



BUSINESS OUTLOOK SURVEY

December 2007

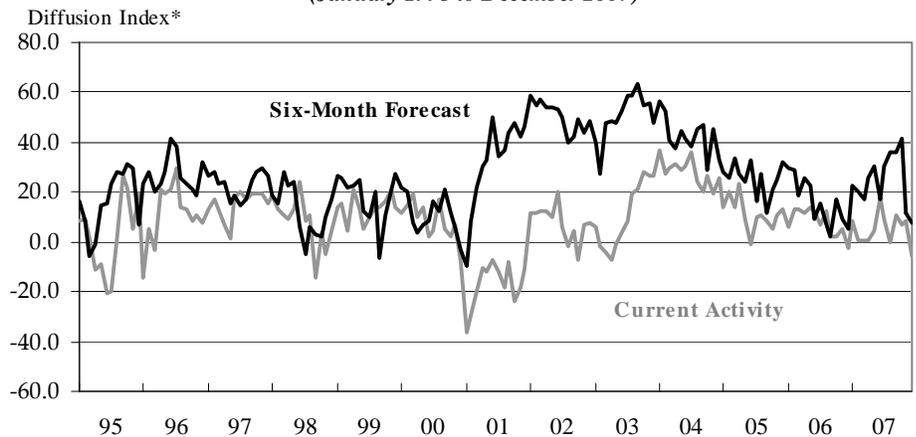
Overall conditions in the manufacturing sector deteriorated slightly in December, according to firms responding to this month's *Business Outlook Survey*. While the general activity index fell notably this month, firms continued to report growth in new orders and shipments. A significant share of the firms is still reporting a rise in prices for inputs and for their own manufactured goods. The region's manufacturing executives were less optimistic about future activity this month, and most future indicators have fallen considerably in the past two months.

Indicators Suggest Slowing

The survey's broadest measure of manufacturing conditions, the diffusion index of current activity, fell notably, from 8.2 in November to -5.7 in December (see Chart). Fifty percent of the firms reported no change in activity from November, but the percentage of firms reporting decreases (27 percent) was greater than the percentage reporting increases (21 percent) for the first time since last December. However, other broad indicators suggest continued growth this month. Demand for manufactured goods, as represented by the survey's new orders index, remained positive and increased seven points; the current shipments index increased 14 points. However, indexes for both unfilled orders and delivery times were negative.

Weakness was also evident in replies about employment and hours worked. The percentage of firms reporting an increase in employment (18 percent) was offset by the percentage reporting a decrease (17 percent). The current employment index declined four points, to its lowest mark since February. The average workweek index remained positive, edging up five points.

Current and Future General Activity Indexes
(January 1995 to December 2007)



* Percentage of respondents indicating an increase minus percentage indicating a decrease.

Firms Report Higher Prices

A sizable share of the firms reported higher prices for inputs again this month. Thirty-five percent of the firms reported increases in input prices this month, which is down from 44 percent last month. The prices paid index fell back three points. The prices received index also edged slightly lower. Nevertheless, one-fifth of the firms reported higher prices for their own manufactured goods this month.

Six-Month Indicators Continue to Fall

Expectations for manufacturing growth over the next six months fell again in December. The future general activity index declined from 11.6 in November to 7.7 this month, following a 30-point drop last month (see Chart). The indexes of future new orders and shipments also declined for a second consecutive month: The two indexes fell 11 points and 13 points, respectively. Firms were somewhat more optimistic about future increases in employment: The future employment index rebounded by six points, following a decline of 13 points last month.

Although 53 percent of the firms indicated that they expect no change in employment over the next six months, the percentage expecting an increase in employment (30 percent) is greater than the percentage expecting a decrease (11 percent).

In this month's special question, firms were asked about their expectations for changes in various categories of input and labor costs for the upcoming year (see Special Question). Excluding labor costs (wages, health benefits, and nonhealth benefits), the largest increase is expected to be for energy (4.9 percent), followed by raw materials (3.8 percent) and intermediate goods (2.8 percent). With regard to labor costs, 68 percent of the firms polled said that wages would increase between 2.5 and 5 percent, with an

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NOTICE: Effective January 2008, the *Business Outlook Survey* will be released at 10 a.m. ET, instead of at noon, on the third Thursday of the month.

average increase of 3.1 percent. The rise in health benefit costs is expected to be 7.2 percent, an increase three times larger than nonhealth benefits, which are expected to increase 2.4 percent.

expectations for future activity have deteriorated sharply in the past two months, suggesting that a slower rate of growth is expected during the first half of 2008.

Summary

On balance, conditions in the region's manufacturing sector appear to have deteriorated slightly this month. While the indicator for general activity fell notably in December, indicators for new orders and shipments suggest continued growth. Price pressures continue to be reported by manufacturing executives, and about one-fifth of the firms reported higher prices for their own manufactured goods this month. Firms'

The survey's annual historical revisions, which incorporate new seasonal adjustment factors, will be released on Thursday, January 10, 2008, at 10 a.m. E.T.

The information will be made available at: <http://www.philadelphiafed.org/econ/bos/boshistory.html>

Special Question (December 2007)						
What percentage change in costs do you expect for the following categories in 2008?						
	Energy	Other Raw Materials	Intermediate Goods	Wages	Health Benefits	Non-health Benefits
Increase > 12.5%	6.1	1.2	0.0	0.0	7.3	0.0
Increase of 10-12.5%	7.3	3.7	0.0	0.0	15.9	1.3
Increase of 7.5-10%	12.2	9.8	3.8	0.0	29.3	2.5
Increase of 5-7.5%	23.2	18.3	11.4	3.6	17.1	7.6
Increase of 2.5-5%	22.0	28.0	32.9	67.5	11.0	36.7
Increase of < 2.5%	12.2	20.7	26.6	19.3	8.5	20.3
Stay at current levels	6.1	12.2	24.1	8.4	7.3	24.1
Decline of < 2.5%	3.7	2.4	0.0	0.0	1.2	5.1
Decline of 2.5-5%	3.7	1.2	0.0	1.2	0.0	1.3
Decline of 5-10%	1.2	1.2	1.3	0.0	2.4	0.0
Decline of > 10%	2.4	1.2	0.0	0.0	0.0	1.3
Average	4.9	3.8	2.8	3.1	7.2	2.4

BUSINESS OUTLOOK SURVEY December 2007	December vs. November					Six Months from Now vs. December				
	<i>Previous Diffusion Index</i>	Increase	No Change	Decrease	Diffusion Index	<i>Previous Diffusion Index</i>	Increase	No Change	Decrease	Diffusion Index
What is your evaluation of the level of general business activity?	8.2	21.4	49.6	27.1	-5.7	11.6	31.2	41.3	23.5	7.7
Company Business Indicators										
New Orders	3.5	34.0	42.6	23.3	10.7	20.5	30.7	42.6	21.5	9.2
Shipments	4.7	37.4	43.6	19.0	18.4	18.5	31.2	38.7	25.2	6.0
Unfilled Orders	-9.2	21.1	53.2	25.6	-4.5	-1.7	13.6	55.8	24.7	-11.1
Delivery Times	-11.7	13.9	70.7	15.2	-1.4	-16.7	5.2	68.5	19.2	-13.9
Inventories	2.5	17.5	55.6	24.2	-6.7	-10.4	22.1	54.8	21.1	1.0
Prices Paid	37.7	35.0	63.6	0.0	35.0	48.6	48.3	38.5	7.0	41.3
Prices Received	18.6	21.3	74.2	4.6	16.7	27.1	36.3	46.9	10.3	26.0
Number of Employees	4.8	17.8	64.9	17.3	0.5	13.6	30.4	52.5	11.0	19.4
Average Employee Workweek	1.6	21.5	62.1	14.4	7.0	-0.9	14.5	68.1	12.5	2.0
Capital Expenditures	--	--	--	--	--	7.1	33.8	44.1	12.0	21.8

NOTES:

- (1) Items may not add up to 100 percent because of omission by respondents.
- (2) All data are seasonally adjusted.
- (3) Diffusion indexes represent the percentage indicating an increase minus the percentage indicating a decrease.
- (4) Survey results reflect data received through December 17, 2007.