



Economics Group

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ISM: Continued Gains Signal Growth—But Prices a Concern

February's ISM came in at 61.4 with continued growth signals from production, orders and employment. Export orders were strong again. Yet, prices paid suggest broad input cost pressures for many sectors.

Sustained Growth for Manufacturing and the Broad Economy

Fourteen of the 18 manufacturing industries reported growth in February. Some of the industries included on the growth side were paper and plastics, fabricated metals as well as machinery, computer & electronic products, chemical products, electrical equipment and textile mills. For the composite, the index of 61.4 is considerably above the break-even level of 42.5, 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. Production, employment, orders and inventories all suggest that manufacturing firms continue to experience (and plan for) a sustained economic expansion. Production came in at 66.3 with 12 industries reporting a gain in output.

New Orders and Employment Are Both in Expansion Mode

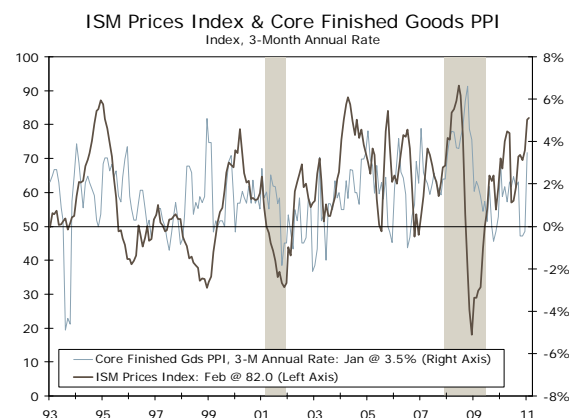
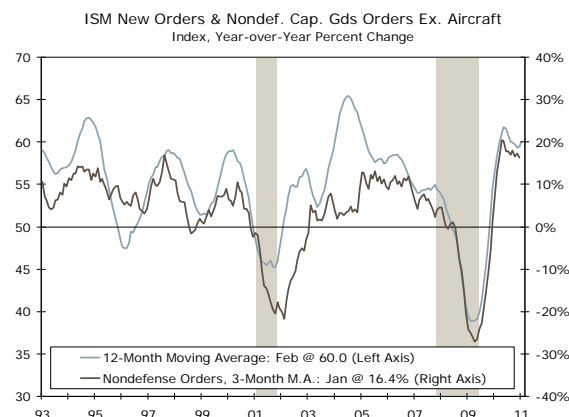
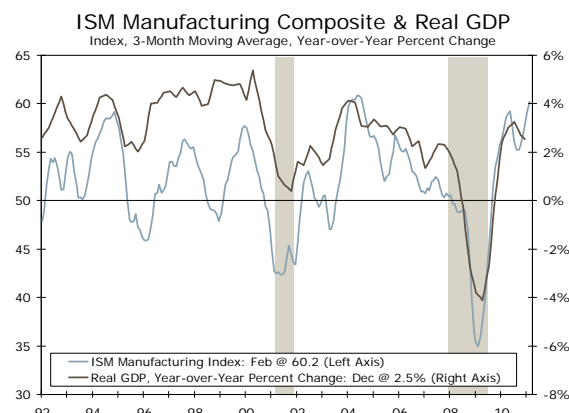
ISM's new orders index came in at 68.0, which supports the case for continued growth in nondefense capital goods orders and therefore business fixed investment. The break-even level for orders is 52.1, which is consistent with an increase in the Census Bureau's series on manufacturing orders. We expect equipment & software spending to grow at a double-digit pace in 2011.

Thirteen industries reported a gain in orders with improvement in such core sectors as paper, chemical products, fabricated metals, computers & electronic products, machinery and electrical equipment. New export orders remained in expansion mode for the 20th straight month. Employment, according to the ISM, came in at 64.5 and has been above breakeven for over a year. This supports our expectation that job growth will pick up in 2011 at a pace of roughly 160,000 per month for the year.

Prices Paid: Input Cost Pressures Ahead

Prices paid remain high with the index at 82.0 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. Base metals such as copper, steel, nickel and aluminum continue to show price increases. Industrial commodities up in price included diesel fuel.

Food commodity prices also continue to rise with price increases for cocoa, corn, sugar and wheat. The breadth and the high level of the price index implies that rising commodity input prices will put the squeeze on corporate profits for industries that are characterized by high commodity inputs as a share of input costs and limited pricing power on the output side. While labor costs may be subdued for now, non-labor input prices are on the upswing and this will squeeze profits in some industries.



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