ECONOMIC UPDATE

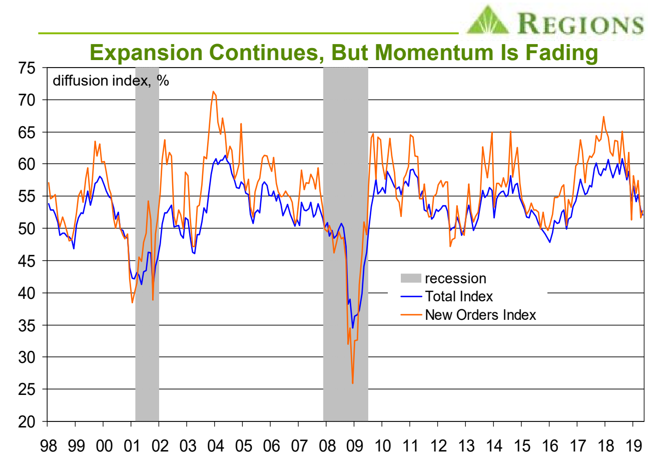
REGIONS

June 3, 2019

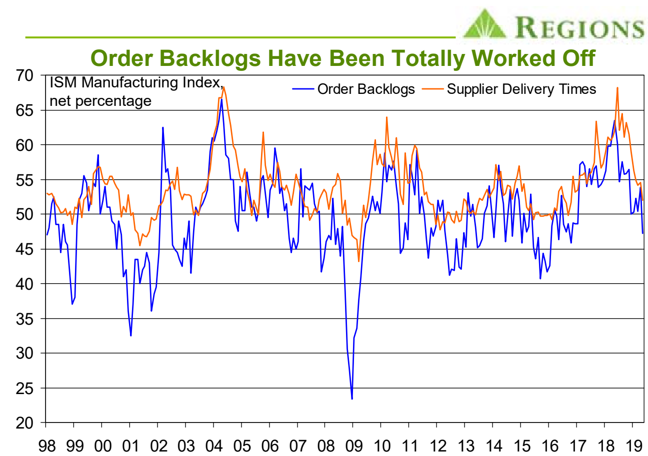
May ISM Manufacturing Index: Expansion Continues, But Momentum Is Fading

- The ISM Manufacturing Index <u>fell</u> to 52.1 percent in May from 52.8 percent in April
- The new orders index <u>rose</u> to 52.7 percent, the employment index <u>rose</u> to 53.7 percent, the production index <u>fell</u> to 51.3 percent

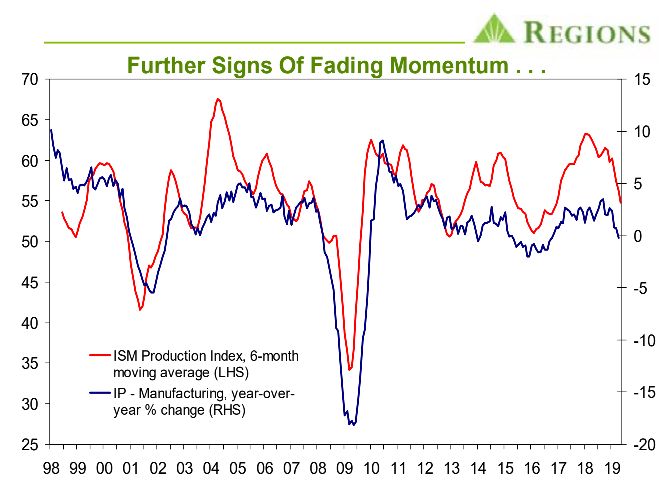
The ISM Manufacturing Index fell to 52.1 percent, slightly above our forecast of 51.8 percent but well below the consensus forecast of 53.0 percent. The May reading puts the headline index at its lowest level since October 2016, though May does mark the 33rd straight month in which the headline index has been above the 50.0 percent break between contraction and expansion. Still, while the key new orders index posted a modest gain, other details signal that what has been a long-running and broad based expansion in the factory sector is losing momentum. We have for some time been pointing to three headwinds confronting the manufacturing sector – an inventory overhang, trade policy, and a decelerating pace of motor vehicle sales – and comments from survey respondents suggest concern over each of these headwinds, particularly trade policy. We expect the ISM data to show further deceleration in manufacturing activity over coming months, and if trade disputes end the wrong way, the headline index could easily slip below that key 50.0 percent threshold.



Of the 18 industry groups included in the ISM survey, 11 reported growth in May with six reporting contraction, pointing to considerably less broad based growth across the factory sector than has been the case over the past several quarters. Comments from survey respondents indicate renewed concerns over tariffs, particularly the necessity of reconfiguring supply chains should a benign resolution to current trade disputes not be arrived at. It is worth noting that there was a brief period in which concerns over tariffs pretty much vanished from the comments section, when there was a much higher degree of confidence that the U.S. and China would strike a trade deal and before the recent threat of tariffs being imposed on all imports from Mexico. There is an interesting mix of groups, such as transportation equipment, pointing to softer demand and groups, such as machinery, that report demand remains strong.



Our forecast anticipated the new orders index would slip below the 50.0 percent mark, indicating shrinking new orders. This proved to be off the mark, and accounts for much of our miss on our forecast of the headline index. The new orders index rose to 52.7 percent in May from 51.7 percent in April, with 12 industry groups reporting higher orders and four reporting lower orders. We've often stated that the new orders index has long been one of our most reliable forward looking indicators, and continued growth in new orders will be even more critical in supporting growth in output and employment in the factory sector. The index of backlogs of unfilled orders fell to 47.2 percent in May, indicating that order backlogs are contracting, thus ending a 27-month run of rising order backlogs. One way to think about this is that unfilled orders provide a buffer against a decline in current orders, and the May ISM data show that buffer to be gone. Another metric worth noting is the index of supplier delivery times; while this index remains above 50.0 percent, it has been steadily slipping over the past several months, suggesting suppliers are under less pressure to make delivery times, which is another sign of slower overall activity in the factory sector. The current production index slipped to 51.3 percent in May, the lowest since August 2016, and only 11 of the 18 industry groups reported higher production, lower than has been the case for some time. The employment index rose to 53.7 percent, with 11 of the 18 industry groups reporting higher head counts. In light of our earlier point about trade, it is worth noting that the ISM's gauge of new export orders rebounded to 51.0 percent in May after April ended a 37-month run of growth in new export orders. That said, the index of new export orders turned higher in May despite only five of the 18 industry groups reporting growth in new export orders, while eight reported lower export orders, which is somewhat of an ominous sign.



Even absent broadening trade disputes, the factory sector would have been hard-pressed to sustain the pace of growth seen over the prior two years. The danger now is that the expansion in the factory sector will end before it otherwise would have.

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