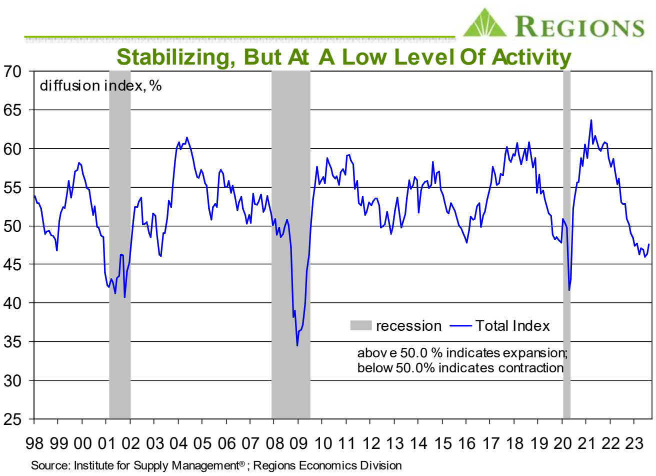
ECONOMIC UPDATE
REGIONS
September 1, 2023

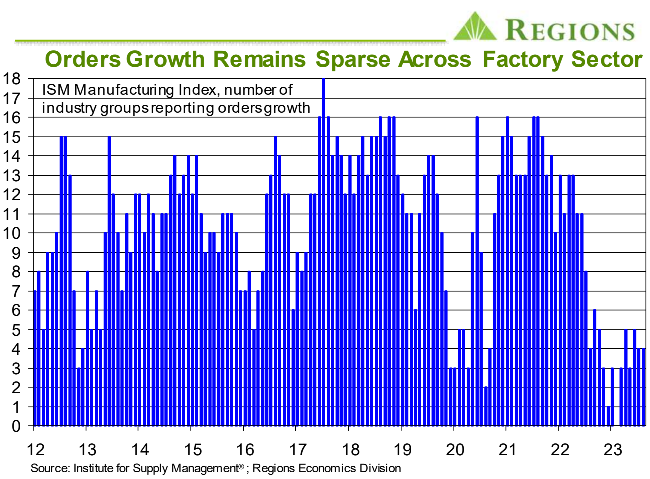
August ISM Manufacturing Index: Signs Of Stability, However Faint . . .

- The ISM Manufacturing Index rose to 47.6 percent in August from 46.4 percent in July
- The new orders index fell to 46.8 percent, the employment index rose to 48.4 percent, and the production index rose to 50.0 percent

As a general rule, you can't get up until you actually stop falling, so in that sense there may be a glimmer of hope in the ISM's latest query of factory sector conditions. The ISM Manufacturing Index rose to 47.6 percent in August, topping our above-consensus forecast of 47.4 percent, but nonetheless marking a tenth straight month of contraction in the factory sector. The production index improved to 50.0 percent, not growth but not contraction either, while there are signs of some firming in input prices, and signs of stress on supplier delivery times may not be much to hang your hat on, but in unison at least offer signs that activity in the factory is beginning to stabilize, even if at a low level. We would feel more confident of that were it not for the index of new orders indicating yet another month of contracting new orders, and unless and until the long-running contraction in new orders turns around, stability is pretty much as good as it's going to get for the manufacturing sector. That is especially the case as faltering growth overseas continues to weigh on export activity.

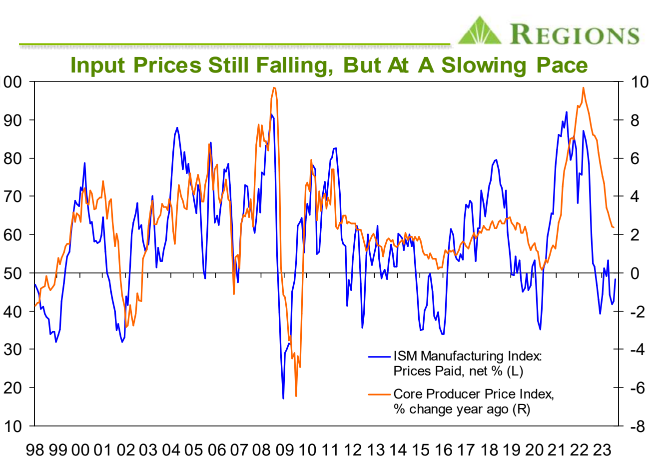


Five of the eighteen industry groups included in the ISM's survey reported growth in August, the most in any month since April, so there's that. After reporting contraction in July, likely reflecting typical slowdowns amongst motor vehicle producers, the transportation equipment industry group reported growth again in August. Still, we question how much longer this growth will persist given the ongoing increase in motor vehicle inventories on the manufacturing and retail levels, part of which could reflect hedging against a potential strike amongst the United Auto Workers. Thirteen of the eighteen industry groups reported contraction in August. Many comments from survey respondents point to slowing demand, and several note that customers continue to work down their own inventories, in turn acting as a drag on new orders, to contend with a slower-growth environment.



The index of new orders fell to 46.8 percent in August and has now been below the 50.0 percent break between contraction and growth for twelve straight months and fourteen of the past fifteen months. Only four industry groups reported growth in orders in August, in stark contrast to the breadth of orders growth seen in the early phases of reopening and seen over the course of the expansion that prevailed in the years ahead of the pandemic, as we show in our middle chart. The production index rose to 50.0 percent, but only five of the eighteen industry groups reported higher output. With new orders continuing to contract and order backlogs continuing to thin down, however, there is little to suggest broader based increases in production in the months ahead. ISM even notes that some firms are slowing the rate at which order backlogs are worked off, perhaps as a means of keeping workers on board and operations running, even if at a slow pace, until demand starts to pick up. There is, however, only so long that can be sustained. To that point, while the employment index rose in August, it nonetheless remains below 50.0 percent, indicating declines in employment, and in August only two industry groups reported higher head counts while eight reported decreases. ISM notes that attrition, not layoffs or hiring freezes, is being used as a slow-motion way for firms to right-size staffing levels until they have a better sense of longer-term demand.

Though not entering into the calculation of the headline index, the indexes of export orders and import volumes are nonetheless instructive as to overall conditions in the factory sector. New export orders have fallen in twelve of the past thirteen months, and respondents point to weak conditions in China and Europe as weighing on growth. Import volumes fell for the tenth straight month, which is noteworthy in that imports of intermediate capital goods used in domestic production account for a sizable share of total imports into the U.S. As such, sagging import volumes are an indication of weakness in production amongst U.S. firms



The prices paid index rose to 48.4 percent, but still points to declines in input prices. It remains to be seen whether recent increases in energy and commodity prices will at some point put upward pressure on input prices despite still-weak demand.

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