



Economics Group

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 374-7034

ISM: Still a Growth Story—Prices Suggest Input Cost Pressures

December's ISM came in at 57.0 with continued growth signals from production, orders and employment. Export orders were also positive. Prices paid suggest input cost pressures from metals and chemicals.

Sustained Growth for the Manufacturing Sector

Eleven of the 18 manufacturing industries reported growth in December. Some of the industries included on the growth side were primary and fabricated metals as well as machinery, computer & electronic products, plastics, chemical products and textile mills. For the composite, the index of 57.0 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 sustained and there is no double-dip in the outlook. In fact, economic growth is likely to be faster than the consensus view of 2.6 percent year-over-year growth in 2011 (Blue Chip Survey, Dec. 2010).

Production, employment, orders and inventories all suggest that manufacturing firms continue to experience (and plan for) a sustained economic expansion. We are moving from recovery to expansion in the economy.

Production came in at 60.7 with nine industries reporting a gain in output. Industries showing gains include apparel, computer & electronic products, machinery and chemical products.

New Orders and Employment Are Both in Expansion Mode

ISM's new orders index came in at 60.9 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.

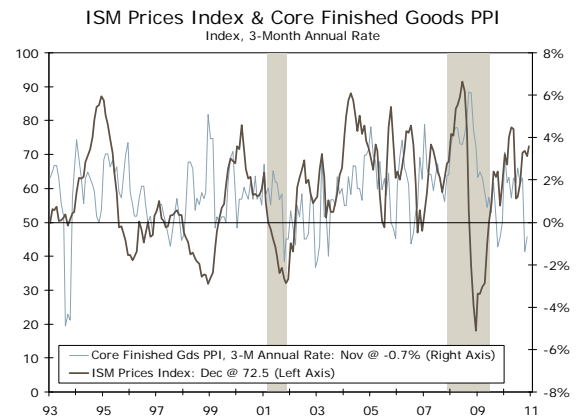
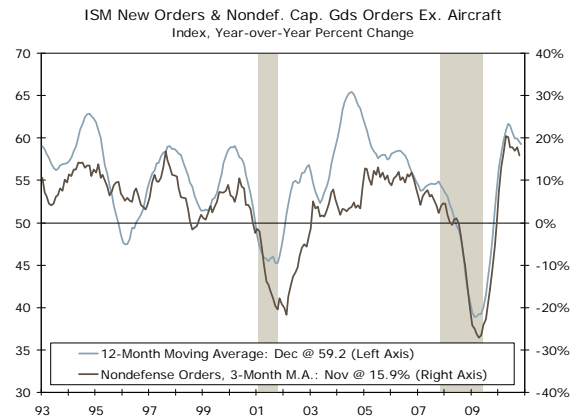
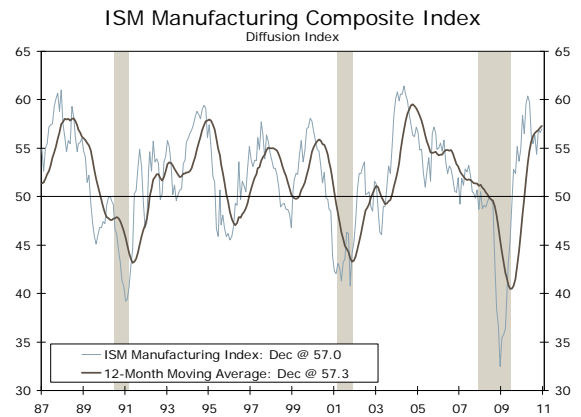
Ten industries reported a gain in orders with improvement in such core sectors as fabricated metals, computers & electronic products, machinery and electrical equipment. New export orders remained in expansion mode for the 18th straight month. Eight industries showed improvement.

Employment, according to the ISM, came in at 55.7 and has been above breakeven for the last thirteen months. This supports our expectation that job growth will pick up in 2011 at a pace of 160,000 plus for the year.

Prices Paid: Input Cost Pressures Ahead

Prices paid remain high with the index at 72.5 and thereby suggesting input price pressures, which could lead to reduced profit growth in 2011. The breadth of commodity price gains has widened. Corrugated containers were up in price for the tenth straight month. Base metals such as copper, steel, nickel and aluminum continue to show price increases.

Now we are starting to see commodity price increases for corn and wheat as well as many chemical products. The breadth and the high level of the price index over 70 suggest that commodity input prices are a risk to profit growth in the year ahead. While labor costs may be subdued for now, non-labor input prices are on the upswing.



Wells Fargo Securities, LLC Economics Group

| | | | |
|-----------------------|-------------------------------------|----------------------------------|---------------------------------|
| Diane Schumaker-Krieg | Global Head of Research & Economics | (704) 715-8437 (212) 214-5070 | diane.schumaker@wellsfargo.com |
| John E. Silvia, Ph.D. | Chief Economist | (704) 374-7034 | john.silvia@wellsfargo.com |
| Mark Vitner | Senior Economist | (704) 383-5635 | mark.vitner@wellsfargo.com |
| Jay Bryson, Ph.D. | Global Economist | (704) 383-3518 | jay.bryson@wellsfargo.com |
| Scott Anderson, Ph.D. | Senior Economist | (612) 667-9281 | scott.a.anderson@wellsfargo.com |
| Eugenio Aleman, Ph.D. | Senior Economist | (704) 715-0314 | eugenio.j.aleman@wellsfargo.com |
| Sam Bullard | Senior Economist | (704) 383-7372 | sam.bullard@wellsfargo.com |
| Anika Khan | Economist | (704) 715-0575 | anika.khan@wellsfargo.com |
| Azhar Iqbal | Econometrician | (704) 383-6805 | azhar.iqbal@wellsfargo.com |
| Ed Kashmarek | Economist | (612) 667-0479 | ed.kashmarek@wellsfargo.com |
| Tim Quinlan | Economist | (704) 374-4407 | tim.quinlan@wellsfargo.com |
| Michael A. Brown | Economist | (704) 715-0569 | michael.brown4@wellsfargo.com |
| Tyler B. Kruse | Economic Analyst | (704) 715-1030 | tyler.kruse@wellsfargo.com |
| Joe Seydl | Economic Analyst | (704) 715-1488 | joseph.seydl@wellsfargo.com |
| Sarah Watt | Economic Analyst | (704) 374-7142 | sarah.watt@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, and Wells Fargo Securities International Limited. 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 © 2010 Wells Fargo Securities, LLC.

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