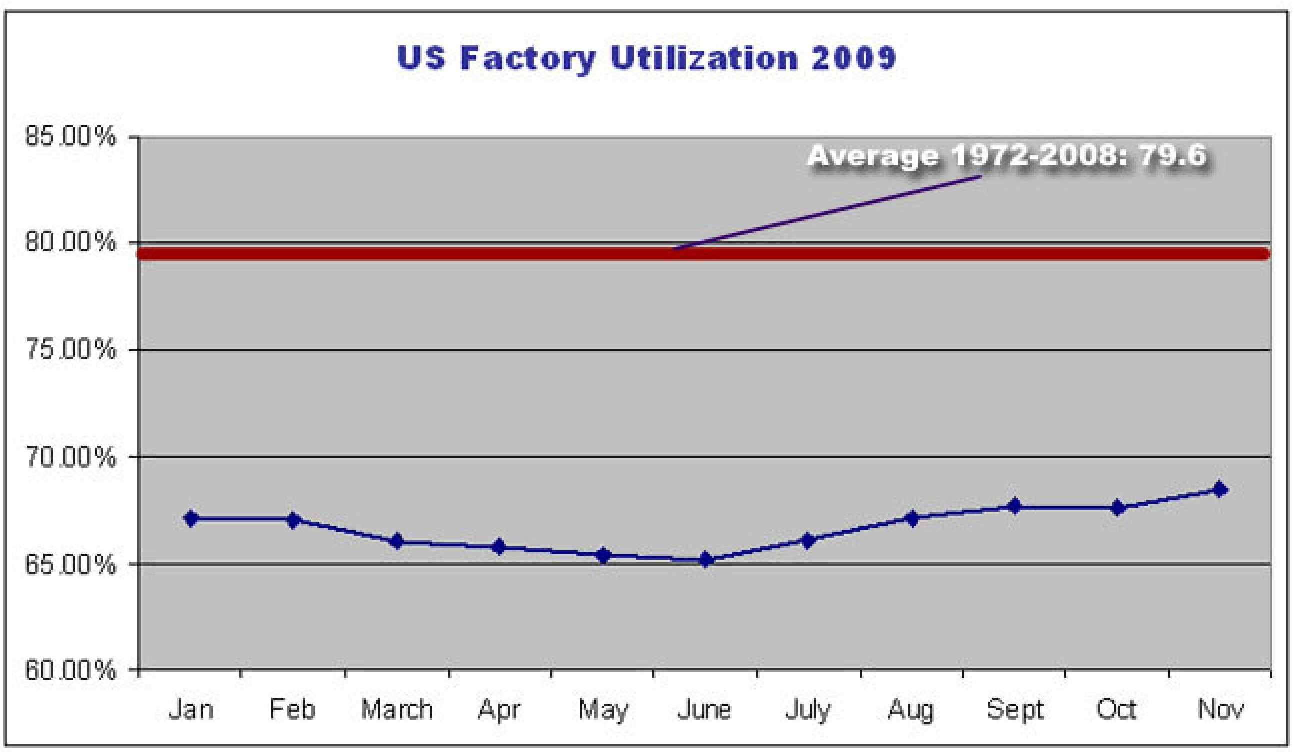
Part of the problem, in a sense, is that unlike many previous recessions, less capacity than normal left the market given the drop in demand. The auto industry provides a good example of this, as many US factories stopped producing vehicles for weeks or months, especially in the first half of the year, but very few if any of these plants as yet have actually closed.

In fact, the Federal Reserve reports US manufacturing capacity has only declined about 1.2% since November of 2008 - a low drop by historical standards given the severity of the recession.

As with output, factory utilization bottomed in June, at about 65%, and has made a modest recovery since then, to about 68%. However, there is still a long way to go to get back to historic levels. As usual, however, the impact was not evenly felt across manufacturing sectors.

While every single sector has had a decline in utilization since the Dec. 2007 peak, the damage ranged from an incredible 31-point decline in utilization at metals producers and 25 points in the high-tech sector, to nearly flat in the oil sector, and just a 2% decrease in food factories. You have to keep eating.

Paper, plastics, electrical equipment, apparel, and textiles all saw utilization drops of between 10 and 20% from the peak. Chemicals dropped about 8%.



ISM Data Reason for Optimism

In addition to the rising numbers in output and utilization, fresh data from the Institute for Supply Management (ISM) also give reason for optimism for the coming year.

Just released today, the ISM Manufacturing Index for December saw a 2.3 point increase in the purchasing manager's index (PMI) to 55.9, sending it to the highest level of the year. (Any score above 50 indicates manufacturing expansion.) By contrast, the PMI in January of 2009 was 35.6, indicating severe contraction.

This marks the fifth straight month of expansion in the PMI, as shown in the chart from ISM below.

Other indicators also remain strongly positive, with new orders up for the sixth straight month, and production growing for the seventh straight month. Pundits were a bit worried that this month's report showed no increase in order backlogs, but other than that the ISM data looks very bullish for manufacturers and gives hope we can forget about the awful year of 2009 soon enough.

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MANUFACTURING AT A GLANCE
DECEMBER 2009

Index	Series Index December	Series Index November	Percentage Point Change	Direction	Rate of Change	Trend* (Months)
PMI	55.9	53.6	+2.3	Growing	Faster	5
New Orders	65.5	60.3	+5.2	Growing	Faster	6
Production	61.8	59.9	+1.9	Growing	Faster	7
Employment	52.0	50.8	+1.2	Growing	Faster	3
Supplier Deliveries	56.6	55.7	+0.9	Slowing	Faster	7
Inventories	43.4	41.3	+2.1	Contracting	Slower	44
Customers' Inventories	35.0	37.0	-2.0	Too Low	Faster	9
Prices	61.5	55.0	+6.5	Increasing	Faster	6
Backlog of Orders	50.0	52.0	-2.0	Unchanged	From Growing	1
Exports	54.5	56.0	-1.5	Growing	Slower	6
Imports	55.0	51.5	+3.5	Growing	Faster	4
OVERALL ECONOMY				Growing	Faster	8
Manufacturing Sector				Growing	Faster	5

*Number of months moving in current direction.

Source: ISM