



# BUSINESS OUTLOOK SURVEY

## December 2006

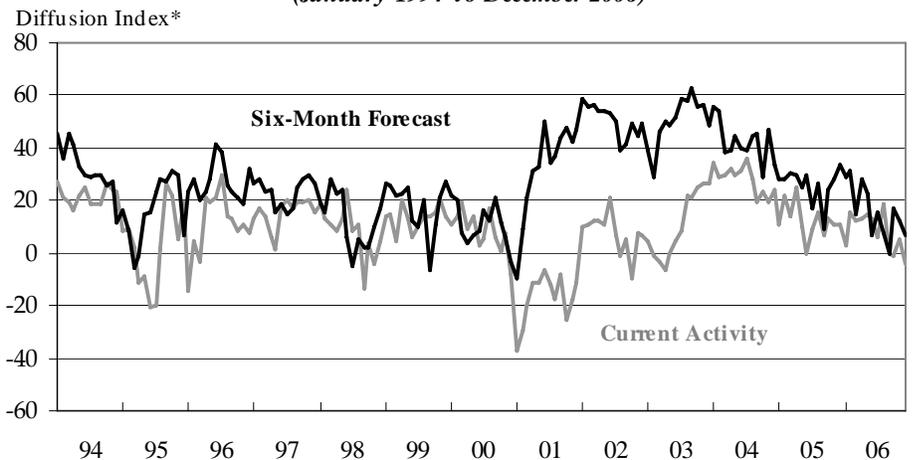
Overall economic conditions in the region's manufacturing sector declined slightly in December, according to firms polled for this month's *Business Outlook Survey*. Indicators for general activity, new orders, and unfilled orders were negative in December. Indicators for shipments and employment, however, were positive and stronger than last month. Although firms again reported higher prices for their own manufactured goods, the survey's prices paid indicator continues to suggest diminishing cost pressures. The region's manufacturing executives were less optimistic about future activity; most future indicators decreased for the second month in a row.

### Indicators Are Mixed This Month

The survey's broadest measure of manufacturing conditions, the diffusion index of current activity, fell from 5.1 in November to -4.3 this month. The index has been hovering around zero since September (see Chart). This month, 20 percent of the firms reported increased activity; 25 percent reported decreased activity. The new orders and shipments indexes offer mixed signals this month. The new orders index rose one point but remained negative for the second consecutive month. The shipments index moved 13 points higher than in November. Indexes for both delivery times and unfilled orders suggest some weakening. Delivery times shortened this month: The delivery times diffusion index fell 12 points, returning the index to negative territory, and the unfilled orders index declined 17 points.

### Current and Future General Activity Indexes

(January 1994 to December 2006)



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

Weakness in manufacturing is less evident in replies about employment and hours worked. The percentage of firms reporting an increase in employment (27 percent) was somewhat higher than that of firms reporting a decrease (19 percent); the current employment index rose eight points from its November reading. The average workweek index edged slightly lower: 20 percent of the firms reported fewer hours, and 18 percent reported increased hours.

### Input Price Pressures Moderate

Respondents reported higher costs for inputs again this month, but increases were not as widespread as in previous surveys. The prices paid index has now fallen for five consecutive months. Thirty-one percent of the firms reported higher input prices this month; 10 percent reported lower input prices.

The prices received index edged four points higher this month. Twenty-one percent of the firms reported higher prices for their final manufactured goods, up slightly from 17 percent last month. Eleven percent of the firms reported lower prices.

### Forecasts Are Less Optimistic

Expectations for manufacturing growth over the next six months moderated again this month. The future general activity index declined from 12.4 in November to 6.7, its lowest reading in three

The survey's annual historical revisions, which incorporate new seasonal adjustment factors, will be released on Thursday, January 11, 2007, at noon E.T.

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

months (see Chart). The indexes for future new orders and shipments also fell, declining three points and nine points, respectively. The future employment index, however, rose five points; 33 percent of the firms expect to increase employment over the next six months; 15 percent expect decreased employment.

In a special question this month, firms were asked about their expectations for changes in various categories of input and labor costs for the upcoming year (see Special Question). A comparison to last year's responses indicates that fewer

firms expect large cost increases for inputs. For example, at the end of 2005, 75 percent of the firms surveyed expected energy cost increases of 5 percent or greater in 2006; only 39 percent expect an increase of 5 percent or more in 2007. In 2005, 33 percent of firms expected cost increases of greater than 10 percent for health benefits in 2006; that has dropped slightly, to 27 percent, for 2007. Regarding wages, the largest share of firms, 86 percent, expect increases of less than 5 percent for 2007, nearly identical to the expectation last year.

## Summary

Conditions in the region's manufacturing sector deteriorated slightly this month. Indicators for general activity and new orders suggest a slight decline, although indicators for shipments and employment improved. Input price pressures continued to moderate, but one-fifth of the firms still reported higher prices received for finished manufactured goods. Indicators for the next six months suggest that firms are less optimistic about future conditions now than they were in November.

### Special Question (December 2006)

What percentage change in costs do you expect for the following categories in 2007?

	Energy		Other Raw Materials		Intermediate Goods		Wages		Health Benefits		Nonhealth Benefits	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
Increase more than 10%	15.2	38.1	9.0	8.3	1.4	4.9	0.0	0.0	26.9	32.9	5.2	2.4
Increase 5-10%	24.1	36.9	21.8	41.7	13.5	23.5	7.5	1.2	35.9	47.1	14.3	16.6
Increase less than 5%	22.8	7.1	38.5	28.6	40.5	42.0	86.2	87.0	23.0	12.9	49.3	39.3
Stay at current levels	25.3	5.9	15.4	14.2	36.5	27.2	6.3	9.4	9.0	3.5	24.7	39.3
Decline less than 5%	6.3	3.6	11.5	3.6	8.1	1.2	0.0	1.2	2.6	2.4	6.5	2.4
Decline 5-10%	2.5	4.8	2.5	2.4	0.0	1.2	0.0	1.2	0.0	0.0	0.0	0.0
Decline more than 10%	3.8	3.6	1.3	1.2	0.0	0.0	0.0	0.0	2.6	1.2	0.0	0.0

Numbers for 2006 reflect response percentages for the same question when it was asked in November 2005.

<b>BUSINESS OUTLOOK SURVEY</b> <i>(December 2006)</i>	December vs. November					Six Months from Now vs. December				
	<i>Previous Diffusion Index</i>	Increase	No Change	Decrease	<i>Diffusion Index</i>	<i>Previous Diffusion Index</i>	Increase	No Change	Decrease	<i>Diffusion Index</i>
What is your evaluation of the level of general business activity?	5.1	20.2	50.5	24.5	-4.3	12.4	29.9	45.7	23.2	6.7
Company Business Indicators										
New Orders	-3.7	25.9	43.9	28.3	-2.4	17.1	34.9	42.0	20.3	14.6
Shipments	6.5	39.0	38.1	20.0	19.0	23.5	34.1	43.0	19.2	14.8
Unfilled Orders	-3.9	13.2	49.0	33.9	-20.7	-0.3	17.9	57.8	20.4	-2.6
Delivery Times	5.9	14.3	63.8	20.7	-6.4	-0.1	11.3	62.9	19.6	-8.3
Inventories	4.4	16.4	63.6	17.3	-0.9	-0.4	24.6	53.2	19.2	5.5
Prices Paid	26.7	30.9	57.8	10.3	20.6	33.4	53.3	34.2	12.5	40.8
Prices Received	5.7	21.2	65.1	11.3	9.9	15.7	44.0	36.2	14.0	29.9
Number of Employees	0.2	26.6	54.7	18.7	7.9	13.2	32.8	51.7	15.1	17.7
Average Employee Workweek	0.4	18.0	58.8	20.4	-2.4	6.4	13.9	62.9	19.0	-5.1
Capital Expenditures	--	--	--	--	--	19.9	20.0	41.1	16.9	3.1

#### 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 18, 2006.