ECONOMIC UPDATE

REGIONS

November 1, 2022

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October ISM Manufacturing Index: Details Paint A Weaker Picture

- The ISM Manufacturing Index fell to 50.2 percent in October from 50.9 percent in September
- The new orders index rose to 49.2 percent, the employment index rose to 50.0 percent, and the production index rose to 52.3 percent

The ISM Manufacturing Index fell to 50.2 percent in October, topping the consensus forecast of 50.0 percent and our forecast of 49.6 percent. Still, while October marked the 29th straight month with the headline index above the 50.0 percent break between contraction and expansion, the details of the October are considerably weaker than the headline index suggests, and it seems only a matter of time until the headline index dips below the 50.0 percent threshold. Over the past several months, the expansion in the factory sector has become slower and less broadly based. 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. While prices for non-labor inputs fell in October and supplier delivery times shortened, these are simply signs of how far demand has fallen off. With the effects of higher interest rates having yet to fully work their way through the U.S. and foreign economies, the factory sector will remain under intense pressure in the months ahead.

Only eight of the eighteen industry groups included in the ISM's survey reported expansion in October, the fewest in any month since May 2020, while ten industry groups reported contraction. Comments from survey respondents relayed by ISM are mostly downbeat, with several respondents reporting waning demand. One respondent from the machinery industry group noted customers have been paring down capital budgets, which is in line with the hard data on capital goods orders. Several respondents also noted easing price pressures, mainly reflecting diminished demand.

While edging higher, the new orders index nonetheless remained below 50.0 percent, making October the fourth time in the past five months new orders have contracted. Only three of the eighteen industry groups reported rising new orders in October while twelve reported falling orders. At the same time, backlogs of unfilled orders contracted in October, ending a 27-month run of rising order backlogs. This is relevant in that 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 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. While the production index did rise to 52.3 percent in October from 50.6 percent in September, only six industry groups reported higher output in October while eight reported decreased production. The employment index rose to 50.0 percent in October, with nine industry groups reporting increased employment and five reporting decreased employment. ISM notes that more firms are implementing hiring freezes and allowing attrition to take down staffing levels but thus far there have been no mentions of large-scale layoffs, a sign that firms remain somewhat confident in the outlook for demand over a longer time frame. It is also worth noting that the JOLTS data show job openings in manufacturing remain far above pre-pandemic levels.

Prices for non-labor inputs fell in October, the first decline since May 2020. Five of the eighteen industry groups reported paying higher input prices in October while ten reported paying lower prices. ISM notes that the main drivers of fading price pressures are lower energy prices and softening demand for metals, chemicals, and plastics. Note that price pressures in the broader services sector remain more intense than is the case in the factory sector. Supplier delivery times were faster in October, the first such occurrence since February 2016 but, as with easing price pressures, faster delivery times are mainly a reflection of the extent to which demand has softened. 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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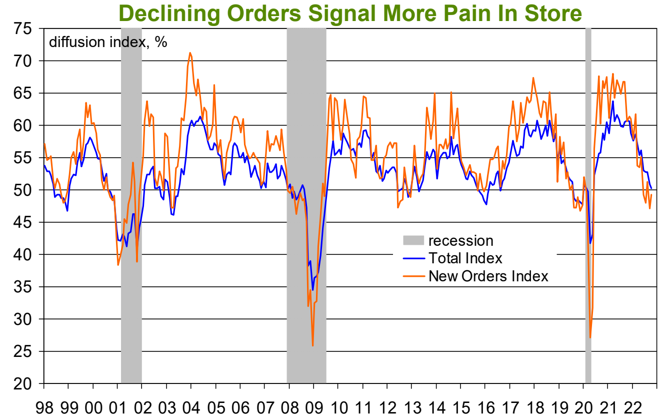
Declining Orders Signal More Pain In Store



Source: Institute for Supply Management®; Regions Economics Division

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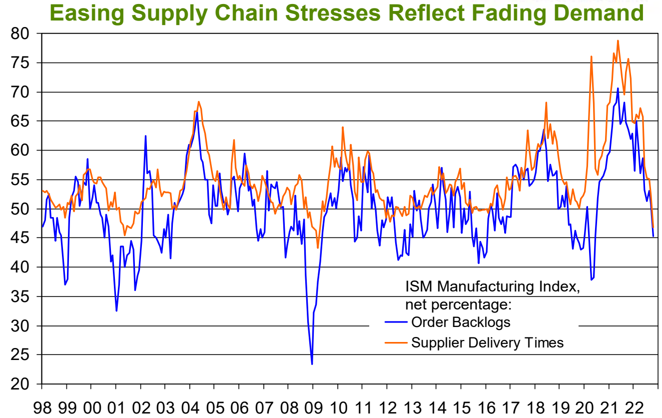
Easing Supply Chain Stresses Reflect Fading Demand



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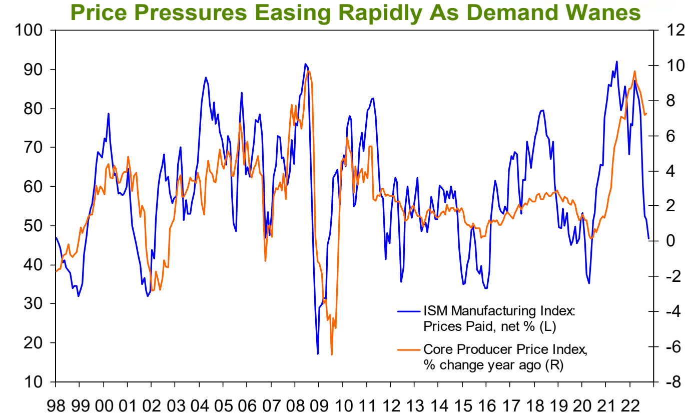
Price Pressures Easing Rapidly As Demand Wanes



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