ECONOMIC UPDATE

REGIONS

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April ISM Manufacturing Index: Modest Deterioration, But Plenty Of Signs Of Stress

- The ISM Manufacturing Index fell to 48.7 percent in April from 49.0 percent in March
- The new orders index rose to 47.2 percent, the production index fell to 44.0 percent, and the employment index rose to 46.5 percent

The ISM Manufacturing Index fell to 48.7 percent in April from 49.0 percent in March, better than the 47.9 percent read we and the consensus expected. Still, this leaves the headline index below the 50.0 percent break between contraction and expansion for a second straight month, and there are signs of growing stress amongst some of the components beneath the headline index. Clearly, concerns over and impacts of higher tariffs are dominating the manufacturing landscape, and while activity hasn't ground to a halt, what is not yet clear is the extent to which activity in April reflected ongoing efforts to pull orders and deliveries forward to mitigate the impacts of higher tariffs, as opposed to business as usual. Our sense is that it's more the former than the latter, particularly given the extent to which tariffs dominate comments from survey respondents. If that is the case, then the next few months could see deterioration in the headline index and the components as firms retreat into holding patterns awaiting clarity on the policy front. This will be just as true of foreign manufacturers as it will be for U.S. manufacturers.

Eleven of the eighteen broad industry groups included in the ISM's survey reported growth in April, up from nine in March and the most in any month since July 2022. Even allowing for front-running higher tariffs, that does seem at odds with the headline index being below 50.0 percent. As noted above, comments from survey respondents relayed by ISM are dominated by tariffs. A sense of frustration is apparent in some of the comments, with one noting that "implementation of tariffs has been sudden and abrupt," one noting that supply chains are "paralyzed in a world that changes daily due to tariffs," and another noting that "supplier relationships are strained by pain-share negotiations." Lack of alternatives to inputs imported from China is weighing on bottom lines of some firms, and there are instances of domestic suppliers raising prices under the cover of higher tariffs on imports. This will all take some time to sort out, particularly as changes in effective tariff rates seem likely to come piecemeal in the weeks/months ahead with little insight into when and how the most pressing trade dispute – that between the U.S. and China – will be resolved. In such an environment, meaningful and broadly based growth in the manufacturing sector is hard to envision, with further retreats in the ISM's headline index likely in the interim.

One surprise in the April survey is that while the new orders index continued to show contraction, the firm level splits were more constructive. Just over twenty-eight percent of firms reported growth in new orders in April, compared to just under twenty percent in the March survey, dominating the more modest increase in the percentage of firms reporting lower orders. ISM notes that rising percentages of firms reporting "higher" and "lower" orders in the same month is unusual. The net result is that the new orders index rose to 47.2 percent in April from 45.2 percent in March, easily above what our forecast anticipated. Eight of the eighteen industry groups reported growth in orders while six reported lower orders, and ISM also notes that discussions over which party will, at least potentially, absorb higher tariffs continue to hold up orders. Though not entering into the headline index, the index of new export orders fell sharply in April, logging the largest monthly decline since April 2020. More tellingly, none of the eighteen broad industry groups reported growth in export orders in April, and there was a significant increase in the percentage of firms reporting lower export orders. ISM notes that retaliatory tariffs imposed on U.S.-made goods contributed to the deterioration in new export orders.

The production index fell to 44.0 percent in April from 48.3 percent in March, with weaker order books and dwindling order backlogs weighing on production. Moreover, uncertainty around the business climate has caused many firms to put plans for capital spending on the shelf for now, which is also weighing on production. That is flowing into employment, with the ISM's employment index remaining below 50.0 percent and ISM noting that layoffs are becoming more common as they are a timelier way to achieve reductions in head counts than is attrition.

The prices paid index rose to 69.8 percent in April from 69.4 percent in March, with fifteen of the eighteen broad industry groups reporting higher input prices. ISM notes that higher prices for steel and aluminum are reverberating through production across a range of products. There are indications of domestic firms in tariff-protected industries pushing prices higher. Higher input costs amid softening demand could trigger more aggressive layoffs over coming months, at least to the extent producers are unable to pass along higher cost structures.