



# Economics Group

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## ISM Signals More Temperate Growth But Watch Out for Prices

*The ISM Manufacturing Index came in at 54.1 for January, essentially unchanged from 53.9 the month prior. The big positive is a jump in the orders component to 57.6, but input prices are showing signs of a bounce.*

### Businesses Look for Temperate Growth...With an Eye on Prices

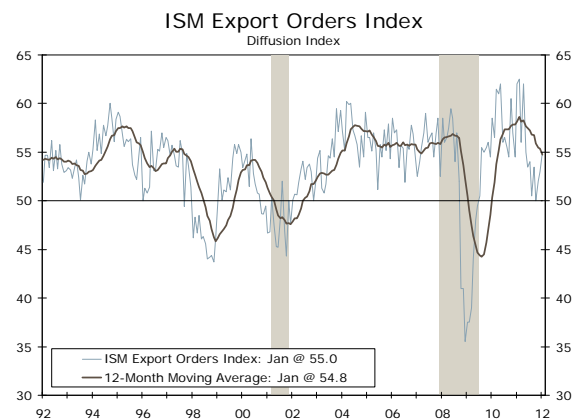
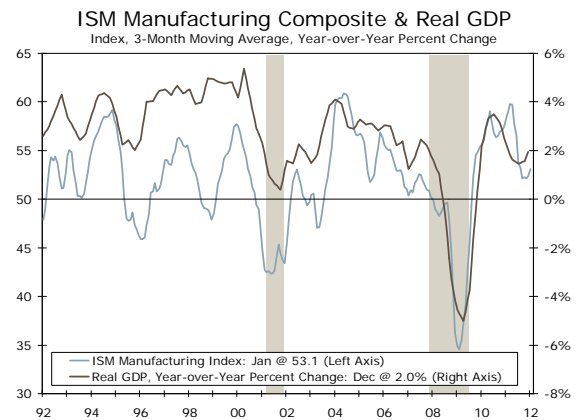
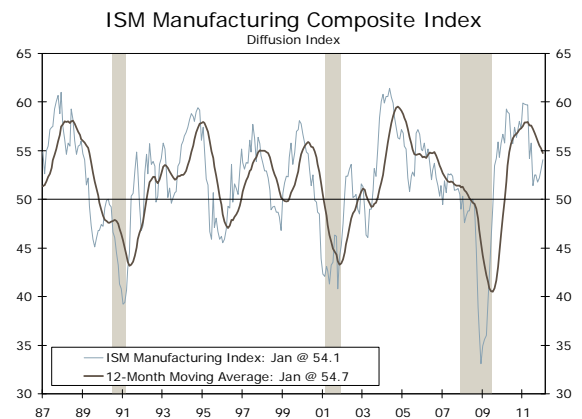
The headline print of 54.1 was somewhat less than the 54.5 that had been expected by the consensus, but not enough to call the report a disappointment. This key sentiment index is still at a level consistent with firmly positive GDP growth.

Seven out of ten of the sub-components were positive. Orders jumped 2.8 points to 57.6, a welcome sign of continued expansion for the factory sector. But the gain in orders was bested by a rather unexpected and unwelcome jump in prices. This could be a flash in the pan. Suppliers and manufacturers have been known to test higher prices at the start of a new year. While this should be taken care of by the seasonal adjustment, the price dynamic of the current cycle might present a unique scenario. For the past two years, producer prices have been increasing at roughly twice the rate of consumer prices. This has put pressure on corporate profits. But we have seen input price increases coming down on trend in the second half of last year. The year-over-year gains in the Producer Price Index have come down from more than 7 percent in July to just 4.8 percent in December. We will keep an eye on the prices paid component in future months, but in the absence of a major, broad run-up in commodity prices, we suspect this jump will prove to be temporary. In the meantime, for decision makers in the private and public sectors, the pace of inflation and modest overall economic gains will remain a challenge to profit margins.

Order backlogs crossed the line from contraction over into expansion territory, as export orders increased to 55.0. Taken together, these measures suggest that the situation in Europe has yet to be manifested by any slowdown in U.S. manufacturing activity. That said, we export more in services than we do in goods, so the ISM non-manufacturing index released on Friday might be a better gauge of the impact of the European slowdown.

### A Note on Annual Adjustments to Seasonal Factors

Yesterday, The U.S. Department of Commerce completed its annual adjustment to the seasonal factors that the ISM uses in the monthly purchasing managers' reports. According to a press release from the ISM yesterday, this "year's seasonal factor revisions include greater attention to two areas: series with marginal seasonality and with improved outlier detection. Due to this focus, the Department of Commerce recommended that ISM no longer seasonally adjust the ISM Manufacturing Inventories Index." The suggestions from the Department of Commerce seem to be seeking to address perceived deficiencies in the seasonal adjustment process; specifically, concerns about how to account for the massive drop-offs is so many measures (particularly inventories) in the autumn of 2008 during the credit crunch.



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