ECONOMIC UPDATE

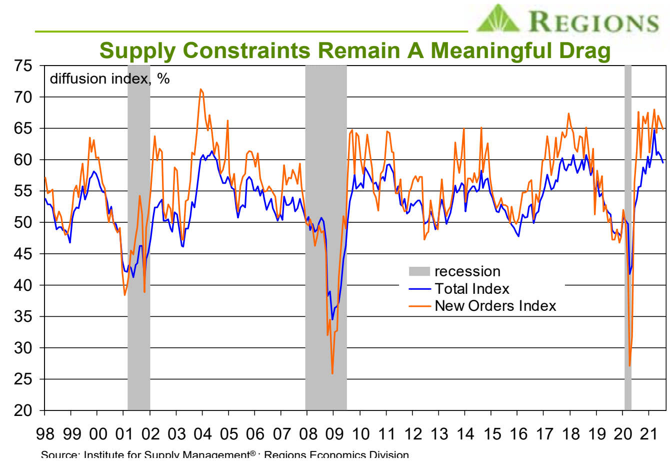
REGIONS

August 2, 2021

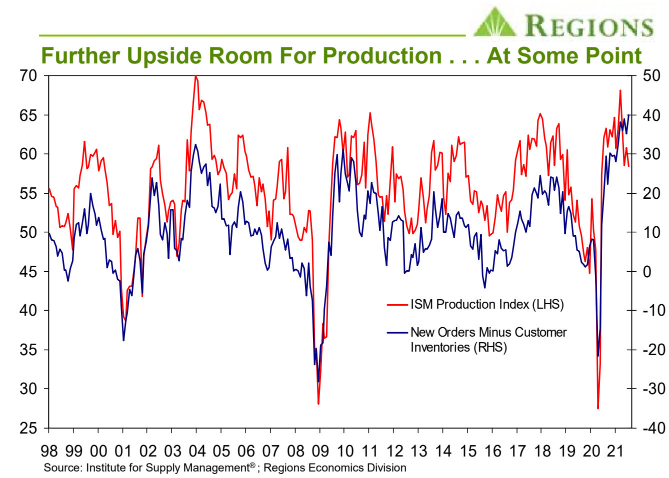
July ISM Manufacturing Index: Supply-Side Constraints Remain A Meaningful Drag

- The ISM Manufacturing Index fell to 59.5 percent in July from 60.6 percent in June
- The new orders index fell to 64.9 percent, the employment index rose to 52.9 percent, and the production index fell to 58.4 percent

The ISM Manufacturing Index fell to 59.5 in July, below the 60.8 percent reading we and the consensus expected. While July marks the second straight monthly decline, it nonetheless marks the fourteenth consecutive month in which the headline index was above the 50.0 percent break between contraction and expansion. That said, the details of the data show supply side stresses remain a meaningful drag on the pace of the expansion in the factory sector. Order books continue to expand faster than firms can fill them, as shortages of materials, shipping delays, and labor supply constraints are acting as ongoing drags on production. The decline in the prices paid index may be a bit misleading, as all 18 industry groups reported paying higher input prices in July, to go along with higher costs for labor and shipping. Moreover, there are signs that limited inventories of raw materials and uncertain delivery timelines are becoming an increasing constraint on production. For months now we've stated that the most pressing problem in the manufacturing sector isn't a lack of demand, it's the ability to meet demand, and the ISM data continues to reinforce our view.

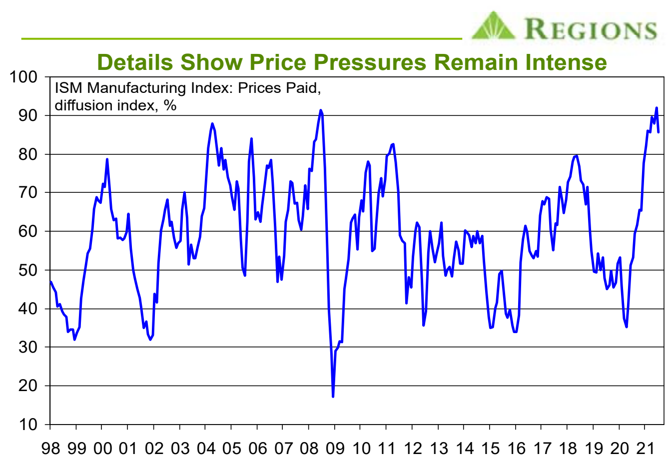


Of the 18 industry groups included in the ISM's survey, 17 reported expansion in July, matching June, with textile mills the lone industry group reporting contraction in July. July marks the tenth consecutive month in which at least 15 of the 18 industry groups reported growth, a sign of how broad based the expansion in the factory sector remains. Though lacking some of the edge that had been prominent in the prior couple of months, comments from respondents to the July survey reveal ongoing frustration with material shortages, shipping delays, and labor supply concerns in an environment characterized by continued strength in demand. More than one respondent indicated that their firm is unable to fill current orders, which is consistent with the elevated level of the index of order backlogs.



The new orders index fell to 64.9 percent in July from 66.0 percent in June, though 15 of the 18 industry groups reported growth in orders. The production index slipped to 58.4 percent in July from 60.8 percent in June, remaining well below its recent peak of 68.1 percent, set in March. Sixteen of the 18 industry groups reported higher output in June with only one industry group reporting a decline. After having slipped below the 50.0 percent mark in June, the employment index rebounded in July, rising to 52.9 percent with 11 of the 18 industry groups reporting higher job counts. Still, based on widespread comments regarding shortages of qualified labor, it is likely that even those firms adding workers are not adding as many workers as they otherwise would.

While the index of supplier delivery times fell from 75.1 percent in June to 72.5 percent in July, this is still consistent with slower delivery times, with all 18 industry groups reporting slower delivery times in July. ISM notes that suppliers themselves are facing labor, materials, and delivery constraints, thus adding another layer to the supply chain and logistics bottlenecks plaguing the industrial sector. Reflecting these supply-side constraints, the ISM's index of order backlogs rose to 65.0 percent in July, with 15 industry groups reporting larger backlogs and one reporting smaller backlogs. If there is a silver lining here, it is that manufacturers will remain busy even should the flow of new orders begin to slow to a meaningful degree. That, however, seems a distant concern given that the index of customer inventory levels fell to 25.0 percent in July, the lowest reading in the life of this index, which dates back to 1997. That customer inventories are so lean bodes well for sustained growth in new orders and for future production, though that of course is contingent upon relief from the supply-side constraints that have bedeviled firms for the past several months.



While the prices paid index fell to 85.7 percent in July from 92.1 percent in June, this nonetheless marks the 14th consecutive month of rising input pries. Higher input, shipping, and labor costs will, at least to some degree, be passed along in the form of higher prices for final goods, thus remaining a source of broader inflation pressures.

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com