



# Economics Group

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## ISM Manufacturing: Slowdown in the Train, Easing Prices

*U.S. manufacturing continues to expand with evidence of gains in output and employment, but the pace has clearly slowed. Meanwhile, the moderation of prices paid suggests some moderation of inflation ahead.*

### ISM Index Suggests Sustained Growth—But Slowing

Headline ISM declined to 50.9 in July, barely in positive territory, with the drop in new orders below 50 the biggest disappointment (see below). The drop in the composite index (top graph) indicates a slowdown in the train for the manufacturing sector. The production index came in at 52.3 in July after a reading of 54.5 in June. Seven industries reported gains in July including computers & electronics, paper, fabricated metals and transportation. Our outlook has been for a moderate pace of growth in the second half of this year of 2.5 percent.

Employment also moderated and yet remained in expansion mode. At 53.5, the employment component is down from 59.9 in June and puts downside risk to our initial estimate of a 78,000 job gain for July. According to the ISM survey, nine industries reported a gain in jobs including electrical equipment, computers, machinery, chemicals and transportation equipment.

### New Orders Component Suggests Slowdown Ahead

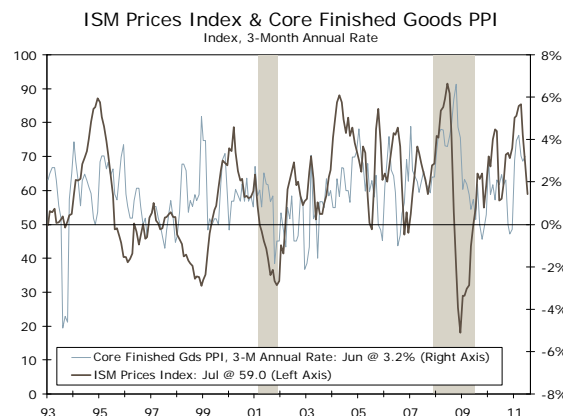
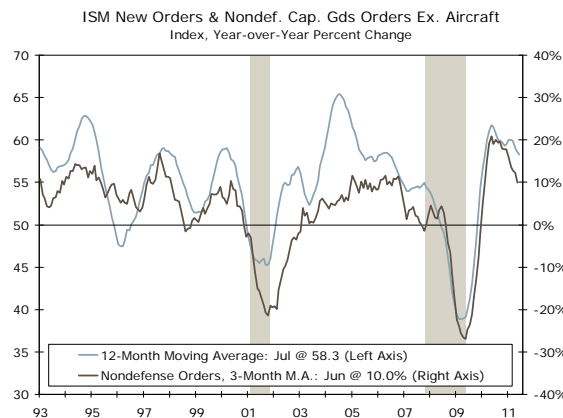
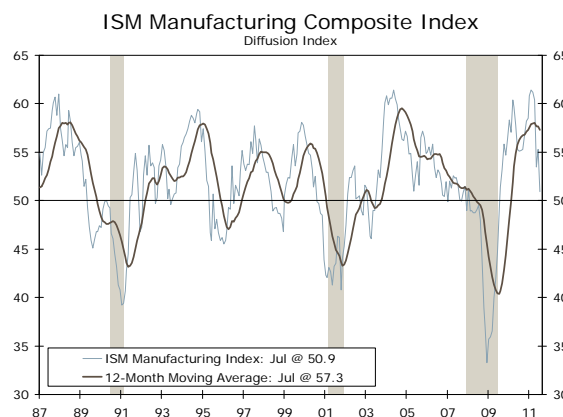
New orders (middle graph) fell below breakeven in July and intimates that there is less support for gains in manufacturing production in the months ahead. Nine industries reported growth in new orders including furniture, chemicals, paper and computers. Since orders are a leading indicator, the drop in this index suggests the second half pickup in growth will be far less than some had estimated.

On the trade side, the new export orders component rose a bit to 54.0 and may reflect the diminishing impact of the Japanese tsunami. The above-50 breakeven does indicate that American producers see greater strength in orders from foreign countries. Nine industries reported a gain in export orders. This result suggests many manufacturing industries, for example paper, computers and chemicals, in the United States can compete globally.

### Prices Paid: Slowdown a Good Sign for Cost Control and Profits

Continued moderation in the prices paid component indicates reduced input cost pressures on businesses and is a welcome sign of reduced inflation pressures at the wholesale level. The price index at 59.0 in July continues the moderation seen in recent months (bottom chart). Ten of the 18 sectors reported higher prices paid including primary metals, chemicals, paper and machinery.

For inflation, the complete pass-through of rising commodity prices to consumer prices does not seem likely, but there certainly will be some elevation in prices. For decision makers in both the private and public sectors, the bias on future prices is to the upside even though the current pace of inflation appears moderate. Specific commodities up in price primarily include the metals along with plastics and rubber products.



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