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Economics Group

WELLS FARGO SECURITIES

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
Erik Nelson, Economic Analyst
erik.f.nelson@wellsfargo.com • (704) 410-3267

ISM Shows Further Slowing in Manufacturing Growth

The ISM manufacturing index fell more-than-expected in September, but remains above the key 50 demarcation line. Inventory patterns and low order backlogs suggest activity will remain restrained.

Walkin' the Tightrope

The ISM manufacturing index declined more-than-expected to 50.2 in September, the lowest reading since May 2013. Only seven industries reported growth in the month, the fewest in nearly three years. Comments from respondents were mixed, with some indicating that "overall business is slowing" and "orders from customers seem to be slowing a bit," while others noted "business is picking up." That said, the above-50 reading suggests domestic manufacturing activity continues to expand on balance, albeit at a more sluggish pace.

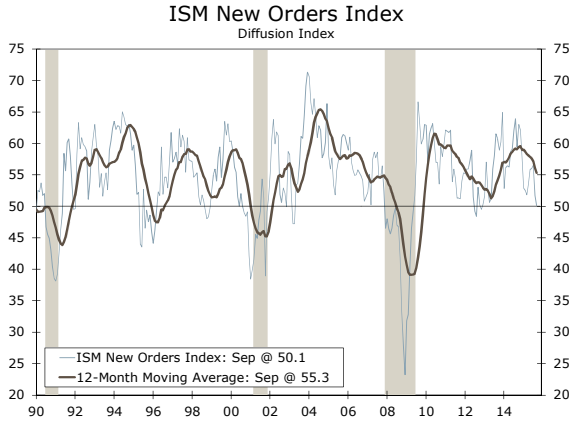
Details of the report were relatively soft as well. The new orders component dipped to 50.1, the lowest reading since 2012, suggesting production in the factory sector is likely to remain soft in the coming months. At the same time, the soft global growth backdrop continues to weigh on new export orders, which remained in contractionary territory for the fourth-straight month. Survey respondents highlighted developments abroad as their most significant concerns, with comments such as "concerns about China downturn" and "international business trending bearish" among those noted in the report. Meanwhile, the employment subcomponent showed a further decline in the month to 50.5, with only eight industries reporting job growth, suggesting the potential for moderation in manufacturing employment growth in the months ahead.

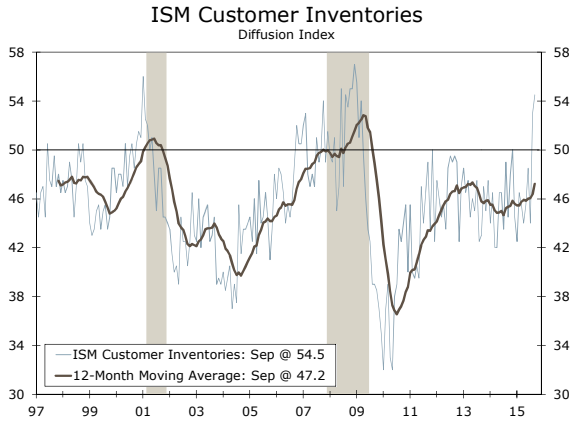
With a third-straight below-50 reading for the inventories component of the index, it seems Q3 GDP growth may take a sizeable hit from inventories. Indeed, we currently forecast inventories will subtract from overall real GDP growth in Q3.

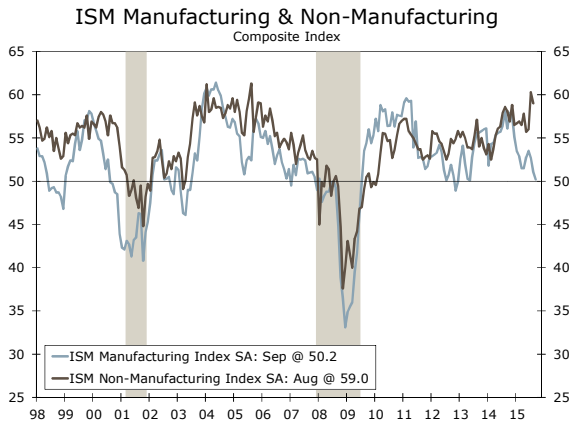
Factory Sector Woes Likely to Persist

On a more forward-looking note, the customers' inventories component has shot up in recent months to a new cycle high of 54.5, suggesting downside risk for future manufacturing activity. A higher figure for this component suggests customers are overstocked and are less likely to place new orders. Moreover, the backlog of orders component fell 5 points to 41.5, highlighting a dearth of pent-up demand in the pipeline. Perhaps more encouragingly, prices paid continued to decline, providing some relief for manufacturers' bottom lines.

We are under no illusion that this is a relatively weak report for the U.S. manufacturing sector. However, keep in mind that manufacturing accounts for less than 15 percent of value added in the domestic economy. Activity in the services sector, as indicated by the still-high readings from the ISM non-manufacturing index, continues to expand at a solid pace. Thus, while challenges among the country's goods producers are likely to persist, we do not believe they will be enough to preclude a December liftoff from the Fed, as overall activity in the broader economy continues to expand at a steady, albeit measured pace.







Source: Institute for Supply Management and Wells Fargo Securities, LLC

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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 Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@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
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com

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