



NAM/*IndustryWeek* Survey of Manufacturers Second Quarter, 2014

When you speak with manufacturers today about the economy, their outlook is often a complicated mix of both optimism and cautiousness. On the one hand, it is true that the manufacturing sector has been a bright spot in the economy since the recession, providing outsized contributions to both output and employment. Moreover, there is a sense that the sector is poised for continued expansion over the coming years, thanks largely to America's newfound energy abundance and the increased competitiveness of the sector globally. As such, conversations with manufacturing leaders about the coming decade tend to be rather "bullish."

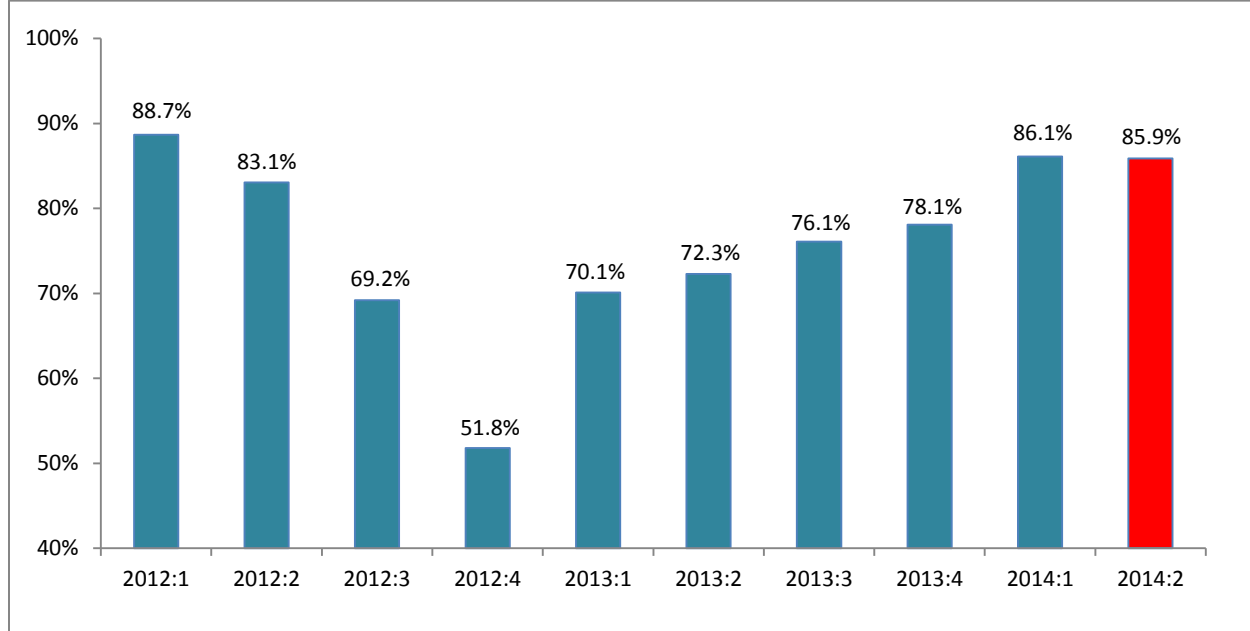
This quarter's National Association of Manufacturers (NAM)/*IndustryWeek* Survey of Manufacturers reflect this, as we have seen the highest expected sales (up 4.1 percent) and capital investment (up 2.3 percent) figures in two years. Along those lines, manufacturers also see an improving economy (75.1 percent), new product development (57.3 percent) and increased efficiencies in the production process (48.6 percent) as the biggest drivers for future growth. In addition, over the next 12 months, nearly 40 percent of manufacturers expect their export sales to increase, with another 57.1 percent saying their international orders should stay the same.

However, manufacturers expressed a palpable sense of frustration both with the slowness of economic growth and with the political process. Washington's burdensome regulatory, tax and health care policies still loom large in business decisions, particularly for the smallest manufacturers. While we have moved beyond the budget showdown of last fall, concerns continue to mount that Washington is not solving the country's problems. In the most recent survey, 79.3 percent of respondents said that the country was on the "wrong track," with just 5 percent suggesting that it was "headed in the right direction." One individual from the machinery sector might have summarized these feelings appropriately with this comment:

We need less Democrats and less Republicans and more smart people that are willing to tackle the longer-term issues with compromise. Not as a bulldozer and not with BS, but something that all Americans can believe in and actually trust.

This year has started out a bit weaker than originally hoped. A number of severe winter storms wreaked havoc with demand and production in the early months, and exports continue to grow at a disappointingly slow rate. Indeed, in the first quarter, real GDP shrank for the first time in three years, and while we have seen a rebound in the spring months, overall activity levels remain below the more robust rates seen at the end of 2013. Already, we have seen forecasts for growth in 2014 downgraded from around 3 percent a few months ago to something closer to 2.5 percent today.

Figure 1: Manufacturing Business Outlook, by Quarter, 2012–2014



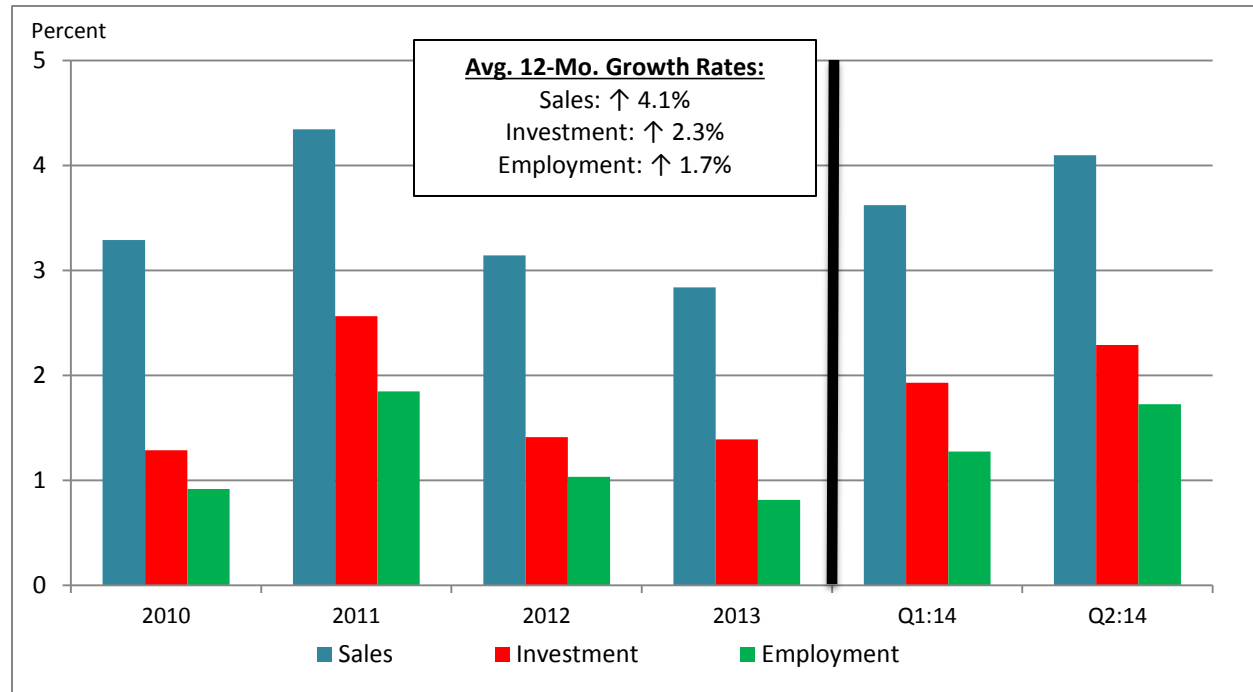
Note: Percentage of respondents who characterized the current business outlook as somewhat or very positive.

Despite recent slowness, it is perhaps interesting that manufacturers in the United States have largely shrugged off much of the softer data in the early months of 2014. In fact, they continue to be mostly upbeat in their outlook for the rest of this year. In the most recent NAM/*IndustryWeek* Survey of Manufacturers, 85.9 percent of respondents were either somewhat or very positive about their own company's outlook (Figure 1). This fell slightly from 86.1 percent who said the same thing in March. In essence, manufacturers' outlook was mostly unchanged from the first quarter, even as the longer-term trend suggests a business community that is more upbeat—particularly since the fiscal cliff. In fact, while growth has been a bit disappointing so far this year, we have also begun to see a spring rebound in output and demand, inspiring hope for a better second half.

As such, manufacturers reported mostly higher expected activity levels across the board over the course of the next 12 months (Figure 2). For example, sales are expected to grow 4.1 percent on average over the next year, up from 3.0 percent six months ago and 3.6 percent in the last survey. In fact, the pace of sales growth marks the fastest in two years—definitely a sign of progress on the demand front. In this survey, nearly three-quarters of respondents said they anticipate sales to increase in the coming months, with 47.5 percent predicting sales growth of 5 percent or more.

Capital investment and employment both continued to move in the right direction, with both measures recording their best rates of growth since the second quarter of 2012. Manufacturers plan to increase capital spending by 2.3 percent over the next 12 months, up from 1.4 percent and 1.9 percent in the past two surveys, respectively. Meanwhile, 49 percent of survey respondents expect to increase their hiring over the next year, up from 42 percent three months ago. On average, firms plan to increase their employment by 1.7 percent in the next year, a significant bump up from the 0.9 percent pace reported in December.

Figure 2: Expected Growth of Manufacturing Sales, Investment and Employment, 2010–2014



Note: Expected growth rates are annual averages.

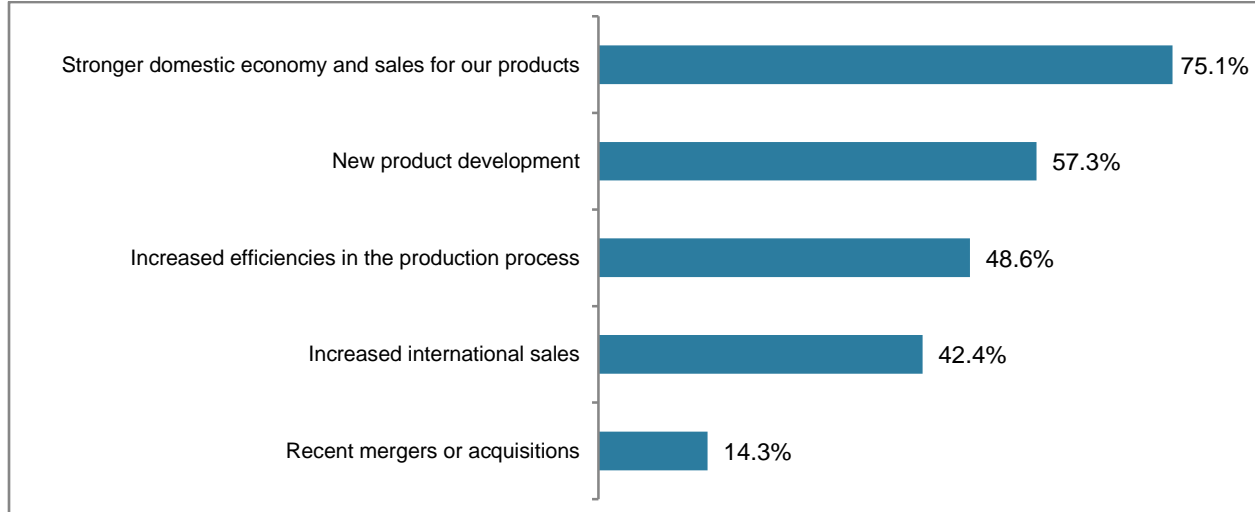
It is worth noting that 41.5 percent of manufacturers in the NAM/*IndustryWeek* survey said that their capital spending levels will be greater this year than last. While this is a positive development—and probably the result of recent improvements in the economy—it also suggests that more than half of those responding were not experiencing increases. In fact, 39.1 percent of those taking the survey said their capital investment levels will remain unchanged from last year, and 15.4 percent cited lower levels of capital spending in 2014 than in 2013. Firms investing in more capital largely attributed the increase to new products or process innovations (49.4 percent), the need to increase capacity (48.8 percent), increased demand (46.3 percent) and equipment replacements (38.1 percent).

As usual, firm size mattered in the data. Sales expectations over the next 12 months ranged from an average of 3.3 percent for small manufacturers (those with fewer than 50 employees) to 3.9 percent for medium-sized firms (those with between 50 and 499 employees) to 5.1 percent for larger entities (those with 500 or more employees). Larger manufacturers were also more upbeat in their outlook (93.0 percent were positive) and in their capital spending plans (2.9 percent growth over the next 12 months versus 0.9 percent for small firms). On the hiring front, medium and large businesses expect to increase their worker totals by nearly 2 percent, with small manufacturers adding just 0.9 percent more workers over the next year.

Exports will continue to drive growth for manufacturers, but the U.S. market is also extremely vital. When asked about the primary drivers of future growth, three-quarters of respondents said that a stronger domestic economy was the key to their strategic plans (Figure 3). At the same time, 42.4 percent of respondents cited increased international sales. Moreover, manufacturers anticipate a 1.6 percent increase in export sales on average over the next year, up from 1.3 percent in the last survey. In

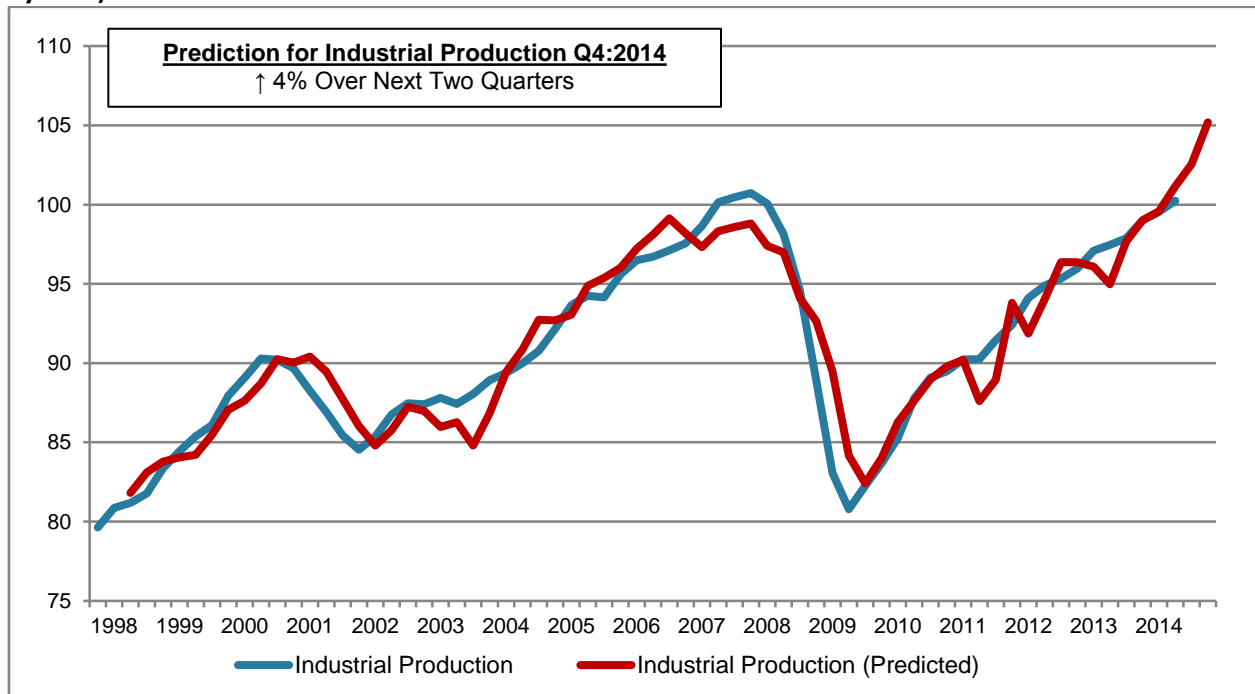
all, nearly 40 percent of those taking the survey anticipate higher exports in the coming months, with 15.9 percent expecting international sales growth of at least 5 percent.

Figure 3: Primary Drivers of Future Growth, Second Quarter, 2014



Note: Respondents were able to check more than one response. Therefore, responses exceed 100 percent.

Figure 4: Predicted Industrial Production (Manufacturing North American Industry Classification System)



Note: Industrial production is predicted two quarters in advance by regressing NAM/IndustryWeek Survey of Manufacturers data as one of the independent variables, with data stretching back to Q4:1997. Other explanatory variables include current values for housing permits, the interest rate spread, personal consumption and the S&P 500.

Meanwhile, manufacturers anticipate their inventories to increase 0.5 percent over the next 12 months, rising for the second straight survey. Prior to that, respondents expected stockpiles of finished goods to decline in six consecutive reports from the third quarter of 2012 to the fourth quarter of 2013. In fact, the predicted inventory growth rate peaked since the first quarter of 2012, when the manufacturing sector was expanding rather robustly. In this survey, 31.2 percent of respondents forecast inventories growing in the coming year, with 23.5 percent foreseeing declines.

For several quarters now, we have used the NAM/*IndustryWeek* outlook data in a regression model to predict manufacturing production two quarters ahead (Figure 4). Other variables include current values for housing permits, the interest rate spread, personal consumption and the S&P 500. This model explains roughly 89 percent of the variation since the data began in the fourth quarter of 1997.

The current model is very encouraging and suggests that manufacturing production should continue to accelerate, growing at a 4.0 percent annual rate over the next two quarters. Consumer spending, improvements in housing and the rising stock market provide positive influences that help to reach this conclusion. Of course, downside risks could derail this projection, including geopolitical risks, uncertainties surrounding the Affordable Care Act (ACA), reactions to monetary policy changes and increased regulatory burdens that might negatively impact the manufacturing sector.

The numbers clearly show that Washington continues to be the major source of burdens facing manufacturers. The top business challenge, cited by nearly 73 percent of those taking the survey, was rising health care and insurance costs (Figure 5). This issue has hovered near the top of the list for much of the past two years, with manufacturers still anxious about the ACA and its implications. This was closely followed by a perceived unfavorable business climate due to taxes, regulations and continuing government uncertainties.

Figure 5: Primary Current Business Challenges, Second Quarter, 2014

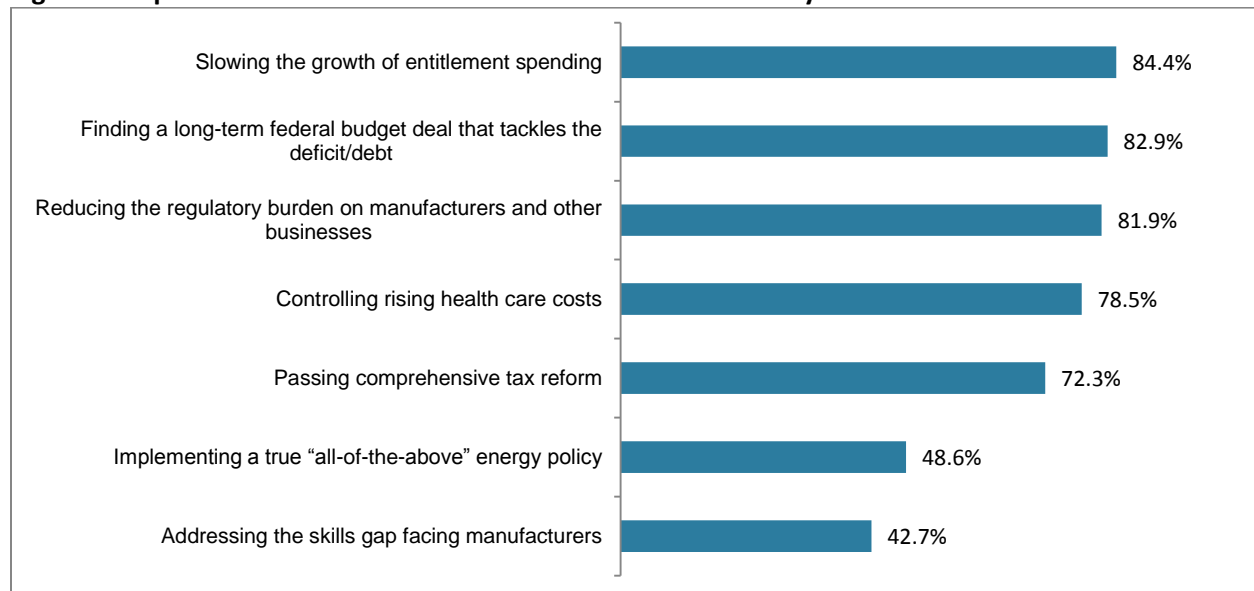


Note: Respondents were able to check more than one response. Therefore, responses exceed 100 percent.

The other challenge that rises toward the top of the list of concerns is the inability to attract and retain a quality workforce (50.3 percent). In fact, just more than 60 percent of respondents said that they were struggling to fill open positions at their company. With the lack of talent readily available, manufacturers are addressing the skills gap in the following ways: creating or expanding internal training programs (60.0 percent), working their existing workforce more (57.2 percent), utilizing temporary staffing services (49.3 percent) and collaborating with educational institutions on skills development (48.4 percent). With these factors in mind, the NAM has made workforce issues one of its top priorities this year, establishing the Task Force on Competitiveness & the Workforce and advocating for more Americans to seek high-skilled jobs within the sector.

Beyond workforce issues, manufacturers continue to seek long-term solutions to the nation's problems. We once again asked for them to list the top policies they would like to see implemented over the next few years, and not surprisingly, many focused on budget and fiscal issues (Figure 6). While we have seen the annual budget deficit fall recently, manufacturers recognize that the United States has failed to find a long-term deal that would bring down those deficits and debt more permanently, and as a result, deficits will again begin to rise in the next few years, largely due to growth in entitlement spending. Finding a way to slow the growth of entitlement spending (84.4 percent) and to tackle our debt and deficits (82.9 percent) topped the list of policy priorities of manufacturers responding to this survey.

Figure 6: Top Policies That Manufacturers Want to See from Policymakers Over the Next Few Years



Note: Respondents were able to check more than one response. Therefore, responses exceed 100 percent.

Manufacturers also seek relief from the regulatory process (81.9 percent), with cumulative burdens becoming an ever-larger concern. Some of the sample comments focused on this as well, including requests for the government to be more "business friendly," to eliminate "undo paperwork" and to limit the number of new rules making their way through the process. Other top priority areas include controlling rising health care costs (78.5 percent), passing comprehensive tax reform (72.3

percent), implementing an “all-of the-above” energy policy (48.6 percent) and addressing the skills gap (42.7 percent). (For a partial listing of comments in this survey, see the end of this report.)

On the issue of taxes, several key provisions for manufacturers expired at the end of 2013. One was enhanced Section 179 expensing, which allows smaller companies to write off up to \$500,000 of capital equipment immediately if they invest less than \$2 million in a year. Along with enhanced Section 179 expensing, the so-called bonus depreciation, available to companies of all sizes, expired as well. Bonus depreciation allowed taxpayers to expense 50 percent of the cost of assets bought and placed into service in 2013. In a series of special questions on this topic, 23.6 percent of respondents said they were holding off on making investments until Congress extends Section 179 expensing or first-year bonus depreciation.

We asked about investment intentions if Section 179 and bonus depreciation were not extended and found that 35.8 percent of manufacturers said that they would not make any investments this year without these provisions. In addition, another 5.1 percent replied that they would not make any purchases at all. That is a significant portion of businesses that would be negatively impacted by the loss of these investment incentives. Moreover, timing for re-enacting such incentives also matters. More than half of those surveyed said there would not be enough time to make capital spending purchases and put these capital expenditures into place by year’s end if these incentives are not extended until mid-November. Therefore, passing these measures after the election might not have the desired effects in 2014 that we would prefer.

The NAM/*IndustryWeek* Survey of Manufacturers has been conducted quarterly since 1997. This quarter’s survey was conducted among NAM membership between May 15 and 30, with 326 manufacturers responding. Responses came from all parts of the country, in a wide variety of manufacturing sectors and in varying size classifications. Aggregated survey responses appear below. The next survey is expected to be released on Monday, September 8.

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Chief Economist
National Association of Manufacturers

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Sample Comments

- “Be more business friendly. Stop increasing fees/taxes on small business that could put them out of business.” (*Machinery*)
- “Concern on increased taxes, fees and possible loss of [Last In, First Out].” (*Machinery*)
- “Controlling rulemaking by agencies outside Congress, particularly the [National Labor Relations Board].” (*Electrical equipment and appliances*)
- “Lack of long-term U.S. transportation bill.” (*Primary metals or fabricated metal products*)
- “Russia–Ukraine situation is challenging for our business.” (*Machinery*)
- “Skilled machinists are impossible to find.” (*Primary metals or fabricated metal products*)
- “Slowdown in mining and uncertainty. How much further will coal mining fall due to current Administration policies in coal.” (*Primary metals or fabricated metal products*)
- “The competition is increasing production capacity and will be more aggressive in the marketplace.” (*Paper and paper products*)
- “Uncertainty on the part of my customers.” (*Machinery*)
- “Weakness in the defense sector.” (*Miscellaneous manufacturing*)
- “We built automated production systems for other manufacturers. Increased productivity is driving that demand, not new products.” (*Machinery*)
- “We need less Democrats and less Republicans and more smart people that are willing to tackle the longer-term issues with compromise. Not as a bulldozer and not with BS, but something that all Americans can believe in and actually trust.” (*Machinery*)
- “We need to replace the exports that we used to ship to the Ukraine and Russia.” (*Primary metals or fabricated metal products*)

Survey Responses

1. How would you characterize the business outlook for your firm right now?
 - a. Very positive – 19.6%
 - b. Somewhat positive – 66.3%
 - c. Somewhat negative – 14.1%
 - d. Very negative – *none*

2. Over the next year, what do you expect to happen with your company's sales?
 - a. Increase more than 10 percent – 15.8%
 - b. Increase 5 to 10 percent – 31.7%
 - c. Increase up to 5 percent – 26.4%
 - d. Stay about the same – 16.8%
 - e. Decrease up to 5 percent – 4.7%
 - f. Decrease 5 to 10 percent – 2.8%
 - g. Decrease more than 10 percent – 1.9%

Average expected increase in sales consistent with these responses = 4.1%

3. Over the next year, what do you expect to happen with prices on your company's overall product line?
 - a. Increase more than 10 percent – 0.6%
 - b. Increase 5 to 10 percent – 9.0%
 - c. Increase up to 5 percent – 41.3%
 - d. Stay about the same – 44.7%
 - e. Decrease up to 5 percent – 3.1%
 - f. Decrease 5 to 10 percent – 0.6%
 - g. Decrease more than 10 percent – 0.6%

Average expected increase in prices consistent with these responses = 1.6%

4. Over the next year, what are your company's capital investment plans?
 - a. Increase more than 10 percent – 15.6%
 - b. Increase 5 to 10 percent – 14.4%
 - c. Increase up to 5 percent – 15.6%
 - d. Stay about the same – 42.9%
 - e. Decrease up to 5 percent – 4.9%
 - f. Decrease 5 to 10 percent – 0.9%
 - g. Decrease more than 10 percent – 5.5%

Average expected increase in investment plans consistent with these responses = 2.3%

5. Over the next year, what are your plans for inventories?

- a. Increase more than 10 percent – 3.7%
- b. Increase 5 to 10 percent – 9.0%
- c. Increase up to 5 percent – 18.5%
- d. Stay about the same – 45.4%
- e. Decrease up to 5 percent – 16.4%
- f. Decrease 5 to 10 percent – 4.3%
- g. Decrease more than 10 percent – 2.8%

Average expected increase in inventories consistent with these responses = 0.5%

6. Over the next year, what do you expect in terms of full-time employment in your company?

- a. Increase more than 10 percent – 3.4%
- b. Increase 5 to 10 percent – 11.4%
- c. Increase up to 5 percent – 34.2%
- d. Stay about the same – 43.4%
- e. Decrease up to 5 percent – 5.2%
- f. Decrease 5 to 10 percent – 1.8%
- g. Decrease more than 10 percent – 0.6%

Average expected increase in full-time employment consistent with these responses = 1.7%

7. Over the next year, what do you expect to happen to employee wages (excluding nonwage compensation such as benefits) in your company?

- a. Increase more than 5 percent – 1.5%
- b. Increase 3 to 5 percent – 21.3%
- c. Increase up to 3 percent – 63.0%
- d. Stay about the same – 13.6%
- e. Decrease up to 3 percent – 0.3%
- f. Decrease 3 to 5 percent – 0.3%
- g. Decrease more than 5 percent – none

Average expected increase in wages consistent with these responses = 1.6%

8. Over the next year, what do you expect to happen with the level of exports from your company?

- a. Increase more than 5 percent – 15.9%
- b. Increase 3 to 5 percent – 13.0%
- c. Increase up to 3 percent – 10.8%
- d. Stay about the same – 57.1%
- e. Decrease up to 3 percent – 2.5%
- f. Decrease 3 to 5 percent – 0.3%
- g. Decrease more than 5 percent – 0.3%

Average expected increase in exports consistent with these responses = 1.6%

9. What are the primary drivers of your company's future growth strategies?
(Respondents were able to check more than one response; therefore, responses exceed 100 percent.)
- a. Increased efficiencies in the production process – 48.6%
 - b. Increased international sales – 42.4%
 - c. New product development – 57.3%
 - d. Recent mergers or acquisitions – 14.3%
 - e. Stronger domestic economy and sales for our products – 75.1%
10. What are the biggest challenges you are facing right now?
(Respondents were able to check more than one response; therefore, responses exceed 100 percent.)
- a. Attracting and retaining a quality workforce – 50.3%
 - b. Challenges with access to capital or other forms of financing – 6.5%
 - c. Rising energy and raw material costs for our products – 39.4%
 - d. Rising health care/insurance costs – 72.7%
 - e. Unfavorable business climate (e.g., taxes, regulations, government uncertainties) – 71.4%
 - f. Weaker domestic economy and sales for our products – 43.5%
 - g. Weaker global growth and slower export sales – 23.0%
11. What is your company's primary industrial classification?
- a. Apparel and allied products – *none*
 - b. Beverages and tobacco products – *none*
 - c. Chemicals – 6.1%
 - d. Computer and electronic products – 3.4%
 - e. Electrical equipment and appliances – 5.5%
 - f. Food manufacturing – 2.1%
 - g. Furniture and related products – 1.5%
 - h. Leather and allied products – *none*
 - i. Machinery – 12.6%
 - j. Miscellaneous manufacturing – 14.1%
 - k. Nonmetallic mineral products – 1.5%
 - l. Paper and paper products – 1.8%
 - m. Petroleum and coal products – 0.6%
 - n. Plastics and rubber products – 7.1%
 - o. Primary metals or fabricated metal products – 32.2%
 - p. Printing and related activities – 1.5%
 - q. Textile mills or textile products – 0.6%
 - r. Transportation equipment – 5.2%
 - s. Wood products – 4.0%

12. What is the size of your firm (e.g., the parent company, not your establishment)?
- a. Fewer than 50 employees – 24.1%
 - b. 50 to 499 employees – 49.4%
 - c. 500 or more employees – 26.5%

General Direction of the Country

13. Do you think the United States is headed in the right direction, or is our country on the wrong track?
- a. Right direction – 5.0%
 - b. Wrong track – 79.3%
 - c. Unsure – 15.8%
14. What do you see as the top challenges for policymakers over the course of the next few years? *(Check all that apply.)*
- a. Slowing the growth of entitlement spending – 84.4%
 - b. Finding a long-term federal budget deal that tackles the deficit/debt – 82.9%
 - c. Passing comprehensive tax reform – 72.3%
 - d. Ending expansionary monetary policy actions – 28.3%
 - e. Reducing the regulatory burden on manufacturers and other businesses – 81.9%
 - f. Expanding economic opportunities with more trade agreements – 21.8%
 - g. Implementing a true “all-of-the-above” energy policy – 48.6%
 - h. Controlling rising health care costs – 78.5%
 - i. Addressing the skills gap facing manufacturers – 42.7%

Hiring and Capital Spending Intentions

15. Do you expect to hire more workers this year than last year?
- a. Yes, we will hire more workers this year than last year. – 35.7%
 - b. No, our hiring pace will not change from last year. – 43.7%
 - c. No, we are hiring fewer workers this year than last year. – 10.8%
 - d. No, we are not hiring right now. – 7.1%
 - e. Unsure – 2.8%
16. Do you have unfilled positions within your company for which you are struggling to find qualified applicants?
- a. Yes – 60.1%
 - b. No – 37.2%
 - c. Uncertain – 2.8%
- If yes, how are you addressing the skills shortage? *(Check all that apply.)*
- a. Working existing workforce more – 57.2%
 - b. Creating or expanding internal training programs – 60.0%
 - c. Collaborating with educational institutions on skills certification programs – 48.4%
 - d. Utilizing temporary staffing services – 49.3%
 - e. Working with local employment office – 19.5%
17. Do you expect to increase your capital spending levels more this year than last year?
- a. Yes, we will increase our capital spending levels more this year than last year. – 41.5%
 - b. No, our capital spending pace will not change from last year. – 39.1%
 - c. No, we expect to decrease our capital spending levels this year relative to last year. – 15.4%
 - d. No, we currently have no capital spending plans. – 2.8%

If yes, what are the major factors contributing to this? *(Check all that apply.)*

- a. Increased demand for our products – 46.3%
- b. Need to replace other capital goods – 38.1%
- c. Need to increase overall capacity utilization – 48.8%
- d. Improved financial position allowing us to invest more in our business – 13.8%
- e. Capital investments due to new products or innovations in our processes – 49.4%
- f. Unsure – 1.3%

18. If your firm does not plan to increase total capital spending, what are the major factors behind the decision? *(Check all that apply.)*

- a. Reduced or slower demand for our products – 25.1%
- b. Already operating below capacity – 41.3%
- c. Limited need to replace existing capital goods – 49.7%
- d. Financial position not allowing us to invest more at this time – 27.5%
- e. Unsure – 4.2%

Expired Tax Provisions

19. During 2013, Section 179 expensing caps were enhanced to allow expensing of purchases up to \$500,000, capped at \$2 million of investment. In addition, companies of all sizes were allowed to expense 50 percent of purchases made in 2013 via so-called “bonus depreciation.” For 2014, Section 179 expensing is limited to \$25,000, and there is no provision for bonus depreciation. Is your company holding off on making an investment on capital equipment until Congress acts to extend the enhanced Section 179 expensing or first-year bonus depreciation?

- a. Yes – 23.6%
- b. No – 64.6%
- c. Unknown – 11.8%

If yes and these incentives are not extended, will you make these purchases anyway?

- a. Yes, this year – 12.4%
- b. Yes, at some point in the future – 32.1%
- c. No, not this year – 35.8%
- d. No, not at all – 5.1%
- e. Unsure – 14.6%

20. If these incentives are not extended until mid-November, will you still have time to make the purchase and get the equipment placed into service prior to the end of the calendar year as required to take advantage of these incentives?

- a. Yes – 17.7%
- b. No – 52.7%
- c. Unsure – 29.5%