**United States**

**ISM manufacturing plunges**

**Highlights**

- The ISM manufacturing index dove from 56.5 to 51.3 in January. Not counting the identical retreat in May 2011, the 5.2-point loss is the largest since October 2008.
- Eight of the ten components contracted in January. Ground was lost mainly in new orders (-13.2 points) and current production (-6.9 points).
- The employment component slipped 3.5 points, as did the order backlog and customer inventories components.
- The prices paid component jumped 7.0 to 60.5. The supplier deliveries component was also up.

**Comments**

The ISM manufacturing index had a big surprise in store for us this morning. It was expected to go down, but not as sharply as the results released. One factor that we believe could explain this retreat is weather conditions that have had some negative impact, particularly on deliveries. Yet we can hardly believe that there is a single cause for all this weakness. After several months on the rise and good levels for the index, there seems to be a real loss of momentum. However, the good news is that most of the ISM manufacturing index components have stayed above 50. For now, only order backlogs and the components associated with inventory are in a state of contraction.

The most worrisome retreat is in new orders. With an average of 63.0, this component was at very good levels in fall 2013. Unfortunately, it plummeted before the strong performance could spread to real business investment in equipment. This decrease has therefore pushed the component closer to results we have already been seeing in new orders for durable goods in recent months. If recovery is not imminent, we can expect more moderate growth than forecasted for investment.

The drop in employment is also disappointing, but at 52.3, the level does not indicate contraction in manufacturing employment.

The decline in inventory was unavoidable, as the strong contribution made to real GDP growth by inventory changes in the last two quarters of 2013 could not continue indefinitely. We should now expect inventory to take a bite out of growth at the start of 2014.

**Implications:** The greater than expected fall in the ISM manufacturing index joins other less than stellar data on the U.S. economy. Real GDP growth should continue nicely in 2014, but the increase could be a bit slower than recently predicted for the first quarter. If it turns out to be fleeting, the decrease in the ISM manufacturing index should not overly worry the Federal Reserve, but additional lost ground that approaches 50 will start to raise questions.

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