The Region's Manufacturing Sector Approaches Recessionary Levels

The region's manufacturing activity declined substantially during the course of the second quarter of 2011. The region's seasonally adjusted PMI dropped below the 50 point mark in May and continued to remain at these low levels in June. The June seasonally adjusted index was at 47.8, slightly lower than the 49.6 level seen in May. The three month moving average declined to 52.7, suggesting that the region's manufacturing posted a barely positive, but positive nevertheless quarterly performance in the second quarter. However, the region's manufacturing sector appears to have ended the quarter with zero growth and bordering recessionary performance.

Significant meltdown was seen in the production indicator. Our seasonally adjusted production indicator declined 9.1 points to 43.6. The number of responders indicating reduced production levels continued to increase and reached 35.7% in June. This sharply contrasts with only 28.6% of responders indicating higher production levels.

New orders indicator also continued to decline. The seasonally adjusted indicator declined to 39.8, a level not seen since the second quarter of 2009. Nearly half of all survey responders indicated reduced new orders activity.

Employment indicator posted a small monthly increase but that merely recovered the indicator to its April level. The seasonally adjusted employment indicator increased by 3.8 points to 48.3. 57.2% of our survey responders indicated unchanged employment levels.

Commodity prices continued to hover at high levels. The seasonally adjusted indicator declined slightly to 71.5 with half of all survey participants reporting higher price levels.

The region's manufacturing sector weakened significantly in the second quarter, but avoided sliding into a recession. Looking ahead, the region's manufacturing, and the broadly defined regional economy remain guided by the macro-economic framework of the US economy. As it was expected in our previous reports, the US economy is undergoing a slowdown that will continue to adversely impact the regional economy. The mini repeat of 2008 when the monetary expansion stimulated commodity markets which in turn only further weakened the economy is underway. The second quarter of 2011 saw a significant reduction in growth, but the US economy will likely avoid sliding into a recession in 2011, although it will be a close call in May - July. The growth is likely to slightly accelerate in the second half of the third quarter and continue into the fourth quarter. This will likely help our regional manufacturing indicators post a small recovery in the next three months.

Looking further ahead, the situation is becoming worse as the probability of a recession in the first half of 2012 is rising significantly. Although it continues to remain less than 50%, its steady rise is a frightening observation.

The macro economic environment continues to deteriorate. The budget deficits of the Federal and State governments will continue to negatively impact the economy on multiple fronts. We will continue to see reduced state and local spending on average, which will cause effective fiscal contraction at a time when we have near 9% unemployment. The federal and state budgets will likely further deteriorate in the next month and then again in the first half of next year. The rise in taxes is now an inevitability, just as is another monetary expansion. We are now at a point where at least partial monetarization of federal debt is an unavoidable factor. The implications of national and state level debt are enormous. These range from reduced government ability to contribute to the GDP to increased uncertainty about future taxes, commodity price inflation due to deficit induced monetary policy.

Consumption spending, an important component in the GDP, and one that has so far been the driving force behind the growth in the current expansion will likely post much lower growth in the summer months, and then again in the first half of 2012.

The GDP numbers will be released later this month and are expected to remain positive, but the growth is likely to slow down to 0.8 - 1.3% range. Ordinarily, such a slowdown would in itself be a bad thing, but coupled with the 9% unemployment and the current state of fiscal and monetary situations is very dangerous. Fiscal policy has become a nearly impossible tool given the level of debt of all levels of the government. And monetary policy has become reduced to merely printing money, which seems to succeed in only causing commodity price inflation and helping the Treasury finance its deficit.

I do not like ending these reports on a negative note, but I am afraid that shortly the term recession may unfortunately return into our lexicon again.

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