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Economics Group

Tim Quinlan, Senior Economist
tim.quinlan@wellsfargo.com • (704) 410-3283
Sarah House, Senior Economist
sarah.house@wellsfargo.com • (704) 410-3282

Take a Deep Breath: ISM Is Not Good, But It's Not 2009

At the risk of sounding unfazed in the face of an obviously bad situation: the fifth consecutive month of manufacturing contraction and worst print since 2009 in today's ISM may not be as awful as it looks.

An Ugly Report, But Don't Fear the Reaper

Let's get the ugly stuff out of the way: the ISM manufacturing index came in at 47.2 for December, signaling that industrial activity shrank in each of the last five months of the year. Even worse is the fact that this marks the lowest headline for the ISM since the recession. Various subcomponents also plumbed lows that haven't been touched in a decade, including most notably employment which fell to 45.1.

What if the ISM Is Overstating the Weakness in Manufacturing?

An argument could be made that the ISM has offered a glass-half-empty look at the industrial sector in recent months. That's not to say there has not been pressure, a number of other purchasing manager surveys have indicated a softening, but the ISM looks decidedly worse than others.

The top chart plots the ISM alongside the Markit Manufacturing PMI and our ISM-weighted compilation of five regional Fed manufacturing surveys. A downward trend in all three lines can be seen starting around the middle part of 2018 signaling a slower pace of growth; *the key difference is that only the ISM has broken through the breakeven and is signaling outright decline*. Our forecast for a modest pick-up in business fixed investment spending this year is better reflected by these alternative gauges, but admittedly this report has us rethinking that somewhat.

All Our Times Have Come…Here but Now They're Gone

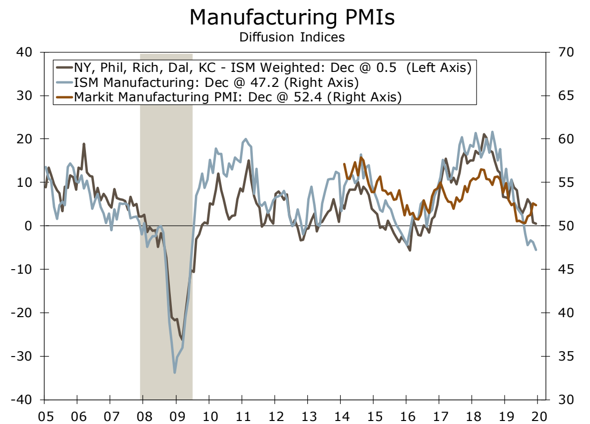
The trade war has been a significant headwind and factor in the trend decline since 2018. The middle charts shows the rising cost of the trade war and the concomitant decline in the ISM.

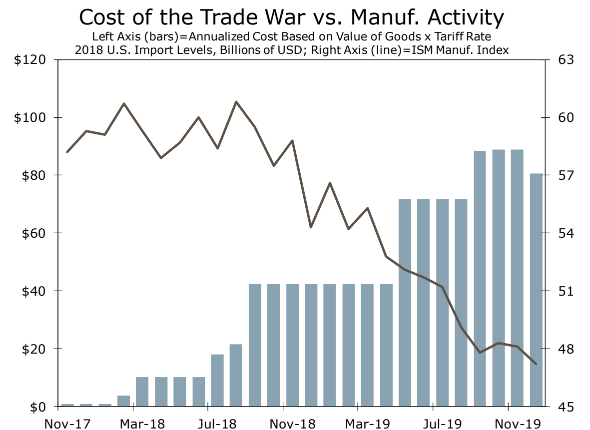
If 2019 was a year of escalation in the trade war, perhaps 2020 will at least be a year in which things stop getting worse. On January 15, the detailed terms of the Phase I trade deal with China are set to be released with a formal signing at the White House.

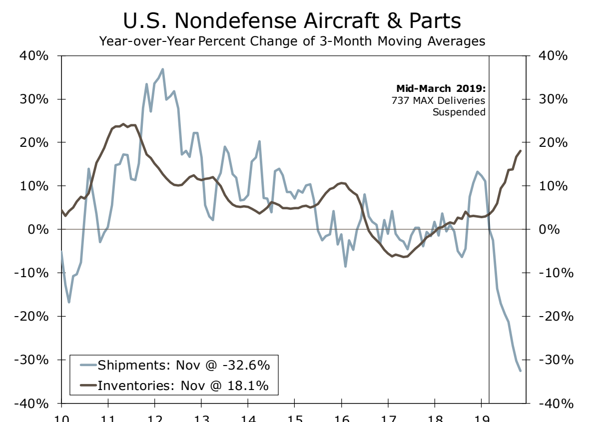
We are not so sanguine as to suggest this is the end of the trade war, but it is certainly a de-escalation and that is a start. To the extent that trade policy put downward pressure on the manufacturing sector, each phase of détente ought to relieve that pressure; if so today's report may mark the low point.

737 MAX Considerations

A top concern for us is the duration of the suspension of production for the 737 MAX because it will reverberate across the manufacturing sector. With production scheduled to halt this month, we have removed the 126 737 MAX jets that would have been produced in Q1 from our forecast and that alone will pull industrial production into negative territory in Q1. For further reading see our recent special report. The longer it goes, the worse it is for industrial output.







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

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Acting Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Macro Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Erik Nelson	Macro Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

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