

Flash Comment

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Signe Roed-Frederiksen, Senior Analyst, +45 45 12 82 29, sroe@danskebank.dk

Peter Passing Andersen, Senior Analyst, +45 45 13 70 19, pa@danskebank.dk

US: Another awful ISM report

Overview: The ISM manufacturing index declined from 43.5 to 38.9 in October, the lowest level since September 1982 and below both our and consensus expectations. After four months during which the ISM index continuously overshoot actual manufacturing production growth, the index caught up with reality last month. The continued decline in October suggests even weaker growth in the coming months.

Details: The details of the survey are overall downbeat, with the forward looking elements all turning worse. New orders declined to 32.2 from 38.8 in September, production declined to 34.1 from 40.8 and backlog of orders fell to 29.5 from 35.0. Employment declined to 41.8 from 49.7 supporting our and consensus expectations that non-farm payrolls fell sharply last month. New export orders took the biggest drop this month to 41.0 from 52.0, underscoring that the recent quarters' support to US economic growth from the export sector is fading rapidly as global growth abates.

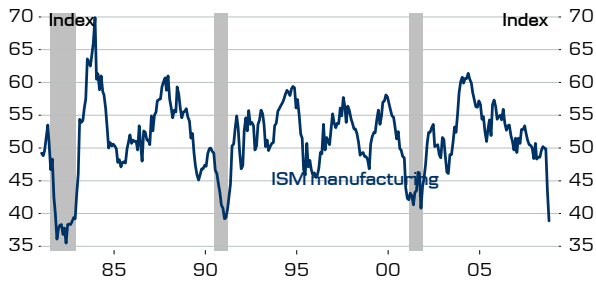
Inventories increased to 44.3 from 43.4, a sign that production is unable to adjust fast enough to the faltering demand. Customer inventories (wholesalers) increased as well to 55.0 from 53.5, indicating weakness in final demand as well. The combination of an increase in inventories and declining new orders suggests that the production index has further to fall (see charts below).

Prices paid declined to 37.0 from 53.5, the lowest level since December 2001 suggesting that inflationary pressures have fallen with the collapse in commodities – the risk of deflation rather than inflation has moved to the forefront of the agenda.

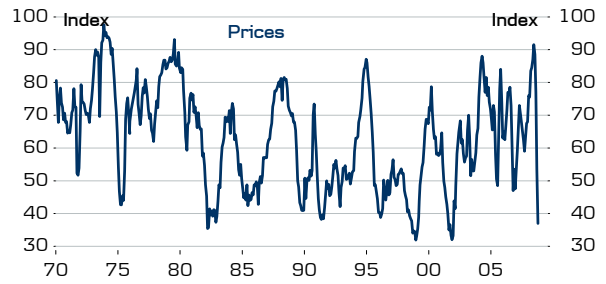
Assessment & Outlook: The ISM index finally caught up with reality last month as manufacturing production growth has been in negative territory on a three-month annualised basis since February. The continued deterioration in October suggests that production growth could turn even more negative in the coming months. The export sector managed to keep the ISM above recession levels until last month, but rapidly slowing global growth and further weakness in domestic demand means that the industrial sector is fighting an increasingly uphill battle.

Our indicators are sending mixed signals on the future path for the ISM. Our six month forward model points to a recovery in November, while the combination of higher inventories and declining orders suggests that the ISM could go lower next month. Of course the October survey has been conducted in a period of maximum financial stress and uncertainty. If there is one month in which customers are likely to have taken a cautious stance to new orders, it is October. However, given the increasing weakness not only in domestic demand but also in global growth, any recovery next month should be modest.

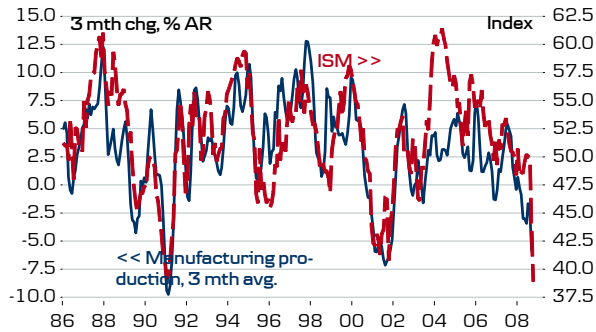
The ISM is clearly at recessionary level...



... and the price index has collapsed



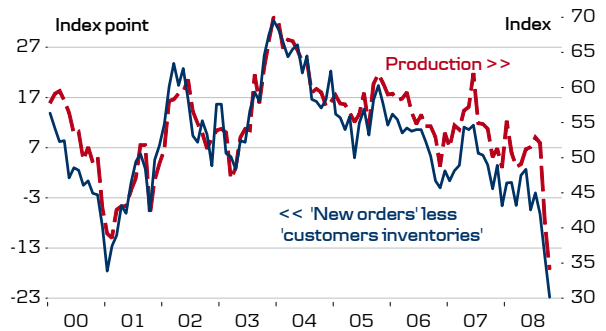
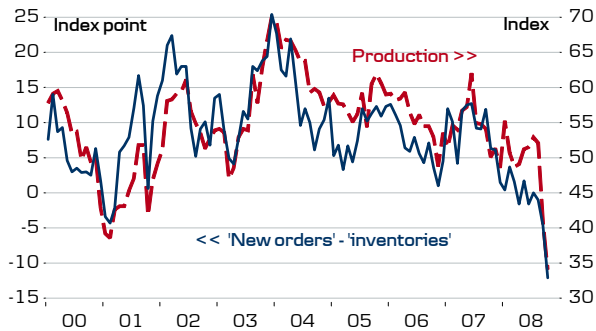
ISM suggests a larger decline in production...



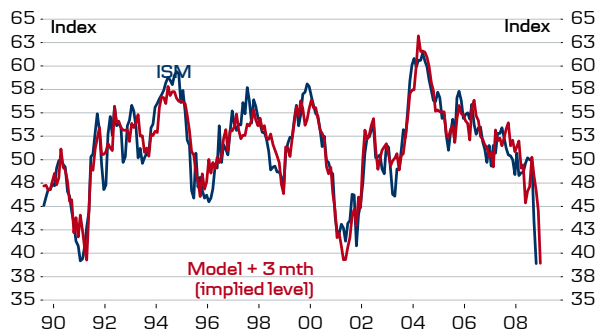
...as weakness is spreading to the export sector



Details spell further weakness...



...contradicting the signal from our six month forward model



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