



BUSINESS OUTLOOK SURVEY

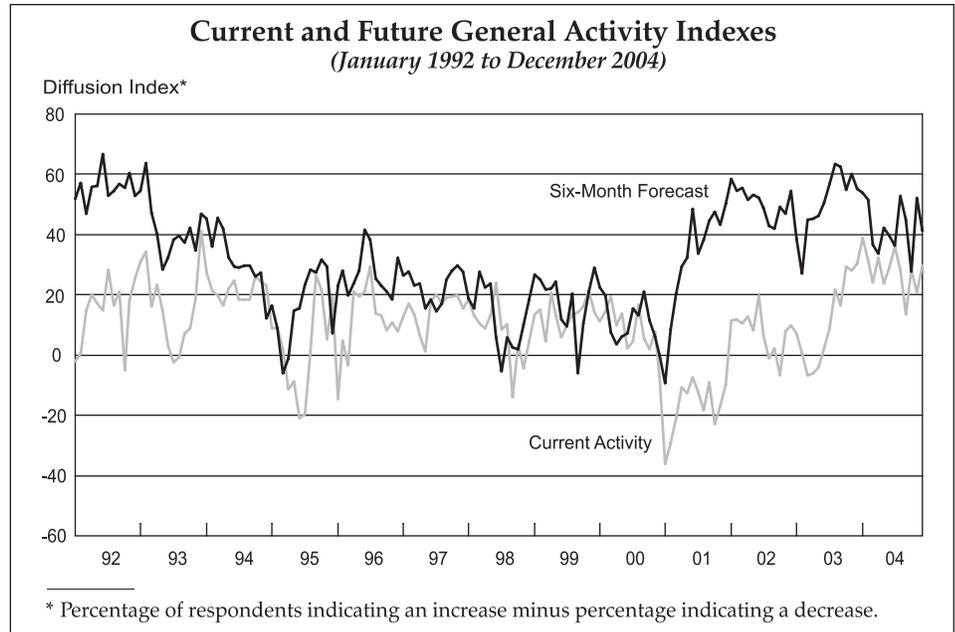
December 2004

Activity in the region's manufacturing sector continues to expand, according to firms surveyed for this month's Business Outlook Survey. Most indicators pointed to continued expansion in December, with increases recorded in the indexes for general activity, new orders, and shipments. Nearly one-quarter of the firms reported higher employment. The survey's price measures suggest continued cost pressures, but there was a slight moderation in upward price pressure for final manufactured goods. Expectations for overall manufacturing growth remained positive, although most indicators fell from their November readings.

Current Indicators Are Higher This Month

The diffusion index of current activity, the broadest measure of manufacturing conditions, increased from 20.7 in November to 29.6 this month. The index has remained positive for 19 consecutive months and is at its highest reading in five months (see Chart). The percentage of firms reporting increases in activity this month (37 percent) exceeded the percentage reporting decreases (8 percent). The new orders and shipments indexes also showed improvement this month: The new orders index increased four points, and the shipments index increased nearly eight points. Corroborating the stronger growth in broad indicators, December's index for unfilled orders was positive for the first time in three months. Delivery times remained steady. The inventory index declined one point and has been in negative territory for the past two months.

Continued expansion in manufacturing is evident in responses regarding employment and hours worked. The percentage of firms reporting increased employment (24 percent) was higher than the percentage reporting lower employment (10 percent). Still, the employment diffusion index,



positive for 15 consecutive months, fell three points. More firms reported longer work hours this month (21 percent) than shorter work hours (3 percent). The current workweek index increased 18 points to its highest reading in 10 months.

Price Pressures Moderate Slightly

Firms continued to report higher production costs this month. Fifty-four percent reported higher prices for inputs, but the diffusion index for prices paid declined two points to its lowest reading in five months.

Firms also reported higher prices for their own manufactured goods. Twenty-five percent reported higher prices for their manufactured products; 5 percent reported lower prices. The diffusion index

for current prices received, however, fell eight points and is now at its lowest reading in eight months.

Six-Month Forecasts Are Less Optimistic

Overall expectations for the next six months remain generally optimistic, although the index for future activity fell this month: from 52.1 in November to 41.2 (see Chart). Other broad future indicators showed similar declines: The future new orders index fell 11 points, and the future shipments index fell 14 points. Firms expect unfilled orders to increase modestly over the next six months and delivery times to hold near their current levels. The percentage of firms that expect inventories to increase over the next six months (18 percent) is about the same as

The survey's annual historical revisions, which incorporate new seasonal adjustment factors, will be released on January 13, 2005, at noon E.T. The information will be made available at: <http://www.PhiladelphiaFed.org/econ/bos/boshistory.html>.

Special Questions (December 2004)

The value of the dollar has recently declined on a trade-weighted basis. Considering both the cost of imported products and exports of your own products, which of the following best characterizes the effect of the decline in the dollar on your business?

	Effect on your business of change in		Net effect on your business
	import prices	exported products	
Substantial negative effect	10.1%	2.6%	7.5%
Some negative effect	44.3%	3.9%	23.7%
No effect	25.3%	38.9%	32.5%
Some positive effect	5.1%	27.3%	21.3%
Substantial positive effect	3.8%	10.4%	7.5%
Not applicable	11.4%	16.9%	7.5%
Total	100.0%	100.0%	100.0%

the percentage expecting them to decrease (19 percent).

Firms' expectations for future employment dipped somewhat this month. The future employment index decreased from 29.2 in November to 21.4 in December. A little less than one-third of the firms anticipate adding workers over the next six months. On balance, firms expect average work hours to increase somewhat over the

next six months. Thirty-six percent of the firms expect higher capital spending over the next six months, and the future capital spending index edged slightly higher this month.

In special questions this month, firms were asked about the impact of the recent declines in the value of the dollar on their businesses: the impact of higher prices for imports and lower export prices as well as

the net effect of the changes (see Special Questions). With regard to imports, 54 percent of the firms indicated negative effects from the falling dollar, while only 9 percent indicated some positive effects. With regard to exports, 38 percent indicated positive effects and 7 percent negative effects. When asked to balance the net effect of the changes, the firms were almost evenly divided between those reporting net negative effects (31 percent) and those reporting net positive effects (29 percent).

Summary

Most indicators of current activity improved this month and continue to reflect growth in the region's manufacturing sector. At least 37 percent of the firms reported an increase in general activity, new orders, and shipments in December. Employment increased again this month. Price pressures are still evident in firms' survey responses, but price indicators showed a slight moderation. Although manufacturers are generally optimistic about growth in their sector, expectations for the next six months fell somewhat in December.

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Summary of Returns December 2004

	Previous Diffusion Index	December vs. November				Six Months from Now vs. December				
		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?	20.7	37.2	54.3	7.7	29.6	52.1	53.8	32.6	12.6	41.2
Company Business Indicators										
New Orders	22.1	40.8	44.8	14.4	26.4	56.6	57.4	26.6	11.3	46.1
Shipments	24.5	39.0	49.7	7.0	32.0	51.8	54.0	26.7	15.8	38.3
Unfilled Orders	-1.2	20.3	65.7	12.5	7.7	22.9	18.7	64.7	12.3	6.4
Delivery Times	-4.7	13.9	71.2	14.8	-0.9	4.9	13.5	67.0	13.6	-0.1
Inventories	-6.1	16.2	56.7	23.8	-7.5	9.2	18.3	56.7	19.4	-1.1
Prices Paid	53.9	54.3	42.3	2.1	52.2	51.1	68.2	24.2	4.5	63.7
Prices Received	28.0	24.6	68.2	4.6	20.0	46.3	47.3	38.6	7.6	39.7
Number of Employees	17.4	24.3	66.1	9.6	14.7	29.2	31.3	53.0	9.9	21.4
Average Employee Workweek	0.6	21.4	72.7	2.9	18.6	16.6	18.5	62.6	12.2	6.3
Capital Expenditures	—	—	—	—	—	25.5	35.8	39.2	8.6	27.2

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 December 13, 2004.