ECONOMIC UPDATE
REGIONS
May 1, 2020

April ISM Manufacturing Index: Headline Number Doesn't Do Justice To The Details

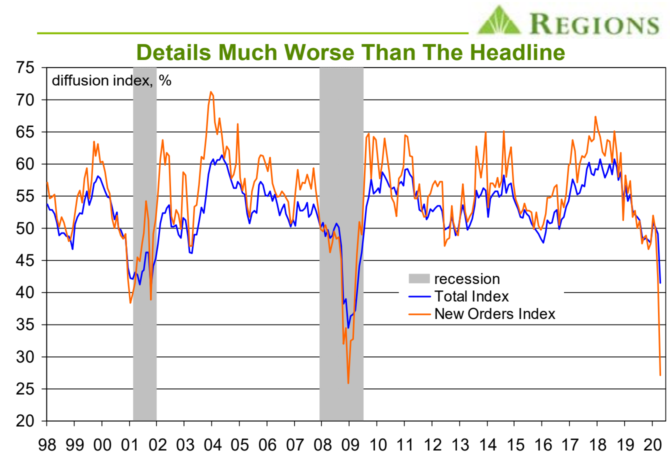
- The ISM Manufacturing Index fell to 41.5 percent in April from 49.1 percent in March
- The new orders index fell to 27.1 percent, the employment index fell to 27.5 percent, and the production index fell to 27.5 percent

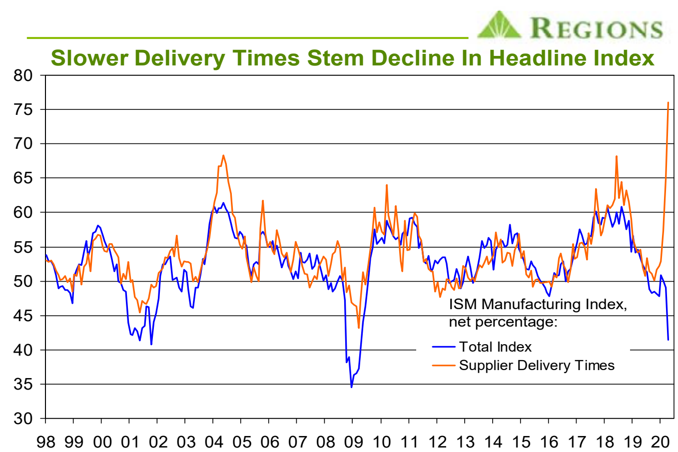
The ISM Manufacturing Index fell to 41.5 percent in April, better than the consensus forecast of 36.0 percent and our forecast of 34.9 percent. As was the case with the March data, however, the April headline number is propped up by a methodological quirk through which clogged up supply chains are interpreted favorably, and that issue was even more pronounced in April than was the case in March, thus stemming the decline in the headline index number. In other words, this is yet another example of a point we routinely make, which is that the headline number is the least informative number in most data releases, with the details beneath the headline number telling you what is really happening. The details of the ISM's April survey are much weaker than the headline number, and while the April data may represent the bottom as economic activity is set to begin coming back on line in the weeks ahead, it will be some time before there is meaningful and sustained improvement in the manufacturing sector.

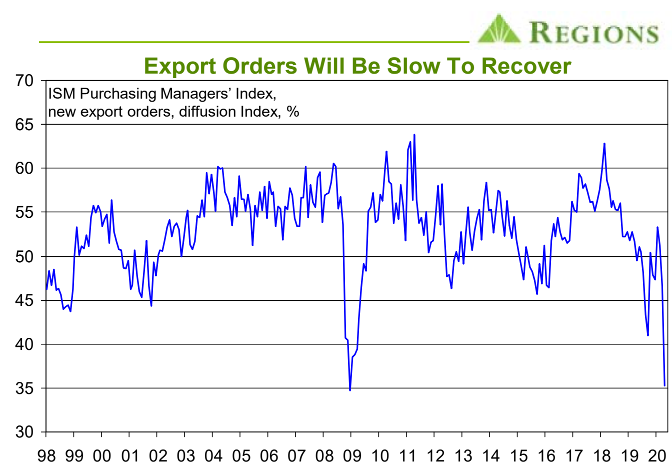
Only two of the 18 industry groups included in the ISM's survey reported growth in April, while 15 reported contraction. That the two industry groups reporting growth were paper products and food, beverage, & tobacco products comes as absolutely no surprise. Comments from survey respondents were "strongly negative," as the ISM put it, with three negative comments for each positive comment regarding the near-term output. In addition to the sudden stop in economic activity stemming from the COVID-19 virus and the efforts to stem its spread, the rout in the energy sector also weighed on survey respondents. While the headline index slipped further below the 50.0 percent break between expansion and contraction in the factory sector, the headline index doesn't fully convey the deterioration in the underlying details, let alone in sentiment amongst those who responded to the survey.

Slower supplier delivery times work to push the headline index numbers in the ISM's manufacturing and non-manufacturing surveys higher. The premise is that slower delivery times are a sign of greater demand and, as such, act as a positive in the ISM's indexes. The measure of supplier delivery times, however, makes no distinction between stronger demand and impaired supply chains, and it is clearly the latter, in the fallout from the COVID-19 virus, that is behind the sharp slowdown in supplier delivery times reported in the manufacturing survey over the past three months. Obviously, ISM cannot be expected to change their methodology out of the blue in response to special circumstances, so this is by no means to be taken as criticism of them, but instead is simply a caution to look to the details of the April data as a better gauge of factory sector conditions. Our middle chart illustrates the extent to which the supplier delivery times sub-index and the headline index went their own ways over the past three months. Had the supplier delivery times sub-index not risen so sharply in April – to 76.0 percent – the decline in the headline index would have been worse.

The new orders index fell to 27.1 percent in April, the lowest since December 2008, with only two industry groups reporting increased orders and 15 reporting lower order volume. The production index fell to 27.5 percent, an all-time low in the ISM's data which go back to January 1948. The employment index fell to 27.5 percent, the lowest reading since June 1949. Backlogs of unfilled orders contracted further in April, with the reading of 37.8 percent marking the lowest for this index since March 2009. Note that the contraction in order backlogs has come amidst a marked slowdown in production, which is an indication of how weak new orders have been over recent months. That weakness extends to export orders, as seen in our bottom chart, which reflects the impacts of the COVID-19 virus on the global economy. Combined with declining new orders, domestic and foreign, the fading backlog of unfilled orders points to further declines in factory employment and output in the months ahead. This goes to our point that the details of ISM's survey suggest a slow and uneven recovery in the factory sector once we're on the other side of the COVID-19 virus.







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