ECONOMIC UPDATE
REGIONS
April 1, 2025

March ISM Manufacturing Index: Factory Sector Slips Back Into Contraction

- The ISM Manufacturing Index fell to 49.0 percent in March from 50.3 percent in February
- The new orders index fell to 45.2 percent, the production index fell to 48.3 percent, and the employment index fell to 44.7 percent

The ISM Manufacturing Index fell to 49.0 percent in March from 50.3 percent in February, below what we (49.8 percent) and the consensus (49.5 percent) expected, falling back below the 50.0 percent break between contraction and expansion after a two-month hiatus on the other side of that line. As we noted in this week's *Economic Preview*, however, rather than feeling like the manufacturing sector embarking on a durable and sustained expansion, that two-month stretch felt more like the factory sector bracing for the storm that could lie ahead as higher tariffs are put in place and foreign countries respond/retaliate. We further noted that the production and new orders indexes, which we consider the two most important components of the data, retreating in March as we expected would affirm our interpretation of the headline index's brief foray into "expansionary" territory. Not only did these two components fall in March, they fell more than our forecast anticipated, as was also the case with the employment index. As ISM worded it, the dips in production and employment reflected firms responding to "demand confusion," and that is reflected in the firm-level data more so than in the diffusion indexes. To the extent firms and their customers had been pulling orders and purchases forward to avoid the impacts of higher tariffs, coming months will bring payback. As such, the manufacturing sector, not only in the U.S. but globally, will likely struggle to gain traction unless and until there is an easing of trade tensions which, unfortunately, instead seem set to ratchet up in the near term.

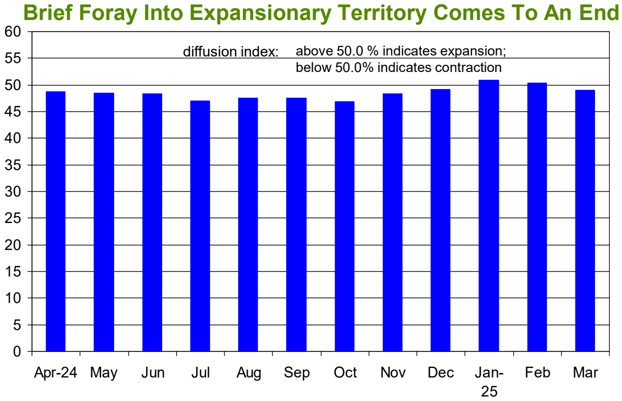
Nine of the eighteen broad industry groups included in the ISM's survey reported growth in March, down from ten in February. Again, though, one factor driving growth across an array of industry groups is firms and their clients attempting to front-run higher tariffs. This is reflected in the comments from survey respondents relayed by ISM which, as was the case in the February survey, are dominated by tariffs. A number of firms report acceleration in orders and inventory building. One respondent noted concern over the extent to which higher pricing will lead to demand destruction, and two respondents pointed to Canada, one noting boycotts of U.S. products could become a reality and one noting Canada's imposing retaliatory tariffs is impacting orders from firms there. In the many years we've been tracking and reporting on the ISM's monthly surveys, we're having a hard time recalling the sentiment expressed by survey respondents being as downbeat as in the March survey.

The new orders index fell to 45.2 percent in March from 48.6 percent in February, with only six of the eighteen industry groups reporting growth in new orders and eight reporting lower orders. The firm-level splits are worth noting; 23.3 percent of firms reported lower orders compared to the 17.3 percent of firms that reported lower orders in February, while the percentage of firms reporting higher orders slipped from 20.3 percent in February to 19.9 percent in March. As in February, ISM again noted that order placements are being delayed pending resolution of discussions around which party will absorb potential increases in tariffs.

The production index fell to 48.3 percent in March, ending a two-month run above the 50.0 percent line. Production will likely soften further in the months ahead as new orders deteriorate further and order backlogs continue to shrink. As ISM notes, this will ultimately lead to head-count reductions and stagnant capital spending. To that point, March marked the thirtieth straight month in which order backlogs thinned. The toll on employment is already apparent; the employment index fell to 44.7 percent in March and only one of the eighteen broad industry groups reported higher employment. While ISM notes that thus far hiring freezes and attrition have been the primary levers being pulled by firms to manage head-counts, it would figure that should order books continue to soften, more firms will begin to resort to layoffs unless they see a clear path to the end of trade tensions which, at least at this point, seems unlikely any time soon. As we expected, the March data show a meaningful boost in inventories and further slowing in supplier delivery times, neither of which we expect to last for very much longer.

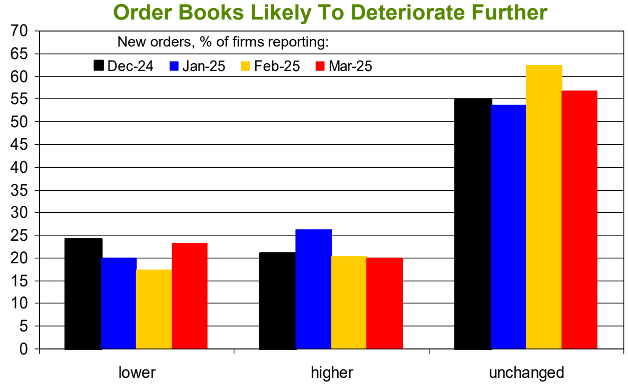
The prices paid index rose to 69.4 percent in March from 62.4 percent in February, with ISM making note of "dramatic increases" in steel and aluminum prices due to higher tariffs. Also, the percentage of firms reporting paying higher input prices jumped to 46.0 percent from 31.4 percent in February. As tariffs are increased and applied to a broader range of countries/goods, price pressures are likely to intensify in the near term, which will further suppress demand.

Brief Foray Into Expansionary Territory Comes To An End



Source: Institute for Supply Management®; Regions Economics Division

Order Books Likely To Deteriorate Further



Source: Institute for Supply Management®; Regions Economics Division

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