

This Economic Update may include opinions, forecasts, projections, estimates, assumptions and speculations (the "Contents") based on currently available information which is believed to be reliable and on past, current and projected economic, political, and other conditions. There is no guarantee as to the accuracy or completeness of the Contents of this Economic Update. The Contents of this Economic Update reflect judgments made at this time and are subject to change without notice, and the information and opinions herein are for general information use only. Regions specifically disclaims all warranties, express or implied, with respect to the use of or reliance on the Contents of this Economic Update or with respect to any results arising therefrom. The Contents of this Economic Update shall in no way be construed as a recommendation or advice with respect to the taking of any action or the making of any economic, financial, or other plan or decision.

October ISM Manufacturing Index: Factory Sector Remains On A Roll

- › The ISM Manufacturing Index rose to 59.3 percent in October from 55.4 percent in September
- › The new orders index rose to 67.9 percent, the employment index rose to 53.2 percent, and the production index rose to 63.0 percent

The ISM Manufacturing Index rose to 59.3 percent in October, blowing past our above-consensus forecast of 56.4 percent. This marks the highest level of the index since September 2018, and the underlying details suggest the expansion in the factory sector is set to continue in the months ahead. The obvious caveat, given the current upturn in COVID-19 cases, is that a return to the broad based shutdowns seen in the spring would not spare the factory sector. Barring that unlikely outcome, with the rebound in the factory sector having become deeper and more entrenched with each passing month, there is room for further growth in the months ahead, even if at a slower pace than that seen in October.

Fifteen of the 18 industry groups included in the ISM's survey reported growth in October, with two (textile mills and printing/support activities) reporting contraction. Recall that in the April survey, only two industry groups reported growth, and that this number has steadily climbed from the depths of April shows a broad based recovery across the manufacturing sector. Comments from survey respondents are mostly positive, the two main themes are the strength of demand and uncertainty around the outlook, mainly stemming from the uncertain path of the pandemic. A couple responses noted that this uncertainty is weighing on capital spending, and we think this is more broadly the case, which will contribute to a marked slowing in growth of business spending on equipment and machinery in Q4.

Though we expected each to increase in October, the increases in the indexes of new orders, current production, and employment all exceeded our expectations. The new orders index jumped to 67.9 percent, the highest reading since January 2004. Of the 18 industry groups in the survey, 16 reported increased orders in October, with only the textile mills industry group seeing orders decline. The index of current production rose to 63.0 percent in October, with 11 industry groups reporting increased output and six reporting no change from the prior month. The index of employment rose to 53.2 percent, ending a run of 14 straight months of contraction, though, as we have pointed out, the ISM's gauge of employment has been at odds with the BLS's monthly employment reports, which have shown rising factory sector payrolls over the past five months (the October employment report will be released on Friday). In October, 11 of the 18 industry groups saw payrolls increase while six saw payrolls decline.

As the headline index can at times be at odds with movements in these three indexes, we combine the indexes of new orders, current production, and employment into what we refer to as an "activity based composite," which we show in our top chart. The strong advances in these indexes pushed our activity-based composite up to 61.4 percent in October, the highest reading since September 2018. Further evidence that the rebound in the manufacturing sector has legs comes from the indexes of supplier delivery times and order backlogs. Supplier delivery times slowed further in October, with 15 of the 18 industry groups reporting delivery times had slowed. While the pronounced slowdown in delivery times seen in the spring/early summer reflected global supply chains being thrown into disarray by the shutdowns, the more recent slowing in delivery times reflects challenges in labor markets and constraints on production and shipping capacity, meaning that delivery times are unlikely to shorten any time soon. Backlogs of unfilled orders grew further in October, in part reflecting continued growth in new orders and delayed deliveries of inputs into production. An additional detail in the ISM data we look to as a leading indicator is the gap between the indexes of new orders and customer inventories. The vast majority of industry groups report customer inventory levels are too low, suggesting further gains in new orders and production in the months ahead, reinforcing the signal being sent by growing backlogs of unfilled orders. So, while the pace may slow, the ISM's data point to further expansion in the factory sector in the months ahead.

