ECONOMIC UPDATE

REGIONS

January 5, 2026

December ISM Manufacturing Index: A Soft End To 2025

- The ISM Manufacturing Index <u>fell</u> to 47.9 percent in December from 48.2 percent in November
- The new orders index <u>rose</u> to 47.7 percent, the production index fell to 51.0 percent, and the employment index <u>rose</u> to 44.9 percent

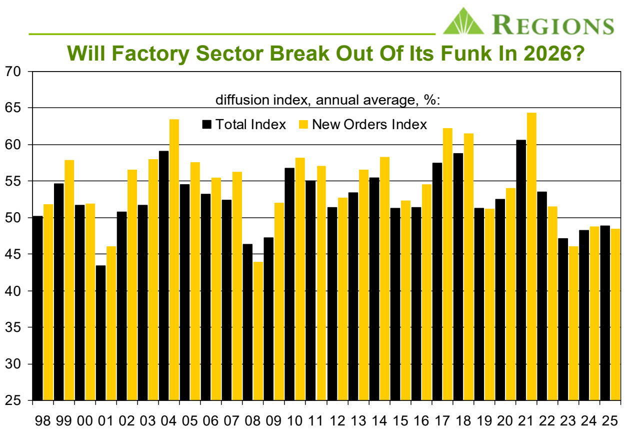
The ISM Manufacturing Index fell to 47.9 percent in December, below what we and the consensus expected and marking the lowest reading since July 2024. December also marks the ninth straight month and the thirty-sixth of the past thirty-eight months in which the headline index was on the wrong side of the 50.0 percent break between contraction and expansion. A particularly large decline in the inventories index knocked eight-tenths of a point off the headline index, whereas the indexes of new orders and employment improved slightly and the production index edged lower while remining above the 50.0 percent break. Beyond having an outsized impact on the headline index, that the inventory index has sunk so low suggests firms still wary over prospects for growth in final demand remaining hesitant to ramp up output without first seeing tangible improvement in order books, which in turn means firms also holding the line on head counts. At this point, there are few signs in the ISM's survey of order books filling faster, suggesting that the soft tone on which the factory sector ended 2025 will carry into the early months of 2026. That said, we're still trying to reconcile the much improved tone of core capital goods orders as reported in the Census data over the past several months with the still depressed tone of the ISM surveys, particularly as growth in core capital goods orders has broadened out, i.e., there is more than AI driving growth in core capital goods orders. So, while this isn't to there are not concerns over the factory sector, there may at least be more room for hope than is turning up in the ISM surveys.

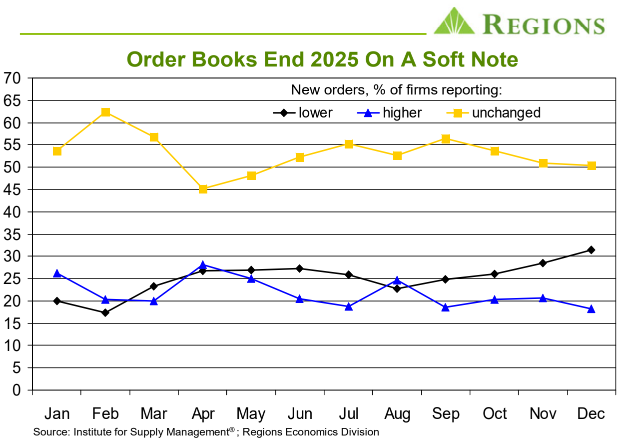
Our first chart below goes to point we've made over the past several months, which is that disruptive impacts of meaningfully higher tariffs notwithstanding, conditions in the manufacturing sector during 2025 did not look all that different than they did in either 2023 or 2024, at least based on the ISM surveys. For 2025, the headline index averaged 48.9 percent, compared to 48.2 percent in 2024 and 47.1 percent in 2023. On a similar note, the new orders index averaged 48.5 percent in 2025, compared to 48.7 percent in 2024 and 46.0 percent in 2023. To be sure, that both the headline index and the new orders index ended 2025 below the annual average merits attention and suggests a soft start to 2026. The broader point, however, is that the factory sector has in many ways returned to the lethargic state it had slipped into prior to the pandemic. What generally goes overlooked is that the ISM's headline index spent the last five months of 2019 below the 50.0 percent line, with increased global trade tensions and soft global growth weighing on the factory sector. Clearly, restoring global supply chains after severe pandemic-related disruptions supported manufacturing activity in 2021 and most of 2022 but by year-end 2022 the ISM's headline index had fallen back below 50.0 percent. Save for a brief foray into expansionary territory in the first two months of 2025, likely reflecting firms trying to front-run higher tariffs, the headline index has been in contractionary territory ever since. While this isn't to dismiss the impacts of higher tariffs, it does suggest that there is much more to the story.

Either way, the tone of that story may not brighten any time soon. Only two of the eighteen industry groups included in the ISM survey reported growth in December, the fewest in any month since December 2021. Comments from survey respondents relayed by ISM remain dominated by concerns over higher tariffs, with more than one respondent noting the effects on margins and pass-through impacts on employment and worker compensation. Though not necessarily speaking for the entire factory sector, one respondent in the fabricated metals industry group noted their firm had "a bad October, an awful November, and a dismal December" with little prospect of January or February looking much better.

The new order index edged up from 47.4 percent in November to 47.7 percent in December, but only two of the eighteen broad industry groups reported higher orders, the fewest in any month since September 2024. In discussing the ISM survey, we often note that we put more stock in the firm level splits than on the industry level splits, and that is cause for concern in the December survey. The percentage of firms reporting higher orders was lower in December than in any month of 2025, while the percentage of firms reporting lower orders was higher in December than in any month of 2025.

Again, we'll point to the much improved tone of the data on core capital goods orders, and further note that more favorable tax treatment should drive improvement in business capital spending in 2026. It would be surprising if such factors did not eventually turn up in the ISM's surveys.





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