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Economics Group

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Rarefied Air for ISM

The ISM Manufacturing Index for December came in at 59.7. That marks the fifth consecutive print of 58 or higher, a feat last accomplished in 2004. Prior to that, you'd have to go back to 1987.

Boom Goes the Dynamite

The ISM survey for December came in at a torrid 59.7–the second fastest pace of expansion in six years. New orders came at 69.4; that means that manufacturers are seeing orders expand at the fastest pace in more than 13 years. There are signs that factories are having trouble keeping up. Order backlogs jumped a full point to 56.0 and supplier deliveries are being held up as well. All the activity is giving supplier a degree of pricing power that has been a fleeting thing in this economic cycle. The prices paid component climbed to 69.0 in December.

It is more than just domestic developments that are lifting animal spirits. A number of the published industry comments focused on a pick-up in demand from overseas, and indeed, the export orders component jumped to six-month high of 58.5.

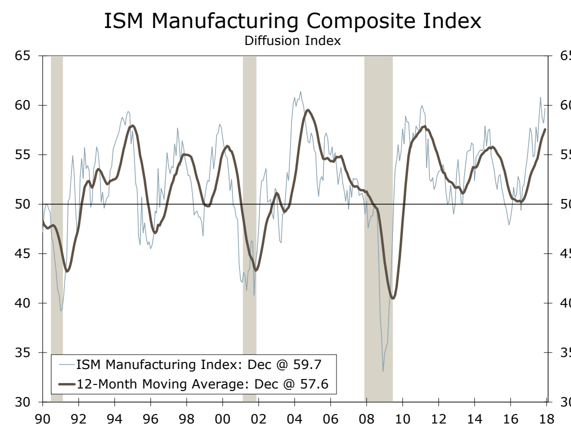
This is the thin air of the high peaks. It is quite uncommon for the ISM index to remain so firmly in expansion territory for such a long period of time. The only other time in the past 40 years that the ISM came in at 58 or higher for this many consecutive months was a streak that lasted from November 2003 to August 2004.

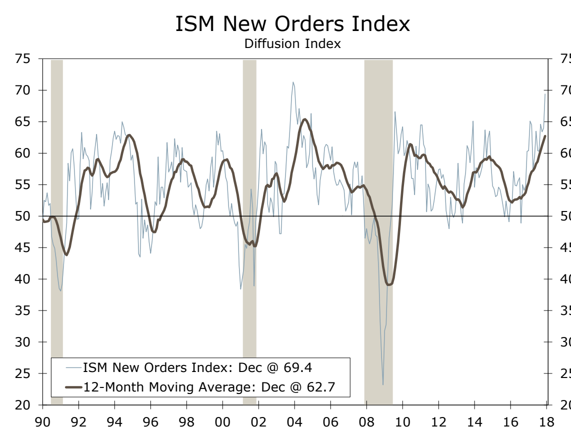
We went back into the archives and found our write-up from August 2004 for the August ISM to see what we were saying at that time so that we could compare with our assessment of where the economy is today. At that time, we wrote, "*…today's manufacturing survey results are consistent with this theme [*of moderation*] as key components are down from their highs but above the 50 break even level…the pace of industrial production will also moderate from rapid recovery to expansion in the year ahead.*"

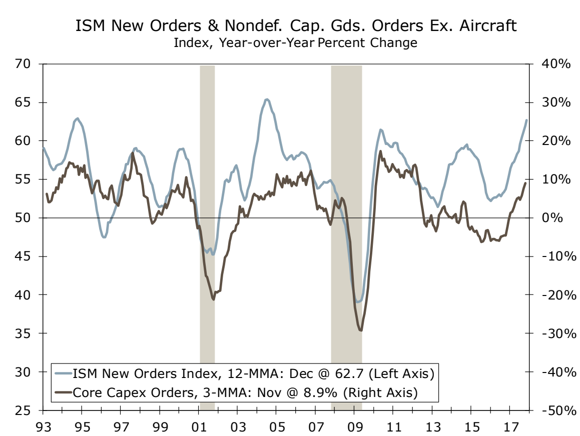
That was not too far afield from how things played out. Full year GDP growth for that expansion peaked in 2004 and slowed in each of the next three years before succumbing to recession at the end of 2007.

We compare that to today's print to our forecast today and after back-to-back quarters of GDP growth of three percent or better growth, we anticipate growth of roughly two and a half percent in the fourth quarter of 2017 and in each quarter of 2018.

While the ISM may have lost some of its luster as a bellwether for broader growth as the U.S. economy has become less reliant on manufacturing, it is still vital as a harbinger of things to come for manufacturing. In that regard, we note that despite the nearly 14-year high for the new orders component, actual core capital goods are still not growing as fast as they were in 2010 and 2011. We expect some convergence between these measures in the months to come and acknowledge there is now some clear upside risk to our equipment forecast.







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

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