



Economics Group

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
Tim Quinlan, Economist
tim.quinlan@wellsfargo.com • (704) 410-3283

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

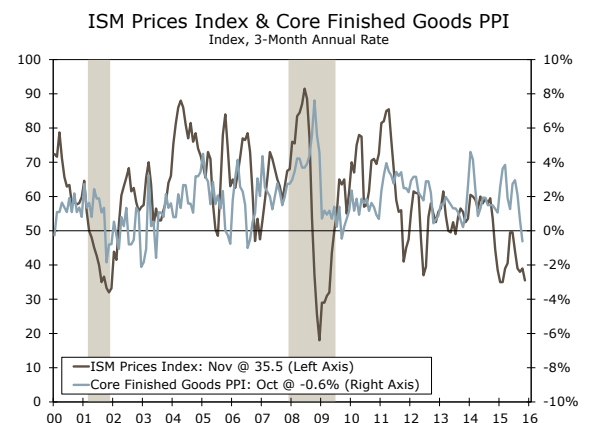
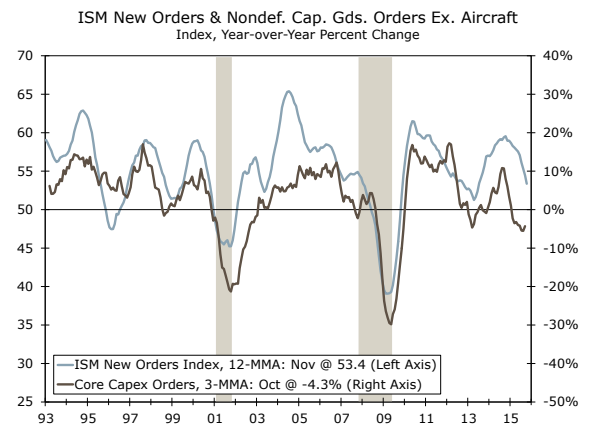
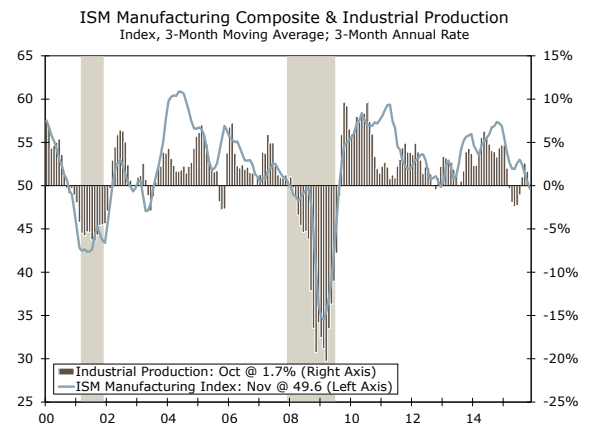
Another signal of correction in the manufacturing sector was the drop in new orders to 48.9—below the breakeven 50 and the six-month average of 52.7. The drop in the ISM is disappointing. One issue is that core capital goods orders (middle graph) reflect nominal values. However, in our other research 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.



Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloría, CFA	Currency Strategist	(212) 214-5637	eric.viloría@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Erik Nelson	Economic Analyst	(704) 410-3267	erik.f.nelson@wellsfargo.com
Alex Moehring	Economic Analyst	(704) 410-3247	alex.v.moehring@wellsfargo.com
Misa Batcheller	Economic Analyst	(704) 410-3060	misa.n.batcheller@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com

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