Markit Economic Research

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United States

Markets misled by factory order book signal

- **A steep fall in the ISM new orders series looks to be a correction from misleadingly-high readings in prior months**
- **Markit PMI™ points to more reassuring underlying growth trend**

Stock markets have fallen sharply in what looks to be an over-reaction to a steep deterioration in the ISM survey. The ISM's manufacturing new orders index suffered its largest fall in points terms since December 1980, plummeting 13.2 points from 64.4 in December to 51.2 in January. The drop in new orders contributed to a steep fall in the survey's headline PMI, which dropped from 56.5 to 51.3.

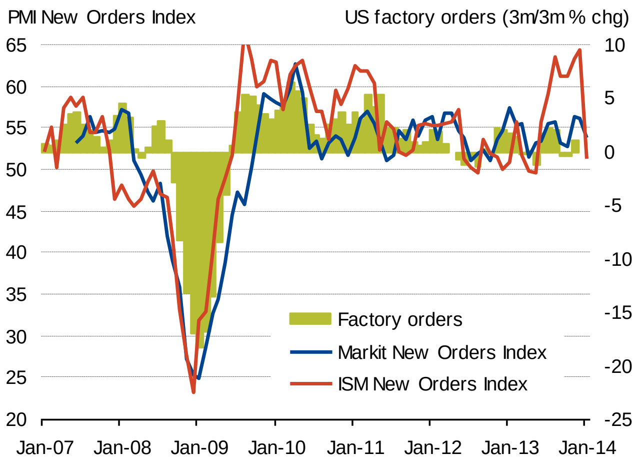
Analysts had been wrong-footed, having expected the PMI to merely dip to 56.0. The severity of the miss against expectations induced new worries that the US economy was not as healthy as previously thought. Benchmark equity indices dropped by around 1%.

However, the market reaction to the survey looks overblown. First, analyst expectations were too high to start with. In its report, the ISM noted unusually cold weather was at least partly to blame for the decline. January had seen record low temperatures across swathes of the US, which Markit's flash PMI (published 23 January) had already shown to have caused a slowdown in manufacturing activity. Analysts should have factored this into their ISM predictions.

Second, the fall in the ISM new orders index needs to be looked at in context of prior months, in which the survey had been signalling far stronger growth of factory orders than official data had been registering.

The ISM new orders index had been running above 60 in the five months prior to January, with an increase to 64.4 in December. To put this in context, the ISM data suggest that the second half of 2013 therefore saw a rise in new orders of a magnitude commensurate with the sharp rebound from the depths of the financial crisis seen in late-2009. However, official data have recorded a mere 0.2% rise in factory orders between June and November of last year, including a 0.5% fall in October, which is likely to have been linked to disruptions caused by the government shutdown.

New orders at US factories



Sources: Markit, ISM, Ecowin.

Markit's PMI, in contrast, to the ISM, has tracked official data on factory orders well (see chart). The survey has shown weak growth of orders in the third quarter of last year, with a marked easing due to the October shutdown, after which growth revived in the final two months of the year. January's final Markit PMI data showed reasonable, if unexciting, growth of orders at US factories. The increase was the weakest for three months (the index dipped from 56.1 in December to 53.9), but once an estimated allowance is made for the number of companies reporting disruptions due to the adverse weather, the underlying trend in new orders appears to have been as strong, if not slightly stronger, than late last year.

The fall in the ISM's new orders index in January therefore needs to be viewed as a hit from the cold weather plus – and most importantly –a correction from misleadingly high readings late last year.

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