

## Trumponomics Is Driving US Manufacturing Into A Deepening Recession

- ISM-manufacturing hit the lowest level since 2009...
- ...sending stocks lower, Treasury prices higher
- Underlying details were weak
- There is shocking breadth to the weakness by industry
- High inventories point to further weakness
- The Trump administration's policies are hurting US manufacturing

### ISM-mfrg PMI, % balance/diffusion index, SA, September:

Actual: 47.8

Scotia: 49.9

Consensus: 50.0

Prior: 49.1

The US manufacturing sector is clearly in a deepening recession brought on by the direct and indirect effects of President Trump's trade wars. That's despite another tweet-based attempt at blaming the Fed right after the ISM release.

Before turning to the ISM details, it's important to expand upon this last point. The Trump administration has pursued strong dollar policies—despite the rhetoric—that have included fiscal stimulus, tariff effects on currency flows and elevated uncertainty that itself has driven safe haven seeking in the dollar and Treasuries over a prolonged period. As transitory softness in inflation is now reverting higher, the US has core inflation that is more than three times higher than Japan's and twice as high as the Eurozone's. The US output gap is strongly in excess aggregate demand while the ECB is still dealing with slack across the Eurozone economy. There's the explanation behind why Fed policy is tighter than monetary policy elsewhere and former Chair Yellen warned Trump about the consequences of easing fiscal policy into a solid economy.

For that matter, go back to [this](#) piece where I argued in November 2016 that Trumponomics would fail the manufacturing sector and in other respects. It may be true that a weak ISM gauge and risks facing the outlook motivate further Fed policy easing, but that's brought on by the heightened risks that are being driven by the Trump administration's trade policies. Layer on the negative effects of US trade policies on world growth and retaliatory gestures by its trade partners that are driving inventory imbalances (chart 1) and you have a full explanation for US manufacturing weakness that traces right back to 1600 Pennsylvania Avenue. Manufacturing is not coming back home in this scenario even apart from relative cost differentials.

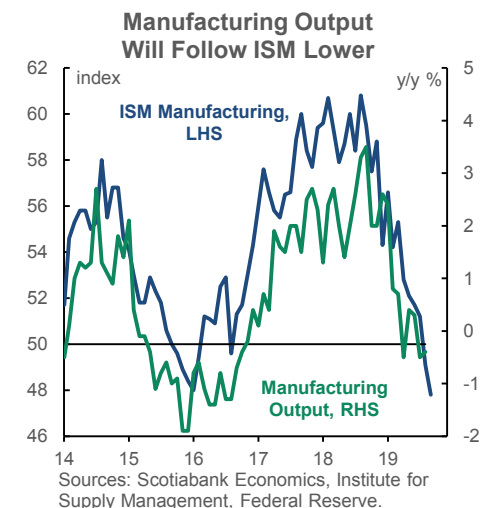
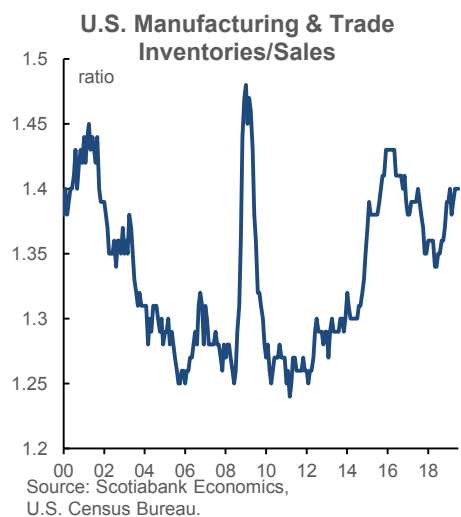
The headline ISM-manufacturing gauge fell to its weakest since June 2009, narrowly below the low set in early 2016. There is nothing good in terms of the underlying details such that the market's first response will likely stick. The two year Treasury yield fell by about 7bps, making the Bank of Japan's knock-on effects on global bond markets a distant memory. The S&P500 fell by ¾% immediately after the release perhaps as markets are weighting weaker growth more than the possibility of further easing by the Fed.

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New orders contracted at a similar pace of 47.3 to the prior month that was only a tick lower.

The weakness in orders was on the export side where new export orders fell to 41 (43.3 prior).

Because the headline new orders gauge was little changed, the drop in new export orders implies a rise in domestic orders.

Employment fell to 46.3 (47.4 prior) so manufacturing payrolls are falling at a quickening pace.

Prices paid rose to 49.7 (46 prior) which signals another second consecutive monthly rise and ebbing of disinflationary pressures that we see in other measures.

Overall the Fed narrative should be relatively little changed on balance here. They've tended to dismiss the weak manufacturing sector and point to strengths elsewhere. They're getting firming inflation figures (core PCE etc). At the margin, a trade shock to manufacturing is having predictable consequences but the automatic stabilizers (lower bond/borrowing costs, gas prices etc) are helping to offset that in the context of the best household finance measures in decades. Another insurance cut this year is feasible as per our forecast for December, but it has to rely upon more than manufacturing evidence. Bring on payrolls.

**The Atlanta Fed is probably going to be revising its nowcast estimate for Q3 GDP lower** than the 2.11% estimate before today's data given a) ISM-manufacturing, b) the disappointing construction spending figures that were up 0.1% m/m (0.5% consensus) with downward revisions, and c) little change in inventory signals in ISM. A sub-2% reading is likely.

**In terms of breadth, the industry breakdown of ISM is really weak.** Only three industries reported any growth in September, down from 9 manufacturing sectors the month before. Only 3 reported higher orders in September. Only four indicated higher hiring activity. Only two reported growth in export orders.

**What the drop in ISM means will be further punctuated by the release of US industrial output for September on October 17th.** Chart 2 spells more pain. After a 0.5% m/m rise in August, expect a renewed funk that pushes the year-ago contraction in manufacturing output toward the 1% y/y mark.

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