ECONOMIC UPDATE
REGIONS
September 3, 2019

August ISM Manufacturing Index: No Quick End To What Ails The Factory Sector

- The ISM Manufacturing Index fell to 49.1 percent in August from 51.2 percent in July
- The new orders index fell to 47.2 percent, the employment index fell to 47.4 percent, the production index fell to 49.5 percent

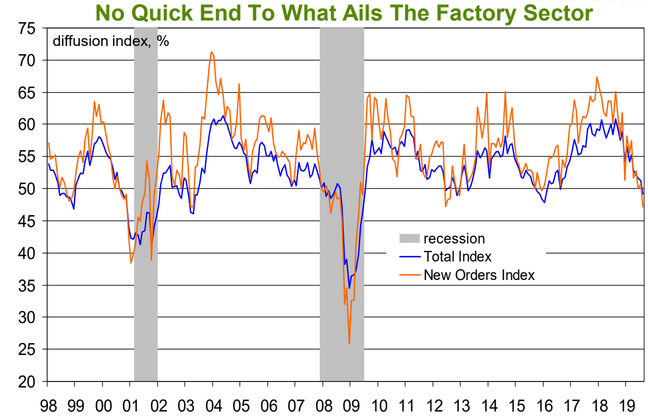
Contrary to expectations, the ISM Manufacturing Index fell to 49.1 percent in August, ending a run of 35 months in which the headline index was above the 50.0 percent break between contraction and expansion. August marks the first time the headline index pointed to a contraction in the manufacturing sector since August 2016. The index of new orders fell below the 50.0 percent mark for the first time since December 2015, the index of current production and the index of employment also fell below 50.0 percent in August. Though it does not factor into the calculation of the headline index, the index of new export orders sank to 43.3 percent in August, the lowest level since March 2009, reflecting the growing impact of ongoing trade disputes. We've noted over the past few months that the details of the ISM's survey of the factory sector have been deteriorating, making it only a matter of time before the top-line index fell below the 50.0 percent break between contraction and expansion. As we noted in our weekly *Economic Preview*, our forecast of a modest increase in the top-line index in August was based on the improvement seen in the regional surveys of manufacturing activity, but we also noted that we expected the ISM index to resume its downward trend in the months ahead. In that sense, that the ISM index fell below 50.0 percent is not surprising to us, it is simply the timing that caught us off guard.

Of the 18 industry groups included in the ISM survey, 9 reported growth in August, matching July as the fewest since September 2016. We've been pointing to the steadily narrowing base of growth within the manufacturing sector as one of the details in the data that we found the most troubling, our point being that this has eroded the base for growth in orders, production, and employment, as is evidenced in the August data. Comments from survey respondents are as downbeat as we can recall seeing over recent years, with concerns about tariffs and softening demand prevalent amongst the comments relayed by ISM. Between the details of the data and comments from survey respondents, nothing in the August report suggests to us that the dip below 50.0 percent in the headline index is more than a one-off drop.

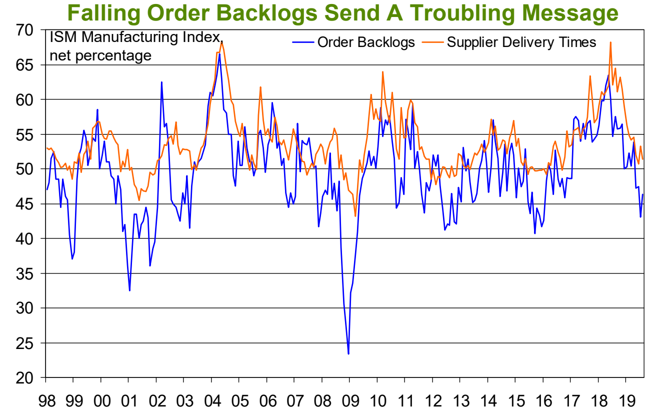
The index of new orders fell to 47.2 percent in August, ending a 43-month run of growth in new orders. Even more alarming is that only three of the 18 industry groups reported growth in new orders in August, with 11 reporting contracting orders. The index of new orders falling below 50 percent in August is a continuation of the erosion seen over recent months, making it no surprise that production and employment have also weakened. The index of production slipped to 49.5 percent, with only four industry groups reporting higher output in August and nine reporting lower output. The index of employment fell to 47.4 percent, with six of the 18 industry groups reported higher job counts in August and nine reporting lower employment. The deterioration in production and employment has lagged the deterioration in new orders thanks to what had been sizable backlogs of unfilled orders. Those backlogs have been worked down over recent months, however, removing a key support for production and employment, as evidenced by the contractions reported in the August data. With backlogs contracting further in August and the outright contraction in new orders, production and employment will be under further downward pressure over coming months. Another sign of this is the steadily narrowing gap between customer inventories and new orders, which we've long used as an indicator of shifts in the current production index. That gap is now narrower than at any time since September 2016. Finally, the sharp and steady erosion in export orders has removed another buffer against contraction in the U.S. factory sector.

Though trade tensions are the most typically cited factor, a sizable inventory overhang, gradually easing motor vehicle sales, and Boeing's issues have contributed to the deteriorating conditions in the U.S. manufacturing sector over recent months. The August ISM survey suggests there is no quick end to what ails the factory sector.

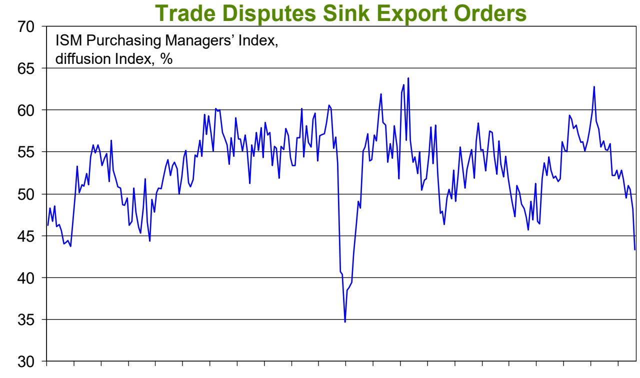
No Quick End To What Ails The Factory Sector



Falling Order Backlogs Send A Troubling Message



Trade Disputes Sink Export Orders



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