



# Economics Group

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## ISM: Still a Growth Story—Prices Signal Input Cost Pressures

**January's ISM reading of 60.8 signals continued growth from production, orders and employment. The ISM has served us well as a signal of the turnaround and now of sustained expansion. Prices paid are a concern.**

### Sustained Growth for the Manufacturing Sector

The ISM composite and the orders subcomponent have served us well as signals for the economic recovery and as evidence against the double dip. Unfortunately, the prices paid index is now signaling input cost pressures and thereby pressure on profits as well as pressures in the producer and consumer price indices down the road.

Fourteen of the 18 manufacturing industries reported growth in January. Some of the industries included on the growth side were electrical equipment, primary and fabricated metals as well as machinery, computer & electronic products, apparel and chemical products. For the composite, the index of 60.8 is considerably above the break-even level of 42.0, which indicates an expansion in the overall economy.

The takeaway here is that economic growth in the U.S. economy looks sustainable and there is no double-dip in the outlook. Our view is for three percent plus growth this year.

Production, employment, orders and inventories all suggest that manufacturing firms continue to experience (and plan for) a sustained economic expansion. We have moved from recovery to expansion in the economy. Production came in at 63.5 with 13 industries reporting a gain in output.

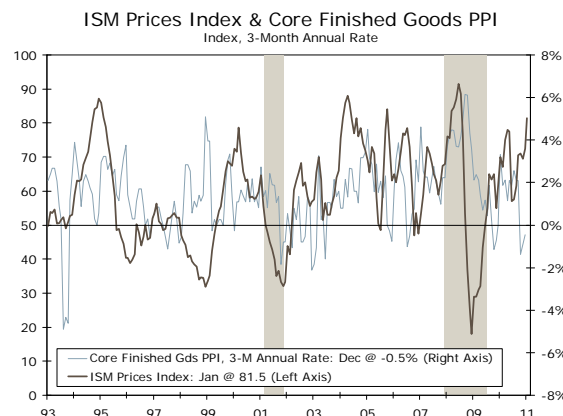
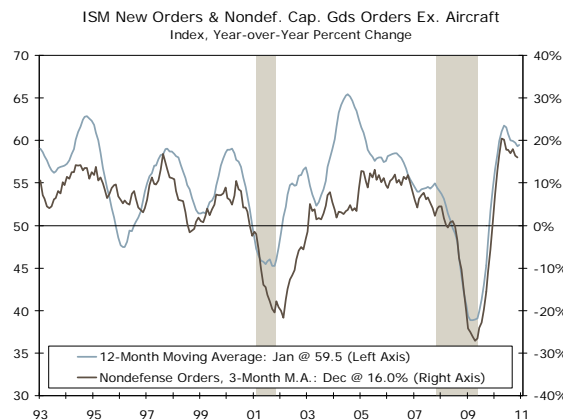
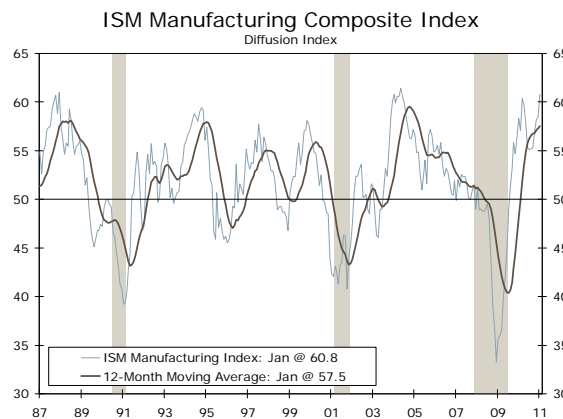
### New Orders and Employment Are Both in Expansion Mode

ISM's new orders index came in at 67.8, which suggests continued growth. The breakeven level for orders is 50.2, which is consistent with an increase in the Census Bureau's series on manufacturing orders. We expect equipment & software spending to grow in double digits in 2011. Twelve industries reported a gain in orders with improvement in such core sectors as paper, fabricated metals, computers & electronic products, machinery and electrical equipment. Employment, according to the ISM, came in at 61.7 and has been above breakeven for the last fourteen months. This supports our expectation that job growth will pick up this year.

### Prices Paid: Input Cost Pressures Ahead

Prices paid remain high with the index at 81.5 and thereby suggesting input price pressures, which could lead to reduced profit growth in 2011. The breadth of commodity price gains has widened. In fact, there were no commodities down in price.

While the prices paid index suggests higher input costs, the overall impact on consumer price inflation monitored by the Federal Reserve will remain muted as wage growth, a key driver of service costs, has remained moderate. The breadth and the high level of the price index suggest rising, not accelerating, inflation pressures.



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