August 25, 2014

TEXAS MANUFACTURING EXPANDS BUT AT A SLOWER PACE

What's New This Month

For this month's survey, manufacturers were asked supplemental questions on health care costs and the impact of the Affordable Care Act.

Texas factory activity increased again in August, albeit at a slower pace than in recent months, according to business executives responding to the Texas Manufacturing Outlook Survey. The production index, a key measure of state manufacturing conditions, fell from 19.1 to 6.8, indicating output growth slowed from July.

Other measures of current manufacturing activity also reflected notably slower growth in August. The new orders index fell 11 points to 2.2 after surging in July. The capacity utilization index also posted a sharp decline, moving down from 18 to 3.6. The shipments index experienced the largest fall, from 22.8 to 6.4, reaching its lowest reading in eight months.

Perceptions of broader business conditions were less optimistic this month. The general business activity index remained positive but fell to a five-month low of 7.1. The company outlook fell from 11.3 to 1.5, due to a smaller share of firms noting an improved outlook in August than in July.

Labor market indicators reflected continued employment growth and longer workweeks. The August employment index posted a third robust reading, holding steady at 11.1. Twenty-one percent of firms reported net hiring compared with 10 percent reporting net layoffs. The hours worked index slipped from 6.3 to 2.9, indicating a smaller rise in hours worked than last month.

Upward pressure on input prices continued at about the same pace in August as in July, while pressure increased for selling prices and wages. The raw materials price index held fairly steady at 26.4. The finished goods price index edged up from 7.3 to 9.1, reaching its highest level in six months. The wages and benefits index rose 5 points to 23.7, also posting a six-month high.

Expectations regarding future business conditions remained optimistic in August. The index of future general business activity inched down 1 point to 18.7, while the index of future company outlook rose 6 points to 30.1. Indexes for future manufacturing activity showed mixed movements in August but remained in solidly positive territory.

The Dallas Fed conducts the Texas Manufacturing Outlook Survey monthly to obtain a timely assessment of the state’s factory activity. Data were collected Aug. 12–20, and 113 Texas manufacturers responded to the survey. Firms are asked whether output, employment, orders, prices and other indicators increased, decreased or remained unchanged over the previous month.

Survey responses are used to calculate an index for each indicator. Each index is calculated by subtracting the percentage of respondents reporting a decrease from the percentage reporting an increase. When the share of firms reporting an increase exceeds the share reporting a decrease, the index will be greater than zero, suggesting the indicator has increased over the prior month. If the share of firms reporting a decrease exceeds the share reporting an increase, the index will be below zero, suggesting the indicator has decreased over the prior month. An index will be zero when the number of firms reporting an increase is equal to the number of firms reporting a decrease. Data have been seasonally adjusted as necessary.

Next release: September 29, 2014

Business Indicators Relating to Facilities and Products in Texas Current (versus previous month)								
Indicator	Aug Index	Jul Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Production	6.8	19.1	-12.3	Increasing	16	26.0	54.8	19.2
Capacity Utilization	3.6	18.0	-14.4	Increasing	21	21.7	60.2	18.1
New Orders	2.2	13.0	-10.8	Increasing	16	23.7	54.8	21.5
Growth Rate of Orders	-9.6	15.2	-24.8	Decreasing	1	10.4	69.6	20.0
Unfilled Orders	3.8	3.6	+0.2	Increasing	3	16.5	70.8	12.7
Shipments	6.4	22.8	-16.4	Increasing	16	30.7	45.0	24.3
Delivery Time	4.8	3.3	+1.5	Increasing	3	11.0	82.8	6.2
Materials Inventories	0.0	-1.1	+1.1	Unchanged	1	18.0	64.0	18.0
Finished Goods Inventories	-6.2	-7.0	+0.8	Decreasing	2	11.5	70.8	17.7
Prices Paid for Raw Materials	26.4	25.4	+1.0	Increasing	61	28.5	69.4	2.1
Prices Received for Finished Goods	9.1	7.3	+1.8	Increasing	13	16.4	76.3	7.3
Wages and Benefits	23.7	18.8	+4.9	Increasing	61	24.6	74.5	0.9
Employment	11.1	11.4	-0.3	Increasing	15	20.7	69.7	9.6
Hours Worked	2.9	6.3	-3.4	Increasing	8	16.0	70.9	13.1
Capital Expenditures	6.6	13.3	-6.7	Increasing	35	15.2	76.2	8.6

General Business Conditions Current (versus previous month)								
Indicator	Aug Index	Jul Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company Outlook	1.5	11.3	-9.8	Improving	15	13.3	74.9	11.8
General Business Activity	7.1	12.7	-5.6	Improving	15	17.0	73.1	9.9

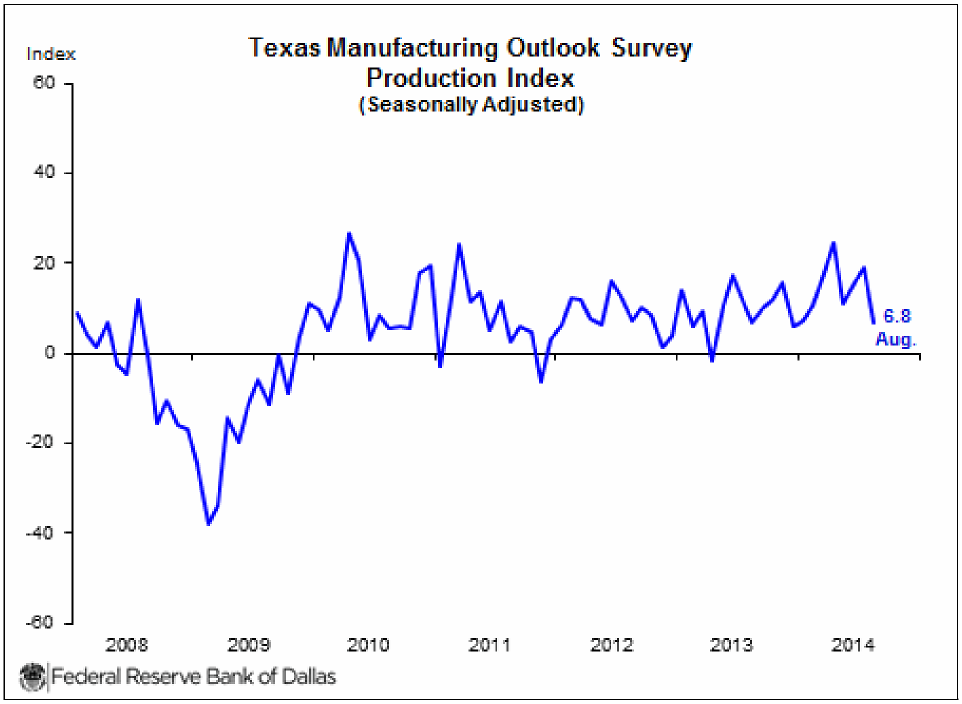
Business Indicators Relating to Facilities and Products in Texas Future (six months ahead)								
Indicator	Aug Index	Jul Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Production	44.5	40.1	+4.4	Increasing	66	53.2	38.1	8.7
Capacity Utilization	39.8	40.2	-0.4	Increasing	66	49.4	41.0	9.6
New Orders	45.3	41.2	+4.1	Increasing	66	52.7	39.9	7.4
Growth Rate of Orders	30.0	32.0	-2.0	Increasing	66	39.0	52.0	9.0
Unfilled Orders	4.5	10.3	-5.8	Increasing	13	13.7	77.1	9.2
Shipments	44.6	43.8	+0.8	Increasing	66	51.1	42.4	6.5
Delivery Time	-1.6	2.1	-3.7	Decreasing	1	6.2	86.0	7.8
Materials Inventories	0.0	-3.7	+3.7	Unchanged	1	17.6	64.8	17.6
Finished Goods Inventories	-1.8	-1.8	0.0	Decreasing	4	13.9	70.4	15.7
Prices Paid for Raw Materials	43.5	34.2	+9.3	Increasing	65	45.4	52.8	1.9
Prices Received for Finished Goods	22.2	24.7	-2.5	Increasing	26	29.6	63.0	7.4
Wages and Benefits	43.8	46.0	-2.2	Increasing	123	43.8	56.2	0.0
Employment	24.1	20.4	+3.7	Increasing	60	32.4	59.3	8.3
Hours Worked	11.7	9.8	+1.9	Increasing	15	18.2	75.3	6.5
Capital Expenditures	16.3	14.8	+1.5	Increasing	57	26.9	62.5	10.6

General Business Conditions Future (six months ahead)								
Indicator	Aug Index	Jul Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company Outlook	30.1	24.4	+5.7	Improving	65	33.1	63.9	3.0
General Business Activity	18.7	19.8	-1.1	Improving	15	25.2	68.3	6.5

*Indicator direction refers to this month's index. If index is positive (negative), indicator is increasing (decreasing) or improving (worsening). If zero, indicator is unchanged.

**Number of months moving in current direction.

Data have been seasonally adjusted as necessary.



Comments from Survey Respondents

These comments are from respondents' completed surveys and have been edited for publication.

Primary Metal Manufacturing

- We continue to see strong indicators in the energy sector. Lead times are again being pushed out two weeks on all casting lines dues to a heavy backlog and material inventory in process.

Fabricated Metal Manufacturing

- Capital expenditure in the Gulf Coast remains high, but most of the equipment is being purchased offshore.
- Quoting remains consistent with no orders being placed. Orders have not been lost to competitors; customers are just not cutting any orders.
- We are currently experiencing mid-single-digit growth in sales volumes. We expect that nonresidential new construction starts will continue to grow at a mid-single-digit pace over the next six months.

Machinery Manufacturing

- We have problems with exportation to Brazil due to duties, tariffs and bureaucracy. We have requested assistance from the U.S. Commerce Department in the U.S. and Brazil. We were disappointed when we were referred to local brokers for assistance. We believe support of exporters should be a priority.
- We are starting our seasonal peak, and it looks like a potential increase over the prior year.

Chemical Manufacturing

- Expected growth over the next 12 months may be tempered by lower margins due to higher raw material costs and labor charges.
- We have seen an increase in new business (products and volume). We are making capital improvements to handle the new business.

Computer and Electronic Product Manufacturing

- We are seeing a slowdown in several industries of capital equipment manufacturing.
- This is the first time we have seen strength carry into the second half since 2010. We have heard some reports of peer lead times starting to stretch, as well as some spot shortages. Distributor and customer inventories remain lean, and demand appears to be stable.

Food Manufacturing

- Record-high prices for dairy products continue to compress our margins. We got some relief from lower diesel prices.

Wood Product Manufacturing

- We are hoping the slowdown we are experiencing is simply a hot August slump.

Printing and Related Support Activities

- We had record sales and shipments in July. We'll come close in August but not to the level of July. Business for us typically ebbs lower in the fourth quarter and surges every January.
- We see continued strong demand from our customers (consumer packaged goods producers). Vendors of goods and services indicate their business is strong, and prompt availability of contractors for construction activities has disappeared, extending lead times for capital project work. Availability of skilled/semiskilled labor has declined significantly over the last seven to eight months.

Miscellaneous Manufacturing

- The increases we are seeing in our business are smaller than historical.

Questions regarding the Texas Manufacturing Outlook Survey can be addressed to Emily Kerr at emily.kerr@dal.frb.org.
The Texas Manufacturing Outlook Survey can be found online at www.dallasfed.org/microsites/research/surveys/tmos/.

Texas Manufacturing Outlook Survey

August 25, 2014

Special Questions

Data were collected Aug. 4–7, and 95 Texas manufacturers responded to the survey.

1. What are your best estimates of the annual percentage change in your firm's overall health care costs per worker, for both this year and next year?

	2013–14 (percent change)	2014–15 (percent change)
Average	12.7	14.2
Median	10.0	11.0

NOTE: 81 respondents answered for the change from 2013 to 2014; 56 answered for the change from 2014 to 2015.

2. How would you say the Affordable Care Act (ACA) has affected your firm's health care costs in question 1 above?

	Effect of ACA in 2014 (percent)	Expected effect of ACA in 2015 (percent)
Reduce costs a lot	0.0	0.0
Reduce costs a little	2.7	3.1
No effect	13.5	12.5
Raise costs a little	35.1	29.7
Raise costs a lot	48.6	54.7

NOTE: 74 respondents answered for the effect in 2014; 64 answered for the effect in 2015.

3. Are you changing (or have you changed) your health care plan in response to the ACA?

	Percent
We are keeping our plan unchanged	25.6
We are making modifications to our plan	62.2
We are dropping health insurance	0.0
We are offering health insurance for the first time	0.0
We do not offer health insurance and don't plan to offer it	3.7
Other	8.5

NOTE: 82 respondents answered this question.

4. How, if at all, are you changing (or have you changed) any of the following because of the effects that the ACA is having on your firm?

	Lower due to ACA (percent)	Higher due to ACA (percent)	No change due to ACA (percent)
The number of workers you employ (including full-time, part-time, etc.)	25.9	2.4	71.8
The proportion of your workers that are part-time, contract or temporary	5.9	16.5	77.6
Amount of work outsourced to other firms	2.4	17.6	80.0
Wage and salary compensation per worker	20.0	11.8	68.2
Other benefits, including retirement	18.8	3.5	77.6
Prices you charge to customers	0.0	35.3	64.7

NOTE: 85 respondents answered this question.

Special Questions Comments

These comments have been edited for publication.

Primary Metal Manufacturing

- The Affordable Care Act is such a huge cost increase we must pass it on to our customers or go broke. The projected cost increase is more money than we made last year. This increase will put us at an even bigger cost disadvantage versus imports. We will lose business to imports and plan to reduce our workforce accordingly.

Fabricated Metal Manufacturing

- We are keeping employment levels below the 50 threshold, which we lowered from 70 during the economic downturn. We will continue to study the impact for 2015 if we should consider to continue to rebuild our work force.
- We offer health coverage to all of our employees and their families with no monthly deductible. We are being forced to review and modify our benefits package in order to curtail costs.
- We moved all of our employees to a professional employer organization due to the Affordable Care Act. They guaranteed us an increase on health insurance premiums of "only" 10 percent. Our company pays a maximum amount of the premium, and anything over that is paid for by the employees.
- It is very challenging for a midsize, low-margin, U.S. manufacturer to compete in a global economy when forced to absorb double-digit operating expenses related to increased medical insurance.

Machinery Manufacturing

- Our employees are being asked to contribute more to the monthly premium for single and family rates. Copay amounts have increased slightly as well.
- The biggest impact of the Affordable Care Act (ACA) will be how we handle "project workers" who supplement our full-time employees. Currently, they are not eligible for insurance benefits (receiving higher wages instead), but we will be required to offer health insurance to a subset of this group next year under the ACA. Several other ACA features also increased or will increase our costs, which will be proportionally shared with our employees via higher copays/deductibles.
- My company has paid 100 percent of employee health insurance for over 20 years and will continue as long as we can afford to do it and remain competitive. But we will pass on the Patient-Centered Outcomes Research Institute fees and reinsurance fees to the employees.
- Our broker offered us a 10 percent discount to sign up with a new plan for 2014 that begins in December 2014. We will renew with the new price structure at that time. We hire people when we need them. We have always offered medical care to employees as we think it is simply good business to have our most important assets healthy and productive.

Chemical Manufacturing

- Our provider has raised prices the past three years (each time more than12 percent), justifying the increase due to changes in the health care statutes. We sourced other vendors and found the same costs so we don't think it is isolated within a few carriers. In anticipation of the still-to-come rate increases, we offset some of the cost with higher customer prices and also hiring more contract/part-time employees where we can. There is still a lot of confusion among the major insurance carriers as to the final impact of the law, and this makes it difficult to plan out our human resources needs.
- The real impact will be felt in a few years as the more onerous mandates evolve. What today is considered a good plan by our employees, with inflationary trends, will likely be classified as a "Cadillac" plan in a few years. This will greatly increase our costs of maintaining the status quo and lead to difficult decisions with a likely negative impact.
- We believe the Affordable Care Act was the worst thing the government could have done. It simply does not help small business. It only adds to health care costs if you want to pay for it for your employees.
- We believe the confusion surrounding the Affordable Care Act and the constant changes, delays, etc. are beyond ridiculous.
- The largest ever increases in costs were in the 2012–13 renewal. In 2013 to 2014 the renewal costs were the same with less benefits.

Plastics and Rubber Products Manufacturing

- We have a second very small business with six employees, and now those six will be added to the 55 employees at our primary business and treated as though the secondary business has over 50 employees for compliance purposes according to the Affordable Care Act (ACA). We believe the ACA is certainly a disincentive to start additional small businesses in the future.

Nonmetallic Mineral Product Manufacturing

- We have dropped our number of employees by over 50 percent (partially due to the Affordable Care Act), and have adjusted by adding automation to improve productivity and by purchasing more from overseas vendors. In addition, we have significantly increased the copay and the deductibles for our health care plan. This is why our costs only increased by 2 percent this year. But we have been informed to expect a much larger increase next year by our insurance carrier.

Computer and Electronic Product Manufacturing

- Our workforce is generally older. This inhibited us from going to an Affordable Care Act (ACA) plan for 2013–14. We used a combination of keeping a grandfathered plan and utilizing an early renewal option to keep costs within a reasonable range. The tiered premium system under the ACA will dramatically impact our workforce and key individuals within the company in a negative way. We expect next year's health care premiums to be a substantial increase if we cannot stay on our grandfathered plan. We have started to utilize more part-time workers to fill specific positions rather than more flexible full-time workers.

- We have had to add additional internal staff members to ensure compliance and have changed health care carriers to reduce the overall mounting cost trend.

Transportation Equipment Manufacturing

- The individual mandate caused many employees who did not participate in our health insurance plan to enroll since it is cheaper to be on our plan (we pay 75 percent of the premium) than to buy on the open market. We had to raise prices to cover the added cost.
- The quality of our insurance went down because the insurance we had in place didn't qualify, but the benefits were better.

Food Manufacturing

- We had to change insurance companies, as the company we had been doing business with for over 15 years dropped out of the small group market because of Affordable Care Act. The new company's premiums are higher, benefits lower and deductibles much higher. There is complete uncertainty for the employee and employer as to where this is going. It's a mess!
- The Affordable Care Act (ACA) has raised our compliance costs even with our "grandfathered" plan. Our paid claims are the primary driver of increased health care costs and are indicative of the true problem with health care (rapidly increasing provider/drug costs), which the ACA did nothing to address. While we haven't changed the wage and salary compensation per worker, our rising health care costs have. Premium growth/cost sharing and higher employment costs translate into two things: 1) Less net money in employee paychecks (because cost sharing on health care outpaces raises). 2) We charge higher prices to continue to maintain margins in the face of higher costs.

Textile Product Mills

- We have had opportunities to significantly increase our employment in our U.S. plant. We have been declining those opportunities as the increase in employment would subject us to the Affordable Care Act and would make us not competitive.

Apparel Manufacturing

- While the costs are moderately increased per employee, we had a 30 percent increase in the cost to the company overall due to the increase in employees who are now covered by health care.

Wood Product Manufacturing

- We have not been forced to move to the Affordable Care Act.
- Like many companies, the "coverage year" was modified last year to Dec. 1, 2013 through Nov. 30, 2014. Therefore, the Affordable Care Act will begin affecting our company this coming Dec. 1.

Printing and Related Support Activities

- While there are some positives about the Affordable Care Act, the impact on small group policies seemed to be a huge, unaffordable price increase.
- In 2014, proposed competitive bids increased health care costs about 19 percent. We modified our plan to eliminate all out-of-network options and some other relatively minor benefits that resulted in a net increase of 5 to 6 percent in overall health care costs. Costs were borne approximately half by employee contributions and half by the company.

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