ECONOMIC UPDATE

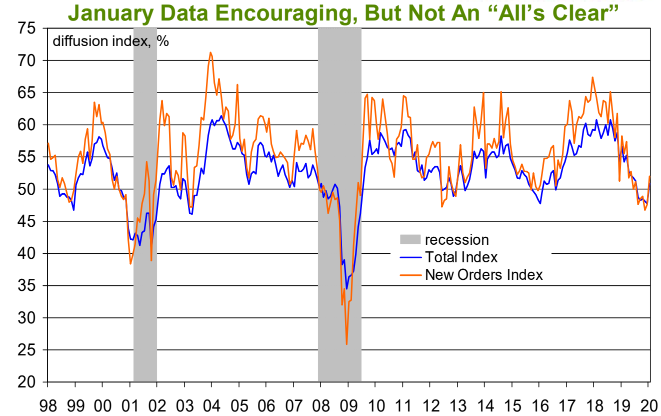
REGIONS

February 3, 2020

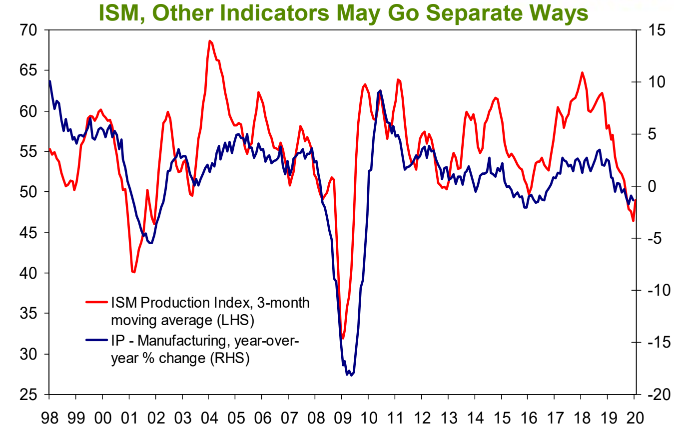
January ISM Manufacturing Index: Better, But Plenty Of Potholes In The Road Through 2020

- The ISM Manufacturing Index rose to 50.9 percent in January from 47.8 percent in December
- The new orders index rose to 52.0 percent, the employment index rose to 46.6 percent, and the production index rose to 54.3 percent

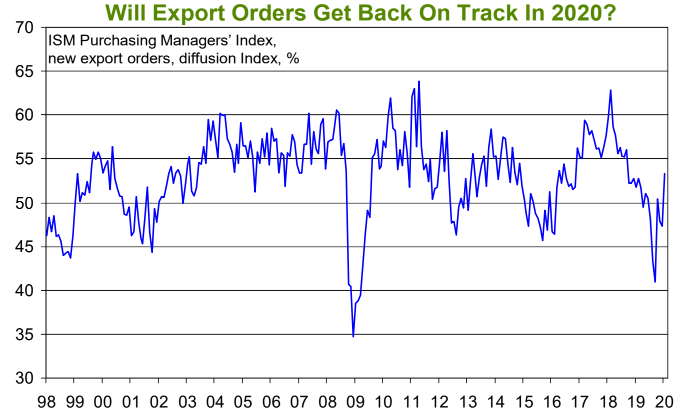
The ISM Manufacturing Index rose to 50.9 percent in January, topping our above-consensus forecast of 49.6 percent and pushing above the 50.0 percent break between contraction and expansion for the first time since July. Our forecast had the key new orders index, long one of our favorite forward looking indicators, topping 50.0 percent but, as we noted in our weekly *Economic Preview*, we worried that we were being overly ambitious with this call. As it turns out, the new orders index jumped to 52.0 percent in January, better than our forecast and first increase since July. We also noted that the ISM's index has lagged other indicators, which over the past few months had shown stabilization, if not modest improvement, in conditions in the factory sector, both at home and abroad. So, in a sense, the ISM's January data are in line with these other indicators. That said, the manufacturing sector is by no means home free, and there are plenty of potholes in the road through 2020. Boeing's halting production of the 737 Max casts a considerable shadow over the factory sector in Q1 2020, if not beyond. What is likely to be further deceleration in the pace of motor vehicle sales over 2020 will act as a drag on manufacturing activity, and, while trade tensions have eased, there are still hot spots that could disrupt manufacturing activity. Additionally, though it is too soon to assess the degree, the corona virus could have a considerable adverse effect on global manufacturing activity over coming months. So, welcome as January's improvement in the ISM Manufacturing Index may be, it is not exactly an "all's clear" sign for the manufacturing sector.



The ISM's January data incorporate revisions to seasonal adjustment factors, and as such the data going back to January 2012 were subject to revision. While there were some changes in some of the monthly readings, none of them change what has been the broader picture of the factory sector over the intervening period. In January, 8 of the 18 industry groups included in the ISM survey reported growth while 8 reported contraction. As we've noted, the number of industry groups reporting growth has been strikingly low over the past four months – varying between three and five – so in that sense the January survey is encouraging. At the same time, that fewer than half of the industry groups reported growth in January goes to our point that all is not yet clear. It is also worth noting that, while Boeing's production cuts could loom large over the manufacturing sector in the coming months, that will likely be more apparent in other series, such as industrial production and core capital goods orders, than it will be in the ISM Manufacturing Index. Recall that the ISM's index is a diffusion index based on the number of industry groups reporting growth/contraction, whereas other series are weighted measures (industrial production) or aggregated dollar volumes (core capital goods orders) in which the significant drop in aircraft production and the downstream impact on suppliers will likely be more visible.



Ten of the 18 industry groups reported growth in new orders in January, with five reporting lower orders volumes. The production index jumped to 54.3 percent in January from 44.8 percent in December, ending a five-month run of contraction, with 7 of the 18 industry groups reporting higher output and 7 reporting lower output. While the employment index rose in January, it nonetheless remains below the 50.0 percent mark, at 46.6 percent, indicating a decline in manufacturing employment. Only 4 of the 18 industry groups reported growth in employment in January, with 10 industry groups reporting decreased employment. With new orders and production having contracted over 2H 2019, order backlogs had been pared down, and the ISM's survey indicates backlogs fell even further in January. It will take a period of steady growth in new orders before rising unfilled orders incent firms to add labor input and expand production schedules. One potential source of growth is new export orders, which rose in January, though not to the point that suggests export orders will become a prime source of growth any time soon. As with the headline index, the January read on export orders is encouraging, but falls short of being an "all's clear" sign.



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