

US ISM Manufacturing Fits The Narrative

ISM manufacturing, October:

Actual: 57.7

Scotia: 59.5

Consensus: 59.0

Prior: 59.8 (unrevised)

- While ISM-manufacturing disappointed expectations, this is not a disappointing report in any absolute sense of the word and it's easy for casual interpretations to misinterpret what the report is telling us. It still signals solid growth coming from the US manufacturing sector and simply reinforces the forecast narrative while the Fed is likely to look through the price signal. The USD and short-term Treasury yields are shaking off the report and sensibly so.
- The headline deterioration was reinforced by the underlying details. New orders decelerated to 57.4 from 61.8 the prior month and this reading is the lowest since April 2017. Recall, however, that new orders accelerated in part to front-run tariff effects and this was reflected through inventory contributions to Q3 GDP growth. Employment eased off to 56.8 from 58.8. Prices paid accelerated to 71.6 from 66.9.
- Overall, the activity readings remain well above the 50 dividing line between expansion and contraction and are consistent with the US economy coming off peak rates of broader economic growth over Q2-Q3 to something more sustainable over time. There is nothing surprising about the report in that sense; ISM simply reinforces that narrative.
- At the same time, I believe that the Fed will likely look through the prices paid reading as a transitory tariff effect; tariffs will remain, but the impact upon the rate of change is temporary on first round effects. We saw that when tariffs were applied earlier this year and then the prices paid component of the ISM report soared to a peak of 79.5 back in May before easing off somewhat. Now it popped higher again after September's US-China tariffs. Over time, even if a new layer of tariffs is implemented against China—with further retaliation—the second round effects of tariffs are likely to be disinflationary through demand destruction effects that may become more apparent over 2019. The evidence of price pass through effects is high in categories like steel, aluminum and laundry machines; there is likely more to come across more sectors before demand reacts.
- Also note that construction spending surprised higher due to revisions. Construction spending was flat as expected in September, but it was revised up to a gain of 0.8% m/m in September (0.1% pre-revision). That starts the march toward positive Q3 GDP revisions and acts as a solid hand-off to Q4 expectations.

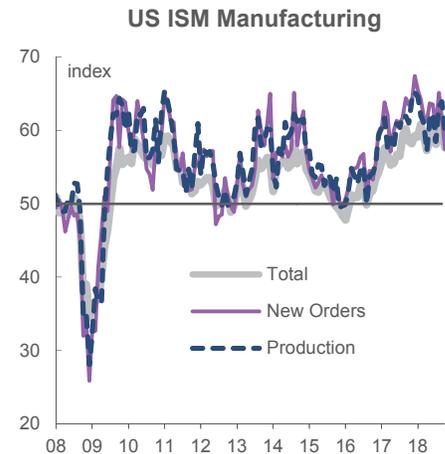
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