

US Economic Comment

Nonmanufacturing ISM -4.1 pt to 51.4 in Aug

Economics

Americas

An unusually sharp decline, not corroborated by other broad indicators

The ISM non-manufacturing index fell 4.1 pts to 51.4 in August (cons 55.0, UBSe 55.5), with sharp declines in the business activity index and the new orders index. The employment index slipped from an already-low level, and the supplier deliveries index inched up from a low level.

The headline index has only rarely fallen as rapidly. Its decline in October 2001 came after terrorist attacks. Its decline in September 2005 was during a record-breaking hurricane season. Its two other (more) rapid declines were as the great recession intensified. Nothing similar now. Except during that hurricane year (when the ISM drop was fairly quickly reversed), the levels of the index were lower after the decline – more convincingly recessionary signals. (See table on page 3.)

In contrast, this month's decline leaves the index a bit above 50, and other broad indicators of activity haven't shown the same degree of deterioration as in earlier instances of nonmanufacturing ISM drops. Payrolls have perhaps slowed, but not nearly as dramatically as in those instances, and the trend pace has been faster. Jobless claims are lower than then and have shown no real recent rise. Equity markets are buoyant now, unlike those past times. (See table on page 3.)

The manufacturing ISM is a bit more concerning, with its drop into contractionary territory. Service-sector measures like the Richmond Fed index and the NACM credit market index are also a bit more worrisome, but nevertheless have not shown the same or as large a deterioration as they did during past severe nonmanufacturing ISM declines.

What kept the ISM index from an even sharper decline this month was the relative resilience of the employment component in August alone—its "only" 0.7 pt decline this August. However, that milder deterioration this month comes after seven months of greater weakness in the employment index than in other components. If other employment indicators were deteriorating, its low readings since February would be more convincing. The employment index averaged 56.1 in 2015, 50.7 in Q1, 51.8 in Q2, and 51.0 so far in Q3.

But with as many counterindicators, we're discounting this month's drop. There's clearly been softening, but it extends the more gradual slowing seen since last year. From the Q415 quarterly average of 56.9, the nonmanufacturing ISM index fell 3.1pts to the 53.8 in Q1. It gained 1.2 pct pt to 55.0 in Q2. Q3-to-date averages 53.5, 1.5 pts below Q2 and 3.4 below Q4 of last year.

With the dual weakening in manufacturing and nonmanufacturing ISM indexes, the two suggest a real GDP growth trend of only about 1%. However, ISM levels had looked far stronger than Q4-Q2 real GDP growth, and this may simply be a correction. (See chart.)

For the Fed...

Although Fed officials may doubt the degree of slowing in the latest payrolls or ISM measures, the weaker figures probably keep the FOMC on the sideline in September.

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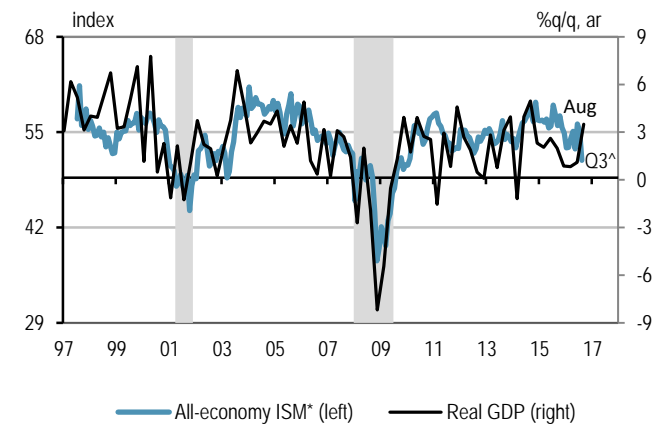
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Our all-economy ISM index (which combines manufacturing and nonmanufacturing surveys) is signalling about a 1% trend in real GDP growth, while we see Q3 growth tracking at about a 3 ½% pace. That divergence reverses the pattern of the last three quarters.



Note: Shaded areas mark recessions. * Economy-weighted average of manufacturing ISM index (12% weight) and nonmanufacturing ISM index (88%). ^Q3 GDP tracking estimate of 3.5%. Source: Institute of Supply Management, Bureau of Economic Analysis, and UBS

Nonmanufacturing ISM

Seasonally-adjusted, unless marked otherwise	May	Jun	Jul	Aug
Composite index	52.9	56.5	55.5	51.4
Business activity (25%)	55.1	59.5	59.3	51.8
New orders (25%)	54.2	59.9	60.3	51.4
Employment (25%)	49.7	52.7	51.4	50.7
Supplier deliveries* (25%)	52.5	54.0	51.0	51.5
Prices	55.6	55.5	51.9	51.8
Backlogs*	50.0	47.5	51.0	49.5
New export orders*	49.0	53.0	55.5	46.5
Inventory change*	54.0	55.5	54.0	48.0
Inventory sentiment*	60.0	62.5	63.0	64.0
UBS all-economy ISM**	52.7	56.1	55.2	51.2
Manufacturing ISM	51.3	53.2	52.6	49.4
Nonmanufacturing ISM	52.9	56.5	55.5	51.4

* Not seasonally adjusted. ** Economy-weighted average of manufacturing ISM index (12% weight) and nonmanufacturing ISM index (88%). Source: Institute for Supply Management and UBS

The employment index did not fall as sharply in August as it had in past instances of sharp ISM deterioration. However, it had fallen more sharply earlier in the year.

Contribution to change in headline nonmanufacturing index of its components, pts.	Headline Index	Business Activity Index	New Orders Index	Employment Index	Supplier Delivery Index
Oct 2001	-4.7	-2.3	-2.4	-0.6	0.6
Sep 2005	-5.6	-2.4	-2.3	-1.2	0.3
Jan 2008	-7.5	-2.8	-2.3	-1.5	-0.9
Nov 2008	-7.1	-2.4	-2.2	-2.8	0.4
Aug 2016	-4.2	-1.9	-2.2	-0.2	0.1

Source: ISM and UBS

Date	ISM Nonmanufacturing (index)	Nonfarm Payrolls (000s)	Jobless Claims (000s)	Change in Jobless Claims (m/m, 000s)	Wilshire 5000 Price Index m/m % ch	ISM Manufacturing (index)	NACM Survey of Credit Managers: Service Sector (index)	Richmond Fed Service Sector: Revenues (index)
200508	61.3	194	316	-9	0.0	52.4	56.5	21
200509	55.7	68	383	67	0.0	56.8	57.6	20
200510	57.4	85	352	-31	0.0	57.2	59.1	24
200712	52.5	97	348	12	0.0	49	51.2	0
200801	45	19	339	-9	-0.1	50.3	51.1	-15
200802	49.9	-86	347	8	0.0	47.6	49.5	2
200810	44.7	-473	475	11	-0.2	38.9	45.9	-6
200811	37.6	-769	520	45	-0.1	36.5	42	-27
200812	40	-695	564	44	0.0	33.1	39.2	-33
201607	55.5	275	259	-9	0.0	52.6	54.4	8
201608	51.4	151	263	4	0.0	49.4	52.5	0

Source: ISM, BLS, DOL, Dow Jones, NACM, Federal Reserve Bank of Richmond, and UBS

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