

Flash Comment

US: ISM recovery intact

- The ISM index extended the upward trend in June and the details of the report strongly suggest that the ISM will be heading higher in the coming months.
- A huge gap between production growth and growth in final demand remains to be closed. Even with final demand growth flat, production growth needs to pick up to slow the rapid decline in inventories.
- Prices paid increased further, likely reflecting the recent run up in commodity prices outside energy. Deflationary pressures thus seem to be receding in the production pipeline. We nevertheless see very little underlying inflation pressure as the slack in the economy remains huge.

Details

The details of the report were somewhat mixed but are generally supportive of a further increase in the ISM.

Production rose to 52.5 from 46.0 but new orders fell back to 49.2 from 51.1. Although new orders gave back some of the increase in May, inventories declined as well, leaving the overall balance between the two virtually unchanged. Usually this gap is a very useful near-term indicator for the ISM index and industrial production growth and it strongly suggests that both will move higher in the coming months.

New export orders and imports both increased confirming signs from other global indicators that global trade is recovering from the collapse earlier this year. A positive surprise was found in the employment index which rose to 40.7 from 34.3 in May. This stands in contrast to the larger than expected decline in the ADP employment estimate released earlier today.

The ISM report indicates that deflationary tendencies in the production pipeline are abating. The supplier deliveries index rose to 50.6 from 49.8 suggesting less slack in supply conditions. The same trend is evident in the prices paid index which jumped to 50.0 from 43.5. This likely reflects the upturn in commodity prices outside energy. We continue to see very little underlying inflation pressure with the current huge slack in the economy.

Assessment and outlook

An ISM index at 44.8 – and still rising – is consistent with our long-held view that the economy should return to positive growth in the coming months. A huge gap between production growth and growth in final demand remains to be closed. Even with final demand growth flat, production growth needs to pick up to ease the rapid decline in inventories. Our expectation of a rebound in growth thus does not hinge on positive growth in inventories but merely a deceleration in the pace of decline.

Going forward we continue to expect that the ISM index will move higher. Our target is for the index to breach 50 by late summer. How high the ISM index will go in H2 will be determined by two factors – the pace of demand growth and the improvement in financial conditions. If things turn out favourably, the rebound in the ISM and industrial production could happen much faster than markets currently expect.

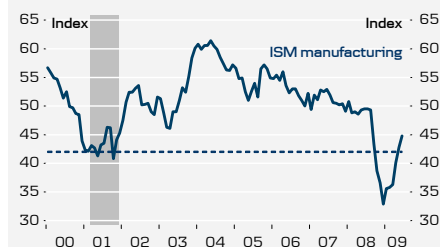
(More charts on page 2)

ISM manufacturing (June)

	Act	Con	DB	Last
ISM	44.8	44.6	45.6	42.8
Prices	50.0	47.0	41.0	43.5

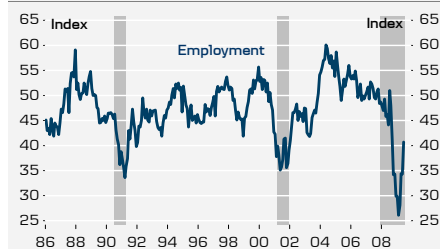
Source: Bloomberg and Danske Markets

ISM recovery intact



Source: EcoWin and Danske Markets

Employment index improving

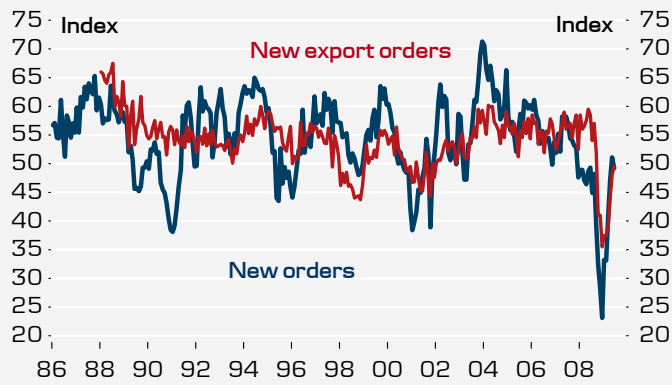


Source: EcoWin and Danske Markets

Senior Analyst

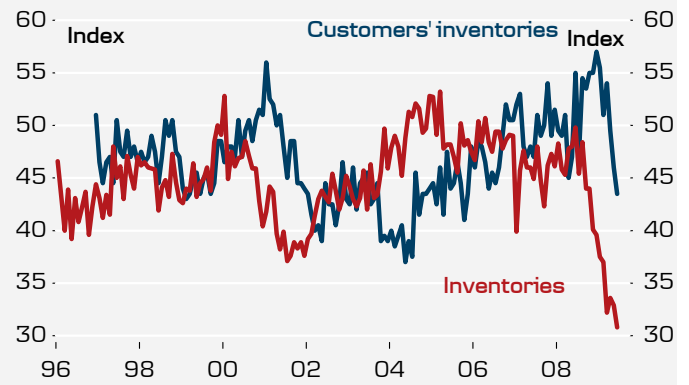
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New orders gave back some of the improvement...



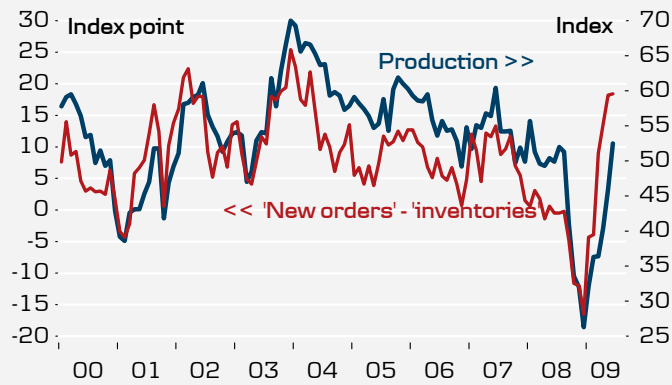
Source: EcoWin and Danske Markets

...but inventories declined as well...



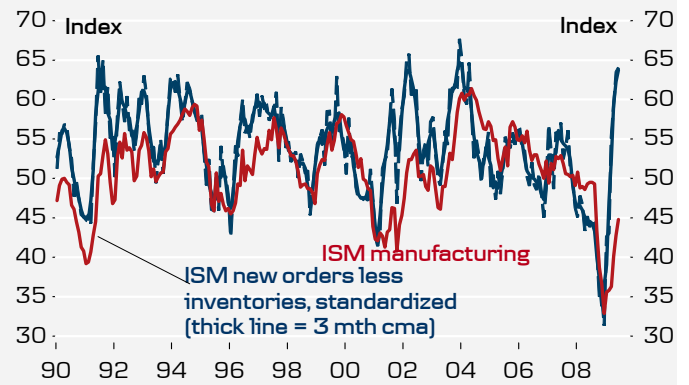
Source: EcoWin and Danske Markets

...leaving the gap virtually unchanged...



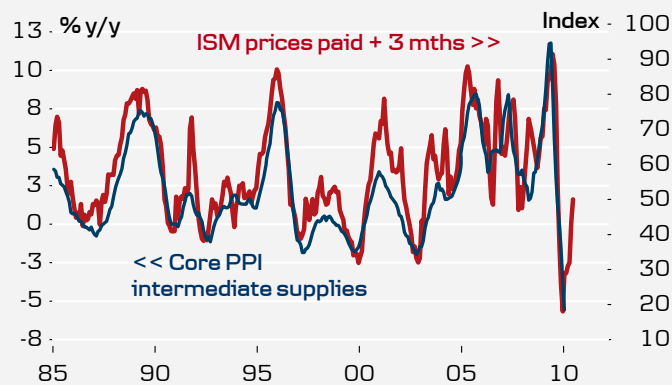
Source: EcoWin and Danske Markets

...strongly indicating a continued upward trend in the ISM



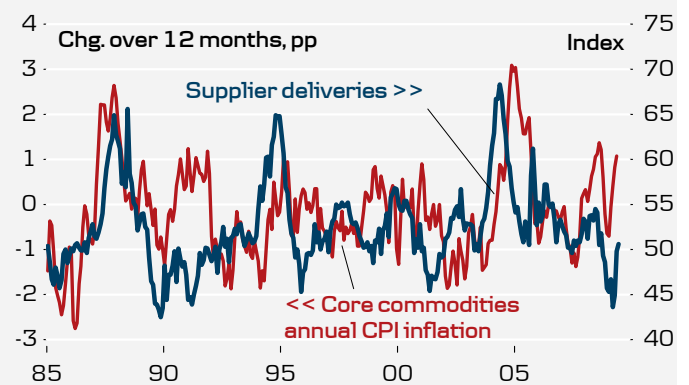
Source: EcoWin and Danske Markets

Deflationary pressures abating in the production pipeline...



Source: EcoWin and Danske Markets

...likely reflecting the recent run up in commodity prices



Source: EcoWin and Danske Markets

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