

ECONOMIC UPDATE



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August ISM Manufacturing Index: Spike In New Orders Propels ISM Index Higher

- > The ISM Manufacturing Index rose to 55.7 percent in August from 55.4 percent in July.
- > The new orders component rose to 63.2 percent while the employment component fell to 53.3 percent.

The ISM manufacturing index rose to 55.7 percent in August, contrary to expectations for a slight decline after July's sizeable increase. The primary factor behind the increase in the headline index in August was a jump in the component for new orders which, at 63.2 percent, now stands at its highest level since April 2011. Though giving back some of July's gains, the components for current production and employment both remained above the 50.0 percent threshold in August, indicating continued expansion.

The increase in new orders in August was fairly broad based across industry groups, with 12 of the 18 industry groups included in the ISM survey reporting increased orders, five reporting orders were unchanged, and only miscellaneous manufacturing reporting a decline in orders. New export orders – which do not figure into the headline ISM index – showed further expansion in August, which marks the ninth consecutive month of rising export orders despite what has been an uneven global economic performance over that time. With the Euro Zone finally showing signs of emerging from recession, export orders should log further gains over coming months.

The ISM survey is consistent with the performance of the monthly data on manufacturing orders from the Census Bureau. Orders for core capital goods (i.e., nondefense goods excluding aircraft and parts) have been steadily advancing over recent months despite dipping slightly in July. On a three-month moving average basis, which we prefer given the volatility in this series, core capital goods orders are now above their pre-recession peak, as seen in the final chart opposite. Rather than marking the start of a sustained reversal of the gains seen over the past several months, July's decline more likely reflects the normal technical quirk that sees core capital goods orders decline in the first month of a quarter, and we expect to see further gains in such orders over coming months.

Should this be the case, it bodes well for production and employment, as inventories held by manufacturers contracted further in August, though at a slower pace than in July. The gap between the components for inventories and new orders in the ISM survey has risen sharply over the past two months and, as of August, stands at its highest level since May 2010. In the past this gap has been a fairly reliable indicator of changes in production and, even though it declined slightly after spiking in July, the current production component of the ISM's index came in at 62.4 percent with 15 industry groups reporting higher levels of production in August.

Should orders and production continue to expand, manufacturing employment should follow suit. Like the production component, the employment component of the ISM index gave back some of July's large gain but indicated further gains in employment in August. Of the 18 industry groups, 14 reported either steady or higher levels of employment in August.

There were some indications that the sequestration spending cuts are having an impact. Comments from respondents in the computer & electronics industry ("military slowdown) and transportation equipment industry ("tight government spending") reflect the fiscal drag that continues to weigh on broader economic growth but should lessen going forward. This is one reason we expect manufacturing's advance to strengthen over coming quarters.

