ECONOMIC UPDATE

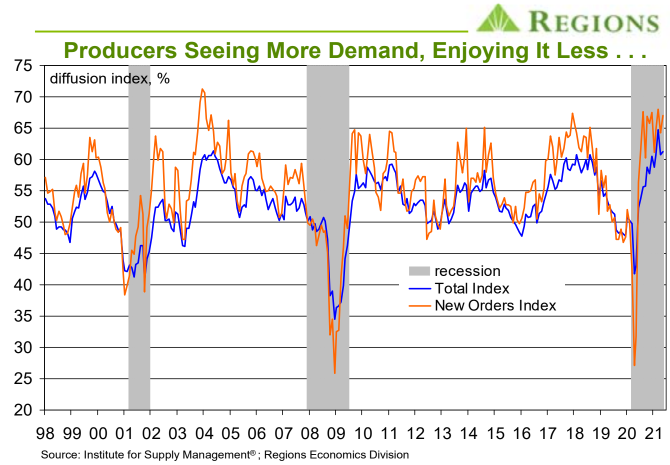
REGIONS

June 1, 2021

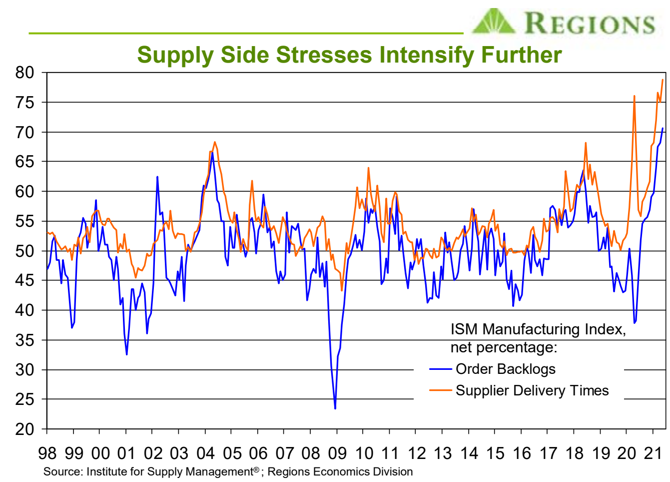
May ISM Manufacturing Index: Producers Seeing More Demand, Enjoying It Less

- The ISM Manufacturing Index rose to 61.2 percent in May from 60.7 percent in April
- The new orders index rose to 67.0 percent, the employment index fell to 50.9 percent, and the production index fell to 58.5 percent

The ISM Manufacturing Index rose to 61.2 percent in May, better than we (60.2 percent) and the consensus (60.9 percent) expected, marking the twelfth consecutive month in which the headline index was above the 50.0 percent break between contraction and expansion. Though the headline index points to further growth, the details of the data indicate supply side stresses continue to intensify, which is clearly weighing on the pace of the expansion in the factory sector. Order books continue to expand faster than firms can fill them, as shortages of materials, shipping delays, and labor supply constraints are acting as increasing drags on production. For months now we've stated that the most pressing problem in the manufacturing sector isn't a lack of demand, it's the ability to meet demand, and the ISM's May survey only goes to reinforce our view.

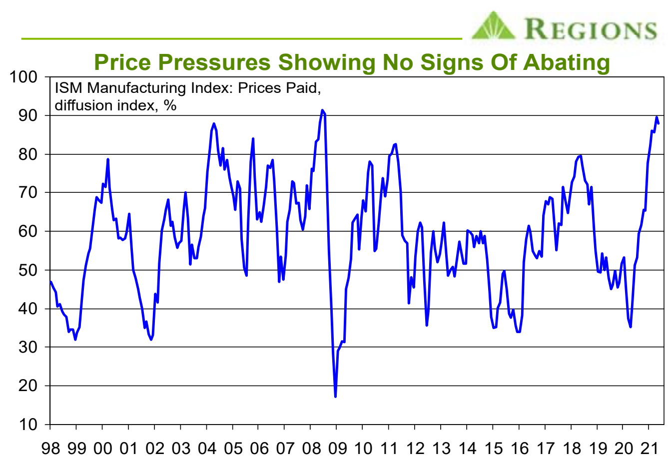


Of the 18 industry groups included in the ISM's survey, 16 reported expansion in May, down from 18 in April, while one industry group – printing and related support activities – reported contraction. May marks the eighth consecutive month in which at least 15 of the 18 industry groups reported growth, a sign of how broad based the expansion in the factory sector remains. Comments from survey respondents were dominated by material shortages, shipping delays, and labor supply concerns. A respondent from the furniture and related products industry group noted that "business is good, but labor and raw materials are becoming very problematic, driving increases in costs," while a respondent in electrical equipment, appliance, and components noted that "logistics performance is terrible." Perhaps the best summary of the opportunities and challenges facing many manufacturers came from a respondent in the nonmetallic mineral products industry group: "demand is strong, but what good is that if you cannot get the materials needed to produce your finished goods?" That may become an increasingly common question in the months ahead.



The new orders index rose to 67.0 percent in May from 64.3 percent in April, with 16 of the 18 industry groups reporting growth in orders. The production index slipped to 58.5 percent in May from 62.5 percent in April, a second consecutive decline and the lowest index value since June, when production was ramping back up after last spring's widespread shutdowns. The employment index fell to 50.9 percent in May, the lowest index reading since December, with only 9 of the 18 industry groups reporting higher payrolls. This poses a downside risk to forecasts of May job growth, though the ISM's survey of the broader services sector (to be released Thursday) will be a bigger tell as it encompasses a much larger employment base.

Manufacturers remain hamstrung by delivery issues, with the delivery time index rising to 78.8 percent, the highest reading since April 1974, as 16 of the 18 industry groups reported slower delivery times. Suppliers are under pressure on a number of fronts, including labor supply, raw materials lead times and shortages, and shipping capacity. These drags are not expected to ease over coming months, which would put producers even further behind in their efforts to keep pace with demand. That gap is already growing, with the index measuring order backlogs rising to 70.6 percent in May, the highest on record since this index was introduced in January 1993. May saw the ISM's index of customer inventories hit another series low, and the vast majority of industry groups continue to report customer inventory levels are too low. This suggests further gains in new orders in the months ahead, but growing backlogs of unfilled orders raise the question of whether, or when, these orders would be filled.



The prices paid index dipped to 88 percent in May from 89.6 percent in April, but the index remans near levels last seen in mid-2008. "Only" 17 of the 18 industry groups reported paying higher prices for inputs in May, breaking a four-month run in which all 18 groups reported paying higher prices. It seems likely that higher input, shipping, and labor costs will be passed along in the form of higher prices for final goods.

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