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Economics Group

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ISM: Ongoing Adjustments in the Manufacturing Sector

U.S. manufacturing continues its adjustment to altered expectations of global growth and domestic energy opportunities. The ISM index came in at 48.2 in December with new orders and production below breakeven.

ISM: Adjustment to Moderate Growth, Global Uncertainty

December's overall ISM index at 48.2 reinforces the message that the manufacturing sector continues to work through the hit on energy and a more modest global economic outlook (top graph). The projected path for industrial production remains modest. For 2016 we expect industrial production will grow 1 to 2 percentage points below the pace seen earlier in this expansion and closer to the slower pace of last year—there is no imminent rebound here.

Production came in at 49.8, up from 49.2 last month. Seven industries reported a gain in production, including paper, chemicals, food & beverages and petroleum.

Employment dropped below breakeven at 48.1, with seven of the eighteen industries reporting gains in employment, including paper, chemicals and electrical equipment.

Orders Component Down, but Actual Orders Might Not Be

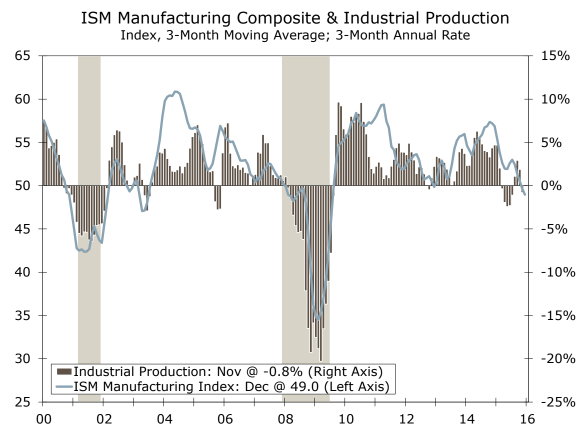
Another signal of correction in the manufacturing sector is the continuation of new orders below 50 at 49.2 in December. Weakness in the new orders index reinforces the view that factory orders and capital spending will remain disappointing at this stage of the economic expansion (middle graph). Seven of eighteen sectors reported better new orders including paper, chemicals and petroleum.

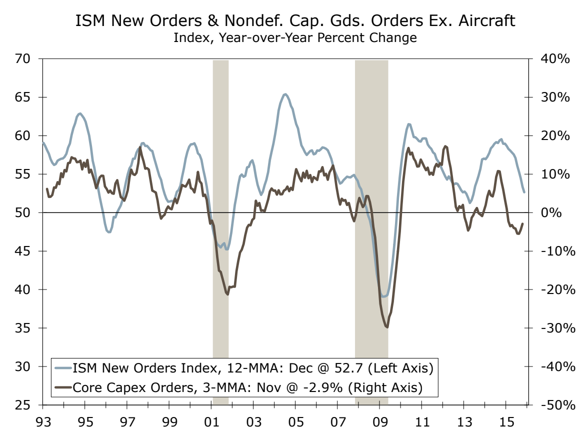
In contrast, net export orders broke above the 50 breakeven at 51.0, with gains in eight sectors including paper, chemicals, fabricated metals and food & beverage. Wrinkles are appearing in the orders data as some foreign buyers are reducing their orders from U.S. firms.

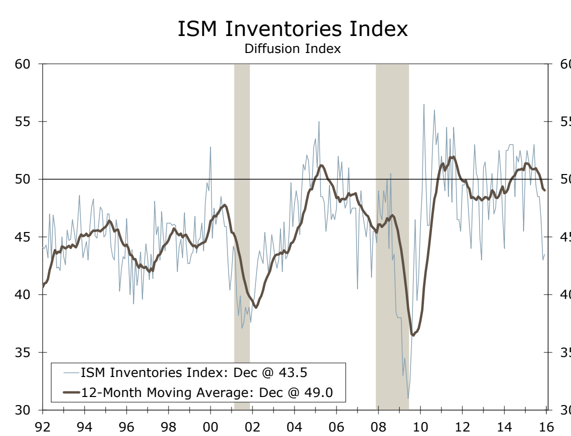
Finally, prices paid declined further to 33.5 in December compared to 35.5 in November. Of the eighteen industries reporting, no industry reported an increase—weakness continues in commodity prices.

Inventories

We have been and remain below consensus in our outlook for the pace of inventory building in the final quarter of the year. The inventories component came in at 43.5 percent in December, 0.5 percentage points higher than the November reading of 43.0 percent. This marks the sixth straight month of inventory contraction. That said, this alone does not necessarily mean that inventories will drop off in the GDP estimate for the fourth quarter. According to the ISM, over time, an inventories index below 42.9 percent is generally consistent with contraction in the BEA figures on overall manufacturing inventories. Still, we expect inventory investment to be a drag on headline growth.







Source: Institute for Supply Management, Federal Reserve Board, U.S. Dept. of Com. and Wells Fargo Securities, LLC

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