U.S. Flash

Manufacturing Activity Contracts on Weak Demand in November

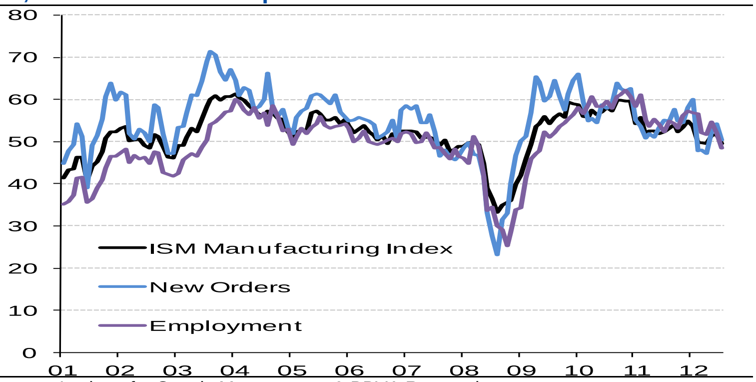
- **The ISM Manufacturing Index dropped to 49.5 in November due to slower domestic and foreign demand, in addition to the impact from Hurricane Sandy**
- **Production held strong in expansionary territory, but employment dropped below 50 for the first time in more than three years**

Far below economists' estimates, the ISM Manufacturing Index fell to its lowest level since 2009 amidst slower demand from foreign economies coupled with domestic slowing as fiscal cliff uncertainty deters firms from spending prior to policy action. Dropping to 49.5, the ISM is also reflecting the impact of superstorm Sandy that devastated the East Coast and hindered both production and demand while businesses assessed the damage and considered what was needed before they could be up and running again. This is most heavily reflected in the plunge in new orders from 54.2 to 50.3. Although still in expansionary territory, new orders have shrunk considerably in November as businesses dealt with restarting their production post-Sandy while the less-affected firms still hesitate to make purchases prior to fiscal policy action. This slowing domestic demand is paired with declining foreign demand as Europe has yet to stabilize enough to demand more goods from the U.S. and China is plagued by the same sluggish recovery.

Other sub sects of the report show the same dismal story, although it is unclear how much of the decline is due to Sandy rather than the diminishing state of manufacturing. Surprisingly, the production component accelerated to 53.7, the highest level in six months, but should revert again next month as the impact from falling new orders finally hits. Employment suffered greatly, falling from 52.1 to 48.4, its lowest level since September 2009. Heavily due to the closing of factories in the Northeast, this contractionary figure is likely to remain close to the 50-mark through the coming months while the Sandy-related effects are fully realized. However, the most prominent measure of Sandy's destruction was seen in inventories, measuring the stock of units on hand, that fell from 50.0 to 45.0.This is likely to be a result of the slowdown in demand from businesses as the storm converged on the Northeastern coast and the subsequent destruction it caused as factories and warehouses were shutdown or even destroyed. A more cautious view on future demand may also explain the fall in inventories as companies determine the risks behind over-production based on lack luster demand.

Overall, the ISM's fall into contractionary territory should be temporary as Sandy's impact dwindles over the coming weeks and December figures perk up slightly. However, until U.S. fiscal policy is clear and European and Asian demand recovers, we do not expect the ISM index to recover quickly.

Chart 1
ISM Manufacturing Index, New Orders, & Employment
SA, 50+ = Economic Expansion



Source: Institute for Supply Management & BBVA Research

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