

Notice of Report Changes

Starting with the January 2015 report, ISM-Houston changed the calculation method used to develop the Houston Purchasing Managers Index™ (H-PMI™). This change was made to improve the accuracy of the H-PMI™ as a forecast tool for predicting moves in the Houston area economy on a three to four month forecast horizon. While the legacy model had a high forecast accuracy, the new model provides a significant improvement. The correlation between the forecast model and the Houston economy, as compared to the Dallas Federal Reserve's Houston-Sugar Land-Baytown Business-Cycle Index, has been increased from a coefficient of determination (r^2) of 0.51 to 0.63 with this change. Additionally, the Mean Absolute Scaled Error (MASE) relative to a Naïve Forecast has improved from 0.72 to 0.64.

An extensive analysis of historical H-PMI™ data showed that seasonally adjusting the underlying indicators and updating the weights applied to these indicators when producing the high level index improved the forecast accuracy. The new model is now being used to calculate the H-PMI™. The report format has also been lengthened to allow the inclusion of more information that is readily available from the analysis. In addition to the difference between the positive and negative responses to the queries regarding the underlying indicators, the calculated values for these responses are now included. The reporting of the underlying indicators now includes the seasonally adjusted diffusion index for these indicators to more closely align ISM-Houston's reporting activities with those of the Institute for Supply Management.

Additional information regarding this model revision can be obtained by contacting the report's author.

New Orders, Production and Employment Indices Fall Lower Finished Goods Levels and Prices Paid Keep Overall Index near Neutral

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The Houston affiliate of the Institute for Supply Management's survey of area supply chain professionals indicates that our economy showed a moderate potential for contraction near term for the second month. Six of the eight underlying indicators are now predicting potential contraction near term, while the remaining two are showing strong support for economic expansion.

The Houston Purchasing Managers Index (H-PMI) rose modestly from 48.9% to 49.3% in February. Readings below 50% generally indicate contraction near term. The seasonally adjusted Finished Goods Inventory and Prices Paid Indices continued to show a strong potential for expansion. All other indicators (Sales/New Orders, Production, Employment, Purchases, Lead Times, and Purchased Inventory) are now indicating possible contraction, with the Employment and Lead Times indices pointing to contraction for the first time in five years.

As with last month's results, our respondents indicated that not all Houston area industries are being negatively impacted by the fall in crude oil prices. The February responses confirmed that much of the current downturn has been driven by weakness in the Oil and Gas Exploration area along with its supporting industries. Sales/New Orders continued to be strong for Durable Goods Manufacturing unrelated to Oil and Gas, and to a lesser extent for Non-Durable Goods Manufacturing. Production, Employment, Purchases, Lead Times and Purchased Inventory are now down for almost all industries reporting.

INDICES AT A GLANCE

Index	Feb	Jan	Change	Track	Rate	Trend* (Mos)
Houston PMI	49.3	48.9	0.4	Contracting	Slower	2
Sales/New Orders	43.4	47.2	-3.8	Falling	Faster	2
Production	41.2	46.0	-4.7	Falling	Faster	2
Employment	37.1	52.1	-15.0	Falling	Fr. Rising	1
Purchases	42.2	49.9	-7.8	Falling	Faster	2
Prices Paid	32.2	35.2	-3.0	Falling	Faster	2
Lead Times	44.1	55.1	-11.0	Falling	Fr. Rising	1
Purchased Inventory	40.9	44.5	-3.7	Falling	Faster	3
Finished Goods Inventory	43.2	41.7	1.6	Falling	Slower	2

* Months on current track



Commodities Reported Up in Price: Custom pharmaceuticals

Commodities Reported Down in Price: Hot rolled steel, steel related items, wage rates for skilled craft labor, services and commodities related to drilling and producing oil and gas, computers and computer components

Commodities Reported in Short Supply: Large diameter pipe and custom pharmaceuticals

WHAT OUR RESPONDENTS ARE SAYING ...

Oil and Gas Exploration, and Key Support Services:

- Low oil prices are slowing a lot of exploration and production
- We are seeing significant effects from low oil prices
- Oil prices have stabilized, but crude inventories are building
- Texas and US rig counts continue to fall
- We anticipate crude and natural gas pricings near current prices for some time to come
- Need rail freight prices to drop; they have not got the message

Manufacturing - Durable Goods:

- Manufacturing for the oil and gas industry is considerably off; raw material continues to come in but there are no new orders to consume it
- Layoffs and salary cuts are anticipates for the first half
- Unlike manufacturers heavily dependent on oil and gas, we continue to show strong results

Manufacturing - Non-Durable Goods:

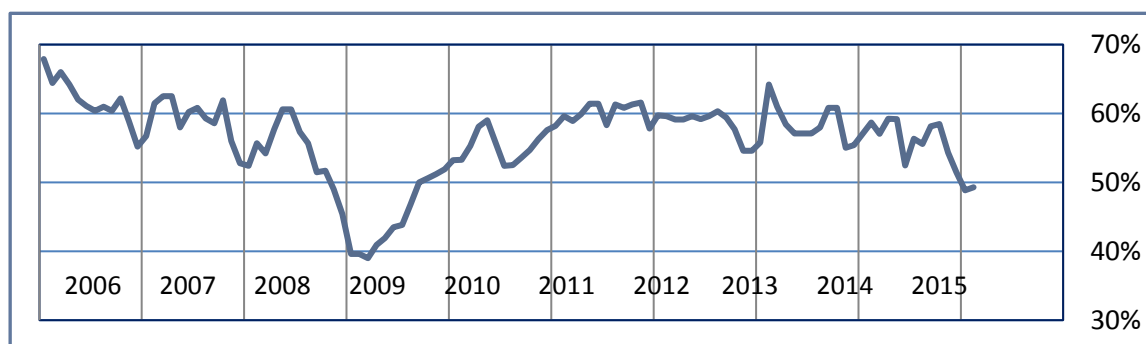
- New projects not in execution have been halted
- Wage rates are down for skilled craft labor

Health Care:

- Facility renovations are continuing
- The Medical Industry is hiring

Houston PMI Trend

The Houston PMI indicates likely shifts in production three or four months in advance. Readings over 50 percent generally indicate production expansion over the near term; readings below 50 percent show coming contraction.

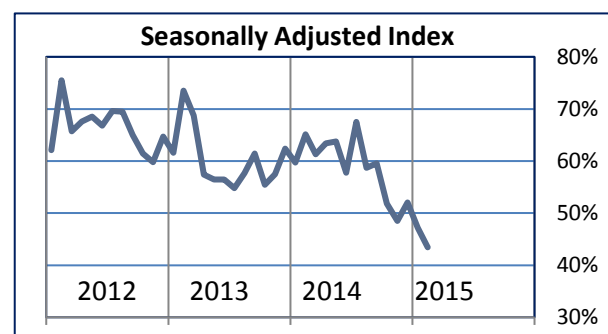


Trend of Underlying Indicators

The Houston PMI is based on diffusion indices for eight underlying indicators as shown below. The net value of each of these indicators is simply the percentage of respondents who cite a positive shift from the previous month minus the percentage who cite a negative shift. The diffusion index is calculated based on the percent of respondents reporting higher results plus one-half of those responding the same with a seasonal adjustment based on an X12 ARIMA forecast using the previous 12 years data. Seasonally adjusted values above 50 percent for the Sales/New Orders, Production, Employment, Purchases, Lead Times and Purchased Inventory indicators point towards expansion and values below 50 percent signal contraction. The Prices Paid and Finished Goods Inventory indicators are inversely correlated to economic activity, meaning that values below 50 percent point to expansion and values above point to contraction.

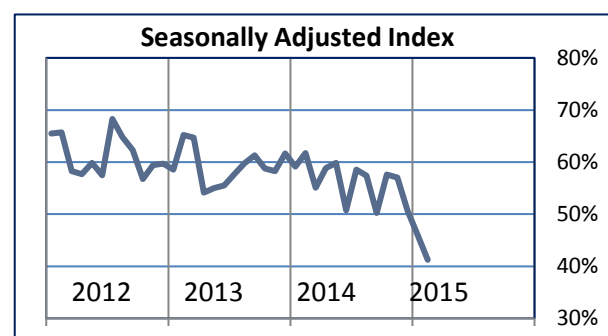
Sales/New Orders

	% Higher	% Same	% Lower	Net	Index	
Sep-14	36	46	18	18	59.5	The seasonally adjusted New Orders Index moved further below 50% this month, continuing to show a potential for economic contraction near term.
Oct-14	29	45	26	3	51.9	
Nov-14	27	40	33	-7	48.5	
Dec-14	25	48	27	-3	52.0	
Jan-15	30	34	36	-6	47.2	
Feb-15	31	28	41	-10	43.4	



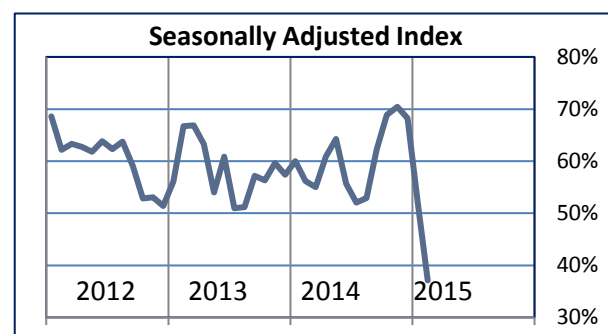
Production

	% Higher	% Same	% Lower	Net	Index	
Sep-14	14	72	14	0	50.3	The Houston Production Index fell 41.2%, completing its second month below neutral.
Oct-14	26	62	12	15	57.6	
Nov-14	27	60	13	13	57.0	
Dec-14	18	60	22	-4	50.7	
Jan-15	21	53	26	-6	46.0	
Feb-15	15	57	28	-13	41.2	



Employment

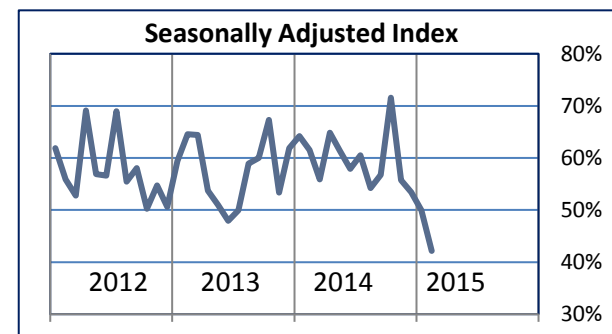
	% Higher	% Same	% Lower	Net	Index	
Sep-14	41	45	14	27	62.2	The seasonally adjusted Houston Employment Index moved significantly lower, reaching 37.1%, its lowest level since 2009.
Oct-14	47	44	9	38	68.9	
Nov-14	43	50	7	37	70.4	
Dec-14	38	52	10	29	68.2	
Jan-15	21	56	23	-2	52.1	
Feb-15	10	54	36	-26	37.1	



Purchases

	% Higher	% Same	% Lower	Net	Index
Sep-14	36	46	18	18	56.7
Oct-14	44	50	6	38	71.6
Nov-14	33	44	23	10	55.8
Dec-14	32	34	34	-3	53.4
Jan-15	38	28	34	4	49.9
Feb-15	28	31	41	-13	42.2

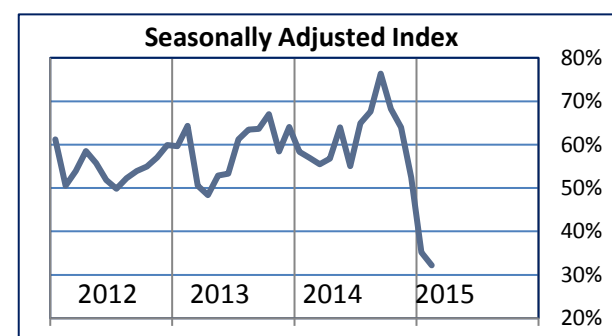
The seasonally adjusted Houston Purchases Index fell to 42.2%, also its second month below neutral.



Prices Paid

	% Higher	% Same	% Lower	Net	Index
Sep-14	50	50	0	50	76.4
Oct-14	38	59	3	35	68.2
Nov-14	30	67	3	27	63.9
Dec-14	15	69	16	-1	52.5
Jan-15	4	66	30	-26	35.2
Feb-15	3	59	38	-36	32.2

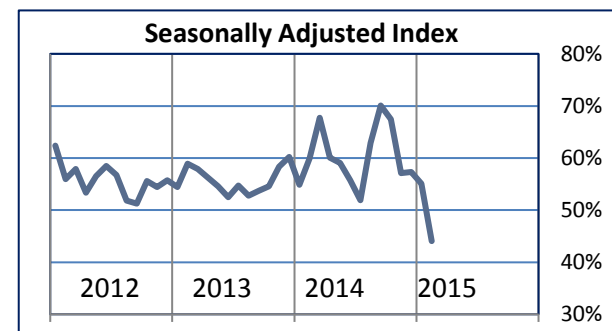
The seasonally adjusted Prices Paid Index fell to 32.2%. As this index is a reverse indicator of future economic activity, this low level buoyed the overall index.



Lead Times

	% Higher	% Same	% Lower	Net	Index
Sep-14	41	59	0	41	70.1
Oct-14	35	62	3	32	67.5
Nov-14	17	80	3	13	57.1
Dec-14	19	73	8	11	57.3
Jan-15	19	70	11	8	55.1
Feb-15	15	59	26	-10	44.1

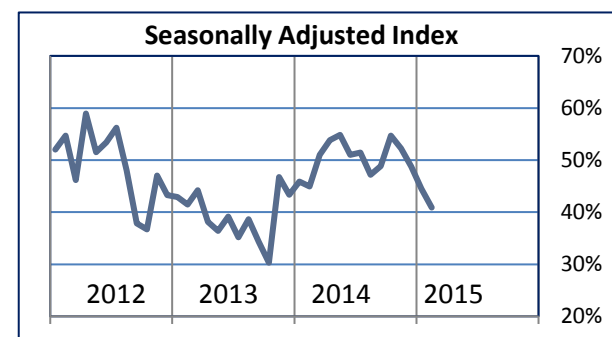
The Houston Lead Times Index softened this month, falling below neutral for the first time in over five years.



Purchased Inventory

	% Higher	% Same	% Lower	Net	Index
Sep-14	9	77	14	-5	48.8
Oct-14	15	73	12	3	54.7
Nov-14	20	60	20	0	52.2
Dec-14	11	67	22	-11	48.7
Jan-15	11	74	15	-4	44.5
Feb-15	10	67	23	-13	40.9

The seasonally adjusted Houston Purchased Inventory Index fell moderately this month to 40.9%.



Finished Goods Inventory

	% Higher	% Same	% Lower	Net	Index
Sep-14	23	59	18	5	51.8
Oct-14	24	58	18	6	57.4
Nov-14	27	63	10	17	57.6
Dec-14	27	59	14	14	56.9
Jan-15	21	51	28	-8	41.7
Feb-15	21	48	31	-10	43.2

The Houston Finished Goods Inventory Index stayed below neutral, moving to 43.2%. Our respondents are continuing to take action to reduce working capital.

