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**Texas Manufacturing Outlook Survey****October 2006****Factory Activity Continues to Cool from High Levels**

The state's manufacturing activity expanded in October, but a larger share of factories reduced output than in the previous month, according to the Texas Manufacturing Outlook Survey.

Manufacturers were more optimistic about their companies' operations than the rest of the economy. Sentiment on general business activity was slightly negative in October. Most firms, however, expect increases in production and the volume of new orders and shipments six months from now.

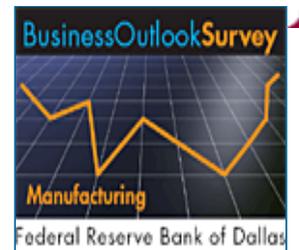
After rising to high levels in the first quarter, the manufacturing index for current production has drifted lower. It has fallen from a high of 45.3 in January to 8.4 in October. The pattern reflects a Texas economy that has slowed some after expanding strongly over the past year.

The share of companies increasing output rose from 24 percent in September to 27 percent in October. The production index slipped because firms decreasing output went from 13 percent to 18 percent. The results suggest some industries are doing better than others. Overall, Texas' manufacturing base continues to be among the fastest growing in the nation. The state's factories are adding workers, while manufacturers are shedding jobs in other parts of the country.

The Dallas Fed conducts the Texas Manufacturing Outlook Survey monthly to obtain a quick assessment of the state's factory activity. Firms are asked whether output, employment, orders, prices and other indicators increased, decreased or remained unchanged over the previous month. Readings above zero point to expansion, while negative levels indicate contraction.

The October survey found:

- The index for volume of shipments remained positive and rebounded slightly.
- Indexes for volume of new orders and growth rate of orders remained negative and fell further. The index for unfilled orders improved but is still below zero.
- Index values for material and finished goods inventories remained positive and increased.
- Producers were more optimistic about the condition of their own firms than they were for general business activity. The index for company outlook decelerated but remained above zero. The index for general business activity fell negative for the first time since the survey began in mid-2004.
- The finished goods price index was zero in October, the lowest index value since the series started. The raw materials price index continued to weaken but remained positive, with a third of responding firms still reporting increases in the prices paid for inputs. The wages and benefits index also rose in October, and no firms reported decreases in wages.

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- There continued to be upward price pressures in the future, although they were lessening. The index for finished goods prices six months from now remained positive, with 23 percent of firms expecting finished goods prices to rise. Most firms expect raw material prices to increase in the future.
- The index for number of employees remained positive and increased slightly.

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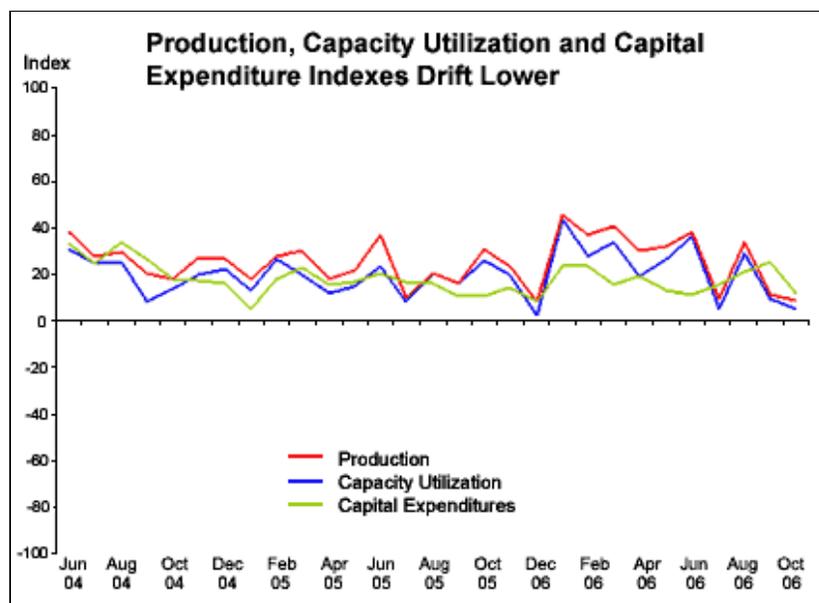
### Production, Capacity Utilization and Capital Spending Cool

The Texas Manufacturing Outlook Survey suggests factory [production](#), [capacity utilization](#) and [capital expenditures](#) continue to expand but at a slower pace than earlier this year.

A larger share of firms (27 percent) reported an increase in [production](#) in October than in September (24 percent), but there was also an increase in the share of firms reporting a decrease (up from 13 percent to 18 percent.)

The [capacity utilization index](#) declined slightly from 9.5 last month to 5 in October. A slightly smaller share of firms (23 percent) reported an increase, and a slightly larger share (18 percent) reported a decrease.

Twenty-two percent of responding firms said they had increased [capital expenditures](#), down from the 30 percent that reported an increase last month. Just 10 percent said capital expenditures decreased in October.



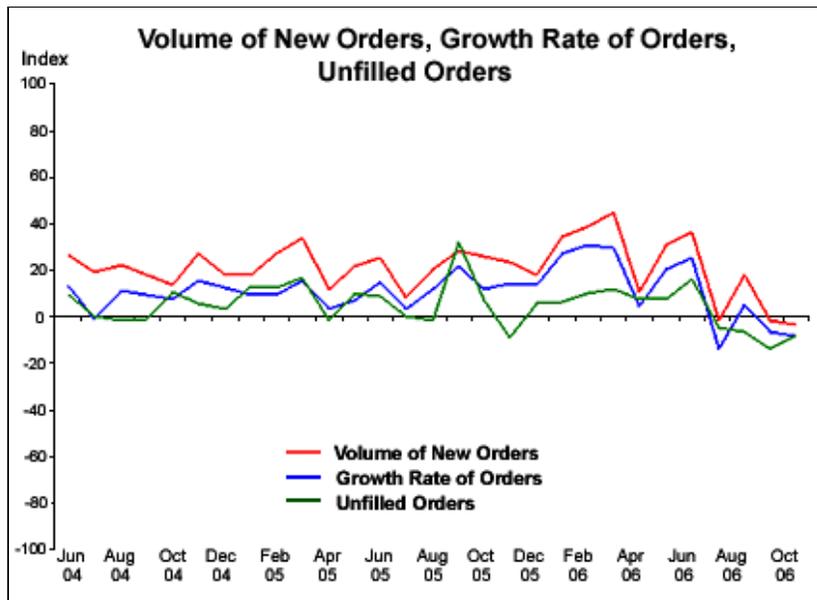
Future indicators suggest optimism about the outlook for activity. Most business executives (48 percent) expect production to increase six months from now, pushing that index up from 28.5 to 36.6. Only 12 percent of firms expect production to decrease six months from now. The future capacity utilization index also remains high, at 35. Forty-five percent of firms expect capacity utilization to increase—the same percentage that expects no change. Only 10 percent expect capacity utilization to decline in the future.

### Orders Dip

The three indexes for orders remained negative in October. The majority of respondents continue to report no change in these indicators, but a larger percentage of business executives reported a decrease than an increase.

The [growth rate of orders index](#) declined from  $-6.5$  last month to  $-8.4$  in October. A larger share of business executives (32 percent) reported a decrease in the growth rate of orders. Twenty-three percent of respondents reported an increase in this variable.

The [index for unfilled orders](#) rebounded slightly, from  $-14.3$  to  $-8.4$ . Slightly fewer respondents (22 percent) said unfilled orders had decreased this month, and a larger share of firms (13 percent) said unfilled orders had increased.

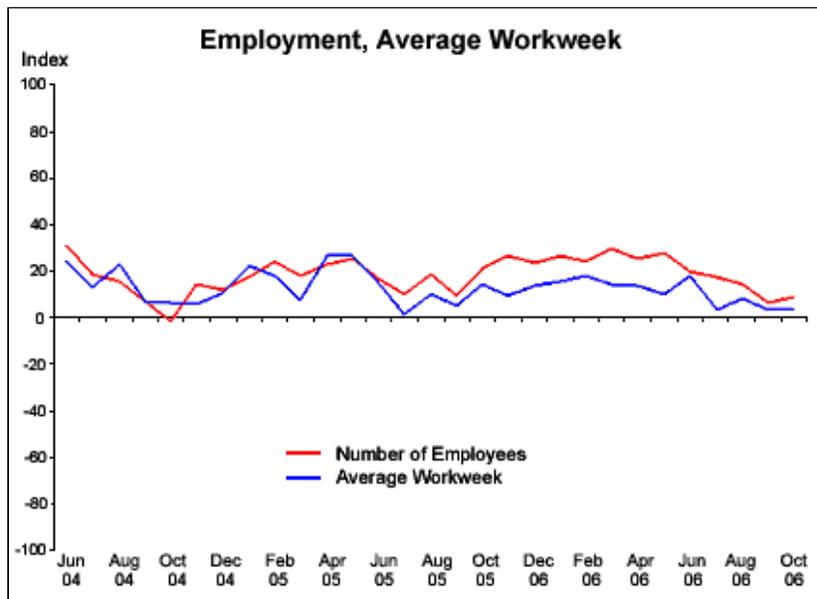


The [index for materials inventories](#) increased from 9.5 to 15 in October. The index for finished goods inventories was also up, rising from 12.7 last month to 21.6 in October. A third of responding executives said finished goods inventories had increased at their firm in October.

The [index for delivery time](#) remained negative in October but rebounded slightly, increasing from -4.8 to -1.7. More than three-fourths of responding business executives reported no change in this indicator, but there was a slight decrease in the percent of firms reporting a decline.

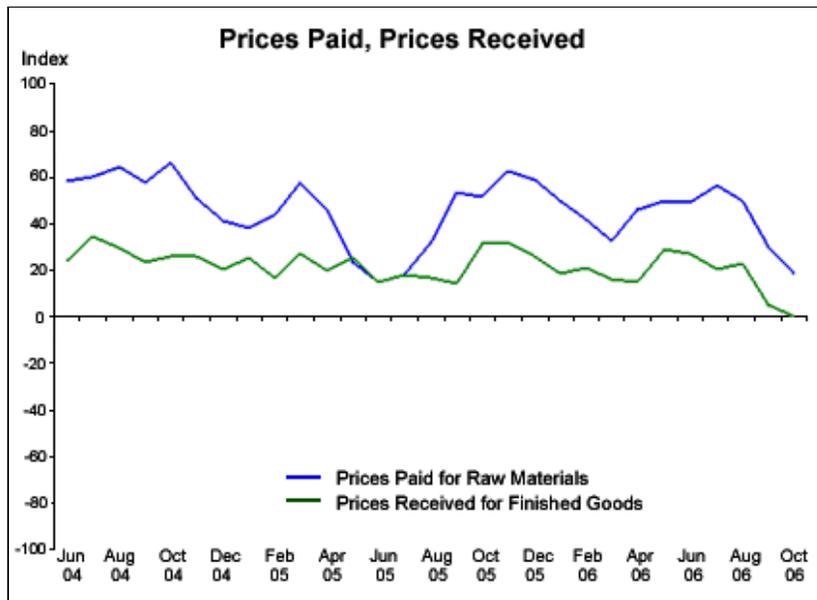
**Labor Market Growth Continues**

Index values for [number of employees](#) and [average employee workweek](#) rebounded slightly. Twenty-four percent of firms reported a gain in the number of employees in October, and 20 percent said the average employee workweek had increased. Forty percent of responding executives plan to increase the number of employees six months from now.



**Upward Price Pressures Continue to Recede**

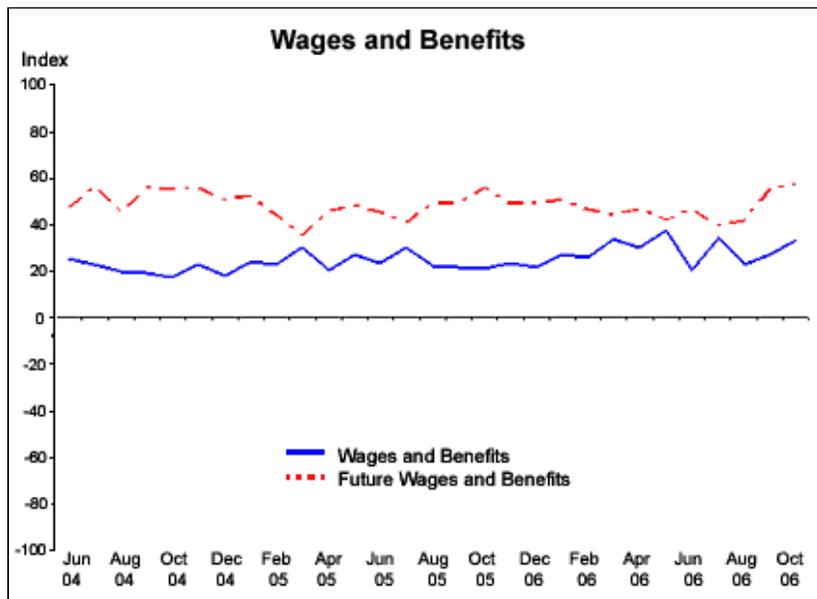
The October [index for finished goods](#) prices fell to zero for the first time since the index began. An index value of zero is registered when the share of firms (15 percent in October) reporting an increase is the same as that reporting a decrease. The future index for finished goods prices drifted lower, from 25.8 to 11.7, with 27 percent of firms expecting prices received to increase six months from now and 15 percent expecting price declines.



The [index for raw materials](#) prices also continued to drift lower, dipping from 30.2 to 18.4 in October. Most business executives (55 percent) reported no change in materials prices since last month, but 32 percent reported an increase.

Forty-seven percent of firms continue to expect increases in future raw materials prices, although the percentage was slightly smaller than last month. The percentage of firms expecting a decline dipped, causing that index to rebound from 31.7 to 36.7.

The [wages and benefits index](#) rose from 27 to 33.3. Thirty-three percent of business executives said wages and benefits had increased in October. The index value for future wages and benefits jumped from 55.5 to 57.6. Fifty-eight percent of manufacturers expect an increase in future wages and benefits, and none expect a decrease.

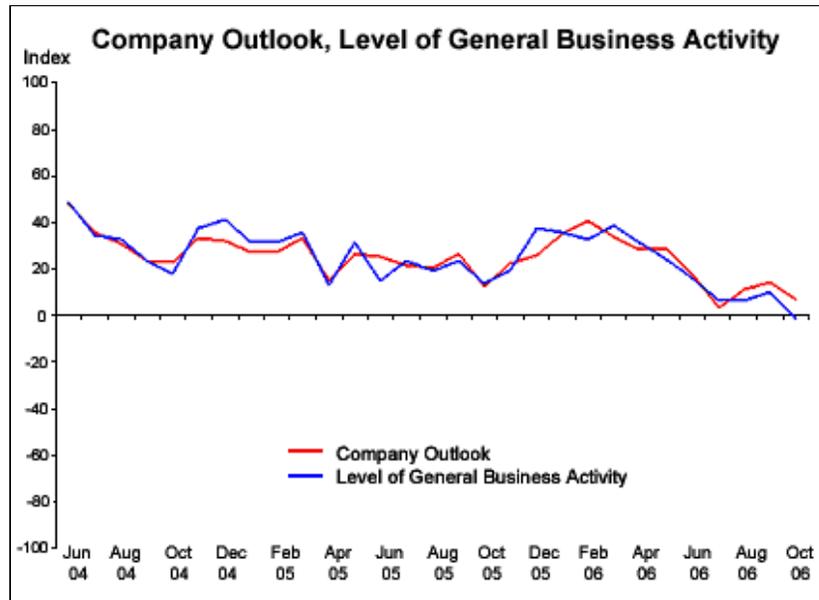


**General Business Activity and Company Outlook Continue to Weaken**

The October [index for company outlook](#) declined to 6.7. Most respondents (67 percent) continue to report no change in company outlook. A slightly smaller share of firms reported an increase in outlook (20 percent, versus 24 percent in September), and a slightly larger share of firms reported a worse outlook (13 percent, versus 10 percent last month).

The index for future company outlook dipped from 24.2 in September to 15.3 in October. Thirty-four percent of business executives reported an improved

company outlook six months from now. Nineteen percent said it has worsened.



The October [index value for level of general business activity](#) dipped slightly negative, from 9.7 last month to -1.7 this month. A smaller share of firms (18 percent) reported an increase in business activity, and a larger share (20 percent) reported a decrease. The index value for the level of general business activity expected six months from now has been rising since July. In October, it increased to 10.2, from 9.9 last month.

Questions regarding the Texas Manufacturing Outlook Survey can be addressed to Fiona Sigalla at [Fiona.Sigalla@dal.frb.org](mailto:Fiona.Sigalla@dal.frb.org) or 214-922-5166.

**Note**

The Texas Manufacturing Outlook Survey does not yet have a sufficiently large sample size to permit seasonal adjustment of the indexes. Thus, while respondents are asked to adjust for normal seasonal variation, the month-to-month values of these indexes may include some normal seasonal variation that is not indicative of changes in the business cycle. Other Federal Reserve Bank business outlook indexes benefit from seasonal adjustment, and the Texas indexes will be seasonally adjusted when a sufficient series are available.

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