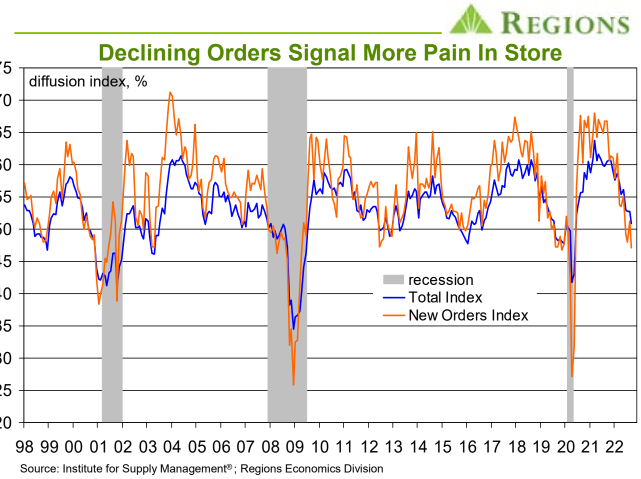
ECONOMIC UPDATE
REGIONS
October 3, 2022

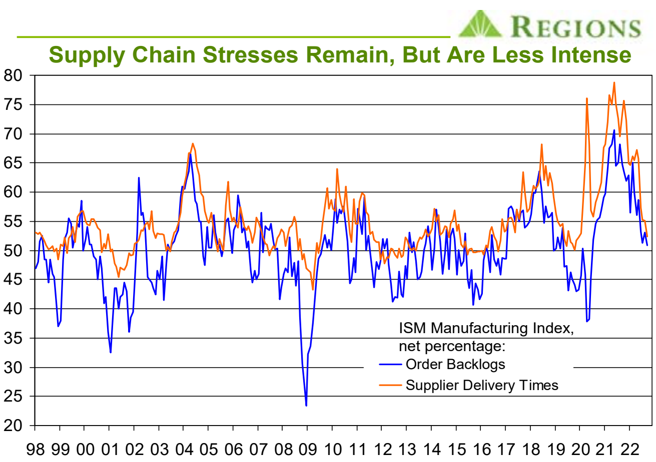
September ISM Manufacturing Index: The Walls Are Closing In On The Factory Sector

- The ISM Manufacturing Index fell to 50.9 percent in September from 52.8 percent in both July and August
- The new orders index fell to 47.1 percent, the employment index fell to 48.7 percent, and the production index rose to 50.6 percent

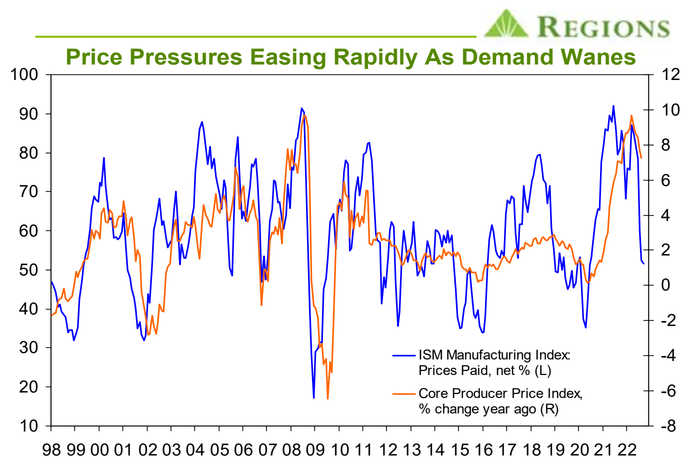
The ISM Manufacturing Index fell to 50.9 percent in September, lower than our below-consensus forecast of 51.8 percent. While September marked the 28th straight month with the headline index above the 50.0 percent break between contraction and expansion, the more relevant story is that the pace of expansion has slowed as the expansion has become increasingly less broad based, and at 50.9 percent the headline index sits at its lowest point since May 2020. The combination of falling new orders, thinning order backlogs, and the ongoing right-sizing of customer inventories (even if more a reflection of slowing demand) bodes poorly for continued growth in output and employment in the factory sector in the months ahead. Though becoming increasingly less binding, supply chain constraints remain a drag on activity, but upward pressure on non-labor input prices continues to abate as demand continues to soften. We've noted over the past few months that the expansion in the factory sector had been slowing and had become less broad based. With the full effects of higher interest rates having yet to fully work their way through the U.S. and foreign economies, the factory sector will come under increasing pressure in the months ahead.



Only nine of the eighteen industry groups included in the ISM's survey reported expansion in September, the fewest in any month since May 2020, while seven industry groups reported contraction. Comments from survey respondents relayed by ISM are mixed, as would be anticipated given the expanding/contracting split across the eighteen broad industry groups. One respondent from the chemical products industry group noted some customers were pulling back orders, while a respondent from the electrical equipment/appliances industry group reports business continues to be strong but supply chain issues remain a drag on production. The decidedly mixed perceptions across industry groups are what would be expected with the broader economy slowing and possibly nearing a cyclical turning point.



The new orders index fell to 47.1 percent in September, the lowest reading since May 2020, with only five of the eighteen broad industry groups reporting growth in orders and eleven reporting declines. September marks the third time in the past four months the orders index has been below 50.0 percent, but as we've noted, unfriendly seasonal adjustment helped push the orders index below that threshold in June and July. With the September seasonal factor more or less neutral, the orders index falling below 50.0 percent is a more clear signal of diminished demand. At the same time, the index of order backlogs slipped to 50.9 percent in September, with eight industry groups reporting larger backlogs and eight reporting slimmer backlogs. As long as they were sitting on material backlogs of unfilled orders, firms would have been somewhat insulated from slower growth, or declines, in new orders. But, with both new orders fading and backlogs closer and closer to being worked down (or orders having been canceled), the buffer that was helping preserve employment and production is rapidly fading. This bodes poorly for employment and production in the months ahead. As it is now, the production index is basically treading water around the 50.0 percent threshold, with only eight industry groups reporting higher output in September while seven reported lower output. The employment index fell to 48.7 percent in September, with only six industry groups reporting higher head counts and ten reporting decreased employment. While the ISM's gauge of employment has been in stark contrast to the data from the monthly employment reports, ISM notes that more firms are implementing hiring freezes and allowing attrition to take down staffing levels. If demand is slowing as rapidly as the ISM survey implies, it seems only a matter of time before the monthly employment reports show declining factory payrolls.



While the ongoing easing of input price pressures may be welcome news for the inflation outlook, that is has largely come about via fading demand will make no one feel better about the growth outlook. Further easing of input price pressures will be a powerful indicator of the extent to which demand has actually slowed.

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