



BUSINESS OUTLOOK

SURVEY

September 2004

Activity in the region's manufacturing sector continues to improve, according to firms surveyed for this month's *Business Outlook Survey*. Although the indicator for general activity fell from its August reading, indicators for new orders and employment improved. Firms reported an increase in industrial prices again this month. Expectations for overall manufacturing growth remain positive, although most indicators fell from their August readings.

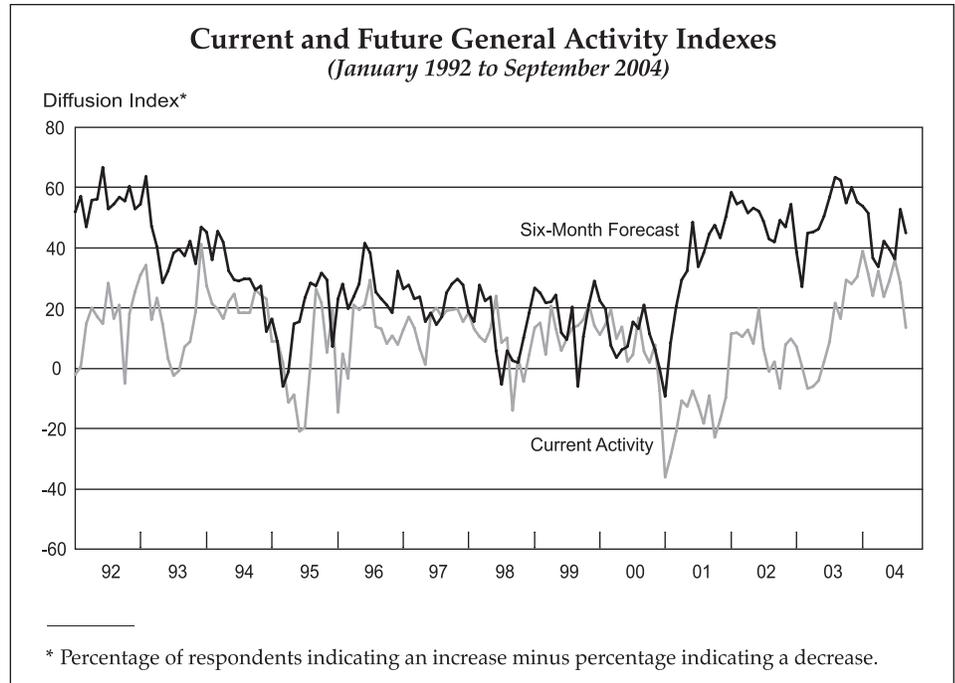
Current Indicators Are Mixed

The diffusion index of current activity, which measures firms' overall appraisal of current economic conditions, decreased from a reading of 28.5 in August to 13.4 in September. The index has remained positive for 16 consecutive months but is now at its lowest reading since July 2003 (see Chart). The new orders index, however, increased seven points, suggesting that demand for manufactured goods remains robust. Nearly 40 percent of the firms surveyed reported growth in new orders this month; 13 percent reported declines. The current shipments index paralleled the decline in the general activity index, decreasing nearly 10 points. Indexes for delivery times, unfilled orders, and inventories all showed increases this month, and all are slightly above zero.

Despite the moderation in manufacturing output growth, employment edged higher this month. The current employment diffusion index increased four points. The percentage of firms reporting increased employment this month (31 percent) was higher than the percentage reporting lower employment (10 percent). The average workweek remained positive and was virtually unchanged from its reading in August.

Price Indexes Drift Higher

Firms continue to report higher production costs. Nearly 58 percent of the firms



reported higher input prices this month, and only 1 percent reported lower prices. The prices paid diffusion index edged up three points and has increased for two consecutive months. The index is at its highest reading since May and is 26 points higher than at the end of last year.

Forty percent of the firms reported higher prices for their own manufactured goods this month; only 4 percent reported lower prices. The current prices received index, which edged up two points this month, is now at its highest reading since 1989.

Six-Month Forecast Is Less Optimistic

Overall expectations for the next six months remain generally optimistic, although most indicators for future conditions were lower this month. The future general activity index decreased from 52.7 in August to 44.9 this month, but it remains

at a relatively high level (see Chart). Other future indicators showed declines as well: the future new orders index fell eight points and the future shipments index fell 13 points. Indexes for future unfilled orders, future delivery times, and future inventories fell from their readings in August.

Expectations regarding future employment also decreased this month. The future employment index decreased from 26.6 in August to 23.4 in September. Thirty-four percent of the firms expect employment to rise in the next six months, while 11 percent expect it to decline. Although the average workweek index edged lower, firms expect the average workweek to increase over the next six months. The future capital spending index fell back about four points. Twenty-seven percent of firms expect higher capital spending over the next six months; 10 percent expect it to decline.

Special Questions (September 2004)

1. Have the special depreciation allowances for new capital equipment purchased before January 1, 2005, increased your level of spending on capital equipment since the beginning of 2004?

Yes 24.4% No 73.9% NR 1.7% Total 100.0%

2. As a result of the special allowances, will capital spending in the fourth quarter of this year be higher than it would have been otherwise?

Yes 27.0% No 71.3% NR 1.7% Total 100.0%

3. How do you expect your firm's spending on new plant and equipment to change for 2005 compared with your expected spending for 2004?

Increase significantly	22.6%
Increase slightly	33.0%
No change	29.6%
Decrease slightly	7.8%
Decrease significantly	7.0%
Total	100.0%

In special questions this month, firms were asked about the impact of special depreciation allowances on new capital equipment. Recent legislation provided temporary bonus depreciation allowances

for capital placed in service before January 1, 2005. Twenty-four percent of the firms indicated that capital equipment spending was higher in 2004 because of the special allowances. About 27 percent of the firms

indicated that capital spending in the fourth quarter of this year will be higher than it would have been without the special allowances. Firms were also asked about their capital spending plans for 2005 compared to 2004. Nearly 56 percent of the firms anticipate that capital spending will be higher next year than this year (23 percent say it will increase significantly and 33 percent expect only a slight increase). About 30 percent foresee no change; 15 percent think spending will be lower.

Summary

Although some indicators of current business conditions declined from their readings in August, all indicators point to continued growth in the region's manufacturing sector. New orders growth continues to show improvement, and a sizable share of firms are expanding payrolls. Manufacturing firms face continuing cost pressures, and about 40 percent of firms reported increases in the prices of their manufactured goods this month. Firms' expectations for growth over the next six months fell in September but remain generally optimistic.

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Summary of Returns

September 2004

	Previous Diffusion Index	September vs. August				Six Months from Now vs. September				
		Increase	No Change	Decrease	Diffusion Index	Previous Diffusion Index	Increase	No Change	Decrease	Diffusion Index
What is your evaluation of the level of general business activity?	28.5	29.5	52.4	16.1	13.4	52.7	50.6	39.9	5.7	44.9
Company Business Indicators										
New Orders	19.2	39.6	44.0	13.2	26.4	48.1	51.0	35.0	10.6	40.4
Shipments	32.0	39.1	44.2	16.7	22.4	50.3	50.0	31.5	12.8	37.2
Unfilled Orders	2.1	18.7	65.6	15.7	3.1	17.4	23.3	54.4	16.6	6.7
Delivery Times	-6.8	13.4	76.6	9.0	4.4	3.8	16.4	62.9	15.9	0.5
Inventories	1.7	19.5	63.1	15.9	3.7	4.4	22.4	48.1	25.2	-2.8
Prices Paid	53.7	57.8	39.5	1.4	56.4	47.2	52.8	38.4	5.4	47.4
Prices Received	34.1	39.9	55.9	3.8	36.1	40.5	40.5	52.4	4.1	36.4
Number of Employees	17.2	31.0	59.6	9.5	21.5	26.6	34.4	51.3	11.0	23.4
Average Employee Workweek	8.0	21.7	62.7	13.4	8.3	18.2	27.5	55.1	13.2	14.4
Capital Expenditures	—	—	—	—	—	21.4	26.9	49.3	9.8	17.1

Notes:

- (1) Items may not add up to 100 percent because of omission by respondents.
- (2) All data seasonally adjusted.
- (3) Diffusion indexes represent the percentage indicating an increase minus the percentage indicating a decrease.
- (4) Survey results reflect data received through September 13, 2004.