March 01, 2012

Economics Group

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ISM Index Points to Some Deceleration in Factory Sector

The ISM manufacturing index slipped a bit in February, perhaps reflecting the recent slowdown in the pace of consumer spending. That said, the index remains well within expansion territory.

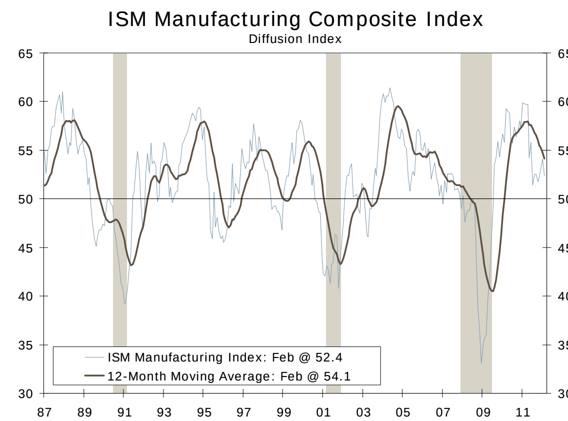
ISM Manufacturing Index Slips a Bit in February

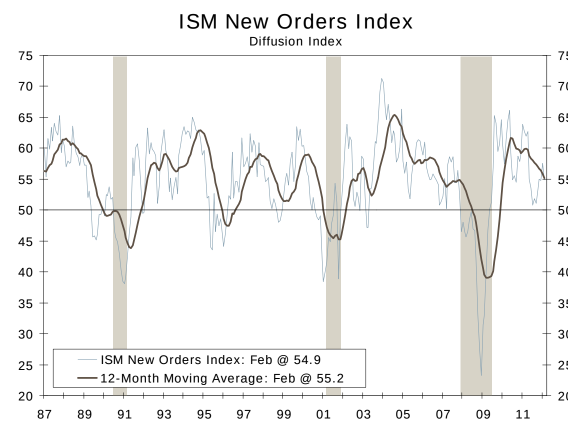
The ISM manufacturing index slipped a bit, falling to 52.4 in February from 54.1 in January (top chart). Not only did February represent the first decline in the index since October, but the headline number was softer than the market's expectation. Regional PMIs have generally been stronger than expected over the past week or so, leading many analysts to expect an increase in the ISM index. Therefore, the decline in the index represents a bit of a disappointment. That said, the ISM index remains well above the demarcation line separating expansion from contraction. In other words, the index suggests that the manufacturing sector continued to expand in February, albeit perhaps at a less rapid pace than that experienced over the previous few months.

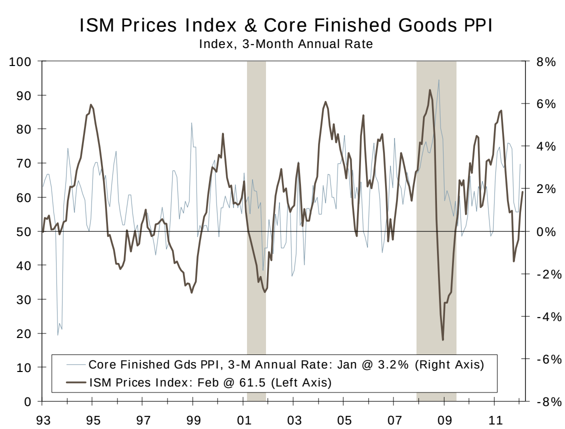
Most of the components that measure production activity fell back in February, although they generally remained above the "50" demarcation line. For example, the new orders component weakened to 54.9 in February from 57.6 in January (middle chart). The production component eased a bit as did the component measuring the backlog of orders that producers still need to complete. Interestingly, the new export orders index rose from 55.0 in January to 59.5 last month, the highest reading for this component since last February. With the Eurozone in a mild recession at present, this rise in the new export orders component seems a bit puzzling. Perhaps the increase reflects stronger economic activity in Asia that is showing up in the United States as rising export orders. Indeed, the Asian PMIs that have been released over the past few days generally strengthened in February. The data on personal income and spending that were released earlier this morning showed that real consumer spending was flat between October and January. Perhaps this slowdown in consumer spending growth over the past few months is starting to show up as deceleration in activity in the factory sector.

Are Pipeline Inflationary Pressures About to Build Again?

The "prices paid" component rose in February to its highest level since June (bottom chart). Clearly, petroleum prices have been rising over the past few weeks due to tensions with Iran. However, many other commodity prices have also trended higher so far this year. For example, copper and zinc prices have risen more than 10 percent since the beginning of the year. This increase in commodity prices may put some upward pressure on PPI inflation in the coming months (bottom chart). With the U.S. unemployment rate still north of 8 percent, however, we do not expect a sharp increase in the CPI inflation rate anytime soon. That said, rising energy prices along with some potential upward creep in PPI inflation means that a deflationary situation in the United States is not likely either, at least not in the foreseeable future.







Source: Institute for Supply Management, U.S. Department of Labor and Wells Fargo Securities, LLC

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