

Flash Comment

Weak ISM manufacturing in November puts Fed in difficult position

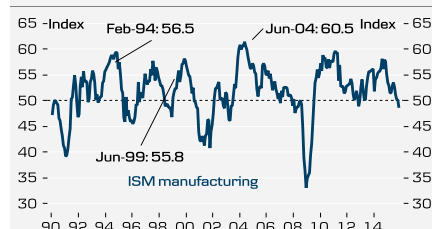
- **The US manufacturing ISM in November declined to 48.6 in November from 50.1 in October (Danske Bank: 50.3, consensus: 50.5), which is the lowest level since June 2009.** It is also the first time since 2012 that the ISM manufacturing index fell below 50. Most regional manufacturing indices and the order-inventory balance from October indicated that ISM would stay above 50, so today's weak ISM index was unexpected. The manufacturing sector still suffers from a combination of the very strong USD and the slowdown in manufacturing globally (and especially in China).
- **The subcomponents were overall weak.** New orders declined from 52.9 in October to 48.9 in November. Production declined from 52.9 to 49.2. New exports stayed weak at 47.5 in November. On a positive note, the employment component increased from 47.6 to 51.3 and is again above 50 indicating further growth in manufacturing. However, the employment index is still weak. **Our models and the order-inventory balance still indicate that we should see an ISM manufacturing index around 50.**
- The Markit manufacturing PMI in November was more encouraging as the final figure in November was revised up slightly to 52.8 from 52.6 in the flash estimate. The two different purchasing manager indices paint a very different picture of activity in the US manufacturing sector. The greatest focus is on the ISM, as this is oldest with the longest history, while the Markit PMI is quite new. Although the weights of the subcomponents are different, it may suggest that ISM has fallen too much (of course it could be the case that Markit PMI is too high – or both).
- **The weak ISM manufacturing index in November puts the Fed in a difficult position.** On the one hand it has never increased the Federal funds rate when ISM manufacturing was this low. On the other hand the domestic part of the economy is booming. The non-manufacturing ISM index in November is due on Thursday but was at 59.1 in October, indicating solid growth.
- **We think the Fed will put more weight on the ISM non-manufacturing index due on Thursday.** In 2014 manufacturing only accounted for close to 14% of gross value added in the US while services and construction together accounted for nearly 82%. Employment within services accounts for over 86% of total nonfarm payrolls while employment within manufacturing accounts for only 9%.
- Attention will now be on Thursday's non-manufacturing ISM index in November and Friday's jobs report for November. If both are very weak as well it will be much harder for Fed to justify a hike in December. We expect a small decline in ISM non-manufacturing to 58.0 in November from 59.1 in October (consensus: 58.0) and that nonfarm payrolls increased by 175,000 in November (consensus: 200,000). **This should be enough for the Fed to feel comfortable raising rates at the December meeting despite the very weak ISM manufacturing index. That being said, there is no doubt that today's weak ISM will raise eyebrows among the FOMC members.**

ISM-manufacturing at lowest level since June 2009



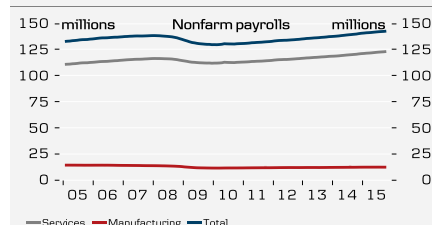
Source: ISM

Fed has never hiked when the ISM was this low



Source: ISM, Federal Reserve

Service sector most important for employment growth



Source: BLS

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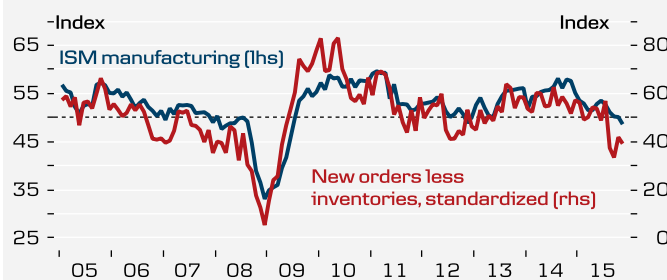
ISM chart book

Very weak ISM and weak subcomponents as well



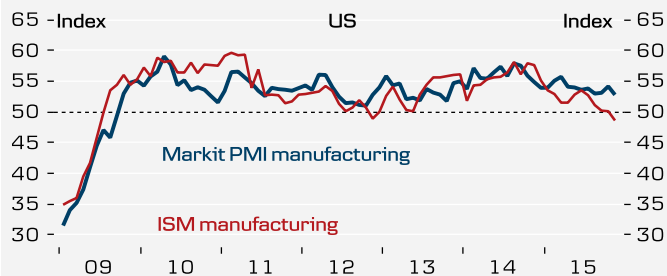
Source: ISM, Danske Bank Markets

Order-inventory balance suggests stabilisation



Source: ISM, Danske Bank Markets

Gap between ISM and PMI manufacturing



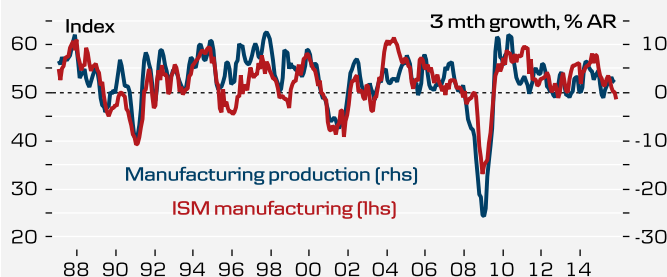
Source: ISM, Danske Bank Markets

Employment index again above 50 but still weak



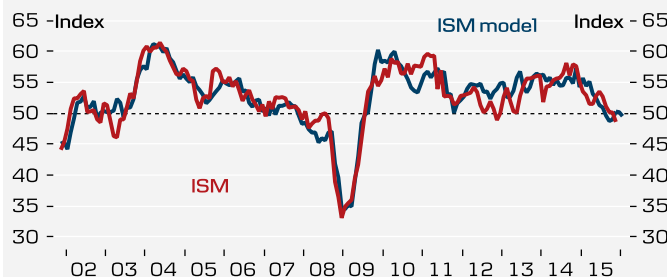
Source: ISM, Danske Bank Markets

ISM and manufacturing production



Source: ISM, Danske Bank Markets

Our model suggests the ISM is bottoming



Source: ISM, Danske Bank Markets

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