ECONOMIC UPDATE

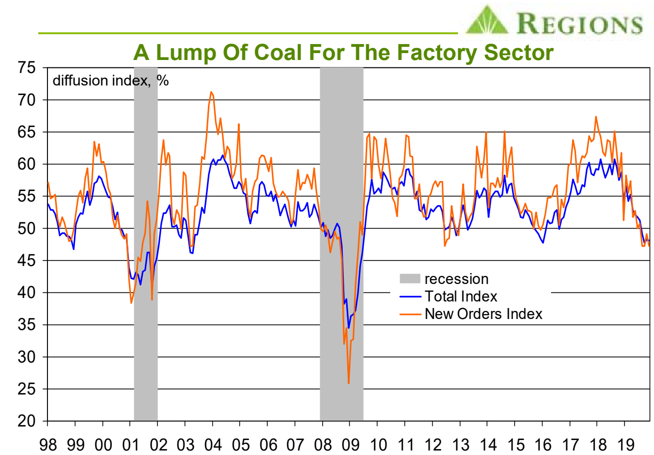
REGIONS

December 2, 2019

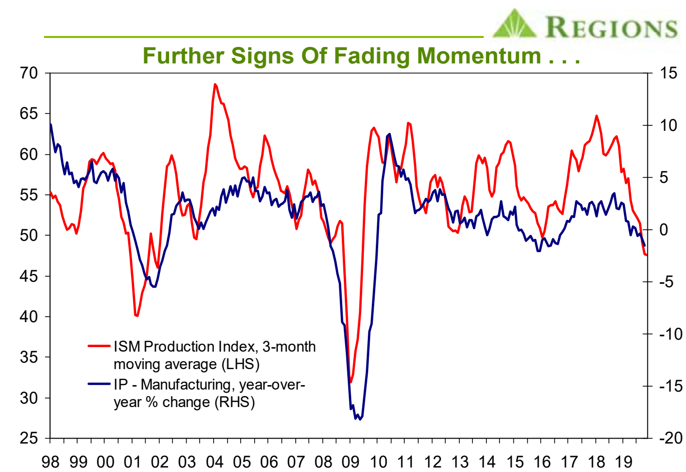
November ISM Manufacturing Index: A Lump Of Coal For The Factory Sector

- The ISM Manufacturing Index fell to 48.1 percent in November from 48.3 percent in October
- The new orders index fell to 47.9 percent, the employment index fell to 46.6 percent, and the production index rose to 49.1 percent

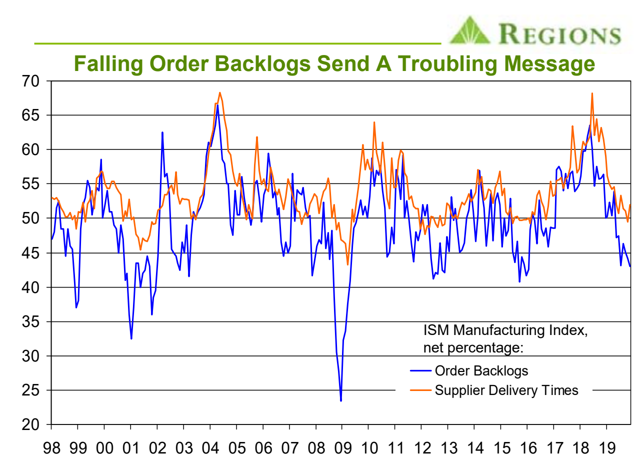
The holiday shopping season may be in full swing, but U.S. manufacturers aren't feeling all that festive. The ISM Manufacturing Index fell to 48.1 percent in November, falling short of our forecast of 49.4 percent and the consensus forecast of 49.2 percent while leaving the headline index below the 50.0 percent break between contraction and expansion for a fourth consecutive month. While we expected the headline index to remain below the 50 percent mark, we did nonetheless expect to see some signs of improvement in the underlying details, as has been the case with the global surveys of manufacturing activity. This proved to not be the case with the ISM data, however, with the new orders index and the employment index slipping further in November. You can't get up until you actually stop falling and, at least based on the ISM's November survey, it does not appear that the factory sector has even begun to stabilize, though if there is one sliver of light in the ISM data, it is that inventories continue to contract. We have for some time been noting that a significant inventory overhang was one of the drags on the manufacturing sector, and inventories being right-sized is a step towards conditions stabilizing.



Another marker of stabilization and, ultimately, improvement in conditions in the manufacturing sector will be a broader base of growth in activity. Recall that in September, only 3 of the 18 industry groups included in the ISM survey reported growth in activity, the fewest in any month since April 2009, when the economy was still in the clutches of the 2007-09 recession. That number improved slightly in October, with 5 industry groups reporting growth. In this week's *Economic Preview*, we noted that whether or not that number rose further in November would be a key marker to watch, but only 5 industry groups reported growth in November while 13 reported contraction. Comments from survey respondents were mostly downbeat. Though some respondents noted that conditions were stabilizing, others pointed to softening demand, with uncertainty over trade remaining a key challenge.



New orders continued to contract in November, and at a faster pace than in October. Of the 18 industry groups in the ISM survey, 5 reported growth in orders in November with 12 reporting lower orders. The index of new orders, which we've long looked to as a reliable leading indicator, had been eroding for several months before falling below the 50.0 percent line in August, which presaged the subsequent weakness in employment and current production. By the same token, without a return to growth in new orders, any improvements in employment and production will be capped. The ISM's gauge of production did improve a bit in November, rising to 49.4 percent from 46.2 percent in October, with 7 of the 18 industry groups reporting increased output and 11 reporting lower output. That the production index turned higher in November could reflect the cumulative effect of months of contracting inventories – firms' own inventories and inventories of their customers. The inventory index, which gauges inventory levels of survey respondents, fell to 45.5 percent in November, the lowest since May 2016. The decline from 48.9 percent in October to 45.5 percent in November alone took seven-tenths of a point off of the ISM's headline index.



The index of customer inventories, which does not enter into the calculation of the headline index, fell to 45.0 percent in November, a sign that firms see inventory levels amongst their customers as being too low. At the same time, however, backlogs of unfilled orders fell for a seventh straight month in November. This gets us back to our point that, despite progress in paring down inventories, there remains little upside for employment and production without growth in new orders. This point is reinforced by what in November was the fourth decline in new export orders in the past five months. Progress in right-sizing inventories and signs of progress on trade talks with China offer hope that conditions in the factory sector will begin to stabilize over coming months, but a return to robust growth seems much further away.

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com