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## November ISM Manufacturing Index: Heading Into 2017 On Firmer Footing?

- > The ISM Manufacturing Index rose to 53.2 percent in November from 51.9 percent in October.
- > The new orders component rose to 53.0 percent, the employment component fell to 52.3 percent, and new export orders rose.

The ISM Manufacturing Index came in ahead of expectations for November, rising to 53.2 percent, the highest level since June. The underlying details are generally positive, as are comments from survey respondents. We have noted over the past several months that the factory sector seemed to be drifting along without clear direction, but the ISM data offer some encouraging signs that steady growth lies ahead in 2017. Still, the recent improvement in the ISM data will have to be built upon in the months ahead before anyone sounds the "all's clear" siren for the factory sector.

Of the 18 industry groups included in the ISM's survey, eleven reported growth in November, up from ten in October and seven in September, though six industry groups reported contraction in November. Comments from survey respondents were mostly on the upbeat side, with several industry groups pointing to rising sales. One respondent from the plastics & rubber products industry group noted his firm is foregoing its usual Christmas break in order to fulfill higher orders. Expectations of higher orders and firmer conditions in 2017 were common amongst respondents.

The index for new orders rose to 53.0 percent in November, up from 52.1 percent in October. Half of the eighteen industry groups reported higher orders in November while half reported declines in orders. Order backlogs fell further in November, and with backlogs generally fading there is some downside risk to production over coming months in the absence of more meaningful and sustained growth in new orders than is apparent in the ISM data, even with the new orders index having risen in November.

Increased production has helped eat into those order backlogs over recent months, with the current production index hitting 56.0 percent in November, the highest level since July 2015. Of the 18 industry groups in the ISM's survey, nine reported higher production levels in November while six reported lower levels. Again, with order backlogs fading it is important that the breadth of orders improve over coming months, otherwise we can expect the production index in the ISM survey to retreat from November's elevated level. As it is, the index for current production in the ISM data has been running a bit ahead of other indicators, most notably the manufacturing component of the Industrial Production Index published by the Federal Reserve. As measured in the industrial production data, manufacturing output has been flat-to-lower on an over-the-year basis for the past several months even as the ISM data show at least modest growth. Going forward we'll be watching to see whether the ISM gauge of production will slip or the industrial production gauge will improve.

For a second consecutive month, survey respondents deemed customer inventories as being too low, which does offer hope that manufacturers will see further gains in orders and production over coming months. For some time inventories have been a drag on manufacturing activity, the question now is how much of a lift diminished customer inventories will provide. After what was a prolonged inventory correction, we're inclined to think firms will remain fairly disciplined on inventories barring evidence of meaningful and sustained acceleration in demand growth. To be sure, expectations do seem to be improving, but that will have to be followed up by firmer and broader growth in orders. Additionally, November marked the 17<sup>th</sup> consecutive month in which manufacturers' inventories of raw materials declined, a sign that manufacturers themselves remain cautious in their expectations of demand growth.

To be sure, the prospect of corporate tax reform and regulatory relief offer hope there will be better days ahead for the factory sector. At the same time, however, a stronger U.S. dollar and an uncertain outlook for global trade pose headwinds. As such, we'll be looking for signs of increased breadth of growth in production and orders in the ISM data over coming months to help assess the course of the factory sector.

