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Economics Group

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ISM: Manufacturing Sector Weaker—Great Divide Continues

The divide between the manufacturing and service sectors persists in the ISM surveys. It is odd that production and orders are in decline yet employment is up. Input prices remain weak.

Manufacturing: Dip Below Breakeven Reinforces Divide View

November's overall ISM index at 48.6 is the first dip below the breakeven level of 50 recently and below the six-month average of 51.0. This reflects our view that growth will moderate (top graph). For the current quarter, we expect industrial production will be roughly flat and equipment spending will grow 5.5 percent (both quarterly annualized rates). So moderation? Yes, but recession? No.

Production came in at 49.2, down from 52.9 last month. Five industries reported a gain in production, including electrical equipment, appliances, furniture and food/beverages.

Meanwhile, the inventory correction in manufacturing continues. The inventory index came in at 43.0, down from 46.5 in October. The inventory correction is ongoing. Eleven of 14 industries reported a reduction in inventories, indicating the inventory adjustment is very widespread.

Orders Component Down, but Actual Orders Might Not Be

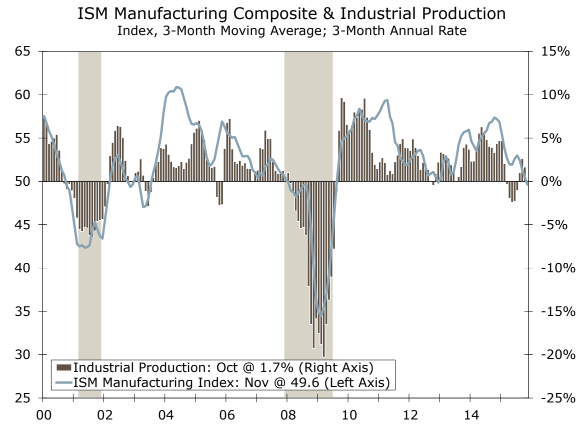
Another signal of correction in the manufacturing sector was the drop in new orders to 48.9—below the breakeven 50 and the six-month average of 52.7. The drop in the ISM is disappointing. One issue is that core capital goods orders (middle graph) reflect nominal values. However, in our other research we noted that this is partly a function of falling commodity prices, which create a significant headwind for nominal orders.

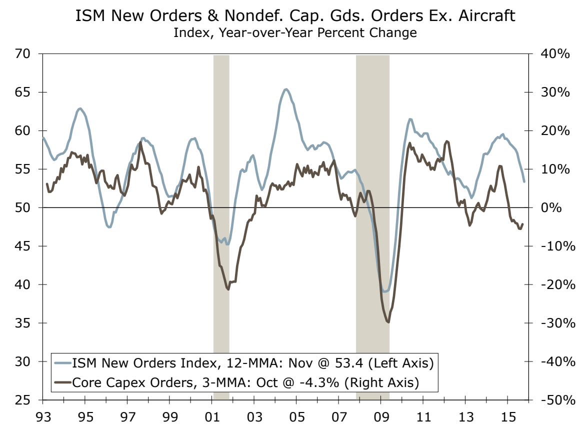
Net export orders remain below breakeven at 47.5 indicating that weaker global growth expectations are appearing in the orders data as foreign buyers are reducing their orders from U.S. firms. Eight industries reported a drop in net export orders including paper, primary metals, chemicals and computers.

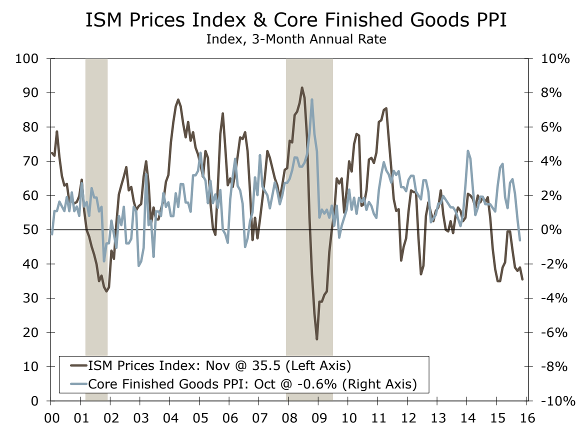
Prices Paid: Lower Now for 13-Straight Months

The ISM prices index came in at 35.5 in November—below the six-month average of 40.8 and a continued signal of weak input prices (bottom graph). None of the 18 industries reported paying increased prices for raw materials. At least one industry commented that they were seeing deflation in raw materials. Comments from the petroleum and oil industry indicated that low oil prices are now the new reality. As for specific commodities, no products were up in price. Commodities down in price include aluminum (12-straight months), stainless steel (13 months) and nickel (5 months).

Our producer price index forecast for the fourth quarter of 2015 shows deflation and that is what we are getting. This reflects the continued adjustment in energy/commodity prices as well as the strength of the dollar. Such moderation in commodity prices contrasts with the increases in prices for consumer services—particularly rents and health care. This bifurcation of consumer inflation manifests another aspect of division.







Source: Institute for Supply Mgmt., U.S. Dept. of Labor, U.S. Dept. of Commerce and Wells Fargo Securities, LLC

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