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United States

Weak September PMI rounds off sluggish third quarter for manufacturing

- **PMI falls to three-month low in September**
- **Manufacturers cut back on hiring in the face of uncertain trading conditions**
- **Data vindicate Fed decision to keep policy stimulus in place**

Flash PMI data for September highlight the on-going lacklustre performance of the manufacturing sector, with job creation stymied by worries about weak demand at home and abroad. The data vindicate the surprise lack of tapering by the Fed.

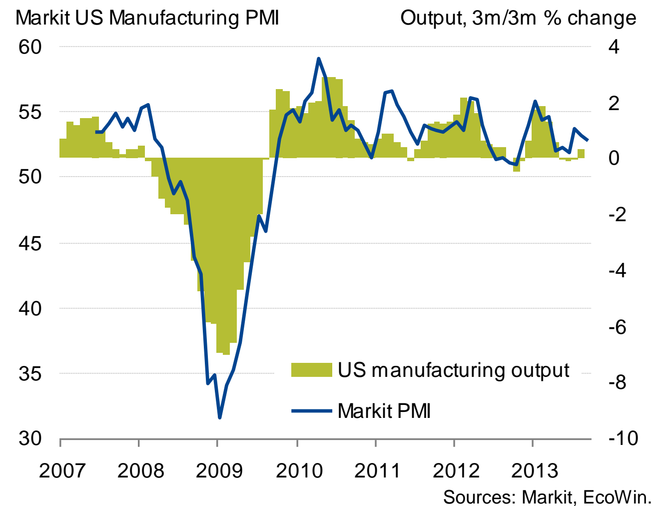
The flash PMI for US manufacturing fell for a second successive month in September, down from 53.1 to a three-month low of 52.8. The average reading for the third quarter of 53.2 was up from the recent low of 52.1 seen in the second quarter, but well down on the first quarter average of 54.9.

The survey is therefore indicative of manufacturing output having revived from the stalling of growth seen in the second quarter, though merely points to a quarterly growth rate of approximately 0.5% in the third quarter. Such performance is broadly consistent with the current consensus, according to Thomson Reuters, for GDP to rise at an annualised rate of just 2.0% in the third quarter.

One of the key takeaways from the PMI is that growth of domestic demand remains markedly weaker than at the start of the year. Export demand has also waned, dropping slightly for the first time in three months during September. Total inflows of new orders increased at the slowest rate for five months as a result.

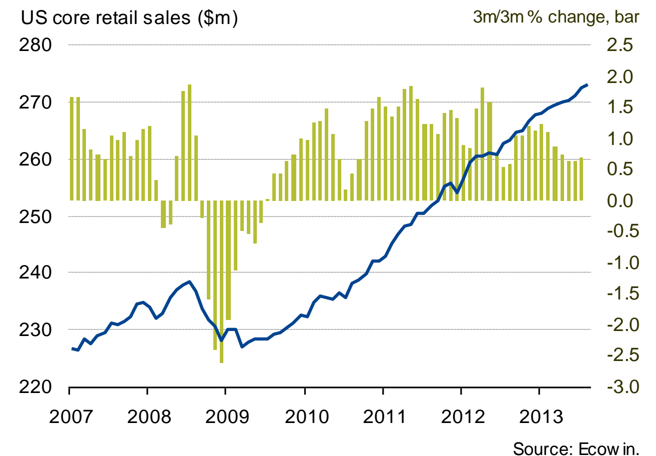
The cooling of domestic demand since earlier in the year signalled by the PMI is consistent with the recent trend in retail sales, which have also disappointed. Core sales, which strip out volatile autos, gas and building material components, were rising at a rate of 1.2% in the three months to February. In recent months, however, this growth has waned, with the rate of increase down to 0.6% in the second quarter and just 0.7% in the three months to August.

Manufacturing output



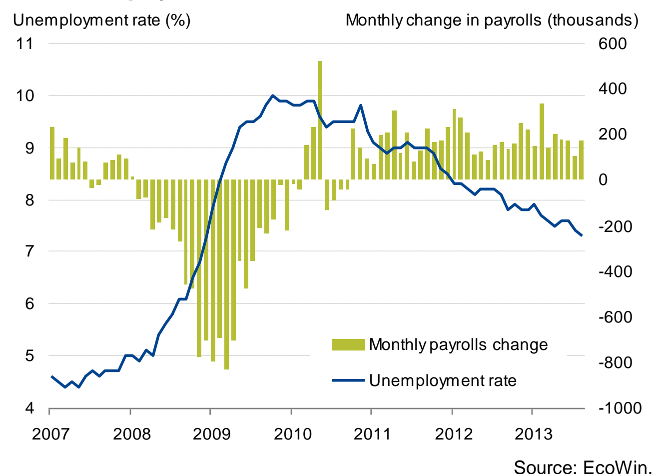
Sources: Markit, EcoWin.

Retail sales



Source: Ecow in.

Non-farm payrolls



Source: EcoWin.

Manufacturers have naturally become increasingly reluctant to take on staff. The rise in employment signalled by the September PMI survey was the worst since December 2010, with the sole exception of the marginal drop in headcounts seen in June of this year.

The survey data therefore suggest that the 14,000 rise in manufacturing payrolls in August was a temporary aberration. The cumulative 39,000 fall in payroll numbers seen over the prior five months is a more representative indication of the true trend in the goods-producing sector.

Fed surprise

The FOMC surprised the markets with a decision to continue its $85bn per month bond purchases at its September meeting[1]. Perhaps this should not have been such a surprise, given the recent weakening in key indicators such as manufacturing output, retail sales and lower than expected job creation. Non-farm payrolls had grown by an average of 148k in the three months to August compared to an average of 209k in the prior seven months.

Although falling, the unemployment rate was also sending misleading signals. The recent drop in the jobless rate to 7.3% was to a large extent caused by people leaving the job market and therefore not being counted as looking for work. The participation rate is currently at 63.2%, its lowest since 1978.

Recent upwards movement in interest rates (which followed the increased talk of tapering since the possibility was raised by the Fed in May), were also a key concern. The Fed's statement noted that the current pace of growth was only moderate, and that recent rises in mortgage rates and the general tightening of financial conditions in recent months could cause the economy and the labour market to slow.

In summing up, "the Committee sees the improvement in economic activity and labour market conditions since it began its asset purchase program a year ago as consistent with growing underlying strength in the broader economy. However, the Committee decided to await more evidence that progress will be sustained before adjusting the pace of its purchases."

In terms of the guessing-game of when the FOMC might decide when to taper, there is little from the PMI to suggest any change in opinion, suggesting tapering could now not start until next year. However, one additional factor behind the Fed's decision was the possibility that a failure to resolve discussions on spending cuts and the need to raise the federal budget ceiling could also derail the economy. If the impasse is avoided at the start of October, the Fed may feel more included to start tapering.

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[1]We had expected the programme to be trimmed by $5bn – a symbolic gesture that would have taken advantage of the market's expectation that QE tapering would start but at the same time having a marginal impact on stimulus.