ECONOMIC UPDATE
REGIONS
March 3, 2025

February ISM Manufacturing Index: Tariffs Dominate The Discussion . . . And The Data

- The ISM Manufacturing Index fell to 50.3 percent in February from 50.9 percent in January
- The new orders index fell to 48.6 percent, the production index fell to 50.7 percent, and the employment index fell to 47.6 percent

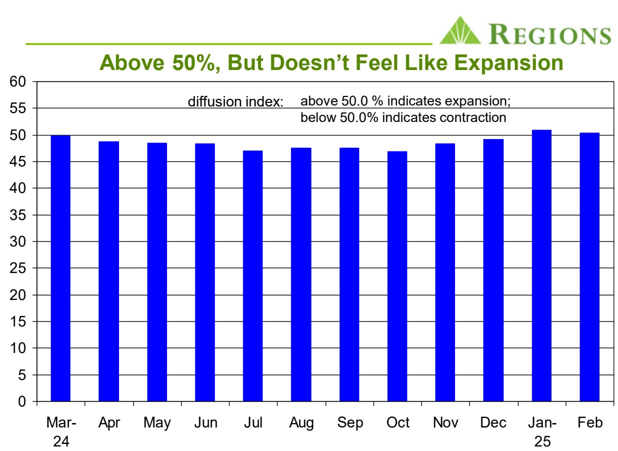
The ISM Manufacturing Index fell to 50.3 percent in February from 50.9 percent in January, below the consensus forecast of 50.7 percent and our forecast of 50.5 percent. While February marks the second straight month in which the headline index was above the 50.0 percent break between contraction and expansion after a run of twenty-six months below that threshold, neither the details of the data nor comments from survey respondents feel all that much like a bona fide expansion. Instead, activity across much of the manufacturing sector is being driven by concerns over higher tariffs which over recent months have impacted orders, output, and prices of non-labor inputs to production. Firms remain hesitant to commit to longer-term purchase and production agreements given the uncertainty around tariffs, and absent such clarity, we'll soon come to a point where the rush to beat tariffs no longer drives activity. At that point, either higher tariffs will depress activity further, the avoidance of tariffs will unleash pent-up orders and production, or there will be some middle ground, with the latter at present seeming the most likely outcome.

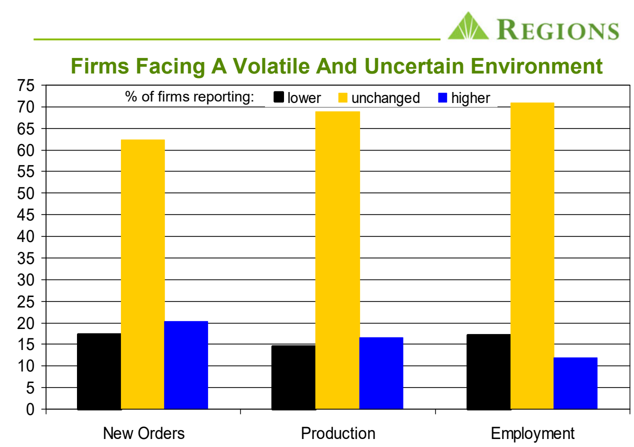
Ten of the eighteen broad industry groups included in the ISM's survey reported growth in February, up from eight in January and the most in any month since August 2022. Again, though, that seemingly positive data point must be put in the context of what is driving this growth and, in turn, how lasting it will prove to be. As relayed by ISM, comments from survey respondents don't exactly lay a foundation for lasting growth. Tariffs clearly dominate the comments, with uncertainty and volatility common themes. Higher prices are another common theme of the comments, with some noting suppliers of non-labor inputs are already adjusting prices higher, significantly so in some instances. One survey respondent, with whom totally sympathize, noted that their management is asking for quick turnarounds on multiple tariff scenarios, which the respondent equated with wild guesses, and it is hard to quibble with them stating that these are "interesting times we live in."

The new orders index fell to 48.6 percent in February, ending a three-month run above the fifty percent threshold, with nine of the eighteen broad industry groups reporting higher orders and six reporting lower orders. The firm-level splits are worth noting; 17.3 percent of firms reported lower orders in February, down from the 20.0 percent of firms that reported lower orders in January, while 62.4 percent of firms reported no change in orders. What drove the diffusion index down, however, is that only 20.3 percent of firms reported higher orders in February, down from the 26.3 percent who did so in the January survey. One interesting observation relayed by ISM is that, in addition to concerns over softer demand, "orders have also been impacted by discussions of which party will pay for potential tariff costs, causing a slowdown in order placements." ISM also notes diminished confidence that interest rates will fall further and that, even if they do fall, lower interest rates may not translate into meaningful boosts in capital spending and construction.

The production index slipped to 50.7 percent in February from January's read of 52.5 percent. Much like the new orders index, however, that a smaller percentage of firms reported higher output in February than did so in January is behind the decline in the diffusion index, as the share of firms reporting lower output slipped from 18.5 percent in January to 14.6 percent in February. Clearly, without sustained growth in orders, output will turn lower, perhaps sharply so, in the months ahead, particularly as backlogs of unfilled orders continue to thin down. February marks the twenty-ninth straight month in which order backlogs declined. That firms have little confidence in sustained orders growth could have contributed to the drop in the employment index, which fell to 47.6 percent in February from 50.3 percent in January, with a notable increase in the share of firms reporting lower employment in February.

The prices paid index jumped to 62.4 percent in February, the highest reading in any month since June 2022. Even more noteworthy is that the percentage of firms reporting paying higher (non-labor) input prices jumped to 31.4 percent in February from 20.7 percent in January while the share of firms reporting paying lower input prices fell to 6.7 percent from 11.0 percent in January. ISM notes that "dramatic increase in commodity prices as a result of new and potential tariffs" are contributing to higher input prices, and the industry splits show price increases have become much more broadly based. As with recent growth in orders and output, however, upward pressure on prices will likely not be sustained.





Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com