Texas Manufacturing
Outlook Survey

DALLASFED

December 28, 2015

TEXAS MANUFACTURING ACTIVITY RISES AGAIN, BUT OUTLOOK WORSENS

What's New This Month

For this month's survey, manufacturers were asked supplemental questions on exports and exchange rates.

Texas factory activity increased for a third month in a row in December, according to business executives responding to the Texas Manufacturing Outlook Survey. The production index, a key measure of state manufacturing conditions, rose from 5.2 to 13.4, indicating stronger growth in output.

Some other indexes of current manufacturing activity also reflected growth in December, but the survey's demand measures showed continued weakness. New orders, an indicator of incoming demand, declined at a faster pace. The index has been below zero for five months and fell to -8.9 in December. The growth rate of orders index has been negative for more than a year and dipped 7 points to -14.3 this month. Meanwhile, the capacity utilization and shipments indexes posted their fourth positive readings in a row and inched up to 7.8 and 7.6, respectively.

Perceptions of broader business conditions weakened markedly in December. The general business activity index has been negative throughout 2015 and plunged to -20.1 this month. After pushing just above zero last month, the company outlook index fell 10 points in December to -9.7, its lowest level since August.

Labor market indicators reflected a notable rise in December. The employment index inched up further to 12.8; 26 percent of firms noted net hiring, while 14 percent noted net layoffs. The hours worked index suggested longer workweeks and rose to 15.2, its highest level since May 2010.

The survey's price measures pushed further negative in December. The raw materials prices index declined to -8.6, suggesting a slightly steeper drop in input costs than last month. The finished goods prices index was negative all year and moved down to -15.9. Meanwhile, the wages and benefits index moved up to 20.4, indicating stronger wage growth.

Expectations regarding future business conditions were mixed in December. The index of future general business activity fell 9 points to -1.4, while the index measuring future company outlook fell but remained positive at 6.6. Indexes for future manufacturing activity declined but remained strongly positive.

The Dallas Fed conducts the Texas Manufacturing Outlook Survey monthly to obtain a timely assessment of the state's factory activity. Data were collected Dec. 14–22, and 116 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: January 25, 2016

Business Indicators Relating to Facilities and Products in Texas Current (versus previous month)								
Indicator	Dec Index	Nov Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Production	13.4	5.2	+8.2	Increasing	4	30.0	53.4	16.6
Capacity Utilization	7.8	5.9	+1.9	Increasing	4	24.0	59.8	16.2
New Orders	-8.9	-1.6	-7.3	Decreasing	5	25.4	40.2	34.3
Growth Rate of Orders	-14.3	-7.3	-7.0	Decreasing	14	18.4	48.9	32.7
Unfilled Orders	-15.0	-4.2	-10.8	Decreasing	13	9.1	66.8	24.1
Shipments	7.6	4.2	+3.4	Increasing	4	29.9	47.8	22.3
Delivery Time	-4.4	1.0	-5.4	Decreasing	1	11.0	73.6	15.4
Materials Inventories	-8.6	-3.4	-5.2	Decreasing	5	14.9	61.6	23.5
Finished Goods Inventories	-6.0	-5.7	-0.3	Decreasing	2	16.4	61.2	22.4
Prices Paid for Raw Materials	-8.6	-5.1	-3.5	Decreasing	5	13.1	65.2	21.7
Prices Received for Finished Goods	-15.9	-12.1	-3.8	Decreasing	12	9.0	66.1	24.9
Wages and Benefits	20.4	16.0	+4.4	Increasing	73	21.7	77.0	1.3
Employment	12.8	11.6	+1.2	Increasing	3	26.3	60.2	13.5
Hours Worked	15.2	9.9	+5.3	Increasing	2	23.1	69.0	7.9
Capital Expenditures	1.7	2.1	-0.4	Increasing	2	16.4	68.9	14.7

General Business Conditions Current (versus previous month)								
Indicator	Dec Index	Nov Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company Outlook	-9.7	0.8	-10.5	Worsening	1	16.8	56.7	26.5
General Business Activity	-20.1	-4.9	-15.2	Worsening	12	10.0	59.9	30.1

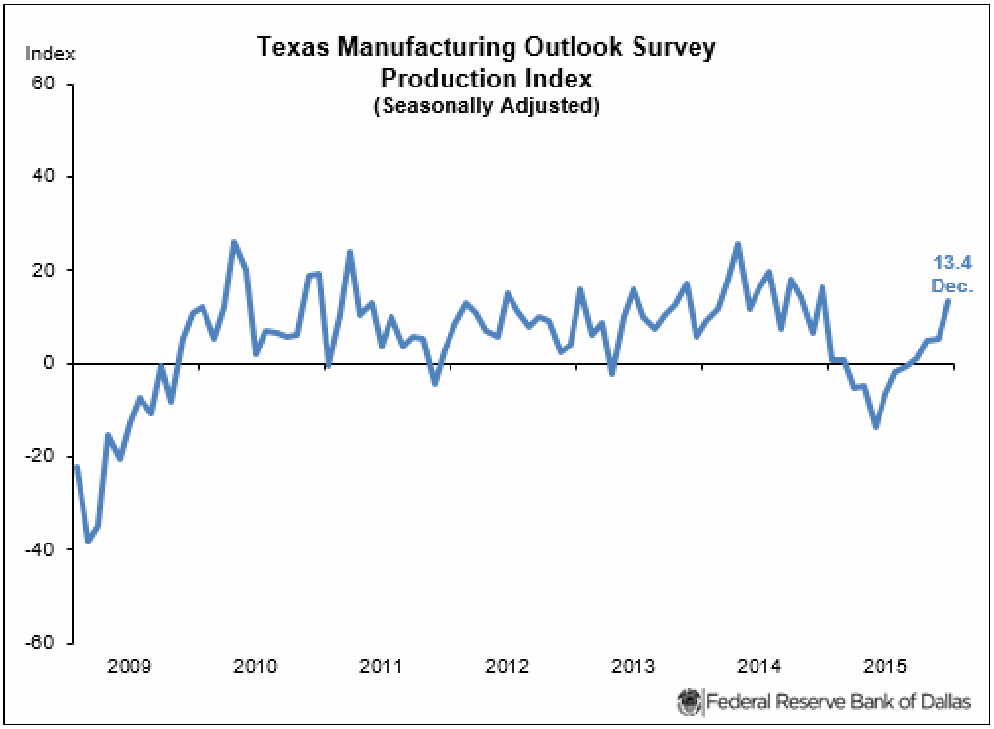
Business Indicators Relating to Facilities and Products in Texas Future (six months ahead)								
Indicator	Dec Index	Nov Index	Change	Indicator Direction*	Trend** (months)	% Reporting Increase	% Reporting No Change	% Reporting Decrease
Production	29.8	34.1	-4.3	Increasing	82	41.8	46.2	12.0
Capacity Utilization	26.3	34.2	-7.9	Increasing	82	35.8	54.7	9.5
New Orders	28.6	35.2	-6.6	Increasing	82	40.5	47.5	11.9
Growth Rate of Orders	16.4	24.3	-7.9	Increasing	82	28.5	59.4	12.1
Unfilled Orders	2.2	4.1	-1.9	Increasing	3	14.5	73.2	12.3
Shipments	25.7	36.3	-10.6	Increasing	82	37.9	49.9	12.2
Delivery Time	-7.1	-3.3	-3.8	Decreasing	5	6.6	79.7	13.7
Materials Inventories	9.1	4.2	+4.9	Increasing	3	22.9	63.3	13.8
Finished Goods Inventories	2.8	-6.8	+9.6	Increasing	1	17.3	68.2	14.5
Prices Paid for Raw Materials	15.6	22.0	-6.4	Increasing	81	24.8	66.1	9.2
Prices Received for Finished Goods	8.3	12.9	-4.6	Increasing	42	20.2	67.9	11.9
Wages and Benefits	29.7	33.6	-3.9	Increasing	139	32.3	65.1	2.6
Employment	18.5	24.6	-6.1	Increasing	37	30.5	57.5	12.0
Hours Worked	0.9	2.2	-1.3	Increasing	10	13.7	73.5	12.8
Capital Expenditures	18.4	14.0	+4.4	Increasing	73	29.4	59.6	11.0

General Business Conditions Future (six months ahead)								
Indicator	Dec Index	Nov Index	Change	Indicator Direction*	Trend** (months)	% Reporting Improved	% Reporting No Change	% Reporting Worsened
Company Outlook	6.6	16.2	-9.6	Improving	81	26.4	53.8	19.8
General Business Activity	-1.4	7.3	-8.7	Worsening	1	18.0	62.6	19.4

*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.

Fabricated Metal Product Manufacturing

- Much of our work comes from petrochemical and midstream owners and contractors. Although our backlog and December work have improved, capital expenditures going out are being reduced by our customers. We have increased some capital expenditures plans in the last quarter, anticipating passage of Section 179 extensions, but Congress' waiting until year-end has been problematic since we cannot do anything significant without actual passage.
- New Environmental Protection Agency regulations on wood-burning furnaces set to take effect Jan. 1, 2016, have decreased orders and will continue to do so throughout the winter months.
- We first saw an increase of orders due to the end of the year, per usual. We are now seeing a continued surge of orders moving into the new year.
- The crude oil and natural gas market price downturn continues to negatively impact our industry and our company. Labor costs remain stable, but the producers of our primary raw material, hot rolled coil steel, have announced price increases effective first quarter of 2016, which the finished goods market will not absorb due to highly competitive pricing, thus further compressing our margins.
- The price of oil is really impacting our customer base and, in turn, purchases of our product. It is getting ugly.
- The Architecture Billings Index mixed-practice index slipped below 50 about nine months ago, which historically would foreshadow a slowdown in booking new work, which we are experiencing. We expect this will likely mean we will experience a slowdown in shipments in our fiscal second quarter (Februaryâ€“April). We are forecasting 2016 low-rise nonresidential construction starts measured in square feet to grow at 4 to 5 percent, which is our expected growth rate for our business.

Machinery Manufacturing

- There are lots of contradictions in the marketplace. As an offshore oil service provider, we have had very strong orders for the last five months, which is bizarre. We continue to read about doom and gloom, but the numbers haven't borne that out. Living in Houston, I continue to see multiple out-of-state license plates on the freeways. People are continuing to pour into Houston; I just don't know what they're doing.
- The oil industry continues to suffer. We will end the year with less debt and more backlog because we have diversified out of the oil patch and out of Houston.
- Weak oil and natural gas prices are having a material adverse effect on our business.
- Several of our customers have slowed down for different reasons that do not appear to be related to a general slowdown in the economy.

Computer and Electronic Product Manufacturing

- Expectations for 2016 and midterm (the next three to five years) are for a low-growth environment.

Transportation Equipment Manufacturing

- Oil and gas work has significantly slowed. There is pressure from customers to lower prices further. We haven't had any feedback provided from customers with regard to future expectations.

Food Manufacturing

- The strong dollar and overall weak Latin American economies are impacting our export business. Domestic demand is strong, base raw material costs are steady to down, and energy costs are reasonable. 2016 looks good.

Paper Manufacturing

- We have had a very slow December. Our outlook for first quarter 2016 is cautiously guarded.
- Several of our large automotive customers shut down their plants for part of December, so our production is naturally down compared to other months. Also, during recent months, we have increased our entry-level wages and increased the pay of existing employees as part of our efforts to reduce employee turnover.
- The business cycle will pick up in the new year.

Printing and Related Support Activities

- It is hard to see what six months away looks like at this point; we need an infusion of new customers to make it look any better. The fourth quarter has been much softer than anticipated. We lost a chunk of work. We had to raise starting pay for trainees just to get qualified folks in the door. Price-reduction pressure from key customers continues, squeezing margins further.
- We often get busy this time of year, and this December has been like thatâ€"not really seasonal, just a busy time of year for us. We are very concerned about lower activity levels and what that will do for business in the upcoming six months.

Miscellaneous Manufacturing

- The new tax changes in December will improve our capital expenditures, and new-product introductions in the next six months will increase sales and productivity.

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

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December 28, 2015

Special Questions

Data were collected Nov. 30–Dec. 3, and 97 Texas manufacturers responded to the surveys.

1. What net effect has the change in the dollar exchange rates over the past year had on your business? Please consider the impact on prices you pay for materials as well as prices you charge for your products and your volume of sales.

Favorable	17.4%
No effect	39.5%
Unfavorable	43.0%

2. Approximately what percentage of your overall revenues came from exports over the past year?

None	35.1%
1 to 4	24.7%
5 to 9	13.4%
10 to 19	9.3%
20 or more	17.5%

3. How do exports as a share of your overall revenue compare with a year ago?

Increased substantially	0.0%
Increased somewhat	10.8%
No change	52.7%
Decreased somewhat	20.3%
Decreased substantially	16.2%

4. How has demand for your products from each of these regions/countries changed from a year ago?

	Canada	Euro Area	Mexico	Japan	China	Other Asia
Substantially weaker	18.5%	20.5%	10.9%	7.1%	9.1%	11.4%
Somewhat weaker	22.2%	22.7%	20.0%	14.3%	24.2%	25.7%
No change	50.0%	45.5%	52.7%	60.7%	60.6%	48.6%
Somewhat stronger	9.3%	9.1%	12.7%	14.3%	6.1%	14.3%
Substantially stronger	0.0%	2.3%	3.6%	3.6%	0.0%	0.0%

Special Questions Comments

These comments have been edited for publication.

Chemical Manufacturing

- Chinese trade is nonexistent but not because of demand or price, but due to political trade embargoes. Indian growth has been strong the last six quarters, and we are seeing more demand in Mexico for our products compared with three years ago.
- Our products are a small cost to the customers compared with their overall costs, but the product is critical to their manufacturing processes. Therefore, the price change due to the strong dollar does not affect demand. Demand for their products affects our demand, but we've seen very little change. Our products go into polyethylene production or Canadian oil sands crude production.

Plastics and Rubber Products Manufacturing

- We do not export except into Canada.

Fabricated Metal Product Manufacturing

- Steel is a large part of our cost of goods sold. The annual increase in the value of the dollar has had a negative effect on commodity prices including steel.
- Customers are sourcing product from China and Korea, and we cannot compete with the prices.
- We have experienced more competition from Mexico due to the dollar exchange rate and more close shoring of manufacturing.

Machinery Manufacturing

- The stronger dollar also means lower crude prices, so it is a double whammy.
- Current customer expansion outside the U.S. has slowed with the higher cost of equipment. It has also made obtaining new customers more difficult due to the nature of the premium price equipment we sell.

Computer and Electronic Product Manufacturing

- Our shipments into a region are not reflective of consumption by that region. We shipped about 45 percent of our revenues into China, and most was put into products that are consumed somewhere else. We also ship product, as a specific example of many, into Europe that is put into an automobile that is shipped to China for consumption. We had about 5 percent of revenues in euro and about 3 percent in yen. The move in the foreign exchange market cost us about $150 million in revenue/profit or 1 percent revenue/5 percent per foreign order just in translation cost. We have no way to measure impact to demand, but many in our industry argue the impact is there.
- We are indirectly and negatively affected by the high dollar valuation, as our customers are all original equipment manufacturers and depend on world economies, dollar stabilization against other currencies and the Export-Import Bank.

Transportation Equipment Manufacturing

- We are no longer able to maintain competitiveness in these foreign countries, as well as others such as Australia and South Africa. Our primary competition is China and India, whose manufacturing conglomerates are subsidized heavily by their respective governments. They further intimidate the U.S. economy by sending comparable goods into the U.S. without being subject to tariffs for the goods coming in. Our product made in U.S. to be exported has decreased approximately 45 percent during 2015 as compared with 2014.

Food Manufacturing

- Because the demand for our raw materials is down due to the strong dollar, our costs are lower.

Wood Product Manufacturing

- We do not export, but we do import. The stronger dollar has resulted in some lower material costs, which in turn has led to improved margins.

Printing and Related Support Activities

- The return on equity impact on our company has been favorable, as it allows us to purchase capital equipment at a more favorable cost. This is particularly true versus the euro zone. Alternatively, imports from Asia (China, Southeast Asia and India) have been more competitive, and we have lost domestic orders to imports of packaging materials from those areas.
- The stronger dollar has helped us more in cost of imported materials that we use, rather than affecting what little export sales we have. We do not sell directly to any international customers; rather, some of our domestic customers have us finish out their printing that then may ship to Mexico.

Miscellaneous Manufacturing

- We sell our products in U.S. dollars and as a result, the relative strengthening of the dollar against other world markets has diminished foreign investment and replenishment orders. Brazil is our largest market outside the U.S., and exports are down considerably due to the exchange rate, local market conditions and Brazilian distributor underperformance.