U.S. Factory Activity Decelerates Sharply Amid Global Slowdown

Manufacturing index falls as demand for American-made products wanes

By Sharon Nunn and Nick Timiraos
Updated Jan. 3, 2019 3:24 p.m. ET

WASHINGTON—American manufacturing growth slowed sharply in December, adding to concerns about cooling economic expansions in the U.S. and abroad.

The Institute for Supply Management said Thursday that its manufacturing index fell to 54.1 in December, the largest one-month drop since the end of 2008, during the financial crisis. Still, a reading above 50 indicates factory activity is expanding.

The report offers the most concrete sign that the U.S. economy is losing steam after expanding strongly in 2018. It follows others indicating ebbing U.S. consumer confidence and vehicle sales last month.

If followed by other data pointing to a worse-than-expected loss of economic momentum, the Federal Reserve would likely break from its recent pattern of raising interest rates by a quarter of a percentage-point each quarter.

That precedent would have pointed to another rate increase in March, but continued weak economic reports could lead central-bank officials to leave rates unchanged at that meeting, according to recent public statements and interviews.

Fed officials raised their benchmark federal-funds rate by a quarter-percentage point to a range between 2.25% and 2.5% when they met on Dec. 19. They penciled in two rate increases in 2019, but that assumed the economy would grow slightly above the 1.8% annual pace they deem likely over the long run.

Fed officials have stressed that their policy plans aren't on autopilot and that they will react to changes in economic data, which could even mean deciding not to raise rates at all this year.

"We know that the economy may not be as kind to our forecasts next year as it was this year," Fed Chairman Jerome Powell said at a press conference last month. "Unforeseen events as the year unfolds may buffet the economy and call for more than a slight change from the policy projections released today."

Dallas Fed President Robert Kaplan, speaking Thursday on Bloomberg Television, said the central bank should hold off on additional rate increases until it determines whether rising anxiety about the economy and financial markets is temporary or a sign of something more troubling.

"In the first couple of quarters in this year, if you ask me my base case, my base case would be take no action at all. That could change if things improve," Mr. Kaplan said. "We should be patient and give some time for the economy, and watch how this situation unfolds."

Economists at Goldman Sachs last week lowered their U.S. growth forecast for the first half of this year to a 2% annual rate from 2.4%. They expect a 1.8% growth pace in the second half of the year. Economists at Morgan Stanley expect the economy to grow just 1.7% this year, the slowest pace since 2012, with quarterly growth slackening to a low of 1% in the July-to-September quarter.

Andrew Hunter, senior U.S. economist at Capital Economics, acknowledged that the ISM report could intensify concerns about the U.S. economy but noted that "even after

December’s fall, the ISM index remains consistent, on past form, with above-trend [gross domestic product] growth of around 2.5% annualized.”

The ISM index has posted a decline of more than 5 percentage points in only two other months in the past 30 years, in Oct. 2001 and Oct. 2008. The index is still above the current expansion’s low point of 47.8 in Jan. 2016.

“We have been looking for a gradual slowdown in manufacturing activity amid headwinds from trade uncertainty, reduced fiscal stimulus and weaker global activity, but the risks of a sharper deceleration have increased,” said Jake McRobie, an economist at Oxford Economics, in a note on Thursday.

December’s ISM drop was driven by slowing new orders for American-made products. Tim Fiore, who oversees the survey of factory purchasing and supply managers, attributed that to cooling global economic growth, as some of the world’s largest economies, including Germany, Japan and China, have shown signs of sputtering in recent months.

Analysts blame U.S.-China trade tensions for much of the slowdown. The Trump administration placed tariffs on a host of Chinese-made goods last year to shrink the U.S. trade deficit, which drew retaliatory tariffs from Beijing.

U.S. negotiators are seeking a deal to defuse those tensions by boosting U.S. exports and loosening regulations that hobble U.S. firms operating in China.

Stocks slumped Thursday after Apple on Wednesday lowered its quarterly revenue forecast for the first time in more than 15 years, a move prompted by weakening iPhone sales in China.

In December, analysts cut earnings forecasts for this year on most of the companies in the S&P 500, according to FactSet, for the first time in two years. But the broad decline in the manufacturing index suggests the weakness wasn’t confined to worries over trade and declines in oil prices that have idled production in the energy sector.

“The U.S. is definitely in the late innings of the current business cycle,” said Joseph Brusuelas, chief economist at consulting firm RSM U.S.

The Labor Department is set to report on December payroll growth on Friday morning. Because Fed officials already judged the economy to be strong in the first half of December, a solid report Friday could deliver little new information about how the economy has weathered a period of tighter financial conditions. As a result of recent market volatility, officials may be less inclined to put as much weight on a sturdy report.

QUESTIONS:

1. To what level did the Institute for Supply Management (ISM) index drop in December? Does this number signal that U.S. manufacturing growth is slowing or that manufacturing levels are falling?

2. What are the likely reasons for the fall in the ISM index in December?

3. How does a drop in manufacturing growth affect worker's wages, unemployment, economic output, and wages in the short run?