**ISM Shows Deepest Contraction Since 2009**

The ISM manufacturing index fell to a cycle low in September, as trade concerns and weak global growth further suppressed activity. A turnaround is not yet in the offing, but watch the ISM non-man for spillovers.

### Silver Lining Hard to Find in Latest ISM Drop

When the ISM manufacturing index sank last month into contraction territory for the first time since 2016, we wrote that it was the most undeniable evidence yet of the rising cost of the trade war and stress in manufacturing. The September ISM report takes that statement to a whole new level. The index fell a further 1.3 points in September. At 47.8, the ISM manufacturing index is now at its lowest level this cycle, including the 2015-2016 slowdown.

Trade rhetoric was turned down in September, with both China and the United States offering up some exemptions and announcing trade talks will resume this month. That, however, appears to have been too little and too late. Every subcomponent in the survey is now below 50, with the one exception of supplier delivery times, which still grew more slowly.

The production component sank further into negative territory, as did inventories, which is consistent with our expectations for slower stock building to be a drag on GDP growth this quarter. Hiring in the manufacturing space reportedly contracted at a faster pace as well, which is consistent with our expectations that the trend rate of private payroll growth will continue to moderate. With backlogs of orders shrinking for a fifth straight month, it is no surprise to see employers cutting back on hiring. New orders were little changed (up a tick to 47.3), but the fact that export orders fell to a fresh cycle low underscores that the headwinds from the global slowdown and strong dollar are not abating.

### Anything to Take the Edge Off?

Before crawling into a foxhole, it is notable that other purchasing managers’ indices are holding up better. On an ISM-weighted basis, the regional Fed manufacturing surveys rose 1.8 points further into expansion territory. At the same time, the final reading on the September U.S. Markit manufacturing survey showed activity firming and remaining above the key 50 level. That said, with no end in sight to trade uncertainty and the closely linked slowdown in global growth, we expect manufacturing to remain in the doldrums and for capex spending to serve as a drag on growth through the remainder of the year.

It is also worth remembering, however, that manufacturing accounts for only 12% of output and even a smaller share of employment (8.5%). Therefore, more important in our view will be Thursday’s reading for the ISM non-manufacturing report. The ISM non-manufacturing survey held up surprisingly well in August, and while we think it is due for some slippage in September, it remains comfortably in expansion territory. Therefore, the pullback in the manufacturing sector still looks to be consistent with a slowdown in the broader economy, but not a recession at this point.

Source: Institute for Supply Management and Wells Fargo Securities