ECONOMIC UPDATE

REGIONS

July 1, 2022

June ISM Manufacturing Index: Decline In Orders Sends A Warning

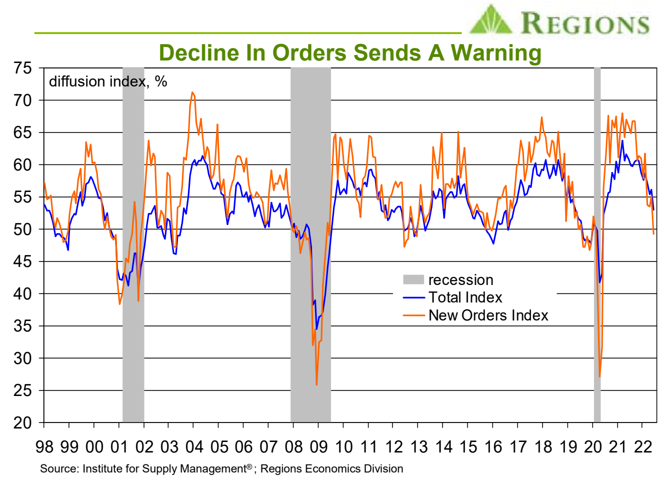
- The ISM Manufacturing Index fell to 53.0 percent in June from 56.1 percent in May
- The new orders index fell to 49.2 percent, the employment index fell to 47.3 percent, and the production index rose to 54.9 percent

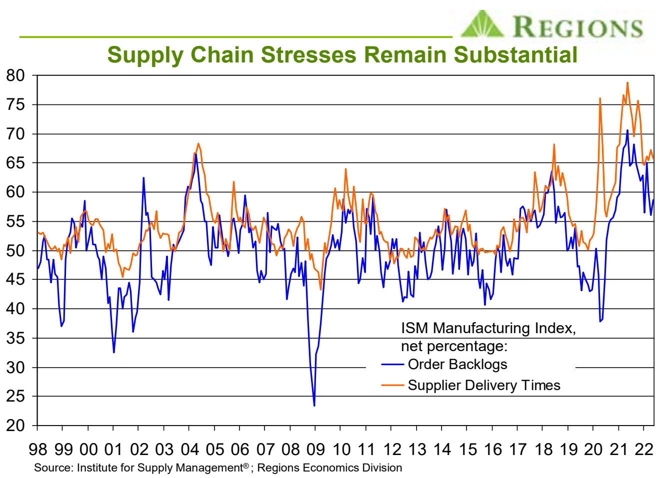
The ISM Manufacturing Index fell to 53.0 percent in June, falling short of our below consensus forecast of 53.8 percent. While June marks the 25th straight month in which the headline index was above the 50.0 percent break between contraction and expansion, the bigger story is that new orders contracted for the first time since May 2020, while the ISM's gauge of employment shows a second straight month of contraction. Clearly, the U.S. and global economies have lost considerable momentum in the face of elevated employment and rising interest rates, but manufacturing has been one area in which there seemed to be considerable pent-up demand as supply chain and logistics bottlenecks have been a significant drag on production. That new orders have come off the boil means firms will turn more attention to working down what had become sizable backlogs of unfilled orders, but as those backlogs diminish further declines in orders could lead to pronounced cutbacks in employment and output in the factory sector in subsequent months if underlying demand is declining.

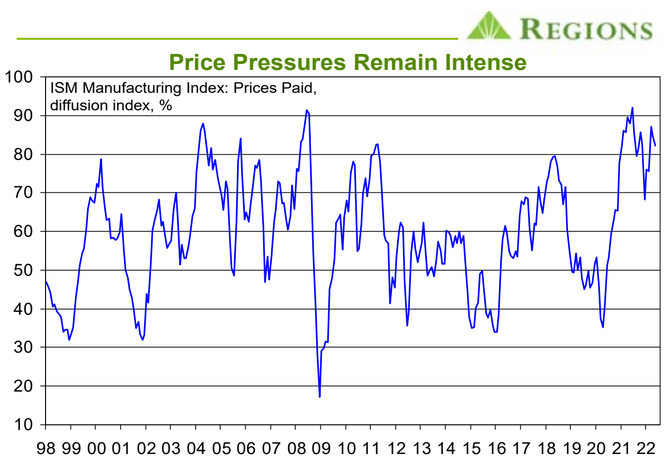
Of the 18 industry groups included in the ISM's survey, 15 reported expansion in June, matching May's tally, while three industry groups – paper products, wood products, and furniture & related products – reported contraction in June. The latter comes as no surprise as the retail furniture sales have clearly softened, and this decline figures to gather pace in the months ahead as the housing market has slowed considerably under the weight of higher mortgage interest rates. One striking element of the comments from survey respondents relayed by ISM is the slowdown in demand noted amongst several industry groups. Indeed, ISM reports that softer orders growth was cited in 17 percent of the general comments, compared to 10 percent in the May survey. The overall tone of the comments is much more cautious than has been the case for some time. One respondent from the primary metals industry group may have summed it up well for all of us by noting that "there are actually more questions than answers this month."

The new orders index fell from 55.1 percent in May to 49.2 percent in June, a less harsh decline than our forecast anticipated but nonetheless the first month of shrinking new orders in over two years. Eight of the eighteen industry groups reported growth in new orders in June while seven reported declines. The production index rose to 54.9 percent in June from 54.2 percent in May, with from 53.5 percent in April, with ten industry groups reporting higher output and three reporting lower output. Even should new orders continue to contract, given the magnitude of order backlogs it would take some time before production falls in line with orders. The employment index fell to 47.3 percent in June, the lowest reading since August 2020, but nine of the eighteen industry groups reported employment growth in June with six reporting declines. Still, ISM reports "an overwhelming majority of panelists" indicate their companies are hiring but also notes that turnover remains elevated. Should orders continue to contract, hiring plans and head counts will be adjusted down accordingly. Firms continue to report customer inventories are too low, and we have often pointed to the gap between the new orders index and the customer inventories index as an indicator of future trends in production. To the extent demand is softening, customer inventories will begin to look more appropriate, thus lessening the need to place new orders, but it will of course take more than one month's data to resolve this question.

The index of supplier delivery times fell to 57.3 percent in June, down sharply from May's reading of 65.7 percent but still indicative of slower delivery times. There are signs that supply chain constraints are beginning to ease, but suppliers themselves continue to be hamstrung by labor supply constraints. The prices paid index fell to 78.5 percent in June, a third straight monthly decline, but we give very little meaning to that given the level of the index and given that 17 of the 18 industry groups reported paying higher prices for non-labor inputs. In the months ahead, input prices will be a powerful indicator of the extent to which demand has actually slowed.







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