PayNet Manufacturing Update
September 2013

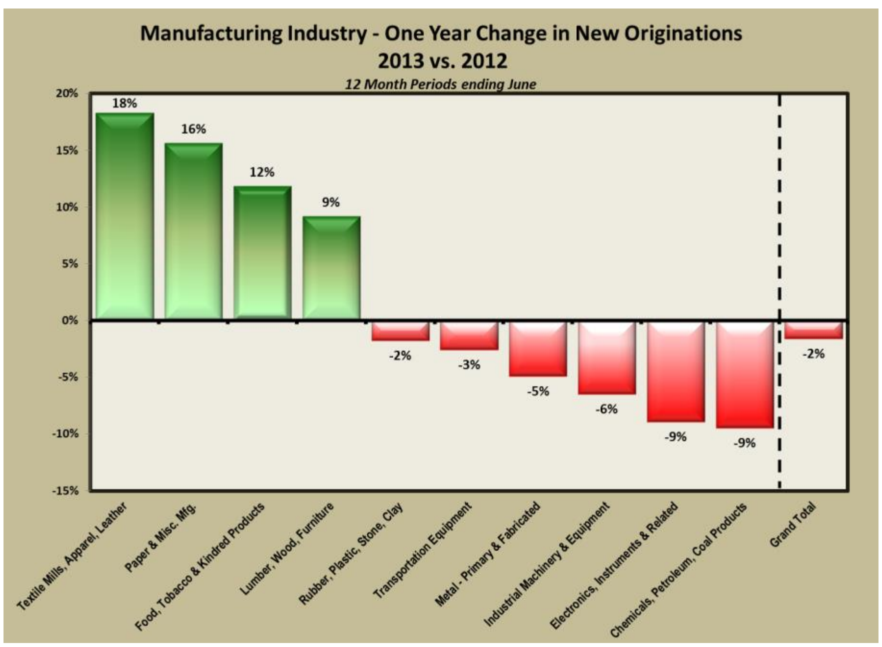
On Hold for a While

Small business manufacturers reduced business investment in capital forming projects based on a recent study by PayNet. The data shows that for the last twelve months, investment to build capacity to produce more goods and services shrank for the Industrial Materials and Manufacturing group. Surprising results are found particularly among significant sectors such as Energy Production, Industrial Machinery and Transportation Equipment. Following strong growth from replacement of worn out equipment, tools and parts, the cycle is now complete and small business manufacturers have no need to retool further until orders for their goods and services increase. Small businesses are seen as a leading economic indicator since they react quickly to order book changes from their customers, who are in part large manufacturers of goods such as cranes, bulldozers or air compressors.

The slowdown in business investment in the manufacturing sector of the U.S. economy has turned into a contraction. PayNet conducted a study of the amount of investment in new property, plant, equipment, tools and new business units by ten major manufacturing sectors. Falling investment activity earlier this year has accelerated as manufacturers, especially in the larger sectors of the manufacturing economy, pare investment levels below last year’s levels. The slowdown in 2012 has become a contraction. Six of the 10 major sectors are pulling back on investment and 3 of those sectors are the largest sectors.

A more detailed look at the Industrial & Materials Manufacturing segment offers a glimpse into the manufacturing slowdown. As shown in the figure below, U.S. manufacturers reduced investments by 2% in the recent 12 months.

Manufacturing Industry: One-Year Change in Business Investment



Source: PayNet 2013 Manufacturing Study

The slowdown in manufacturing investment is striking compared to last year. In 2012 all sectors were borrowing and investing at higher rates. This year only four sectors are investing more: Textile Mills, Apparel, Leather; Paper & Misc.; Food Products; and Lumber, Wood, Furniture. Higher investment in these sectors is related to increased orders from customers. The sectors investing the most were those hardest hit during the recession. Increased demand for lumber and furniture products are driven by new housing construction. Paper production is recovering as printed materials find a new role in the digital era.

The largest manufacturing sectors are pulling back the most on investment as evidenced by the biggest sector, Industrial Machinery and Manufacturing. These companies produce diverse industrial goods such as carburetors and air compressors. Investment to expand production capacity shrank over the past 12 months by 6%. Other big drivers of manufacturing also shrank. Transportation equipment producers reduced investment by 3% as truck fleets have completed the replacement cycle. Coal producers are shrinking investment as Natural Gas receives more attention and replaces coal as a cheaper and cleaner source of energy.

When manufacturers reduce investment, they are experiencing lower demand for the goods and services they produce. Replacement cycles are over so the easy growth is done. Sluggish demand means manufacturers will be leveraging their recent investments and delaying further capacity expansion until the next growth cycle. We don't expect much new investment in manufacturing equipment among small businesses until demand moves above the 2% growth rate trend of the economy. Subpar growth means little or no new business investment in manufacturing equipment. Service and equipment providers to small business manufacturers will likely see slower orders also as this sluggish growth stalls the entire supply chain to the manufacturing industry.

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