

The region's manufacturing sector continued slow expansion in January. The region's seasonally adjusted PMI advanced to 53.3, indicating that both, the region's manufacturing sector and the overall regional economy entered 2011 on a positive note. However, the January's rebound in the index from 51.3 to 53.3 failed to erase the 9.3 point decline posted in December. The less volatile three month moving average also declined in December by 1.3 points. All of this suggests that the slowing growth we observed in December is becoming a trend at the start of 2011.

The region's production indicator advanced by 0.6 to 54.8. Again, the January advancement failed to compensate for the nearly 8 point decline in December. Although we did observe a slightly lower level of responders reporting lower production levels, the percentage of responders reporting higher levels of production remained unchanged from the previous month. In January, about 35.7% of survey responders indicated higher levels of production.

The New Orders indicator remained consistent with the overall index and the production indicator. The number of responders indicating lower new orders activity declined, but the number of responders indicating higher levels of new orders remained unchanged from December. The New Orders indicator also edged slightly higher in January (by 1.1 points to 53.0), but just as in the case of the overall index, the rise failed to compensate for the decline observed in December, when the indicator declined by nearly 10 points.

Commodity prices continued to remain of serious concern. The indicator of Commodity Prices eased slightly to the level of 75 points, but this unusually high level appears to have become a norm, as the indicator remained above 75 for three out of the last four months.

The Employment Indicator rebounded in January. Here we saw some clear signs of improvement as not only fewer responders reported lower employment levels, but more responders indicated higher levels of employment. But even here we saw some signs of reduced momentum in the economy as about half of all responders indicated the same levels of employment. The indicator increased to 56.5, but failed to reach the November level of 63.0.

The survey results support our earlier expectations from last month. The regional economy continues to expand but at a significantly slower rate than the expansion we saw in October – November of last year. It appears that it was those two months that accounted for the growth in the fourth quarter. December brought some cooling to the regional economy that seems to have continued into January. The expectation is that this slower, but still positive growth will continue into February and March. This is not a regional, but a macro issue, as the US economy slows down in the first part of 2011. This will likely be accompanied by a small appreciation in the USD against the CAD, which would expand this slower growth into the retail and service sectors. However, if no further negative shocks emerge on the macro level, the USD/CAD exchange will reverse in May, and the CAD will appreciate, helping our region.

Commodity prices continue to remain a significant threat to the US economy. Costs of production of firms increase due to commodity inflation, but their ability to pass those cost increases onto consumers

is severely restricted by the weak labor market. Furthermore, high commodity costs deplete business sector ability to raise wages.

The government sector also negatively weighs on the economy, and is expected to further worsen the performance of the national economy. State and local governments are effectively in a contractionary stage. Their tax collections are reduced to a large extent by the housing prices, but also by income and sales tax collections. The Congressional Budget Office just reassessed the budgeted deficit for the current year. Their current assessment is in line with our prior outlook of 1.5 – 2 trillion dollar deficit. Income tax collections during the next three months will suffer, putting further pressure on the ability of the Federal government to continue to offer positive contributions to the GDP growth.

The printing press continues to be the key policy at the macro level. The current expansion program will likely be expanded to 900 billion dollars (additional 300 billion to be added). Although this will continue to do miracles for the stock market, the danger imposed by it on the commodity markets is real. But a recession in Europe, which has a very high probability at this point, will help offset some of the effect on the commodity prices.

On an optimistic note, a double dip in the US economy in 2011 is highly unlikely, but a return to weak growth (1.6 – 2.2 % RGDP) in the first half of the year and a robust acceleration in inflation in the summer-fall is likely.

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