ECONOMIC UPDATE

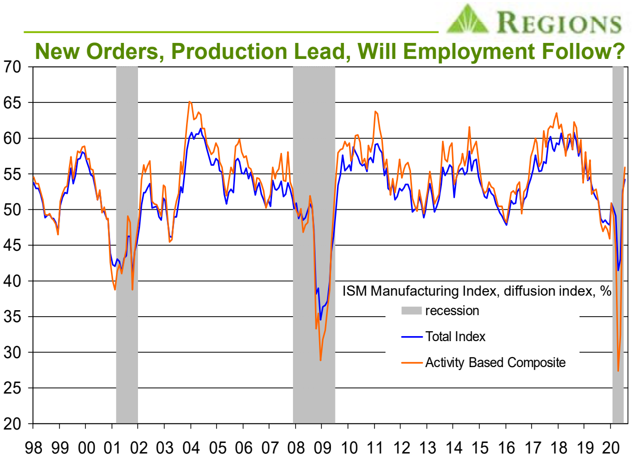
REGIONS

August 3, 2020

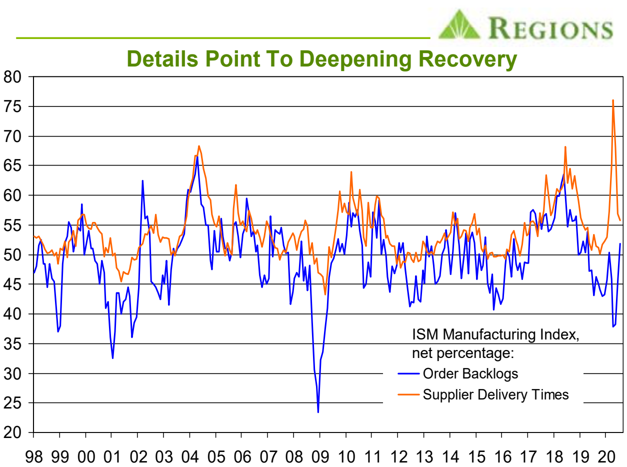
July ISM Manufacturing Index: Will Employment Follow Orders And Production Higher?

- The ISM Manufacturing Index rose to 54.2 percent in July from 52.6 percent in June
- The new orders index rose to 61.5 percent, the employment index rose to 44.3 percent, and the production index rose to 62.1 percent

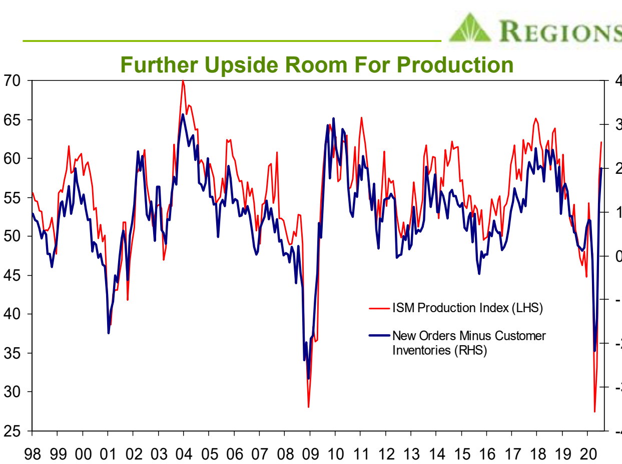
The ISM Manufacturing Index rose to 54.2 percent in July, just shy of our above-consensus forecast of 54.4 percent but nonetheless marking the highest headline print since March 2019. The recovery in the factory sector has become more entrenched, with activity expanding across larger number of industry groups, rising new orders, and rising production, yet one of the underlying details of the ISM data remains puzzling, if not a bit troubling. Despite marked improvement in other components, the ISM's gauge of employment continues to show contracting employment, albeit at a slightly slower pace in July. Still, with order books expanding and many industry groups reporting growing backlogs of unfilled orders, it is reasonable to assume that, at some point, the ISM's employment index will push back above the 50.0 percent mark. For now, though, the broader point is that the industrial sector seems to be on firmer footing than other segments of the economy, and though manufacturing is by no means immune to weakness in other segments of the economy, we look for the recovery in the manufacturing sector to become more entrenched in the months ahead.



Of the 18 industry groups included in the ISM's survey, 13 reported growth in July with three reporting contraction – recall that in April, only two of the 18 industry groups reported growth, with that number rising to six in May. Our question upon the release of the June data, when the top-line index pushed back above the 50.0 percent mark and 13 of the 18 industry groups reported growth, was whether the June data simply reflected a bounce off of the bottom, or whether it marked the start of a sustained period of at least modest group. Our thought was that it was the latter, and while the July data support our view, it is too soon to draw any definitive conclusions. Comments from survey respondents point to downside risks, as respondents from several industry groups pointed to an uncertain outlook even as the overall business climate is stabilizing in some industry groups and improving in others.



The index of new orders jumped to 61.5 percent in July, the highest since September 2018, with 13 of the 18 industry groups reporting higher orders and two reporting lower orders. The index of production rose to 62.1 percent in June, its highest level since August 2018, with 16 of the 18 industry groups reporting higher output in July and no industry groups reporting lower output. Even with rising production, however, backlogs of unfilled orders grew in July after having contracted in each of the prior four months. The spread between new orders and customer inventories, which we track as a leading indicator of changes in production, widened in July to the largest spread since November 2018. Additionally, new export orders grew, albeit modestly, in July, the first month of growth since February.



The one soft spot in the ISM data remains the index of employment, which rose in July but, at 44.3 percent, nonetheless indicates further declines in employment. We will note that while the ISM's index of manufacturing employment remains below the 50.0 percent mark, the BLS reported manufacturing payrolls rose in both May and June and we and others look for a further increase in July. In the ISM's survey, only five of the 18 industry groups reported rising employment in July with 10 industry groups reporting lower head counts. It could be that, with a still-uncertain outlook for demand firms are relying on enhanced productivity to yield higher output. It does help to remember that, while the ISM indexes reveal the direction of activity, i.e., rising or falling, the tell us nothing about the intensity of activity, so it could be that the gains in production being reported are somewhat modest, which would make it more plausible to assume productivity gains are driving higher output. Also, keep in mind that many factory workspaces have been reconfigured to comply with social distancing protocols, which in many cases means they can accommodate fewer workers. Still, given the improvement seen in other components of the ISM data, it seems likely that the employment index will push above 50.0 percent, barring a collapse in demand.

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