ECONOMIC UPDATE
REGIONS
March 1, 2022

February ISM Manufacturing Index: Supply Side Constraints Bite Harder

- The ISM Manufacturing Index rose to 58.6 percent in February from 57.6 percent in January
- The new orders index rose to 61.7 percent, the employment index fell to 52.9 percent, and the production index rose to 58.5 percent

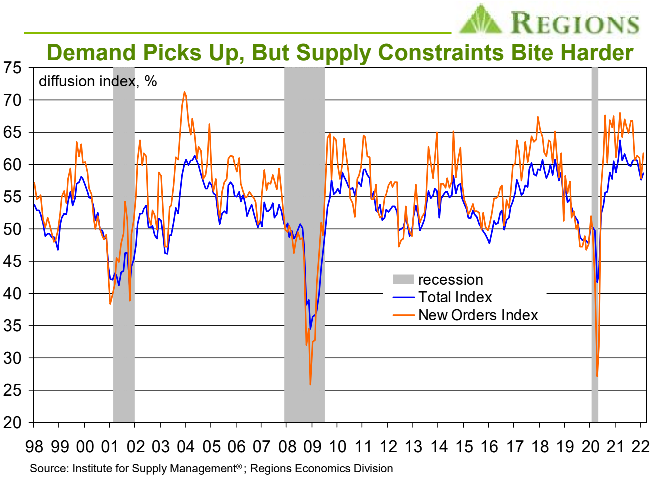
The ISM Manufacturing Index rose to 58.6 percent in February, matching our above-consensus forecast, marking the 21st consecutive month in which the headline index was above the 50.0 percent break between contraction and expansion. The expansion in the factory sector firmed up after having wobbled a bit in January and growth was broader based, but at the same time what had been hopeful signs of easing supply side constraints in recent months faded from view in the February survey. Supplier delivery times slowed further, order backlogs grew, and there was no relief from input price pressures. These supply side constraints and price pressures figure to intensify further in the wake of Russia's invasion of Ukraine at a time when the adverse impacts of Omicron are rapidly fading. While steady growth in demand leaves room for further growth in factory employment and output over the course of 2022, there is a risk that long and uncertain delivery times may trigger order cancelations, so our outlook of continued expansion in the manufacturing sector is not free of downside risks.

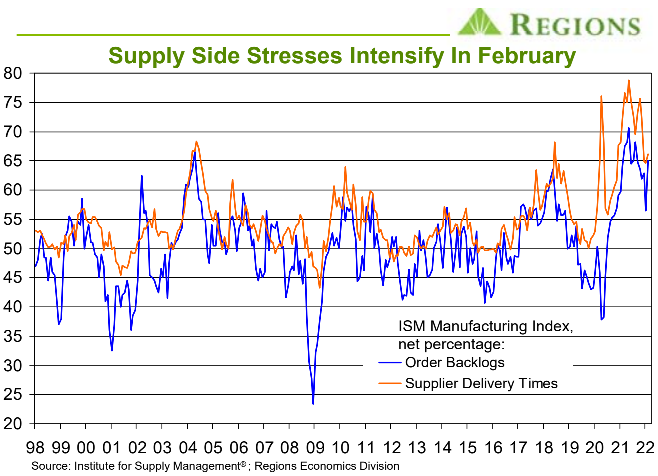
Of the 18 industry groups included in the ISM's survey, 16 reported expansion in February, up from 14 in January and the highest number since October. The sole industry group reporting contraction in February was wood products. Comments from survey respondents share two main themes – demand remains strong, and supply chain/logistics constraints continue to make it difficult, if not impossible, for firms to keep pace with demand. In noting that the "electronic supply chain is still a mess," one respondent from the computer & electronics products industry group could have easily been speaking for most, if not all, of the entire manufacturing sector. One striking element of the comments shared by ISM is that not one of them makes mention of labor supply constraints, though that surely is not an indication that firms, and their suppliers, do not continue to face staffing challenges.

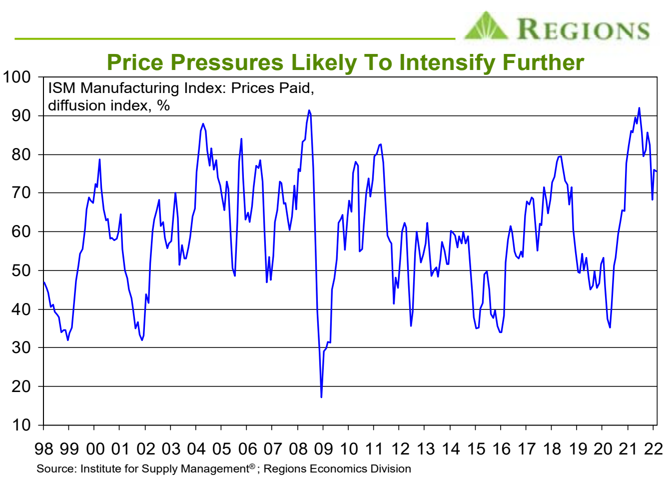
The new orders index rose to 61.7 percent in February from 57.9 percent in January, with 13 of the 18 industry groups reporting growth in orders while only one – non-metallic mineral products – reported a decline. February marks the 21st straight month of growth in new orders. The production index rose to 58.5 percent in February, with ten industry groups reporting increased output, two reporting lower output, and six reporting no change in output. While February marks the 21st consecutive month of increased output, the level of the production index nonetheless remains lower than levels seen earlier in the expansion. Clearly, that is not a reflection of softening demand, given continued growth in new orders and order backlogs, but instead is a reflection of the extent to which materials and labor shortages continue to weigh on production. The employment index slipped to 52.9 percent in February from 54.5 percent in January, with ten industry groups reporting increased staffing. This is one element of the February data we found surprising, as we looked for a stronger reading in the employment index as the spike in Omicron case counts that weighed on labor force participation in January subsided.

Reflecting the combination of continued growth in new orders and supply-side stresses having intensified, order backlogs expanded further in February, with 14 industry groups reporting larger backlogs after 11 had done so in January. At the same time, supplier delivery times slowed further in February, with 15 of the 18 industry groups reporting longer delivery times. ISM did note that suppliers recovered quickly after spikes in absenteeism in late-December and January, so it could be that the March data will show some improvement in delivery times.

At 75.6 percent, the prices paid index was little changed in February from January's reading of 76.1 percent, but the more telling metric is that 17 of the 18 industry groups reported paying higher input prices. Input price pressures are likely to intensify further in the months ahead, and while thus far firms have been able to pass along much, if not all, of these higher costs on to customers given the strength of demand.







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