ECONOMIC UPDATE

REGIONS

August 1, 2019

July ISM Manufacturing Index: Ongoing Growth, But Troubling Details

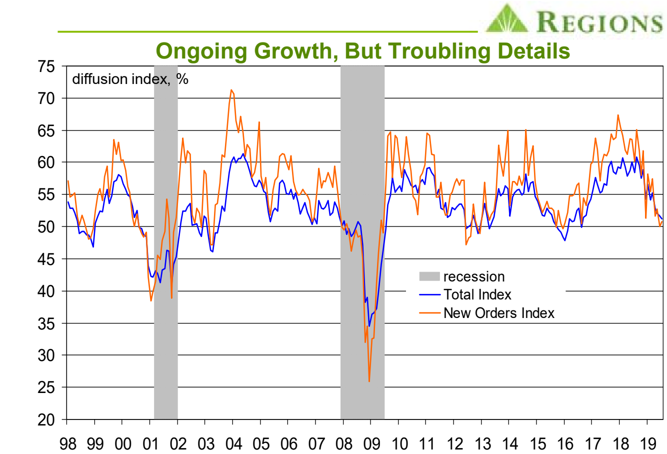
- The ISM Manufacturing Index fell to 51.2 percent in July from 51.7 percent in June
- The new orders index rose to 50.8 percent, the employment index fell to 51.7 percent, the production index fell to 50.8 percent

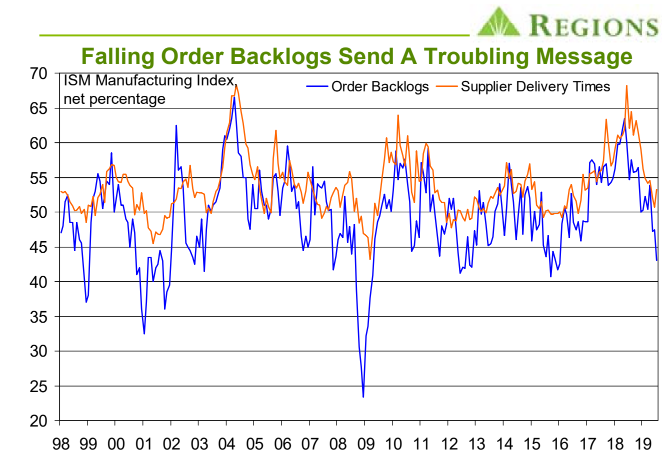
The ISM Manufacturing Index fell to 51.2 percent in July, below what we and the consensus expected. July marks the 35th straight month in which the headline index was above the 50.0 percent break between contraction and expansion, but at the same time the headline index now sits at its lowest level over the life of this streak, which began in September 2016. The index of new orders rose slightly in July, but the indexes of current production and employment fell, while at the same time backlogs of unfilled orders continue to contract. The details of the July survey are consistent with our view that activity in the manufacturing sector is likely to soften further in the months ahead. We have for some time been pointing to three headwinds confronting the manufacturing sector – an inventory overhang, trade policy, and a decelerating pace of motor vehicle sales – and the impacts of these headwinds are clear in the ISM survey and other data pertaining to the manufacturing sector.

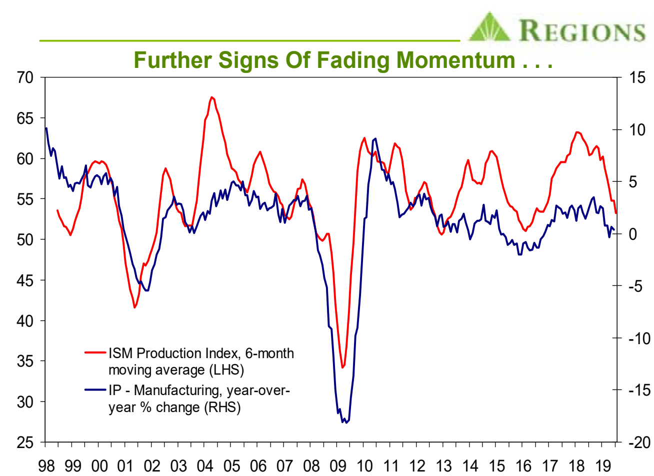
Of the 18 industry groups included in the ISM survey, only 9 reported growth in July, which continues a troubling pattern – though the headline index remains above 50.0 percent, growth has become more concentrated amongst a smaller number of industry groups. Indeed, nine industry groups reported contraction in July – it is odd to see an even 50-50 split such as in July (there are typically a few industry groups which report no change in activity). Comments from survey respondents point to the ongoing effects of tariffs and uncertainty over the course of trade policy. A response from the transportation equipment industry group specifically points to sagging motor vehicle sales and notes increased emphasis on controlling costs of production.

Though the new orders index rose to 50.8 percent from 50.0 percent in June, ten industry groups reported declining new orders in July while only seven reported growth in new orders. The breadth of growth in new orders across industry groups has steadily diminished over recent months; should this continue, it is only a matter of time before the index of new orders falls below 50.0 percent. As we have often noted, we place considerable importance on the ISM's index of new manufacturing orders, as it has long been one of our most reliable forward looking indicators of economic activity. The index measuring order backlogs fell to 43.1 percent in July, the lowest since January 2016, with only two industry groups reporting growing backlogs and 12 reporting smaller backlogs. Though the index of order backlogs does not factor into the headline index, it is nonetheless informative, particularly in conjunction with ebbing growth in new orders. Taken together, these signs point to lower levels of output and employment in the factory sector over coming months. The index of current production has fallen sharply over recent months, touching 50.8 percent in July, with 10 of the 18 industry groups reported lower output. The employment index fell to 51.7 percent, with nine industry groups reporting higher levels of employment and six reporting lower levels. One puzzling element of the July data is the increase in the index of supplier deliveries, which points to slowing delivery times, a seeming contrast to the rest of the data and at odds with other reports of growing spare capacity amongst freight shippers. We expect the ISM's gauge to show delivery times shorten over coming months, which will put downward pressure on the headline index. It is worth noting that assessments of customer inventory levels have become more balanced. The spread between the current production and customer inventory indexes, a useful indicator of future production, is narrower than at any point since October 2016. The adverse effects of trade disputes can be seen in the ISM data, with the index of new export orders and index of imports each falling below 50.0 percent in July.

Even absent ongoing trade disputes, the factory sector would have been hard-pressed to sustain the pace of growth seen over the prior two years. The danger now is that the expansion in the factory sector will end before it otherwise would have, and the details of the July data suggest we are correct in worrying about that being the case.







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