

Purchasing Managers Index

[UPSC Notes]

What is the Purchasing Managers Index?

Purchasing Managers Index also known as PMI is an indicator of the health of the manufacturing sector. There is also a Purchasing Managers Index for the non-manufacturing sector but the manufacturing sector is given more importance and is closely watched in the economy.

The Institute for Supply Management (ISM) compiles the Purchasing Managers Index each month by surveying purchasing managers in the manufacturing sector across the United States.

The Purchasing Managers Index is a compilation of the information on 5 key topics relevant to the manufacturing sector that is-

- Production levels
- New orders
- Supplier deliveries
- Inventories
- Employment levels

Economists have the view that the Purchasing Managers Index is an important indicator not just for the manufacturing industry but for the economy as a whole.

IHS Markit in India produces the Purchasing Managers Index. It assesses the manufacturing sector in India, which contains an index based on a survey of 500 manufacturing firms.

Features of PMI (Purchasing Managers Index)

The mission of the Purchasing Managers Index is to inform about the present and prospective business conditions to the analyst, investors, and decision makers.

- Before being combined to create a composite index, it is calculated individually for the manufacturing and services sectors.
- It is a Metric based survey that asks about the changes occurring in their assessment of important business compared to the past month.
- The range of Purchasing Managers Index is from 0 to 100.
- If the Purchasing Managers Index (PMI) range is above 50, it indicates expansion, while if the range of PMI is below 50, it indicates contraction in the economy.
- When the value of the Purchasing Managers Index is 50, there has been no change.
- If the Purchasing Managers Index of the current month is lower than the previous month's PMI, it is a sign that the economy is contracting.

- The IHS Markit compiled the purchasing Managers Index of more than 40 economies globally.
- As it is generally issued at the starting of each month, it is regarded as an excellent leading predictor of economic activity.
- There is a difference between the Purchasing Managers Index (PMI) and the Index of Industrial Production (IIP), which also measures economic activity.

How does Purchasing Managers Index work?

The Institute for Supply and Management released and compiled the PMI monthly. The value of the PMI is based on the monthly survey sent to the senior executives of more than 400 companies under 19 Primary Industries.

- Five major survey areas are primarily focused on Purchasing Managers Index- Production levels, New orders, Supplier Deliveries, Inventories, and Employment levels. All these 5 surveys are weighted equally by the Institute for Supply and Management (ISM).
- The range of the Purchasing Managers Index lies between zero and a hundred. when the Purchasing Managers Index value of the current month is above 50 as compared to the previous month, it represents the expansion in the economy, while when the Purchasing Managers Index value of the current month is below then 50 as compared to the previous month's PMI value, represent the contraction in the economy and when the Purchasing Manager Index value shows exactly 50 it means there has been no change.

Calculations of Purchasing Managers Index

The formula to calculate the Purchasing Managers Index (PMI) is-

$$PMI = (P1 \times 1) + (P2 \times 0.5) + (P3 \times 0)$$

In the above formula-

- P1 = is the percentage of answers reporting an improvement
- P2 = is the percentage of answers reporting no change
- P3 = is the percentage of answers reporting a deterioration

A series of qualitative questions are used to calculate the Purchasing Managers Index. Hundreds of the executives of enterprises are asked to judge whether indicators like production levels, employment levels, new orders, etc. were greater compared to the previous month. and the nature of the questions is factual.

The weightage of questions in the five survey areas is New orders(30%), Output (25%), Employment levels(20%), Supplier deliveries (15%), and stock of the bought products (10%).

Role of Purchasing Managers Index

Purchasing Managers Index plays a significant role in the economy of the country as it is used as a tool in decision-making by both the manager as well as the suppliers. The decision-makers, analysts, and investors of the company get information regarding the current and future conditions of a business through the Purchasing Managers Index.

Some of the important roles of the Purchasing Managers Index are as follows-

- To estimate the amount of the future demand for the desired products, the supplier follows the Purchasing Managers Index value of a particular company and the PMI value also helps the supplier to know how much inventory its customers have on hand.
- The prices charged by the supplier may also be affected by the information provided by the Purchasing Managers Index on the demand and supply as during the increase in the growth rate of the new orders the manufacturer can increase the prices from the suppliers while if the growth rate of a new orders decreases, the manufacturer has to lower its prices.
- The information provided by the Purchasing Managers Index can also be used by the company in planning the annual budget and managing the staff levels.
- Investors can also use the Purchasing Managers Index information as a leading indicator of economic conditions. Purchasing Managers Index plays an important role in providing a useful understanding of the economic activity of a business which consists of the GDP, Employment, and Industrial production.

Implications of Features of Purchasing Managers Index

- It is regarded as an excellent leading predictor of economic activity as the Purchasing Managers Index is provided ahead of the majority of the official statistics on industrial production, GDP growth, and manufacturing at the beginning of each month.
- The Economist considers that the information provided by the Purchasing Managers Index leads to the growth of the manufacturing sector is a good sign of industrial production, which was revealed later. The PMI is also used to make interest rate decisions by central banks to assist them.

Significance of Purchasing Managers Index

The PMI Index provides a reliable expectation of the economic activities of an economy as a whole and manufacturing in particular, which has become the most tracked indicators of business activities worldwide.

- The PMI is considered a leading indicator of economic activity as it is released at the beginning of every month and is closely watched by Businessman, Investors, Traders, Financial Professional, and Economist which provide a good gauge of boom and bust cycles in the economy and helps in decision making for them.
- Central Banks also use the PMI Index to set interest rates, which also impact the market's bond and currency.
- PMI indicators also provide information about an economy and its attractiveness for the business, based on which suppliers can decide on the prices of goods and services.