ECONOMIC UPDATE

REGIONS

January 3, 2024

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December ISM Manufacturing Index: Few Signs Of A Turnaround On The Horizon

- The ISM Manufacturing Index rose to 47.4 percent in December from 46.7 percent in November
- The new orders index fell to 47.1 percent, the employment index rose to 48.1 percent, and the production index rose to 50.3 percent

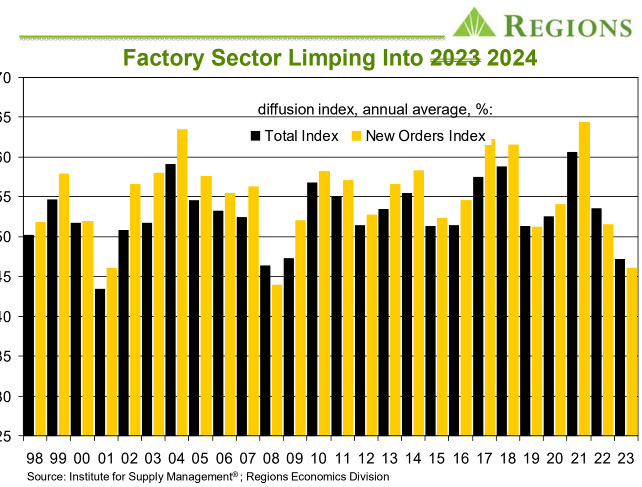
The ISM Manufacturing Index rose to 47.4 percent in December, slightly ahead of expectations but nonetheless indicating a fourteenth straight month of contraction in the factory sector. Owing entirely to what were very generous seasonal adjustment factors, we had looked for the headline index to register a modest increase in December, but at the same time cautioned that the details of the survey data would signal continued weakness with little hint that a turnaround was close at hand. Our assessment was correct even though the headline index was modestly above our forecast. It is worth noting that for at least some survey respondents the prospect of lower interest rates holds out hope for conditions to improve over the course of 2024. We too see that as a possibility, but nonetheless expect the next several months to remain challenging.

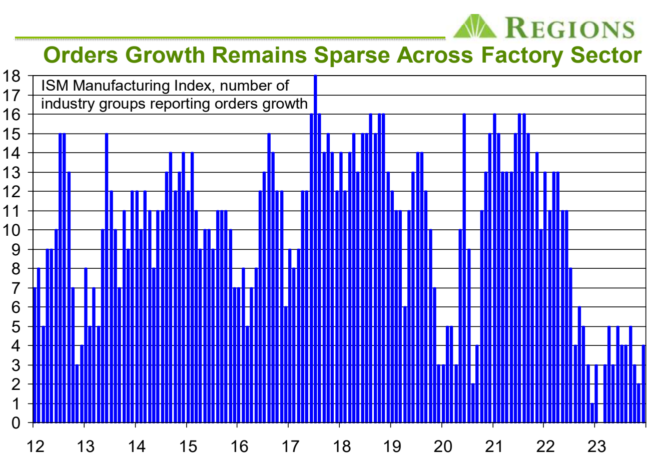
Of the eighteen industry groups included in the ISM's survey, only one – primary metals – reported growth in December, with the end of the UAW strike acting as a support. In contrast, however, sixteen industry groups reported contraction in December, two more than did so in November. If seeing a rising number of industry groups reporting growth is a step toward growth in the overall sector, then December was decidedly a step in the wrong direction. That said, comments from survey respondents were surprisingly mixed, with some pointing to pick-ups in demand. As alluded to above, some respondents noted that lower interest rates could spark capital investment and faster growth in residential investment, both of which would provide a lift to certain segments of the manufacturing sector. It will, however, take more than lower interest rates to spark a meaningful, sustained, and broadly based rebound in the factory sector, and the ISM's December survey offers little evidence of a turnaround.

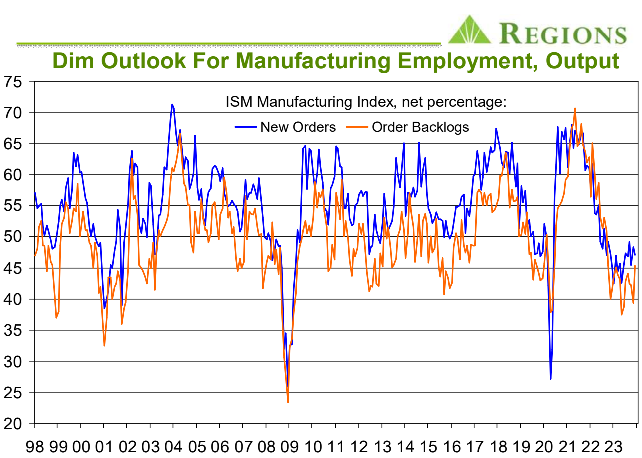
The new orders index fell to 47.1 percent in December from 48.3 percent in November despite a sizable assist from seasonal adjustment, with four industry groups reporting growth in new orders and thirteen industry groups reporting lower orders. The new orders index has now indicated contraction, in sixteen straight months, the longest such streak since 1981-82. December also saw backlogs of unfilled orders dwindle further, marking a fifteenth straight month of falling backlogs. Though some may see a silver lining in the customer inventories index slipping back below 50.0 percent, indicating that, on net, customer inventories are seen as being too low, the reality is that the vast majority of firms see their customer inventories as being "about right" so, other than that whole any port in a storm thing, we don't see this as being a very hopeful sign. One reason this matters is that for a time firms scrambling to right-size inventories after the significant and sustained disruptions in supply chain and logistics networks triggered by the pandemic was a key support for manufacturing activity, and that support seems mostly faded at this point. Doing the math, contracting new orders, shrinking backlogs of unfilled orders, and customers at best not looking to build inventories all adds up to a weak outlook for employment and production in the manufacturing sector. That this comes fourteen months into a contraction makes it all the more discouraging.

The production index rose to 50.3 percent, and while in theory this is consistent with rising output, we'll again caution that this is more a reflection of favorable seasonal adjustment. To our point, only three of the eighteen industry groups reported higher output in December while thirteen reported lower output. Moreover, the employment index remained below the 50.0 percent mark, indicating further shrinking in factory sector payrolls and ISM for a third straight month referencing layoffs as being the most common method of reducing headcounts, as opposed to hiring freezes and attrition.

Firms have also become more resolute in their own inventory management, with December marking the tenth straight month in which inventories contracted. With hopes of a rebound in early-2024 dimming, firms will continue to strictly control inventories. An ongoing slide in export orders – down in sixteen of the past seventeen months – is reinforcing the dour outlook for demand. Input prices continue to slide, with weak demand affording buyers room to negotiate prices down further.







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