ECONOMIC UPDATE

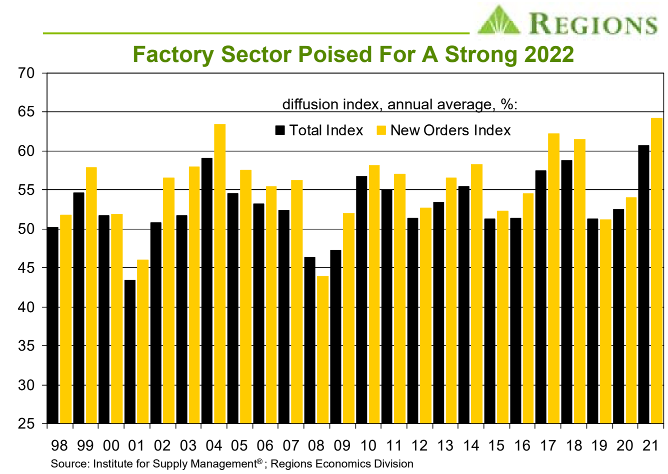
REGIONS

January 4, 2022

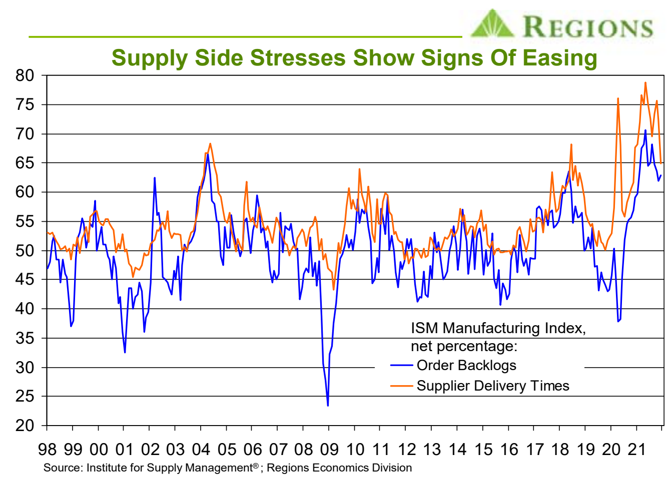
December ISM Manufacturing Index: Factory Sector Poised For A Strong 2022

- The ISM Manufacturing Index fell to 58.7 percent in December from 61.1 percent in November
- The new orders index fell to 60.4 percent, the employment index rose to 54.2 percent, and the production index fell to 59.2 percent

The ISM Manufacturing Index fell to 58.7 percent in December, below what we and the consensus expected but nonetheless marking the 19th straight month in which the headline index was above the 50.0 percent break between contraction and expansion. We had wondered whether the December survey would show any effects from the emergence of the Omicron variant of the COVID-19 virus, though there are no indications of this in either the data or the comments from survey respondents. Indeed, the December survey shows the expansion in the factory sector remains broad based, and also shows signs of further easing in the global supply chain and logistics bottlenecks that have hampered activity over the past several months. This still leaves supply-side conditions far from normal, but we do expect further progress over the course of 2022, allowing of course for the possibility of recurrent spikes in case counts that could sustain supply chain and logistics constraints for longer than would otherwise be the case. As things now stand, however, the factory sector is poised for a strong 2022, which is apparent in the continued broad based growth in new orders, which we see as the most important forward looking indicator in the ISM's survey. On an annual average basis, 2021 was the strongest year for the new orders index in the life of the current series, and with 2021 having ended with many firms sitting on top of sizable order backlogs, employment and production should expand further in 2022.

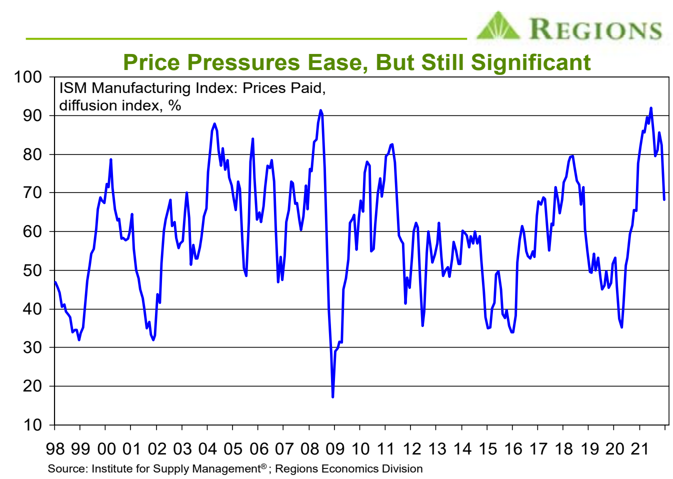


Of the 18 industry groups included in the ISM's survey, 15 reported expansion in December, up from 13 in November, with three industry groups reporting a decrease in activity. Comments from survey respondents continue to indicate overall solid demand, though some respondents point to continued supply-side stresses making it difficult for them to keep pace with demand. Overall sentiment was perhaps summed up the best by a respondent in the fabricated metals industry group, who stated they "hope we have reached the top of the hill to start down a gentle slope that lets us get back to something that resembles normal."



The new orders index slipped from 61.5 percent in November to 60.4 percent in December, with 15 of the 18 industry groups reporting growth in orders and two reporting lower order volumes. It was interesting that one respondent in the food, beverage, and tobacco products industry group noted that supply chain issues are leading to cutbacks in new orders. The production index fell to 59.2 percent in December from 61.5 percent in November, with 10 of the 18 industry groups reporting higher output while four reported lower output. Production remains constrained by inadequate supplies of labor and raw materials. The employment index rose to 54.2 percent in December from 53.3 percent in November, though only 8 of the 18 industry groups reported employment growth while 5 reported decreases in employment.

Reflecting the combination of continued growth in new orders and ongoing supply-side stresses, order backlogs grew at a faster pace in December, marking the 18th consecutive month of growing backlogs. Eleven of the 18 industry groups reported larger backlogs in November with only one reporting smaller backlogs. Even if new orders do tail off more than we think likely at this point, sizable backlogs of unfilled orders will keep manufacturers busy for some time. One reason we think orders will continue to hold up is that firms continue to see their customers' inventories as being too low, indicating further upside room for new orders and production.



Supplier delivery times slowed further in December, but the rate at which delivery times slowed eased a bit, contrary to our expectations and thus contributing to our miss on our forecast of the headline index. The prices paid index fell sharply, from 82.4 percent in November to 68.2 percent in December, but 16 of the 18 industry groups reported paying higher input prices. The sharp decline in the ISM's prices paid index is more indicative of a slower rate of input price increases rather than outright declines in input prices, though this is at least a step in the right direction.

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