ECONOMIC UPDATE
REGIONS
October 1, 2012

September ISM Manufacturing Index: Orders, Employment Lift Overall Index Higher

- The ISM Manufacturing Index rose to 51.1 percent in September ending a 3-month string of contraction,
- The index for new orders rose to 52.3 percent while the employment index rose to 54.7 percent.
- The prices paid index rose to 58.0 percent, indicating input prices are rising at an accelerating rate.

The manufacturing sector showed renewed life in September, with the ISM Manufacturing Index rising to 51.1 percent, ending a string of three consecutive months below the 50.0 percent threshold that acts as the boundary between expansion and contraction. September's increase is mainly due to improvement in the employment and new orders components. There are, and you just knew this was coming, some dark clouds looming over the manufacturing sector, as current production continues to contract and export orders contracted for the fourth consecutive month. Moreover, the previously released regional indexes once again show a highly uneven performance across the U.S.

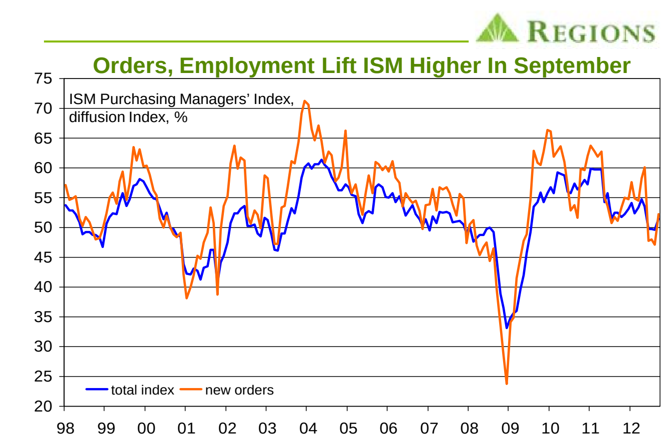
The increase in the index for new orders was driven by gains in, amongst others, petroleum & coal, food, beverage, & tobacco products, paper products, furniture, and primary metals. In all, eight industry groups reported higher orders, six reported lower orders (including electrical equipment, machinery, and transportation equipment), while order books were unchanged in the remaining industries. The ISM notes that a reading of 52.3 percent or higher for their new orders component is consistent with growth in the Census series on manufacturing orders, which has turned in a decidedly uninspired performance of late. As such, the jump in the ISM new orders index does not necessarily mean we can expect to see an increase in the Census series later this month.

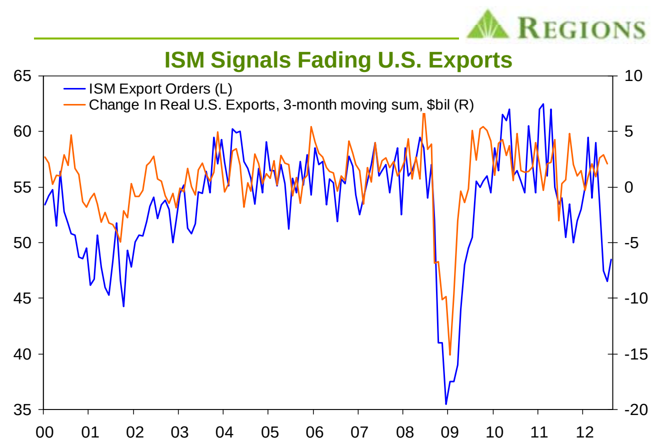
The decline in the current production index reflects declines in new orders over prior months, and points to a weak performance of the manufacturing component of the September industrial production data. Normally we would expect that if the gains in new orders are sustained over coming months the production index would turn higher, but at least in the near term this effect will likely be blunted by what have been rising inventories, with the ISM inventories index over 50 percent in September for the second consecutive month.

After having slumped below 40 percent in June and July, the prices paid index has risen sharply over the past two months, coming in at 58.0 percent in September. Prices for steel, fuels, and grains posted further advances in September, and the increase in the overall prices paid index points to another sizeable increase in the Producer Price Index for September (to be released next week). Still, with global growth having slowed over recent months, price increases on the wholesale level are not as widespread as may be suggested by the headline gains.

Despite rising to 48.5 in September, the index for new export orders remains in contractionary territory, as it has for four months running. As seen in the second chart below, the ISM index for export orders tracks changes in exports of goods from the U.S., with a one-quarter lead when the data are looked at on a quarterly basis. That the ISM index has indicated slipping export orders for four months raises some concern on our part that we could see a decided deterioration in exports of goods in the GDP data as early as Q3, which poses a downside risk to our growth outlook.

The increase in the ISM Manufacturing Index in September comes as a welcome surprise, but does not alleviate our concerns over either the manufacturing sector or the broader economy. The ISM data continue to point to modest growth in the broader economy, but growth that is unlikely to make much of a dent in the considerable slack that remains in the labor market. It is also worth noting that the ISM indexes represent diffusion indexes which can signal directional changes but not necessarily the intensity of those changes. This is worth keeping in mind, particularly as respondents to the ISM survey report that, while finding the increase in new orders encouraging, they nonetheless remain concerned over the global growth environment and the lack of policy clarity in the U.S. Neither of these concerns is likely to abate over the next several months, so we would expect manufacturing activity to remain somewhat range bound between modest expansion and modest contraction but do not expect manufacturing to slip into free-fall.





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