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Economics Group

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ISM: On the Right Side of the Line…Barely

For a factory sector beset by falling commodity prices and diminished interest in capital spending, today's print of 50.1 for the ISM manufacturing index feels more like a reprieve than an affirmation of expansion.

I Keep a Close Watch on This Chart of Mine

For the ISM manufacturing index, 50 is the demarcation line for expansion. A number above signals factory sector expansion and a number below signals contraction. When we are this close to the demarcation line, it bears repeating that 50 is not a demarcation line for the broader economy. In other words, the ISM can slip below 50 without a significant impact on the broader economy. The top chart at right looks at a three-month moving average of the ISM index versus the year-over-year rate of real GDP growth. The chart shows that over the last 25 years, the ISM has broken into contraction territory several times without a corresponding contraction in GDP growth.

Negative Signal for Jobs & December Rate Increase

One key takeaway from today's report is that the employment component declined to 47.6 from 50.5 previously. This is the lowest level for this key bellwether of factory employment since 2009. The manufacturing sector shed a combined 27,000 jobs in the past two months.

If the Federal Reserve is going to be able to deliver on a December rate increase, it will need two unequivocally positive jobs reports for October and November. On that score, today's six-year low for the employment component is troubling. The middle chart shows the employment component (line) vs. the monthly change in manufacturing jobs (bars).

The affirmation of the weakness is underpinned by the drop in order backlogs, which is still low at 42.5. Employment and backlogs tend to move together and backlogs tend to lead a bit.

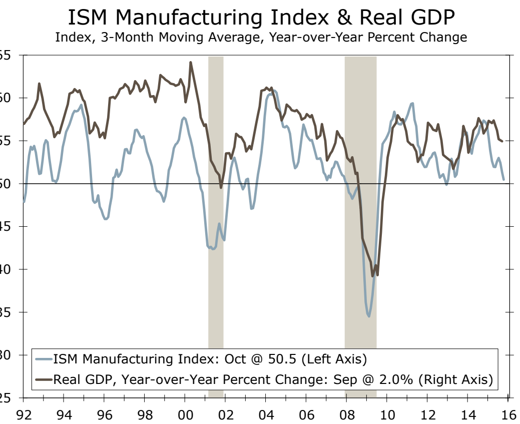
One potential offset to the jobs worries was highlighted in the comments section where a purchasing manager from the fabricated metals industry said "Business is improving. We still need young machinists to replace those retiring."

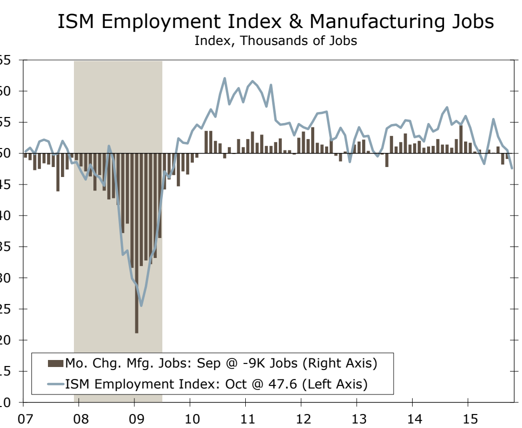
Orders Component Up, but Actual Orders Might Not Be

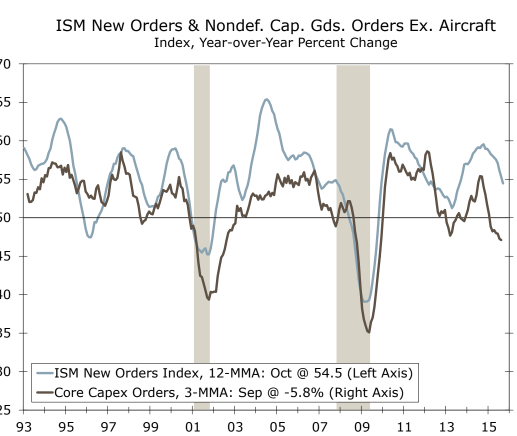
Another potential positive was the increase in orders to 52.9. That said, the bottom chart shows a considerable gap in recent years between what the new orders component tells us (blue line) and how actual core capital goods orders materialize (darker line).

This is partly a function of falling commodity prices which creates a significant headwind for nominal orders. For example, if your orders increase 0.1 percent on the month but your prices are down 0.2 percent, it looks like orders are falling even though in volume terms they are up.

Speaking of prices, the prices component at 39.0 is still quite low, suggesting the low price environment persists for manufacturers at present.







Source: U.S. Department of Labor, U.S. Department of Commerce, ISM and Wells Fargo Securities, LLC

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