ECONOMIC UPDATE

REGIONS

April 1, 2022

March ISM Manufacturing Index: A Harbinger Of (Bad) Things To Come?

- The ISM Manufacturing Index fell to 57.1 percent in March from 58.6 percent in February
- The new orders index fell to 53.8 percent, the employment index rose to 56.3 percent, and the production index fell to 54.5 percent

The ISM Manufacturing Index fell to 57.1 percent in March, below both our forecast (59.1 percent) and the consensus forecast (58.8 percent). While March does mark the 22nd consecutive month in which the headline index was above the 50.0 percent break between contraction and expansion, the details of the March survey clearly indicate the manufacturing sector is far from being worry free. The measures of new orders and current production, while still in expansion territory, dropped sharply in March while input price pressures ratcheted up significantly. While over the past several months the issues in the manufacturing sector have been on the supply side, not the demand side, the plunge in the new orders index raises the possibility that this is changing. Moreover, with the March data not reflecting the recent wave of shutdowns of major manufacturing and shipping hubs across China, supply side and shipping constraints figure to intensify and price pressures figure to build further, and at least some of this is likely to be reflected in the ISM's April survey. While this does not mean the end of the expansion in the manufacturing sector is at hand, it does mean that the pace of that expansion is likely to slow further in the months to come.

Of the 18 industry groups included in the ISM's survey, 15 reported expansion in March, down from 15 in February. Two industry groups – petroleum & coal products and wood products – reported decreases in activity in March. Comments from survey don't ease our fears that supply constraints and price pressures could intensify over coming months. Impacts from Russia's invasion of Ukraine are being felt in the form of higher grain prices and higher transportation costs, with higher fuel costs making shipping more expensive. The overall tone of the comments was somewhat dour given the lack of improvement in, or in some cases worsening, supply chain and shipping bottlenecks. It is notable that, for a second month in a row, complaints about labor availability/retention don't show up in comments from survey respondents.

The new orders index fell to 53.8 percent in March from 61.7 percent in February, and while 13 of the 18 industry groups reported growth in orders, responses on the firm level indicate a smaller percentage reporting growth in orders and a higher percentage reporting declines in orders. In this week's *Economic Preview,* we noted our concern that sizable order backlogs, sustained price pressures, and uncertain delivery times might at some point weigh on growth in new orders, with implications down the line for employment and output. While we cannot say that the decline in the new orders index in March is proof of that happening, that decline does amplify our concerns. The production index fell from 58.5 percent in February to 54.5 percent in March, with eleven industry groups reporting increased output and four reporting declines in output. March does mark the 22nd consecutive month of increased output, but the level of the production index is the lowest since May 2020. To be sure, after a prolonged period of steady growth in new orders and rising backlogs of unfilled orders, the lower levels of the production index are more a reflection of the extent to which materials shortages and shipping delays continue to weigh on production. The employment index rose from 52.9 percent in February to 56.3 percent in March, but further deterioration in new orders would weigh on growth in employment.

Though they did so at a slower rate, backlogs of unfilled orders nonetheless grew further in March, with eleven industry groups reporting larger backlogs and only two reporting smaller backlogs. The supplier delivery index ticked lower, which could simply reflect suppliers rebounding after COVID-related spikes in absenteeism earlier in 2022. The prices paid index shot higher in March, rising to 87.1 percent from 75.6 percent in February. More tellingly, each of the 18 industry groups reported paying higher input prices in March, and input price pressures are likely to intensify further in the months ahead, as are shipping costs. While thus far firms have been able to pass along much, if not all, of these higher costs on to customers given the strength of demand, it remains to be seen how much longer this will remain the case.

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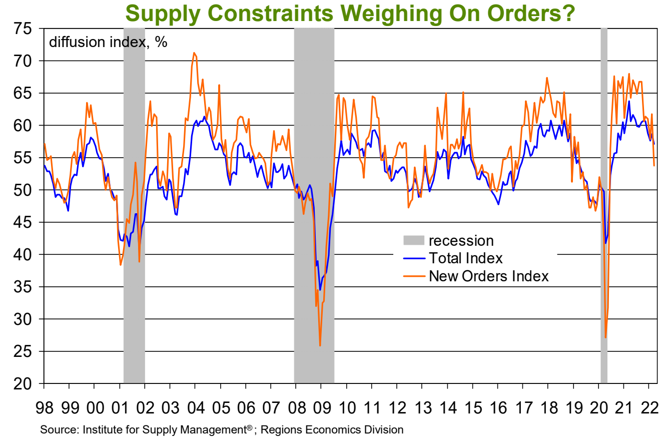
Supply Constraints Weighing On Orders?



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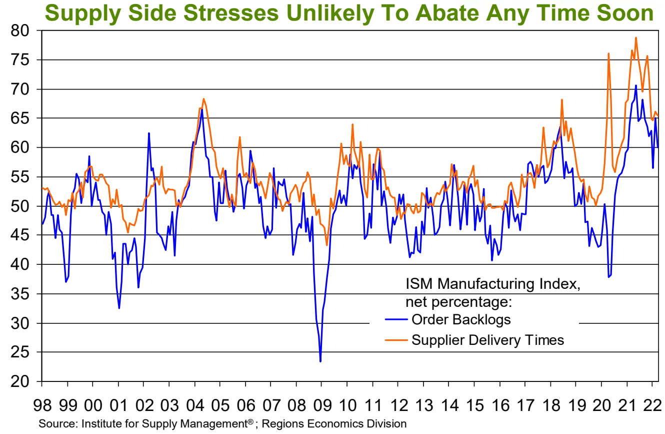
Supply Side Stresses Unlikely To Abate Any Time Soon



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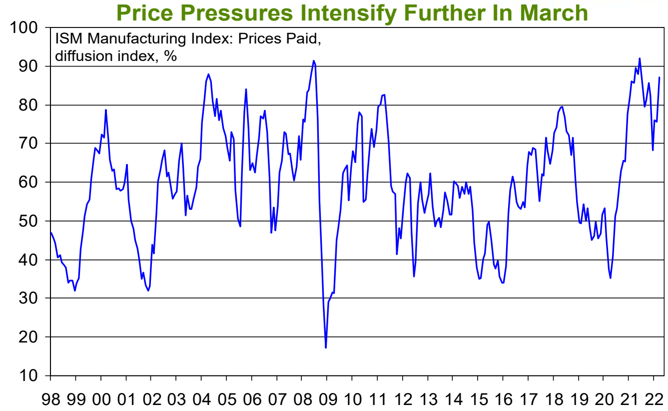
Price Pressures Intensify Further In March



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