ECONOMIC UPDATE

REGIONS

October 1, 2024

September ISM Manufacturing Index: No Particular Place To Go . . .

- The ISM Manufacturing Index was unchanged at 47.2 percent in September
- The new orders index <u>rose</u> to 46.1 percent, the employment index <u>fell</u> to 43.9 percent, and the production index <u>rose</u> to 49.8 percent

The ISM Manufacturing Index held steady at 47.2 percent in September, between our forecast of 47.0 percent and the consensus forecast of 47.5 percent, marking the twenty-second time in the past twenty-three months in which the headline index was below the 50.0 percent break between contraction and expansion. The underlying details – firm level and industry level – remain weak, particularly those pertaining to new orders, which would suggest no quick turnaround for the factory sector. Over the past few months, we've noted that the manufacturing sector seemed more or less stuck in a holding pattern, with sluggish global economic growth, still-high financing costs, and an uncertain outlook for U.S. tax, regulatory, and trade policy acting as stiff headwinds, with the uncertain policy outlook seeming to be the stiffest of these headwinds. As such, it will not be until sometime in 2025 before the combined impacts of clarity on the policy front and lower financing costs begin to drive meaningful improvement.

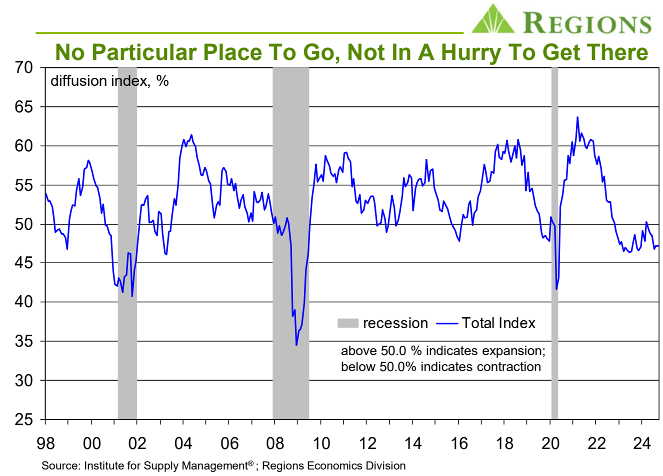
September marks the third straight month in which only five of the eighteen industry groups included in the ISM's survey reported growth. The firm-level responses show the majority of firms continue to report no month-to-month changes in new orders, production, or employment, which goes to our point about factory sector activity being stuck at a fairly low level. Comments from survey respondents point to soft demand, with financing costs and election-related uncertainty also getting mentions. Nothing in the comments, however, points to meaningful improvement in conditions in the near term.

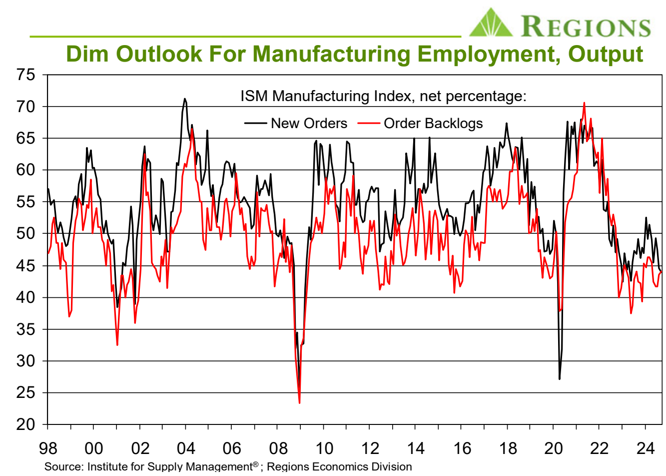
The new orders index rose to 46.1 percent in September from 44.6 percent in August. Only two of the eighteen broad industry groups reported growth in new orders, while 56.1 percent of firms reported no change in order volumes. Of those firms reporting a change in orders, a slightly higher share reported growth than did so in August, but a higher share reported a decline in orders. ISM continues to note a high degree of uncertainty and a low degree of confidence around the future economic environment. At the same time, the backlog of unfilled orders shrank further in August and has now contracted for twenty-four straight months. To the extent that new orders continue to decline, order backlogs will be pared down at a faster rate and, as this occurs, the demand for inputs and the demand for labor begins to fade in what can, should it persist for long enough, become a somewhat vicious circle.

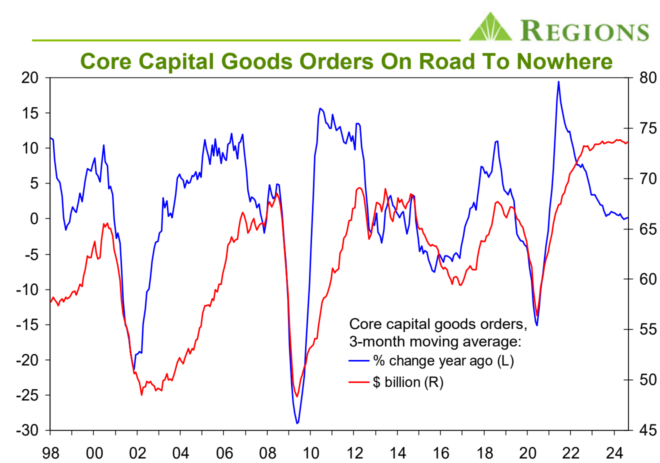
Much like new orders, the majority of firms – 60.7 percent – reported no change in output levels in September, though there was a notable increase in the percentage of firms reporting higher output. This accounts for the increase in the production diffusion index, which rose to 49.8 percent from 44.4 percent in August. With new orders trending lower and order backlogs becoming increasingly thin, it follows that production will drift lower. One implication is that firms will continue to adjust head counts to the perceived path of demand, which firms continue to do via layoffs, attrition, and hiring freezes. The ISM's employment index slipped to 43.9 percent in September and has been below the 50.0 percent mark in each of the past four months. Though 69.3 percent of firms reported no change in staffing levels in September, amongst those that did report a change a much larger share continue to report declines than increases.

One thing that has surprised us over the past several months is that the ISM's prices paid index continued to show rising costs for non-labor inputs, surprising given the long-running contraction in the domestic factory sector and weak manufacturing activity around the globe. That changed in September, with the prices paid index falling to 48.3 percent in September, the first month since last December in which prices paid for non-labor inputs fell. Further declines seem likely in the months ahead.

Though not part of the ISM surveys, the monthly data on orders for core capital goods (nondefense capital goods excluding aircraft & parts) are consistent with the premise of the factory sector being in a holding pattern. Core capital goods orders been rangebound since the beginning of 2023, and we've noted that we do not look for a breakout over the remainder of this year. That will likely also be the case for the ISM Manufacturing Index.







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