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June ISM Manufacturing Index: Details Support Improvement In Headline Index

- › The ISM Manufacturing Index rose to 52.6 percent in June from 43.1 percent in May
- › The new orders index rose to 56.4 percent, the employment index rose to 42.1 percent, and the production index rose to 57.3 percent

The ISM Manufacturing Index rose to 52.6 percent in June, a 14-month high and ending what had been a run of three months with the headline index below the 50.0 percent break between contraction and expansion. The June print topped both our forecast of 51.6 percent and the consensus forecast of 49.8 percent. As seen over the past few months, a quirk in how supplier delivery times are accounted for can leave the headline index out of alignment with underlying conditions in the manufacturing sector. Specifically, what have remained impaired supply chains pushed the index of supplier delivery times materially higher, which meant the headline index, even though below 50.0 percent, was outperforming the details on new orders, production, and employment. This is not the case with the June data, with the headline index better aligned with the key components. That the headline index pushed back over the 50.0 percent mark is not surprising given that factories had begun to come back online in late-May with activity picking up pace in June. What remains to be seen, however, is whether the growth reported in June was a one-off, simply reflecting the bounce from reopening, or whether coming months will see continued, even if somewhat modest, growth in manufacturing activity. With rising numbers of positive tests for the COVID-19 virus raising the possibility of another round of restrictions on economic activity and/or another leg down in consumer and business sentiment, we think it too soon to venture a guess as to the ultimate answer to our question.

Of the 18 industry groups included in the ISM's survey, 13 reported growth in June with four reporting contraction. Recall that in April, only two of the 18 industry groups reported growth, with that number rising to six in May which, given that activity was beginning to come back online over the course of the month, made May seem like a transition month. In that sense, that growth in the manufacturing sector was broader based in June was to be expected, though in all honesty we weren't sure how much conviction we had in that call. Comments from survey respondents reflect that broader based growth, with respondents across industry groups reporting growth in demand, though that growth is not uniformly strong across industry groups.

The index of new orders jumped to 56.4 percent in June from 31.8 percent in May, with 11 of the 18 industry groups reporting higher orders and only two reporting orders declined. June's print on the index of new orders is the highest since March 2019. That new orders are again rising takes on added importance given that backlogs of unfilled orders continue to contract, even if at a slower pace than seen over the past several months. Order backlogs can act as a buffer against declines in new orders, helping to preserve employment and production, but that buffer was worn very thin over the past several months. Again, though, the key will be whether the growth in new orders seen in June will be sustained in the months ahead. The index of production rose to 57.3 percent in June from 33.2 percent in May, with 13 of the 18 industry groups reporting higher output. If there is one soft spot in the June data, it is the index of employment, which rose in June but, at 42.1 percent, nonetheless indicates further declines in employment. We will note that the ISM's index of manufacturing employment stood at 32.1 percent in May, but the BLS reported factory sector payrolls rose by 225,000 jobs. Still, even with the employment index remaining below 50.0 percent, our equally weighted composite of the indexes of new orders, production, and employment pushed above 50.0 percent in June, rising to 51.9 percent. This goes to our point about the headline index being in better alignment with the underlying details than had been the case over the past several months.

While the ISM's headline index pushing back above the 50.0 percent mark in June is certainly welcome news, we'll reiterate the concern expressed above. With a still-sluggish global economy and an upturn in COVID-19 cases in the U.S., there are meaningful downside risks to continued expansion in the manufacturing sector.

