May 01, 2014

Economics Group

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After Rough Q1, ISM Signals Business Spending Improvement

The ISM at 54.9 signals the fastest pace of activity in the factory sector so far in 2014. The details of the report suggest a brightening outlook for employment and an easing for input cost pressures.

Goodbye Gray Skies, Hello Blue

The definitive purchasing manager survey for the U.S. manufacturing sector came in better than the consensus had expected in April. At 54.9 the ISM survey signals the fastest pace of expansion in the factory sector so far this year.

On the eve of Employment Friday, today's ISM also offers a brighter assessment of activity in the labor market as the employment sub-index posted the largest gain of any component, rising 3.6 points to 54.7.

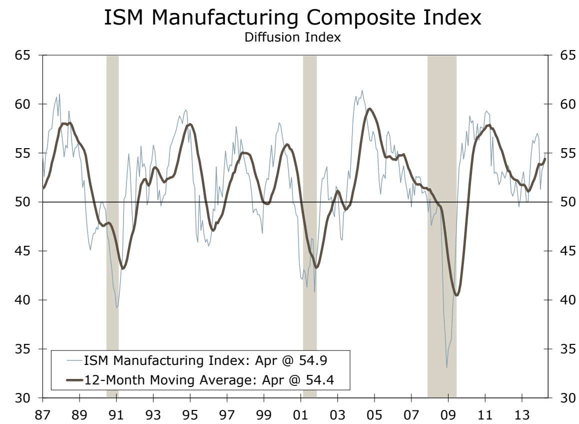
In the first quarter, manufacturers faced rising prices as evidenced by high readings in the prices-paid component in this report as well as gains in two out of the first three months of the year in the producer price index. This price dynamic presented a challenge to corporate profits. However, today's report suggests at least a temporary reprieve. The prices-paid component fell 2.5 points, which was the largest decline of any component. Even with that decline, the prices component is still high at 56.5, but that is lower than it was in the first three months of the year.

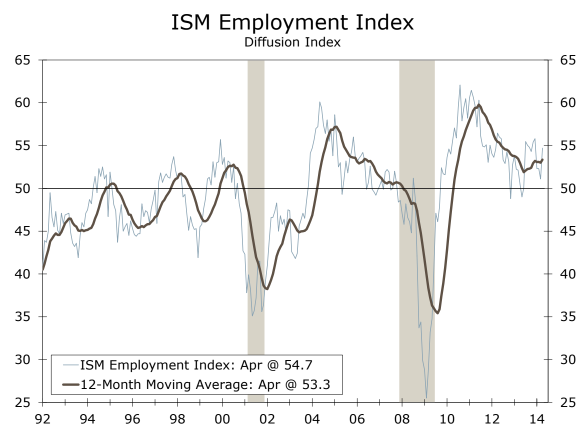
Implications for Business Spending

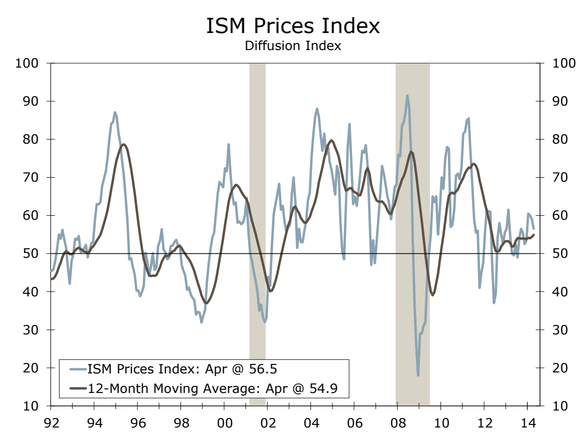
Yesterday's release of first quarter GDP revealed the U.S. economy expanded at a scant 0.1 percent annualized rate, well below consensus expectations. There were a number of reasons for the miss, including three-tenths of a percentage point drag attributable to businesses cutting back on equipment outlays and six tenths of a percentage point drag from a slower pace of inventory building. Taken together, these numbers would ordinarily raise fears about a turn in the cap-ex cycle. Judging by the way financial markets shrugged off the lousy GDP report, it appears as though the well-established narrative of stormy winter weather seems to have alleviated at least some of the worries about the direction of business spending.

Recognition of weather effects may have excused first quarter weakness, but it should not justify diminished expectations for capital outlays going forward. On the contrary, if anything, the weather effects may raise expectations for spending on the reasonable premise that if weather was the culprit for a weak start to the year, then pent-up demand must exist. It is for that reason that today's strong report is particularly valuable as a harbinger for better cap-ex spending going forward.

We have maintained our view that business spending would firm in the second quarter and this ISM report corroborates that view. The orders component remained firmly in expansion territory at 55.1. Both the import and export orders component climbed higher in April as well, as the U.S. expansion continues and global growth firms.







Source: Institute for Supply Management and Wells Fargo Securities, LLC

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