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October ISM Manufacturing Index: Less Bad, But Still Bad

- › The ISM Manufacturing Index rose to 48.3 percent in October from 47.8 percent in September
- › The new orders index rose to 49.1 percent, the employment index rose to 47.7 percent, and the production index fell to 46.2 percent

When the rallying cry in the wake of an economic data release is "it wasn't as bad as was feared," you can pretty much bet it was a lousy report. That is the case with the ISM's report on manufacturing conditions in October. The ISM Manufacturing Index rose to 48.3 percent in October, below our forecast of 49.1 percent. In this case, however, up still means down, as the headline index remains below the 50.0 percent break between contraction and expansion for a third straight month. Moreover, in the wake of a surprisingly weak Chicago PMI report, many rushed to push already-low expectations for the ISM report even lower, hence the sigh of relief over a sub-50 print on the October ISM's headline index. The reality, though, is that while conditions in the factory sector may not be getting worse, neither are they getting better. As relayed by ISM, "sentiment remains more cautious than optimistic."

Upon the release of the September data, which saw the headline index dip to 47.8 percent, we noted that the most telling detail in a report full of weak details was that only three of the 18 industry groups reported growth in September, which was the fewest since April 2009, when the factory sector was still in the clutches of the 2007-09 recession. That got better in October, but not by much, with five of the 18 industry groups reporting growth. Between ongoing trade disputes and lingering uncertainty over the course of trade policy, meager global economic growth, Boeing's issues, inventories that are still too high, and a gentle but steady deceleration in the pace of motor vehicle sales, it's hard to see a quick end to what ails the factory sector. It does, however, help to keep in mind that a contraction in the factory sector and ongoing expansion in the broader economy are not mutually exclusive. At least outside of certain segments of the transportation industry, there is little evidence that the ills in the manufacturing sector are infiltrating the broader economy. That could, however, change, which is why we won't let what is becoming the familiarity of weak data on the factory sector turn into complacency about weak data on the factory sector.

New orders continued to contract in October, but at a slower pace than in the prior two months. Five of the 18 industry groups reported growth in new orders (up from three in September), while 10 reported declining orders. The index of new orders, which we've long looked to as a reliable leading indicator, had been eroding for several months before falling below the 50.0 percent line, which presaged the subsequent weakness in employment and current production. The ISM's gauge of production fell to 46.2 percent in October, the lowest since April 2009, with only five industry groups reporting higher output and 11 reporting decreased output. The employment index rose to 47.7 percent in October from 46.3 percent in September, indicating ongoing declines in employment but at a slower pace than in the prior two months.

That new orders have been steadily weakening for some time now has given firms time to work off backlogs of unfilled orders. The ISM's index of order backlogs fell to 44.1 percent in October, with 11 of the 18 industry groups reporting shrinking order backlogs. This matters because sizable backlogs of unfilled orders had for some time acted as a buffer against diminishing orders. But, in conjunction with further erosion in new orders, that backlogs of unfilled orders have increasingly been worked off suggests further cuts in employment and production over coming months. Even one seeming ray of light in an otherwise dim set of data isn't as bright as it may seem – while the index of new export orders rose to 50.4 percent in October, indicating growth in new export orders for the first time since June, only five of the 18 industry groups reported rising export orders.

Clearly, trade tensions continue to weigh on the manufacturing sector though, as noted above, there are other factors acting as stiff headwinds. The ISM data for the past three months suggest there is no quick end to what ails the factory sector.

