ECONOMIC UPDATE
REGIONS
September 1, 2020

August ISM Manufacturing Index: Recovery Becomes More Entrenched

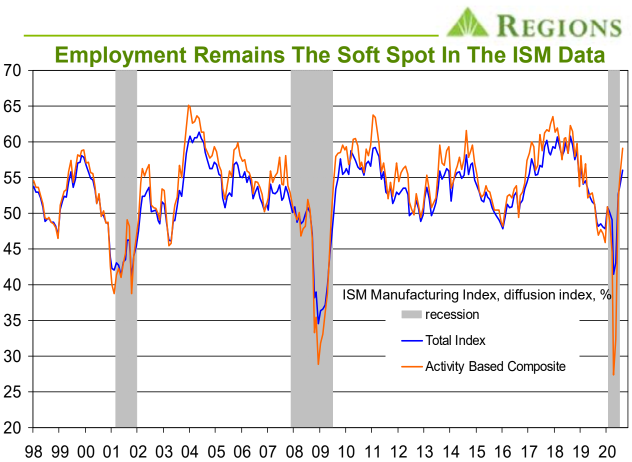
- The ISM Manufacturing Index rose to 56.0 percent in August from 54.2 percent in July
- The new orders index rose to 67.6 percent, the employment index rose to 46.4 percent, and the production index rose to 63.3 percent

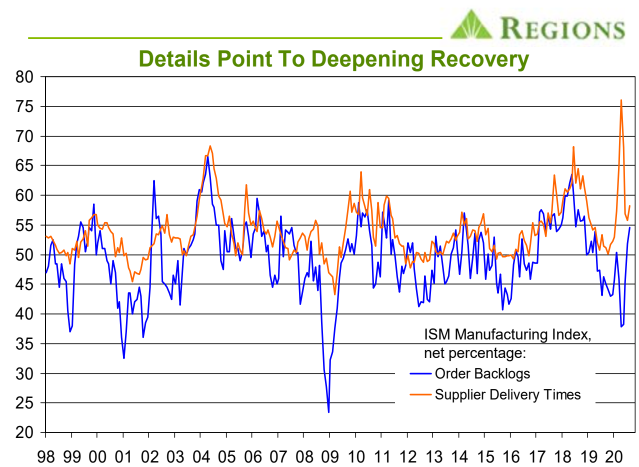
The ISM Manufacturing Index rose to 56.0 percent in August, topping our above-consensus forecast of 55.1 percent, marking a third straight month of expansion in the factory sector after the deep but short-lived contraction associated with the COVID-19 virus and the efforts to stem its spread. The recovery in the factory sector has become increasingly entrenched, with activity expanding across a growing number of industry groups, rising new orders, and rising production. But, as we noted last month, the one puzzling element of the ISM data is the ongoing contraction in employment, though the pace of contraction is slowing. With order books and backlogs of unfilled orders continuing to expand, it is reasonable to assume that the ISM's employment index will push back above the 50.0 percent mark, but that it isn't at least closer to that mark at this point is somewhat puzzling. Still, it does seem that the industrial sector is on firmer footing than other segments of the economy, and we look for the recovery in the manufacturing sector to become more entrenched in the months ahead.

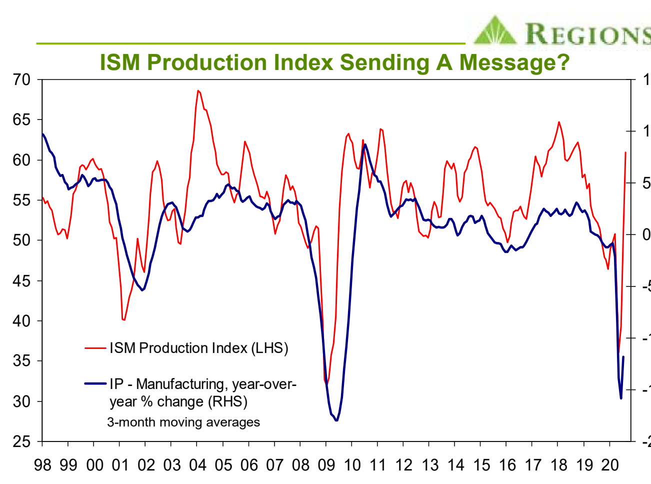
Of the 18 industry groups included in the ISM's survey, 15 reported growth in August with three reporting contraction. This is the largest number of industry reporting growth in any month since March 2019, and the increased breadth of expansion across industry groups supports the contention that the expansion is becoming more entrenched. Comments from survey respondents are, on the whole, more constructive than was the case a month ago; whereas in the July comments the main themes were looming downside risks and a highly uncertain outlook, the main theme in the latest batch of comments is strengthening demand.

The index of new orders rose to 67.6 percent in August from 61.5 percent in July, with 15 of the 18 industry groups reporting higher orders and only one reporting lower orders. The index of production rose to 63.3 percent in August from 62.1 percent in July, with 15 of the 18 industry groups reporting higher output in July and only one reporting lower output. Other details of the data point to the recovery in the factory sector gathering pace in August. Backlogs of unfilled orders and new export orders both grew at a faster pace in August than in July, and supplier delivery times slowed further. As we've discussed before, slower supplier delivery times provide a boost to the headline index, which in some instances can be a "false positive." As such, we put more weight in the equally-weighted composite of the indexes of new orders, production, and employment, which rose to 59.1 percent in August, the highest since November 2018.

Still, whether you fancy the headline index or the equally-weighted composite, the increases seen in August come despite the ISM data signaling a further contraction in employment. This contradiction has caused some to discount the ISM data, noting that the ISM index is a diffusion index, which can tell us the direction of, but not the intensity of, change. With each passing month, however, it seems harder to cling to this explanation, as the number of industry groups reporting increased activity has grown and order books and order backlogs continue to grow. To be sure, the recent gains in the ISM index must be put in the context of the deep contraction from which we are emerging but, at some point, even marginal gains add up – just ask Team Ineos (today's Tour de France reference, for anyone wondering). Still, the ISM's production index has tended to lead the measure of manufacturing output in the industrial production data around cyclical turning points. If that relationship still holds, the industrial production data should show continued steady growth in manufacturing output in the months ahead. It is also worth noting that orders for core capital goods have rebounded smartly in recent months, another sign that the rebound in manufacturing is for real. Obviously, manufacturing is not immune to weakness elsewhere in the economy but, at present the ISM's index of employment seems more of an outlier than it does a signal of the fortunes of the entire manufacturing sector.







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