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April ISM Manufacturing Index: Expansion Continues, But At A Slower Pace

- > The ISM Manufacturing Index fell to 60.7 percent in April from 64.7 percent in March
- > The new orders index fell to 64.3 percent, the employment index fell to 55.1 percent, and the production index fell to 62.5 percent

The ISM Manufacturing Index fell to 60.7 percent in April, below what we and the consensus forecast expected but nonetheless marking the eleventh consecutive month in which the headline index was above the 50.0 percent break between contraction and expansion. As with the headline index, the sub-indices measuring production, new orders, and employment all slipped in April but remain elevated. While the various regional manufacturing surveys suggested a stronger headline print on the ISM survey, April's decline does not come as a complete surprise given the supply chain and logistics bottlenecks that a growing number of manufacturing industries find themselves contending with. In short, the most pressing problem in the manufacturing sector isn't a lack of demand, it's the ability to meet demand. To that point, inventories of raw materials fell in April while backlogs of unfilled orders rose further. At the same time, price pressures remained intense in April, and it remains to be seen whether, or to what extent, higher input prices and higher shipping costs will ultimately make their way into broader measures of inflation. Still, with order books expanding faster than firms can fill them, output and employment in the manufacturing sector are poised for further growth in the months ahead.

All 18 industry groups included in the ISM's survey reported expansion in April, the first such occurrence since July 2014 and making April the seventh consecutive month in which at least 15 of the 18 industry groups reported growth, which goes to our point about the expansion in the factory sector being notably broad based. Shortages of materials, supply chain bottlenecks, and strong demand are front and center in the comments by survey respondents relayed by ISM, and many respondents indicate there is no let-up in sight for any of these traits. While supply chain issues have gotten considerable attention of late, the reality is that they have been cited in the ISM's survey for months. Either way, these issues are likely to endure for some time, particularly as the pace of global economic activity picks up in the months ahead.

The new orders index fell to rose to 64.3 percent in April from 68.0 percent in March, with 16 of the 18 industry groups reporting growth in orders. The production index slipped to 62.5 percent in April from 68.1 percent in March, with 14 industry groups reporting higher production in April while two reported decreased production. The employment index fell to 55.1 percent in April from 59.6 percent in March, with 13 of the 18 industry groups reporting employment growth in April and two reporting a decrease in employment. It is one of the quirks of diffusion indexes that April saw declines in these key indexes despite the overwhelming majority of industry groups reporting growth, with the latter being more relevant to us than the former. In any event, just looking at the level of these indexes in April is an indication of the vigor of the expansion in the manufacturing sector despite the drags from supply chain issues. The index of delivery times fell slightly in April but, at 75.0 percent remains notably elevated, and 17 of the 18 industry groups reported slower delivery times. Between strong demand and supply chain issues, backlogs of unfilled orders grew further in April, with 14 industry groups reporting larger backlogs and none reporting smaller backlogs. 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 and thus reinforcing the signal being sent by growing backlogs of unfilled orders.

The prices paid index rose to 89.6 percent in April and continues to hover at levels last seen in mid-2008. April is the fourth straight month in which all 18 industry groups reported paying higher prices for inputs. With producers having more pricing power than has been the case over the past several years, these higher input prices, along with higher shipping costs, are likely to be passed along in the form of higher prices for intermediate and final goods.

