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www.eurobank.gr/research
research@eurobank.gr

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FOCUS NOTES

The US manufacturing sector expanded in August at its slowest pace in 2 years

Olga Kosma
Economic Analyst
okosma@eurobank.gr

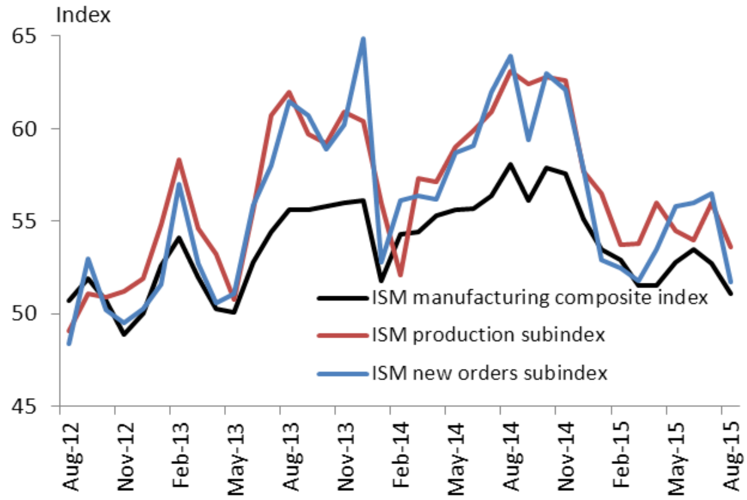
- The US ISM manufacturing index declined more-than-expected to a two-year low of 51.1 in August (vs. consensus estimate of 52.5) from its July level of 52.7 (Figure 1). As was evident in earlier readings from regional manufacturing surveys (eg. Empire State, Richmond, Kansas City etc.), production fell significantly to 53.6 from 56.0 in the prior month, while the forward-looking new orders index also posted a large decline to 51.7 from an eight-month high of 56.5 in July. As far as employment growth is concerned, it actually softened to 51.2 from 52.7, falling to the lowest reading since March 2015.

- The breakdown of the report also revealed that export demand continues to contract. In more detail, the new export orders index plunged to its weakest level since July 2012 (to 46.5 from 48.0 previously), remaining below the boom-or-bust level of 50.0. Possible reasons for the export demand contraction could be the slower global growth amid waning confidence about China's economic outlook and the US dollar's strength, as the DXY dollar index has increased to ca. 98.00 at the first week of August from a one-month low of ca. 94.00 in mid-June.

- Although overall US macroeconomic data have recently been positive, the goods-producing sector could present lower rates of growth in the following months. Inventories in the manufacturing and the retail sectors have increased in the second quarter of the year, so an inventory correction may follow. Adding to this, the new orders-inventory differential has also worsened given the significant decline in new orders and the sharp increase in customers' inventories (to 53.0 from 44.0 in July), pointing to subdued manufacturing sector performance ahead.

- The soft manufacturing report has probably lowered the chances for a Fed funds rate hike in the September 16-17 FOMC policy meeting. Notably, the Boston Fed President, Eric Rosengren, highlighted yesterday the need for a gradual monetary policy tightening cycle amid low inflation and global spillovers to US economic growth, irrespective of the timing of the first rate hike. In our view, the Fed is likely to begin its monetary policy normalization process not earlier than December. Nevertheless, the US nonfarm payrolls release due on Friday should be crucial for the upcoming Fed's policy deliberations in the sense that a remarkable improvement in the nonfarm payroll monthly gain could prompt an interest rate hike as early as in September. This holds provided that the recent turmoil in global markets does not take a turn for the worse.

Figure 1: US ISM manufacturing index slumped to a two-year low in August



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Eurobank Economic Analysis and Financial Markets Research

Dr. Platon Monokroussos: *Group Chief Economist*
pmonokrousos@eurobank.gr, + 30 210 37 18 903

Research Team

Anna Dimitriadou: *Economic Analyst*
andimitriadou@eurobank.gr, + 30 210 37 18 793

Ioannis Gkionis: *Research Economist*
igkionis@eurobank.gr + 30 210 33 71 225

Stylianos Gogos: *Economic Analyst*
sgogos@eurobank.gr + 30 210 33 71 226

Olga Kosma: *Economic Analyst*
okosma@eurobank.gr + 30 210 33 71 227

Arkadia Konstantopoulou: *Research Assistant*
arkonstantopoulou@eurobank.gr + 30 210 33 71 224

Paraskevi Petropoulou: *G10 Markets Analyst*
ppetropoulou@eurobank.gr, + 30 210 37 18 991

Galatia Phoka: *Research Economist*
gphoka@eurobank.gr, + 30 210 37 18 922

Theodoros Stamatiou: *Senior Economist*
tstamatiou@eurobank.gr, + 30 210 33 7 1 228

Global Markets Sales

Nikos Laios: *Head of Treasury Sales*
nlaios@eurobank.gr, + 30 210 37 18 910

Alexandra Papathanasiou: *Head of Institutional Sales*
apapathanasiou@eurobank.gr, +30 210 37 18 996

John Seimenis: *Head of Corporate Sales*
yseimenis@eurobank.gr, +30 210 37 18 909

Achilleas Stogioglou: *Head of Private Banking Sales*
astogioglou@eurobank.gr, +30 210 37 18 904

George Petrogiannis: *Head of Shipping Sales*
gpetrogiannis@eurobank.gr, +30 210 37 18 915

Vassilis Gioulbaxiotis: *Head Global Markets International*
vgioulbaxiotis@eurobank.gr, +30 210 3 718 995

Eurobank Ergasias S.A, 8 Othonos Str, 105 57 Athens, tel: +30 210 33 37 000, fax: +30 210 33 37 190, email: EurobankGlobalMarketsResearch@eurobank.gr

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