ECONOMIC UPDATE

REGIONS

June 1, 2022

May ISM Manufacturing Index: Better Than Expected, But Still A Long Way From Normal

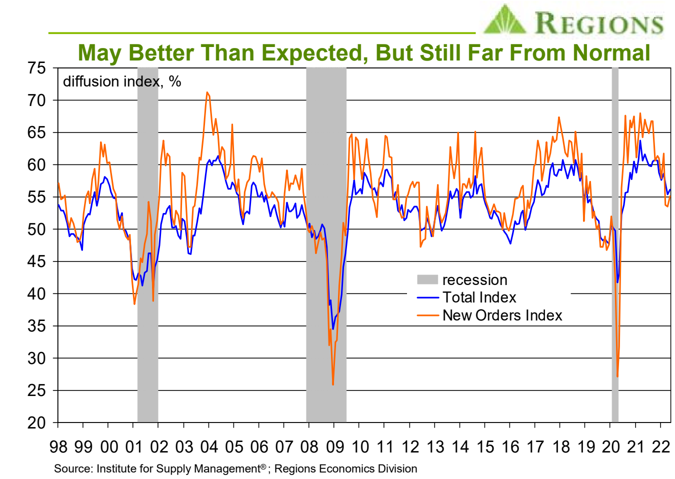
- The ISM Manufacturing Index rose to 56.1 percent in May from 55.4 percent in April
- The new orders index rose to 55.1 percent, the employment index fell to 49.6 percent, and the production index rose to 54.2 percent

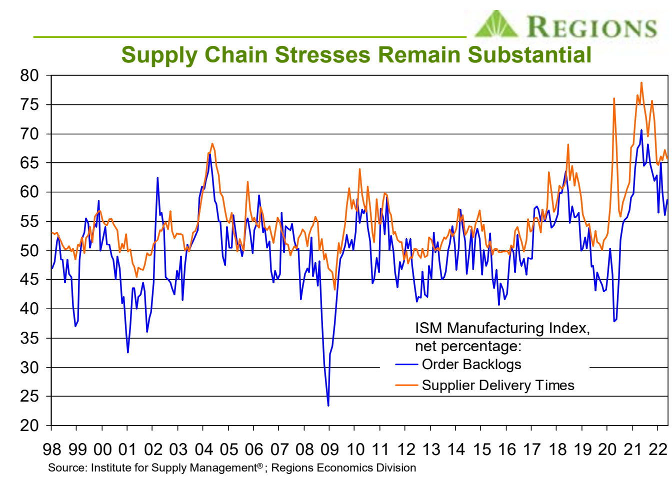
The ISM Manufacturing Index rose to 56.1 percent in May, ahead of our above consensus forecast of 55.2 percent and marking the 24th straight month in which the headline index was above the 50.0 percent break between contraction and expansion. In all honesty, our reaction upon seeing the May data was to breathe a sigh of relief; while our forecast was above the consensus forecast, we nonetheless had a bad feeling about the May survey, and in particular were worried that the data would show new orders fading fast amid rapidly souring sentiment over the economic outlook. As our long-time readers are aware, we put considerable stock in the ISM's gauge of new factory orders as a reliable indicator of activity, not only in the factory sector but in the broader economy as well. In that sense, that the ISM's gauge of new orders increased in May is encouraging. At the same time, however, the employment index dipped below 50 percent and labor supply constraints remain a powerful drag on output growth. While the unexpected increases in both the new orders index and the headline index come as a relief, conditions in the factory sector remain far from normal, with supply-side constraints weighing on production and input price pressures remaining intense. As with the broader economy, we continue to see the most likely course being continued expansion in the manufacturing sector in the months ahead but at a slower pace absent more broad based relief from supply side constraints.

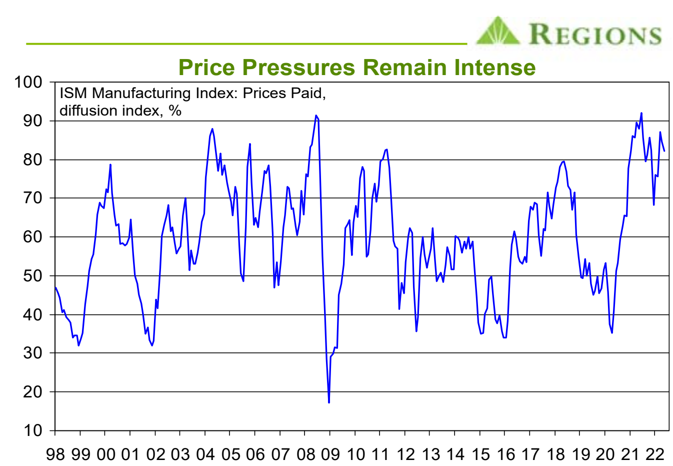
Of the 18 industry groups included in the ISM's survey, 15 reported expansion in May, down from 17 in April, with furniture & related products the only industry group reporting a decrease in activity. ISM reports that sentiment regarding demand "remained strongly optimistic," with five positive growth comments for each cautious comment, up from the three-to-one ratio in the April survey. At the same time, however, volatility in global energy markets and shutdowns across China continue to wreak havoc on production schedules. Comments relayed by ISM note ongoing strength in demand but lingering frustration over lead times and price pressures. ISM summed it up succinctly, noting that the factory sector "remains in a demand-driven, supply chain-constrained environment," to which we'll add that given souring sentiment, rising interest rates, and some slowing in overall economic activity, it is more than a bit encouraging that demand for factory output remains so buoyant.

The new orders index rose to 55.1 percent in May from 53.5 percent in April, with 11 of the 18 industry groups reporting growth in orders and only one reporting a decline in orders. The production index rose to 54.2 percent in May from 53.6 percent in April, but while eight industry groups reported higher output in May, eight others reported lower output. This split, however, is more about supply – inputs and labor – than it is about demand, with ISM noting labor supply constraints and high degrees of labor turnover are leading to productivity declines. To that point, the employment index fell from 50.9 percent in April to 49.6 percent in May, with eight industry groups reporting higher levels of employment and seven reporting lower levels, with ISM noting that labor constraints are the biggest factor weighing on growth in output.

Continued strong demand coupled with lingering supply-side constraints account for persistent growth in backlogs of unfilled orders. The ISMs index of order backlogs rose to 58.7 percent in May, the 23rd straight month in which order backlogs have expended. In addition to labor constraints, longer supplier delivery times are also contributing to larger order backlogs, with suppliers contending with their own labor supply issues and lockdowns across China. In this environment, it is no surprise that input cost pressures remain intense, including raw commodities, packaging, energy, and transport. Though down from 84.6 percent in April, at 82.2 percent the prices paid index indicates ongoing upward pressure on non-labor input prices, with 17 of the 18 industry groups reporting paying higher prices. Thus far, firms have been successful in passing higher input costs along to customers, and as long as demand remains strong, firms will continue to take advantage of this pricing power.







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