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April ISM Manufacturing Index: Details Show Manufacturing Expansion Still On Track

- The ISM Manufacturing Index fell to 54.8 percent in April from 57.2 percent in March.
- The new orders component fell to 57.5 percent, the employment component fell to 52.0 percent, and new export orders rose.

The ISM Manufacturing Index fell to 54.8 percent in April, a larger than expected decline from March's reading of 57.2 percent. The consensus forecast was 56.5 percent and our forecast was slightly lower at 56.4 percent. While we anticipated the components for new orders and employment would give back some of the rapid gains posted over recent months, those declines turned out to be larger than we had forecast. Still, April marks the eighth consecutive month in which the headline index was above the 50.0 percent break between expansion and contraction in the factory sector, and the underlying details as well as comments from survey respondents are generally positive. More significantly, the expansion in the factory sector remains notably broad based, which has not always been the case over the current expansion.

In light of what has been considerable discussion of late about the gaps between the "soft" data and the "hard" data, we think it useful here to point out that the ISM's index is a diffusion index and, as with any diffusion index, can tell us the direction of change but not the intensity of that change. In other words, that the headline index has been above the 50.0 percent mark for the past eight months tells us little, if anything, about the intensity at which the manufacturing sector is expanding. Other measures, i.e., "hard" data, such as new orders for core capital goods and the manufacturing component of the industrial production data, have been increasing over recent months, but at a still-measured pace. This is simply a caution against using the ISM data to draw broader conclusions about the rate at which the broader economy is expanding.

To our point that the expansion in the manufacturing sector has become increasingly broad based over the past several months as captured in the ISM survey, 16 of the 18 industry groups included in the ISM survey reported growth in April, with only the apparel, leather, & allied products group reporting contraction. Comments relayed to the ISM point to improving orders and a favorable business outlook, with a number of respondents noting increasing price pressures. One respondent noted that while global headlines may be causing personal anxiety, business conditions remain solid.

The index for new orders slipped to 57.5 percent in April which, again, was a larger decline than we had anticipated. It should be noted that the orders index declined from a very high level – it had hovered around 65 percent over the prior two months – that was not likely to be sustained, as our top chart shows. It is also worth noting that 16 of the 18 broad industry groups reported higher new orders in April while none of the industry groups reported lower orders. Steady growth in new orders bodes well for production over coming months, particularly in the context of what remain lean customer inventories and a still-growing backlog of unfilled orders – 14 of the 18 industry groups reported higher backlogs in April. At the same time, 17 of the 18 industry groups in the ISM survey reported rising production with none reporting lower output, with the production index standing at 58.6 percent. In turn, rising production suggests continued growth in manufacturing payrolls. In April, the employment index fell to 52.0 percent which is consistent with rising payrolls. Twelve of the 18 industry groups reported higher head counts in April, but one notable instance of lower payrolls is transportation equipment which, as we noted in our weekly *Economic Preview*, could be a drag on manufacturing employment over coming months as rising inventories of smaller automobiles lead to production cuts. Finally, new export orders rose for a 14th consecutive month in April, consistent with further growth in real (i.e., inflation adjusted) exports of U.S. goods, which is another sign that global economic growth is improving, even if at a modest pace.

The U.S. manufacturing sector is on a nice roll. While we don't doubt this expansion will continue in the months ahead, the pace at which it will do so remains highly uncertain, with much riding on the evolution of fiscal, regulatory, and trade policy.

