



Economics Group

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
Sarah House, Economist
sarah.house@wellsfargo.com • (704) 410-3282

ISM Signals Manufacturing Weakness Continued in January

The ISM manufacturing index edged up ever-so-slightly in January, but at 48.2 continues to signal weakness. Employment and inventories are firmly negative, but new orders suggest some modest relief ahead.

Manufacturing Contraction Continues, but Signs of Moderation

The ISM manufacturing index edged up in January, but at 48.2 continues to signal declining activity in the manufacturing sector. Annual revisions showed recent weakness has been a bit more pronounced. Activity is now reported to have contracted beginning back in October, which makes January the fourth straight month of sub-50 readings. Still the index remains above 43.1, the level consistent with a broad contraction in the economy. The index has previously posted at least a four-month streak of sub-50 readings without ushering in a recession (most recently 2003 and 1998), but with the headwinds on manufacturing not expected to abate over the near-term, it highlights the precarious state of the economy.

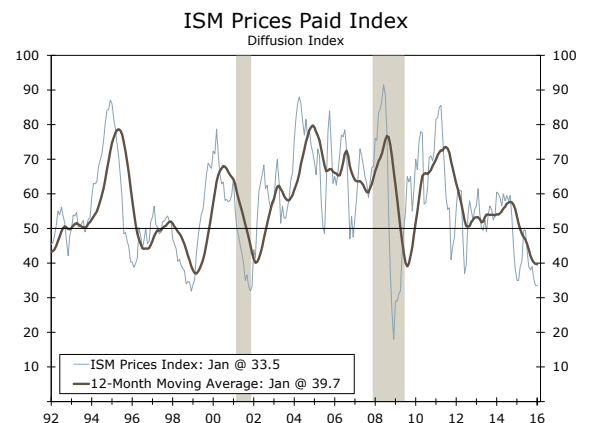
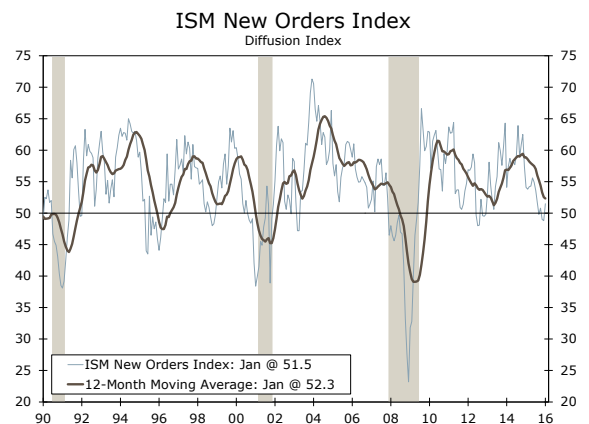
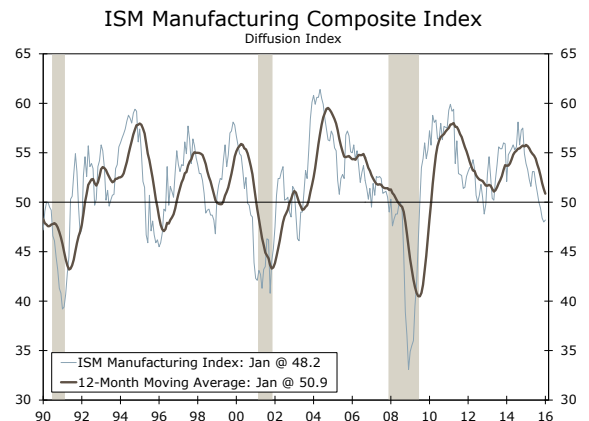
Details pointed to some modest improvement in the currently weak trend. Production edged back into positive territory at 50.2. The new orders index, the most forward-looking component of activity, also turned positive and is the highest since August. The rebound in production and new orders in the first month of the year supports our outlook for a modest rise in equipment spending as the drag from the falloff in energy-related investment eases.

Readings on inventories were unchanged in January. Respondents indicated inventories continued to contract last month (43.5), while customer inventories are still too high (51.5).

Employment conditions in manufacturing deteriorated more quickly, with the index falling to 45.9—the lowest reading this cycle. Only four industries reported adding workers last month, down from seven in December. At face value, the sub-50 reading points to manufacturing payrolls having declined sharply in January and presents downside risk to our forecast for total payroll growth of 190,000. The non-manufacturing employment component, due out on Wednesday, however, is more telling of the trend in job growth.

The prices paid component continues to signal deflation in the industrial sector and little pricing power for businesses. The price index was unchanged at 33.5 in January amid another broad decline in commodity prices. Prices paid have been in negative territory for 15 consecutive months—the longest streak since 1998-1999.

It is worth reiterating that manufacturing is not the entire U.S. economy. The factory sector accounts for only 12 percent of output in the economy and 9 percent of employment. Manufacturing is more exposed to the predominant challenges currently facing the economy—sluggish global growth, the strong dollar and falling commodity prices. However, the longer the pullback in manufacturing drags on, the greater the risk that weakness spills over into other sectors. For now at least, the ISM indicates the trend in activity did not worsen in January.



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
Julianne Causey	Economic Analyst	(704) 410-3278	julianne.causey@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Advisors, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC, is registered with the Commodities Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and Wells Fargo Bank, N.A. are generally engaged in the trading of futures and derivative products, any of which may be discussed within this publication. Wells Fargo Securities, LLC does not compensate its research analysts based on specific investment banking transactions. Wells Fargo Securities, LLC's research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm which includes, but is not limited to investment banking revenue. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company
© 2016 Wells Fargo Securities, LLC.

Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. The content of this report has been approved by WFSIL a regulated person under the Act. For purposes of the U.K. Financial Conduct Authority's rules, this report constitutes impartial investment research. WFSIL does not deal with retail clients as defined in the Markets in Financial Instruments Directive 2007. The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients. This document and any other materials accompanying this document (collectively, the "Materials") are provided for general informational purposes only.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE

WELLS
FARGO

SECURITIES