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Economics Group

John E. Silvia, Chief Economist
john.silvia@wellsfargo.com • (704) 410-3275
Tim Quinlan, Economist
tim.quinlan@wellsfargo.com • (704) 410-3283

ISM Sees Its Shadow, But Growth Story Still Intact

The ISM manufacturing index came in at 51.3 for January, a marked departure from the 56+ readings we have seen since January 2013. Read on to see why we are not rattled by this report.

Six More Weeks of Winter?

The headline ISM print of 51.3 for January was somewhat jarring considering the fact that this key barometer for the factory sector has been above 56 since August. The 5.2 percentage point drop this month signals a much slower pace of activity.

To find a larger one-month drop-off, you would have to go back to the height of the financial crisis in September 2008. Having said that, it bears noting that in October 2008, the ISM fell to 38.9 from 44.8 previously. Even with this large month-to-month change here in January, we are on the right side of the 50 demarcation line. We are still talking about growth in the manufacturing sector, just not at the swift pace we could reasonably expect from 56+ level readings that we saw in the second half of last year.

Out in the Cold

The ISM manufacturing index is seasonally adjusted, but the much-colder-than-usual weather this January may have had an adverse effect on signals of activity. The text of the report note that a "number of comments from the panel cite adverse weather conditions as a factor negatively impacting their businesses in January, while others reflect optimism and increasing volumes in the early stages of 2014."

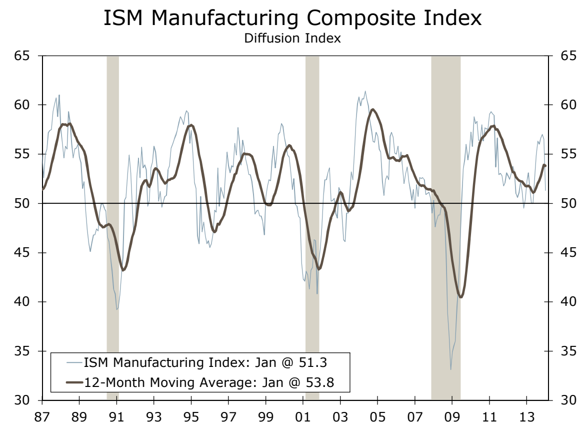
Inventory Story

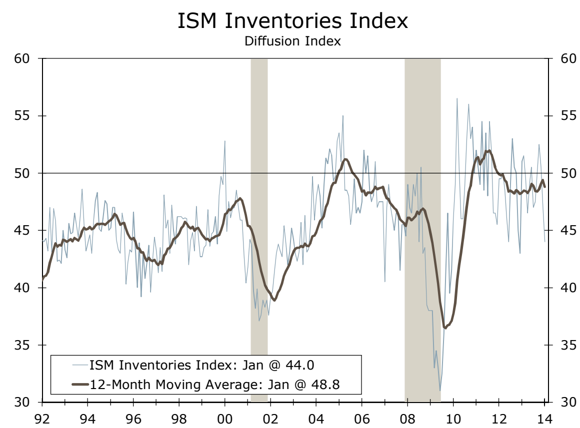
Inventories have been a key figure in the past two GDP reports. In the third quarter, inventory building added 1.7 percentage points to headline GDP growth. Typically a boost like that would be followed by some payback in the subsequent quarter. However, we learned last week that was not the case, as inventories added another 0.4 percentage points to GDP growth in the fourth quarter. So, are businesses going to continue stockpiling in 2014? Today's ISM tells us that is unlikely as both the business inventories component and the customer inventories component fell further into contraction territory, and both measures came in at 44.0 for January.

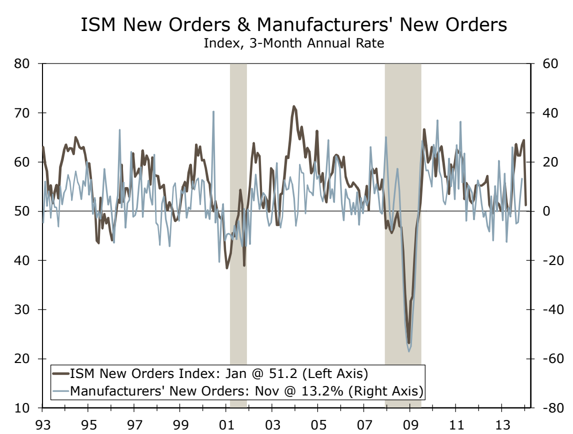
Growth Fundamentals Intact

Despite a few downside surprises, this report does not fundamentally alter our expectation for sustained slow growth in the manufacturing sector. The new orders component at 51.2 still signals modest growth, as does a 54.8 reading for the production index. The employment component at 52.3 remains consistent with the steady, if somewhat tepid, pace of hiring we have seen in the manufacturing sector in recent months.

In the autumn we were skeptical about the inconsistency of sky-high survey readings and falling factory orders. As we surmised at the time, the truth turns out to be somewhere in between and today's ISM print against a backdrop of firming orders activity is consistent with that.







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

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Anika R. Khan	Senior Economist	(704) 410-3271	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Sarah Watt House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael T. Wolf	Economist	(704) 410-3286	michael.t.wolf@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 410-3284	zachary.griffiths@wellsfargo.com
Mackenzie Miller	Economic Analyst	(704) 410-3358	mackenzie.miller@wellsfargo.com
Blaire Zachary	Economic Analyst	(704) 410-3359	blaire.a.zachary@wellsfargo.com
Peg Gavin	Executive Assistant	(704) 410-3279	peg.gavin@wellsfargo.com
Cyndi Burris	Senior Admin. Assistant	(704) 410-3272	cyndi.burris@wellsfargo.com