ECONOMIC UPDATE
REGIONS
September 1, 2022

August ISM Manufacturing Index: Troubling Signs Beneath The Headline Index

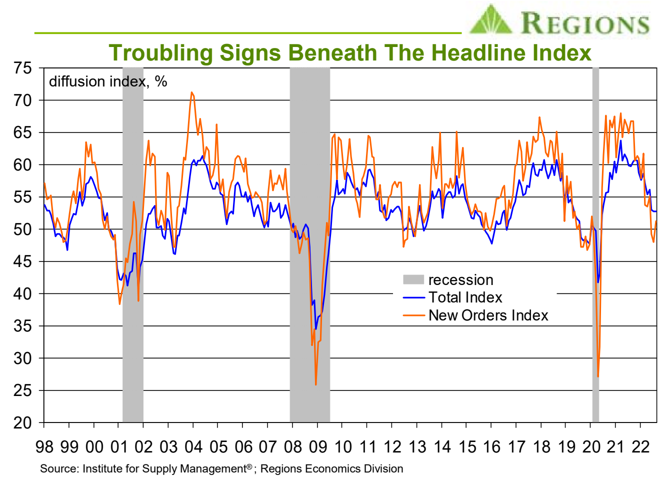
- The ISM Manufacturing Index was unchanged at 52.8 percent in August
- The new orders index rose to 51.3 percent, the employment index rose to 54.2 percent, and the production index fell to 50.4 percent

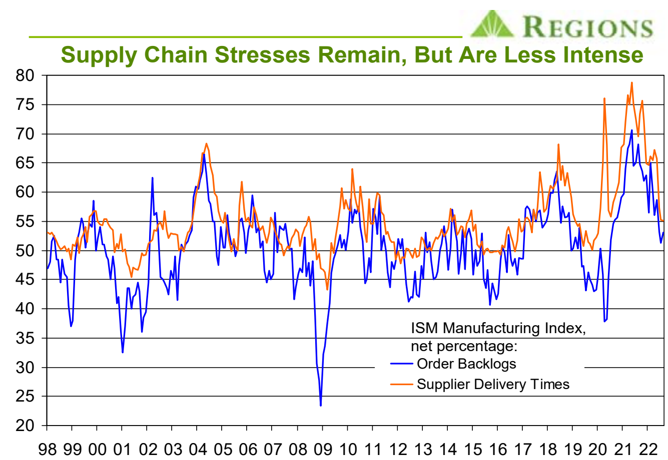
The ISM Manufacturing Index was unchanged at 52.8 percent in August, a touch better than our above-consensus forecast of 52.6 percent, marking the 27th consecutive month in which the headline index was above the 50.0 percent break between contraction and expansion. While new orders and employment improved in line with our expectations, the production index slipped and is only marginally in expansionary territory. Price pressures eased considerably in August, and while prices for non-labor inputs are still rising, they are doing so at a markedly slower pace, with the rapid deceleration over recent months reflecting waning demand. To that point, only ten of the eighteen industry groups included in the ISM's survey reported growth in August while seven reported contraction. We've noted over the past few months that the expansion in the factory sector had been slowing and had become less broad based. That the expansion in the factory sector has become increasingly less broad based is a worrying sign, particularly as the full effects of higher interest rates have yet to work their way through the U.S. and foreign economies.

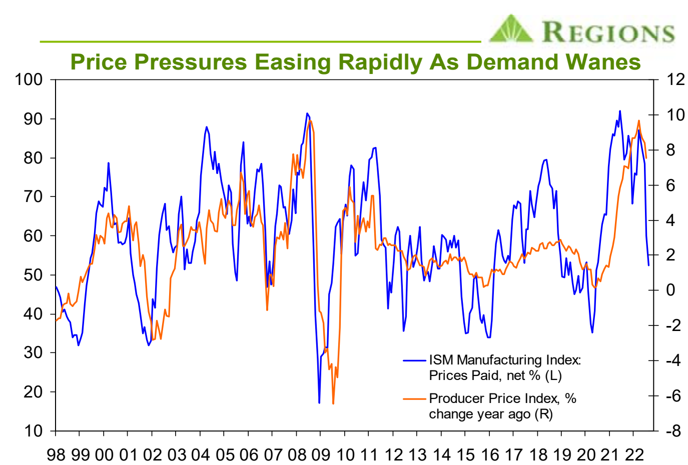
As noted above, only ten of the eighteen industry groups included in the ISM's survey reported expansion in August, the fewest in any month since May 2020, while seven industry groups reported contraction. ISM reports 18 percent of comments from survey respondents expressed concern about contracting order books. Still, ISM notes that for each cautious comment about demand there were five positive comments. Reflecting the much narrower split between growing and contracting industry groups, the comments relayed by ISM are very much mixed, with some (chemical products, primary metals) noting shrinking demand, and others (transportation equipment, petroleum & coal products) reporting still-strong demand. Some survey respondents indicated that customers are stocking up now due to continued worries about supply chain constraints, and some indicated that while their order books are thinning, they are still producing in order to build their own inventories. The decidedly mixed perceptions across industry groups is what would be expected with the broader economy slowing and possibly nearing a cyclical turning point.

The new orders index rose to 51.3 percent in August after two straight months below 50.0 percent. We noted after both the June and July surveys that a slowdown in orders growth was being exaggerated by unfavorable seasonal adjustment, but the August seasonal factor would be much more forgiving and, as such, we expected the new orders index to push back over 50 percent, even if only barely. That only six industry groups reported growth in orders in August while eight reported declines aligns with our premise on the effect of seasonal adjustment. What the past three months of the orders index tell us is that orders are, in the aggregate, basically flatlining. The index of production slipped to 50.4 percent in August from 53.5 percent in July, but of more significance is that only six industry groups reported higher output in August while nine reported lower output. The employment index rose to 54.2 percent, ending a run of three straight months below 50.0 percent. It is worth noting that ISM attributed that run to firms not being able to find and/or retain data, as opposed to rising layoffs. That has been borne out by the JOLTS data showing that the ratio of current to pre-pandemic quits is higher in manufacturing than in any other industry group. Still, with orders and production slowing, it could be that coming months will bring rising layoffs in the factory sector.

The prices paid index continued its hasty retreat in August, falling to 52.5 percent with only eight of the eighteen industry groups reporting paying higher prices for non-labor inputs, the fewest in any month since June 2020. There has over time been a fairly strong relationship between the ISM's prices paid component and the Producer Price Index, and easing input price pressures should eventually be reflected in measures of retail inflation. As we've noted, however, further easing of input price pressures will be a powerful indicator of the extent to which demand has actually slowed.







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