ECONOMIC UPDATE

REGIONS

December 3, 2012

November ISM Manufacturing Index: Manufacturing Sector Watching, Waiting

- The ISM Manufacturing Index fell to 49.5 percent in November from 51.7 percent in October
- The new orders component fell to 50.3 percent, while the component for export orders fell to 47.0 percent.

U.S. manufacturing activity weakened in November as indicated by the ISM Manufacturing Index declining to 49.5 percent from October's reading of 51.7 percent. The ISM"s gauge of manufacturing activity now stands at its lowest level since July 2009, but nonetheless is consistent with moderate growth in the broader economy. While the ISM did not specifically comment in their release as to any potential effects from Hurricane Sandy, it is likely that some of the deterioration seen in November, such as the sharp decline in the employment index, is tied to Sandy. It is, however, interesting to note that in the comments from survey respondents there were more references to the fiscal cliff and what remains an uncertain global growth environment.

The new orders index declined sharply, falling from 54.2 percent in October to 50.3 percent in November, which leaves the index in expansionary territory but only marginally so. Still, the performance of new orders varies across industry groups. Among those industries reporting higher orders in November were petroleum & coal, paper products, machinery, computer & electronics, appliances, and furniture. Those industries seeing orders decline include primary metals, chemical products, transportation equipment, and fabricated metal products. In all, more industry groups reported falling orders than rising orders.

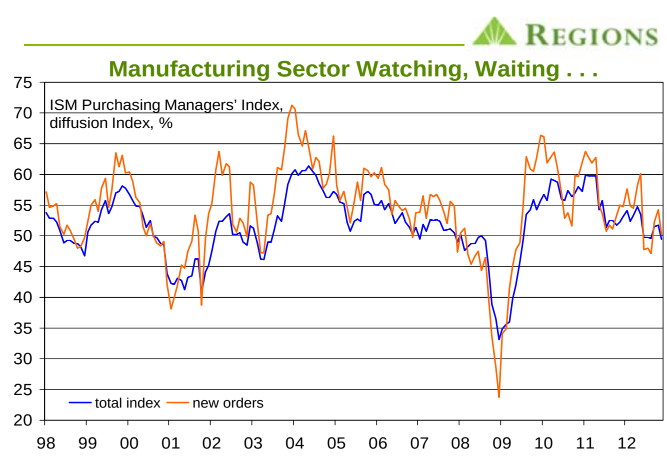
Over the past six months, the new orders index has sent a decidedly mixed message, with three months of contractionary readings now followed by three months of expansionary readings, albeit only marginally in the latest reading. This is consistent with what has been a weak trend in orders for core capital goods that we expect will translate into a second consecutive decline in business investment spending on equipment and software in Q4

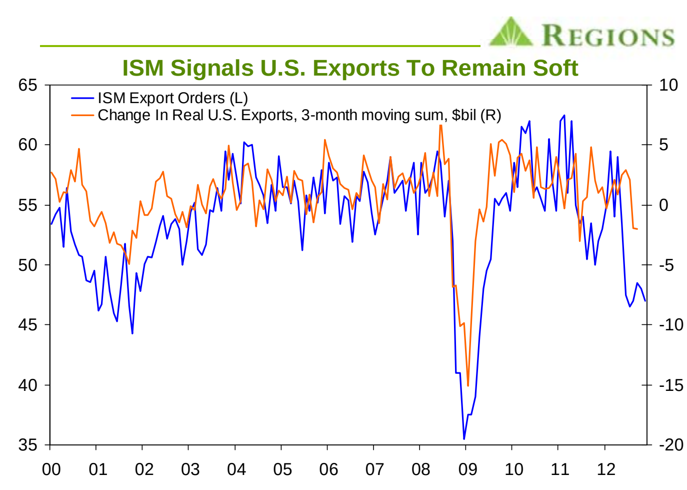
The current production index notched a second consecutive increase in November, rising to 53.7 percent, the second consecutive month in which this index is above the 50.0 percent mark. Still, the majority of industry groups reported current production was unchanged in November, so it is not likely the gain in the ISM's production index will translate into a meaningful gain in the manufacturing component of the November industrial production data.

The employment index not only fell in November but slipped below the 50.0 percent mark with a reading of 48.4 percent, the lowest reading since September 2009. This suggests we could see a decline in manufacturing payrolls in the November employment report to be issued this Friday, thus posing a downside risk to our expected 116,000 increase in nonfarm payrolls. It is, however, worth noting that most of the industry groups surveyed by the ISM reported employment levels were unchanged in November.

Per the ISM data, new export orders posted a sixth consecutive decline in November which, as seen in the second chart below, indicates we can expect U.S. exports of goods to remain soft over the next few months. Among those industry groups reporting lower export orders in November were transportation equipment, primary metals, machinery, and computer & electronic products.

While it may be difficult to discern what the ISM's November survey is telling us about the state of the manufacturing sector, the reality is that the November data are consistent with the mixed message being sent over the past several months. Indeed, over the past six months, the headline index has averaged 50.3 percent, right on the border between expansion and contraction in the factory sector but still consistent with the middling growth being seen in the broader economy. The two main drags on the factory sector remain the same – the lack of policy clarity surrounding not only the fiscal cliff but the broader longer-term U.S. fiscal picture, and what remains an uneven and uncertain global growth outlook. Until there is more clarity on these two fronts, we can't expect the message from the factory sector to be any clearer than has been the case for the past several months.





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