April 02, 2012

Economics Group

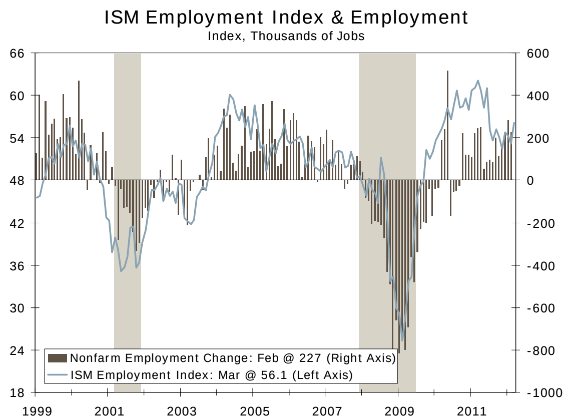
John Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 374-7034
Tim Quinlan, Economist
tim.quinlan@wellsfargo.com • (704) 374-4407

ISM Shows Improving Business Sentiment

The March reading of 53.4 for the ISM index is a shade better than consensus estimates and suggests that despite choppiness in orders, business spending will be additive to GDP growth in the first quarter.

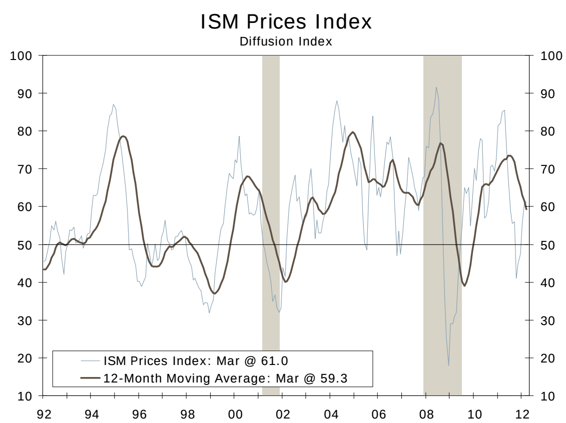
Gains Fueled by Production, Jobs

The ISM survey of purchasing managers revealed that manufacturing sentiment was improving as the third quarter was winding down. The key drivers of the gain included a 3.0 percentage point jump in production and a 2.9 point pickup in the critical employment component. The improving production sentiment is welcome news after hard data from the Federal Reserve's Industrial Production report showed that output stalled in February. According to the ISM, an index reading above 51.2 for the production component is generally consistent with increasing industrial production over time. Additionally, the gain in the employment component will likely lead to upward revisions to estimates for Friday's jobs report. The consensus is presently clustered around a net gain of 200K nonfarm jobs for March.



Pipeline Inflation Pressures?

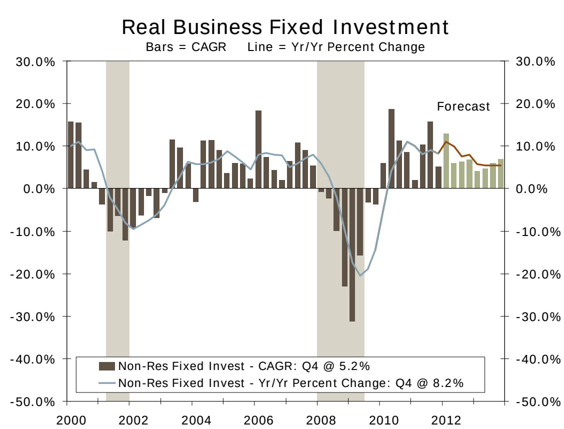
The prices paid component came down a bit, but at 61.0, this measure is still consistent with an environment of increased inflationary pressure for businesses. While soft patches in prices for commodities like natural gas and steel take some of the pressure off, the increased cost for aluminum, copper and crude oil are clearly influencing producer sentiment. For now, we still look for full-year producer price growth of only 3.2 percent for 2012. While upward price pressure remains in the near term, we suspect that a cooling off in some emerging market economies and slower growth in Europe will alleviate price pressures as the year goes on.



What Does This Mean for Orders?

Hard data on factory orders has been mixed so far this year. A 3.6 percent drop-off in durable goods in January may have been attributable to a change in tax law, which made infrastructure spending less desirable for businesses. The decline was partially reversed by a 2.2 percent bounce-back for durables in February.

The orders component in today's ISM came in at 54.5, a number that is consistent with expansion but also reflects a slight decline from the level in the prior month. Somewhat more worrying is the 5.5 percentage point decline in export orders to 54.0. It was the largest negative move of any of the components and may signal vulnerability to problems in Europe. Recent data suggests that the slowdown in economic growth in the Eurozone that began in the fourth quarter likely continued in the first quarter. Further deterioration in Europe would clearly not be a positive for export sentiment. That said, the present level of 54.0 for export orders is still firmly in expansion territory. Our forecast looks for a jump in business fixed investment spending in the first quarter, followed by a slower pace of business spending on the order of 5 to 6 percent for the rest of the year.



Source: ISM, U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities, LLC

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	Senior Economist	(704) 715-0575	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 374-4407	tim.quinlan@wellsfargo.com
Ed Kashmarek	Economist	(612) 667-0479	ed.kashmarek@wellsfargo.com
Michael A. Brown	Economist	(704) 715-0569	michael.a.brown@wellsfargo.com
Joe Seydl	Economic Analyst	(704) 715-1488	joseph.seydl@wellsfargo.com
Sarah Watt	Economic Analyst	(704) 374-7142	sarah.watt@wellsfargo.com
Kaylyn Swankoski	Economic Analyst	(704) 715-0526	kaylyn.swankoski@wellsfargo.com

WELLS FARGO SECURITIES