June ISM Manufacturing Index: Umm, Happy Anniversary?

The ISM Manufacturing Index fell to 46.0 in June, weaker than our below-consensus forecast of 46.8 percent anticipated, marking an eighth straight month of contraction in the factory sector. Unlike the May survey, each of the main components – new orders, production, employment, and inventories – was below the 50.0 percent break between contraction and expansion in June. As we noted at the time, the seemingly mixed messages in the May data, with the production and employment indexes above that 50.0 percent break, were more a matter of favorable seasonal adjustment for those components, distorting the signaling value of those readings. With the June seasonal adjustment factors much less favorable, we anticipated retreats in those components, which proved to be the case. That said, the declines were more pronounced than we expected. The June survey marks an anniversary of sorts, but not the kind that merits celebrating, as it was a year ago that the index of new orders first fell below the 50.0 percent break between contraction and expansion, and save for the bounce last August, new orders have contracted in each month since, including this June. Between the ongoing slump in new orders and backlogs of unfilled orders having been significantly whittled down, there is little to suggest a turnabout in the factory sector in the months ahead, particularly with the domestic and global economies looking to slow further.

Only four of the eighteen industry groups included in the ISM’s survey reported growth in June, matching May’s count, with eleven industry groups reporting contraction. It will likely come as no consolation that the number of industry groups reporting contraction in June was down from fourteen doing so in the May survey. As in May, transportation equipment was one of the few industry groups reporting growth in June, as motor vehicle manufacturers continue to play catch-up from protracted supply chain disruptions and aircraft producers continue to book and fill new orders. As the broader economy weakens in the months ahead and motor vehicle inventories are right-sized, producers of transportation equipment could face a steep drop-off in demand. Survey respondents in a number of industry groups pointed to slowing demand, with one noting that the anticipated second half rebound seems to not be happening. That caught our eye given that expectations of a second half rebound had been fairly common across the broad industry groups and were cited as warranting hiring and holding on to workers through a weak first half of 2023. If more industry groups begin to lose faith in a rebound, be it in 2H 2023 or 1H 2024, that could lead to at best a pronounced slowdown in hiring or at worst significant job cuts across the factory sector.

As we anticipated, the index of new orders rose in June but remained below 50.0 percent, indicating further contraction in new orders with only five of the eighteen industry groups reporting growth in new orders. The index of order backlogs rose to 38.7 percent in June from 37.5 percent in May, which was the lowest reading since February 2009, so the modest bounce in June is not surprising but still leaves firms with shrinking order backlogs. As we’ve noted, contracting new orders and dwindling order backlogs set up a weak profile for employment and output over coming months. To that point, the index of production fell to 46.7 percent in June, though eight industry groups reported higher output, while the employment index fell to 48.1 percent in June, with only six industry groups reporting higher job counts. One saving grace could be that survey respondents, on net, deemed customer inventories to be too low in the June survey, but as this reverses the assessments in both April and May, it’s a bit soon to take much consolation from this, particularly with so few signs of life in new orders.

After having alternated between signaling rising and falling input prices over the prior four months, the ISM’s gauge of input prices sent a clear signal of weakness in June, with the prices paid index falling to 41.8 percent, the low point of 2023 to date. Only three industry groups reported paying higher input prices in June while thirteen reported paying lower input prices. Weakness in input prices suggests core goods inflation will ease further in the months ahead, acting as a check on overall inflation pressures.