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February ISM Manufacturing Index: Manufacturing Walks The (Fine) Line . . .

- › The ISM Manufacturing Index fell to 50.1 percent in February from 50.9 percent in January
- › The new orders index fell to 49.8 percent, the employment index rose to 46.9 percent, and the production index fell to 50.3 percent

In our weekly *Economic Preview*, we noted that nothing we would see in the February ISM Manufacturing Index data would surprise us. After January saw the headline index push above the 50.0 percent break between contraction and expansion for the first time since July, the factory sector entered February with some positive momentum. But, as the month wore on, the effects of the coronavirus became more and more widespread, blunting any momentum that had built up. In that sense, it seems fitting that the ISM Manufacturing Index fell to 50.1 percent in February, leaving it walking the fine line between contraction and expansion. The underlying details and comments from survey respondents don't offer much in the way of clarity, neither uniformly upbeat nor uniformly downbeat. On the whole, however, with the geographic and economic reach of the virus spreading, it seems unlikely that the March data will show the headline index holding above the 50.0 percent threshold.

Fourteen of the 18 industry groups included in the ISM's survey reported growth in February, up from 8 in January and the highest number since last March. While we've pointed to the breadth of growth across industry groups as a meaningful indicator of the underlying health of the factory sector, the details beneath the headline index don't seem to line up with 14 of 18 industry groups reporting growth in February. It does help to recall that the ISM index is a diffusion index, which tells us the direction of, but not the intensity of, changes in activity from one month to the next. It comes as no surprise that several comments from survey respondents relayed by ISM point to the effects of the coronavirus, with the ability to obtain parts sourced from China a common concern. One respondent from the transportation industry group noted that "layoffs are here," which could reflect downstream parts suppliers being pressured by Boeing having halted production of the 737 Max.

The new orders index, which we often note is one of our favorite forward looking indicators, fell to 49.8 percent in February from 52.0 percent in January. The decline in the index, however, seems at odds with ISM reporting that 16 of the 18 industry groups saw higher levels of new orders in February, with petroleum & coal products and transportation equipment the only two industry groups reporting lower orders. The production index slipped to 50.3 percent in February from 54.3 percent in January, indicating further growth in current production but at a slower pace than seen in January. Twelve of the 18 industry groups reported growth in production in February, with three reporting lower output. The employment index came in at 46.9 percent in February, up slightly from 46.6 percent in January but nonetheless indicating further contraction in manufacturing employment; February marks the seventh consecutive month of contraction in employment as measured by the ISM's index. While 3 of the 18 industry groups reported higher employment in February, 9 reported lower levels of employment relative to January.

Supplier delivery times slowed in February, with the supplier delivery index jumping to 57.3 percent (higher index values denote slower delivery times). Thirteen of the 18 industry groups report slower delivery times in February, and ISM reports "concerns about current and ongoing reliable Asian supply dominated the comments from panelists." It seems likely that delivery times will slow further in the near term, and the effects of slower delivery times can be seen in the form of rising order backlogs. The ISM's index of order backlogs rose to 50.3 percent in February, indicating growing order backlogs for the first time since last April, and ISM points to slower delivery times as a contributing factor. Though new export orders rose in February, growth was softer than was the case in January, and to the extent the coronavirus takes a toll on global economic growth, export orders will come under increasing pressure. So, while the ISM's headline index remained above 50.0 percent, the February data likely reflect only the tip of the iceberg in terms of the effects of the coronavirus.

