ECONOMIC UPDATE

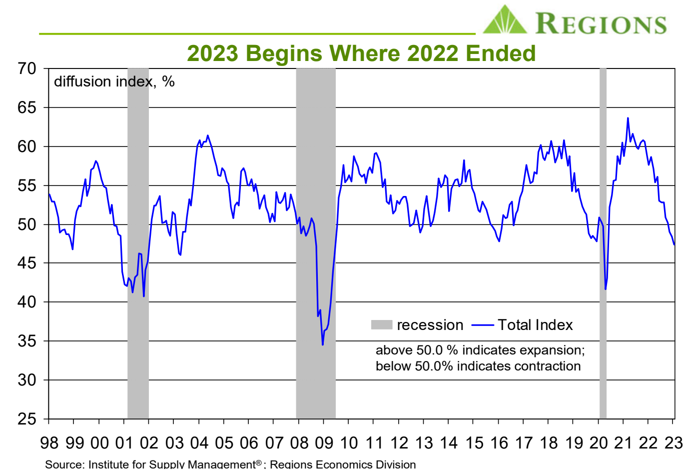
REGIONS

February 1, 2023

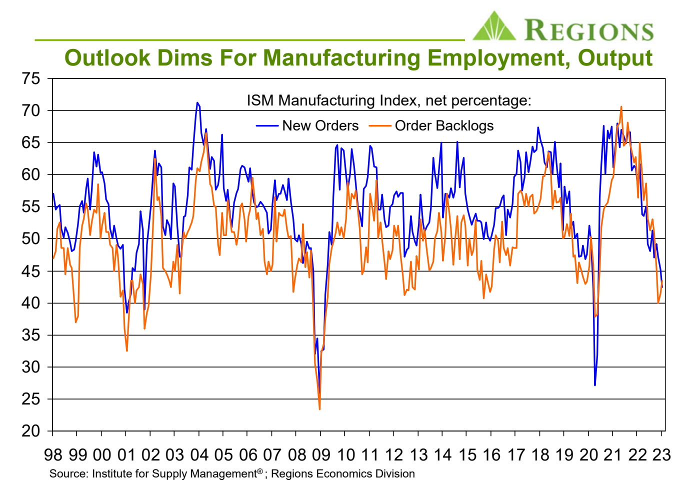
January ISM Manufacturing Index: 2023 Begins Where 2022 Ended

- The ISM Manufacturing Index fell to 47.4 percent in January from 48.4 percent in December
- The new orders index fell to 42.5 percent, the employment index fell to 50.6 percent, and the production index fell to 48.0 percent

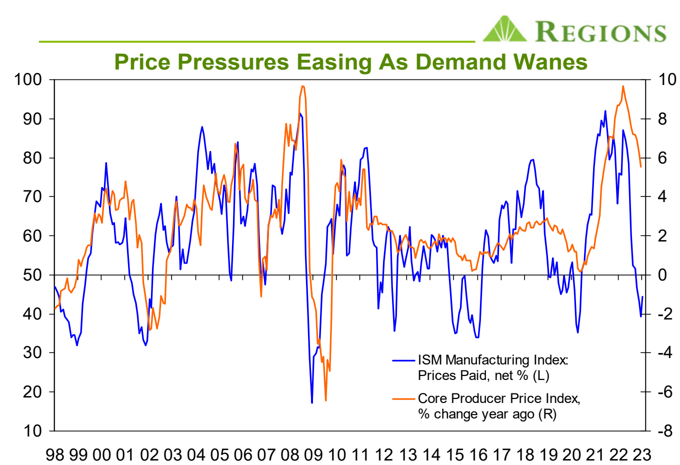
The ISM Manufacturing Index fell to 47.4 percent in January, below what we (47.8 percent) and the consensus (48.0 percent) expected, marking a third straight month below the 50.0 percent break between contraction and expansion after a 29-month run of growth. Just as that expansion in the factor was notably broad based across the main industry groups, so too is the current contraction, with only two of the eighteen broad industry groups reporting growth in each of the past two months. Continued downward pressure on non-labor input prices and improving supplier delivery times are a testament to how far demand has dropped off. Moreover, with customer inventories becoming much more right-sized than had been the case during much of the expansion, new orders have fallen significantly over the past several months. In short, there is nothing to suggest a quick turn in the cycle in the factory sector, particularly with the pace of growth in the broader economy having slowed and much of the global economy bumping along at a listless pace. As such, the next several months will be challenging for the manufacturing sector.



As noted above, only two of the eighteen industry groups included in the ISM's survey – miscellaneous manufacturing and transportation equipment – reported growth while fifteen reported contraction in January. By way of contrast, from 2021 through mid-2022, on average rage sixteen of the eighteen industry groups reported expansion in a given month. That number tailed off over the back half of 2022 and there was no pick-up in activity in early-2023, as reflected in the slide in both the headline index and the index of new orders. Comments from survey respondents reveal mixed progress in clearing supply chain issues, though it is interesting that some point to customers pushing back on pricing while others note rising inventories are curbing demand. On the whole, however, softening demand and increased uncertainty around the economic outlook are taking a toll on manufacturers across a wide range of industry groups. One respondent from the chemical products industry groups summed it up by noting that "the crystal ball remains a little blurry for the rest of 2023" though, in all honesty, our first reaction to that comment was "what, only a little blurry?"



New orders contracted for the seventh time in the past eight months, and what is striking is that none of the broad industry groups reported growth in orders while seventeen reported contraction. Barring the disruptions around the onset of the pandemic, January's 42.5 percent read on the new orders index is the lowest since March 2009, when the economy was in the throes of the severe 2007-09 recession. At the same time, what were once sizable backlogs of unfilled orders have been pared down, with the orders backlog index indicating a fourth straight month of shrinkage and fourteen industry groups reporting smaller backlogs in January. As we've noted, the combination of contracting new orders and shrinking order backlogs bodes poorly for employment and output in the factory sector in the months ahead, particularly as customer inventories are much more balanced than was the case over the recently ended expansion in the factory sector. To that point, the production index fell to 48.0 percent in January with one lone industry group – computer & electronic products – reporting higher output and fourteen reporting decreased output. While the employment index remained above the 50.0 percent mark in January, only five of the eighteen industry groups reported higher head counts while nine reported reductions. ISM notes a four-to-one ratio of hiring to separations in January, double that seen over the prior four months, as firms look to retain workers to support what they will expect to be growth over the back half of 2023. That said, unless there is a turn in new orders over the next few months firms could decide that retention is no longer an appropriate strategy.



Though the prices paid index ticked higher in January, it nonetheless remained below the 50.0 percent mark, indicating a fourth straight month of falling prices for non-labor inputs. The ongoing slide in the ISM's gauge suggests that core inflation on the producer level will continue to slow in the months ahead.

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