

Sector Morsel

Manufacturing: near term pressures, but longer term positives

05 December 2022

Key takeaways

- The latest Institute for Supply Management (ISM) manufacturing survey suggests the sector contracted in November, the first time since May 2020. And it's clear that following the strong bounce back after the pandemic, that growth is at least moderating.
- In the near term, manufacturing faces downward pressure as the tailwind from easing global supply chain fades and final demand undergoes a cyclical weakening. The strong dollar and an inventory overhang in retail are further drags on the sector.
- This moderation is starting to become evident in Bank of America data. Small businesses in manufacturing are showing slower growth in payroll payments –down from a peak of 16.4% YoY in March to 7.6% in October. And payments per small business client for this group has also flattened out lately, after growing at a strong pace for the past two years.
- But we see two reasons to be cheerful in the longer run. First, the auto sector likely has considerable pent-up demand following the chip shortage, which should support manufacturing in this space. And second, 'onshoring', aimed at shortening supply chains and bringing manufacturing back to the US from overseas, should provide longer-lasting support.

Manufacturing engineers impressive bounce-back from the pandemic

The pandemic hit the manufacturing sector hard. Output declined by around 15% in 2020 Q2 relative to the pre-pandemic level. At the same time, there was a big shake-out in employment – with a million fewer manufacturing jobs at the trough (Exhibit 1).

As lockdowns and other restrictions eased, the manufacturing sector got a boost from surging goods demand. At the peak in March 2021, the ISM manufacturing index reached its highest level since the 1980s. In the most recent quarterly data, manufacturing output was 3.3% higher than in 2019 Q4, while 72k more people are employed today than during 2019 Q4.

However, the global supply chain wasn't fully able to handle this sudden surge in demand. This resulted in long queues at ports and longer waits for many products, not to mention intense price pressure. In many cases, US manufacturers couldn't get the intermediate products they needed to meet the demand from their customers, hampering their ability to ramp up production.

Exhibit 1: Nonfarm payroll: Manufacturing (thous.)

The level of manufacturing employment in October was around 72k higher than the 4Q 2019 level



Source: Bureau of Labor Statistics

Exhibit 2: ISM manufacturing: supplier deliveries index (seasonally adjusted, 50+=slower)

Supplier delivery times have come right down as the global supply chain has unclogged



Source: Haver Analytics

But the good news is that many of these supply chain issues look well on the road to being resolved. The queues at ports have dissipated and the prices of many commodities are well off their highs. As a result, manufacturer reports of supplier delivery times have come right down (Exhibit 2).

Short-run downside cyclical pressures...

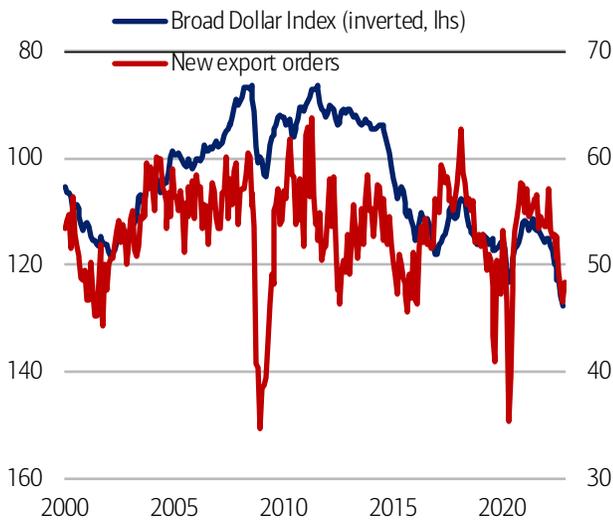
As global supply chain pressures ease and underlying demand in the economy undergoes a cyclical weakening, manufacturing sector growth in the short-run looks likely to ease. An additional factor is that some retailers have excess inventories on their books, so manufacturing demand may also be squeezed by some destocking.

These points are echoed by the new orders component of the ISM manufacturing index, which has been in contractionary territory (<50) over September–November 2022. Moreover, the headline number for the November 2022 ISM index for manufacturing was at 49.0 – taking it into contractionary territory for the first time since May 2020. An additional headwind for manufacturers is the strength of the US dollar (Exhibit 4), which is already negatively impacting export orders.

Bank of America internal data sheds some light on the moderation in manufacturing: since the beginning of this year, Bank of America small business’ clients in the manufacturing sector have seen slower growth in payroll payments than overall small business clients, though still elevated at 7.6% YoY in October compared to 8.7% for all small businesses.

Exhibit 3: Dollar index and ISM new export orders

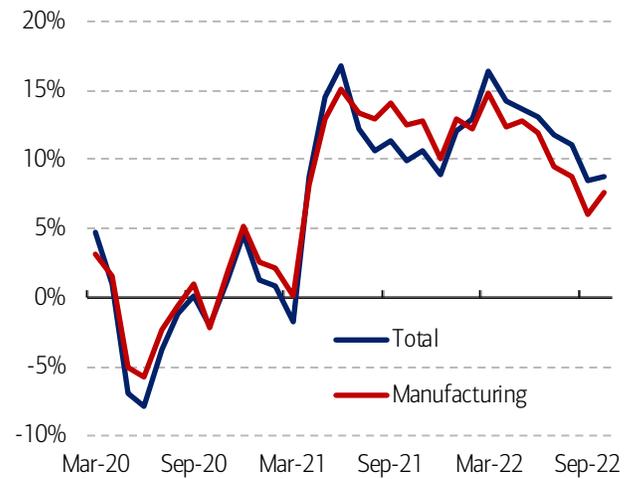
The rise in the dollar has seen export orders drop back



Source: Haver Analytics

Exhibit 4: Growth in small business payroll payments: overall and manufacturing (% YoY, 3-month moving average as of October)

After outpacing overall small business payroll payments growth in 2021, small businesses in the manufacturing sector have lagged again

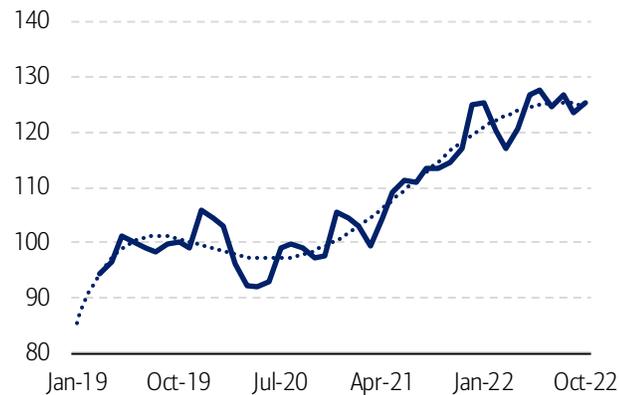


Source: Bank of America internal data

Similarly, the level of payments per client for small businesses in manufacturing may have flattened-off of late, which would be consistent with this view that the immediate outlook for manufacturing may get somewhat tougher (Exhibit 5). Bank of America card data also points to an ongoing switch into services spending and away from goods (Exhibit 6). This suggests that even if the US consumer remains fairly robust over 2023, demand for consumer goods could continue to be relatively softer.

Exhibit 5: Payments per manufacturing small business, based on Bank of America internal data (monthly, 3-month moving average, 2019 average =100)

Payments per manufacturing small business appears to be flattening off



Source: Bank of America internal data

Exhibit 6: Aggregated BAC credit and debit card spending on retail as a percentage of total card spending

Retail spending on cards has been declining as a share of total spending



Source: Bank of America internal data

..but two reasons to be cheerful longer-term

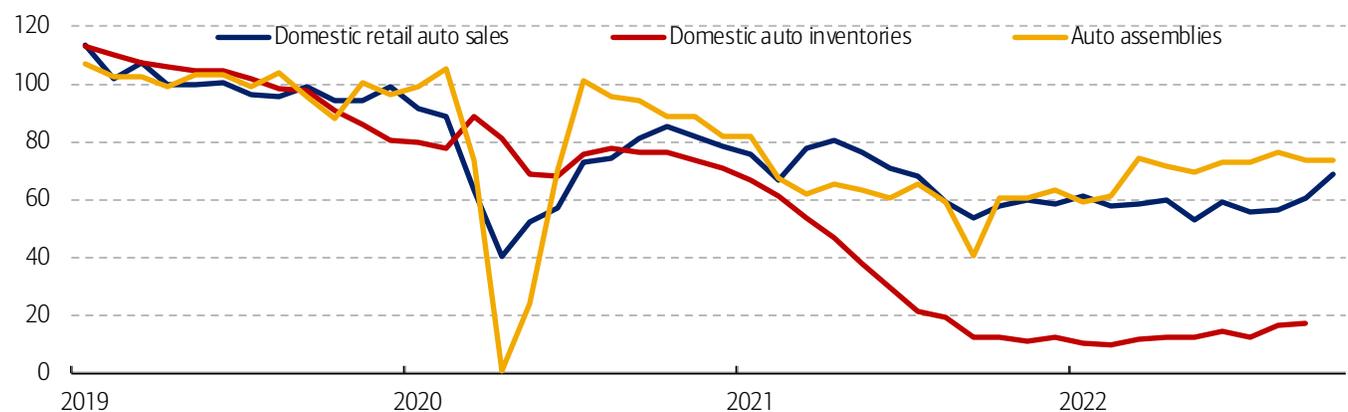
However, we see two reasons to be more optimistic on the manufacturing sector away from the cyclical softening we are seeing in the current data – both of which we have discussed in previous Bank of America Institute publications.

The first upside to manufacturing comes in the auto sector, as discussed in the [November Consumer Checkpoint](#). This sector has been particularly impacted by the global chip shortage due to the high number of imported chips in a typical car or truck. In contrast to other areas of manufacturing, it appears auto makers are still experiencing difficulties securing a steady supply of semiconductors.

As a result, even as other areas of consumer spending cool, the ‘pent-up’ demand for autos, alongside the need to rebuild dealer inventories, can support car manufacturers. (Exhibit 7), who employ roughly 8% of total manufacturing jobs in the US in 2022.

Exhibit 7: Auto assemblies, sales and inventories (Index 2019=100)

Auto inventories fell sharply in the pandemic and are only now beginning to rise



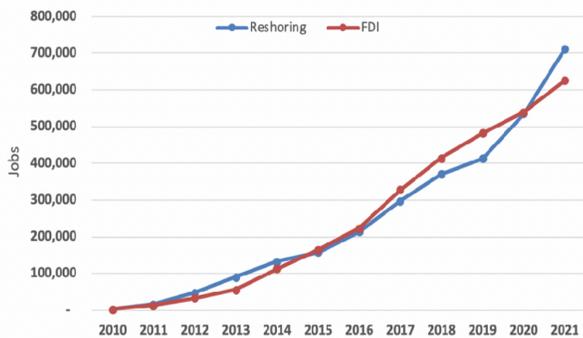
Source: Haver Analytics

Another important good news story, relates to ‘onshoring’. This is the push to shorten supply chains so that more of the end manufacturing process takes place in the US. We wrote about some of these trends in [‘The rising tide of reshoring’](#) in September. According to the Reshoring Initiative, 1.3 million reshoring and foreign direct investment (FDI) manufacturing jobs were announced from 2010-21, and in 2021 reshoring-tied jobs surged to nearly 180,000. This represents around a 1.4% boost to the total US manufacturing labor force (12.3 million in 2021).

Exhibit 8: Over 1.3 million reshoring + FDI jobs since 2010...

Cumulative reshoring + FDI jobs announced, 2010-2021

Exhibit 1b | Jobs Announced, Reshoring and FDI, Cumulative 2010-2021



Source: The Reshoring Initiative® 2021 Data Report
(https://reshorenw.org/content/pdf/2021_RI_data_report.pdf)

Exhibit 9: ...with a surge in those announcements the last two years

Reshoring + FDI jobs announced by year, 2010-2021

Exhibit 1c | Jobs Announced, Reshoring + FDI by Year 2010-2021



Source: The Reshoring Initiative® 2021 Data Report
(https://reshorenw.org/content/pdf/2021_RI_data_report.pdf)

The reshoring story is likely a multi-year one, in our view. For strategic and in some cases environmental reasons, there will likely be ongoing pressure to locate supply chains closer to the final consumer. And the US Chips ('Creating Helpful Incentives to Produce Semiconductors') Act will also provide incentives for more reshoring, with a \$53 billion package to be made available for US chip production and research. This includes \$39 billion for construction of semi plants and \$11 billion for semi R&D, spread over FY22-26.

So, while the post-pandemic surge in manufacturing will struggle to be maintained, there are still some reasons for cheer as we enter 2023. We think the impending boosts from autos and reshoring are enough to warrant a healthy dose of optimism.

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Methodology

Selected Bank of America transaction data are used to inform the macroeconomic views expressed in this report and should be considered in the context of other economic indicators and publicly available information. In certain instances, the data may provide directional and/or predictive value. The data used are not comprehensive; they are based on aggregated and anonymized selections of Bank of America data and may reflect a degree of selection bias and limitations on the data available.

Total payments include total credit card, debit card, ACH, wires, billpay, person-to-person, cash and checks. The payments data represents aggregated spend from Retail, Preferred, Small Business and Wealth Management clients with a deposit account or credit card.

Any Small Business payments data represents aggregate spend from Small Business clients with a deposit account or a Small Business credit card. Payroll payments data include channels such as ACH (automated clearing house), bill pay, checks and wire. Bank of America per Small Business client data represents activity spending from active Small Business clients with a deposit account or a Small Business credit card and at least one transaction in each month. Small businesses in this report include business clients within Bank of America and generally defined as under \$5mm in annual sales revenue.

Unless otherwise stated, data is not adjusted for seasonality, processing days or portfolio changes, and may be subject to periodic revisions.

Bank of America credit/debit card spending per household includes spending from active US households only. Only consumer card holders making a minimum of five transactions a month are included in the dataset. Spending from corporate cards are excluded. Data regarding merchants who receive payments are identified and classified by the Merchant Categorization Code (MCC) defined by financial services companies. The data are mapped using proprietary methods from the MCCs to the North American Industry Classification System (NAICS), which is also used by the Census Bureau, in order to classify spending data by subsector. Spending data may also be classified by other proprietary methods not using MCCs.

Additional information about the methodology used to aggregate the data is available upon request.

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