ECONOMIC UPDATE

REGIONS

June 2, 2025

May ISM Manufacturing Index: "Don't Just Do Something, Stand There"

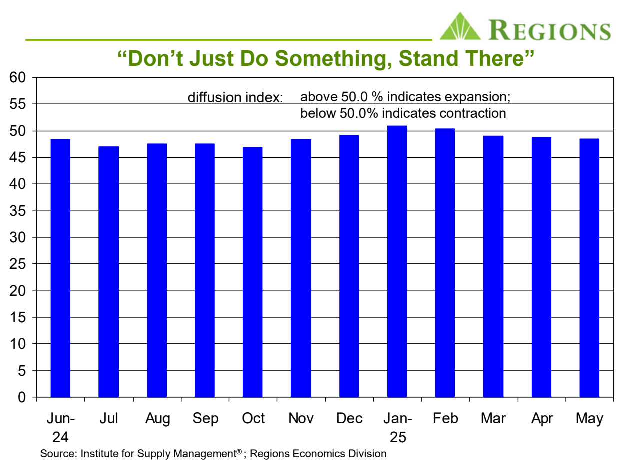
- The ISM Manufacturing Index fell to 48.5 percent in May from 48.7 percent in April
- The new orders index rose to 47.6 percent, the production index rose to 45.4 percent, and the employment index rose to 46.8 percent

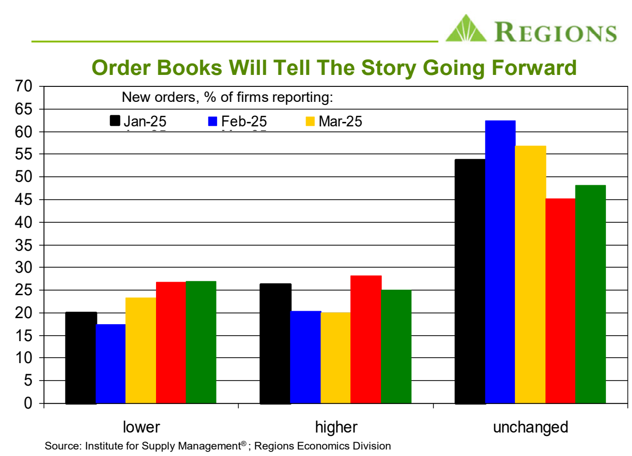
The ISM Manufacturing Index fell to 48.5 in May from 48.7 percent in April, below what we (50.1 percent) and the consensus (49.5 percent) expected and marking a third straight month of the headline index being on the wrong side of the 50.0 percent break between contraction and expansion. As we noted in this week's *Economic Preview*, that we looked for the headline index to nudge above that 50.0 percent break didn't mean we saw genuine improvement in underlying industry conditions, but instead that we expected firms to take advantage of a transitory trade "truce" to pull activity forward, as they clearly did during the year's first quarter. That activity, however, seems to have largely run its course, one difference being that businesses, and consumers for that matter, who pulled activity forward into the first quarter did so in anticipation of higher tariffs so without any specifics on how high tariffs might go, whereas having actually seen how high tariffs might go three months down the road likely just pushed firms to the sidelines. We'll note that while the indexes of new orders, production, and employment rose in May, as we anticipated, the increases were not as pronounced as we expected. Still, a sharp decline in the inventory index knocked eight-tenths of a point off the headline index, which could reflect firms simply being unwilling, to our earlier point, to get caught out holding elevated inventories given all the uncertainty over tariffs. Unfortunately, the next two surveys may not, barring of course new developments on the trade front, look all that much different than the May survey.

Only seven of the eighteen broad industry groups included in the ISM's survey reported growth in May, down from eleven in April and the fewest in any month thus far in 2025. To the surprise of no one, comments from survey respondents are dominated by the effects of tariffs. One respondent from the primary metals industry group noting that we're now in the "wait" part of wait and see seems an apt summary of conditions in the factory sector. Another respondent noted that tariffs have led to supply chain disruptions reminiscent of the COVID period. It is interesting to note that while one respondent from the transportation equipment industry group sees vehicle manufacturers as having the upper hand over suppliers, in terms of absorbing higher tariffs, another respondent from the chemical products industry group sees suppliers as having the upper hand over firms. This goes to a point we've made about the effects of higher tariffs, which is that there is simply not a one-size-fits-all answer that will apply to every single industry group. Either way, one common theme of the comments from survey respondents is that increased uncertainty has led many firms, and their customers, to simply retreat to the sidelines, where we think many will stay for a while.

The new orders index edged up to 47.6 percent in May from 47.2 percent in April, with eight of the eighteen broad industry groups reporting orders growth. The firm-level splits were slightly less favorable in May than was the case in April, but nearly one-half of all firms reported no change in order volumes in May. In other words, while we anticipated a bigger boost in new orders in May, in part reflecting the tariff "truce" between the U.S. and China, that clearly did not materialize. At the same time, backlogs of unfilled orders contracted further in May, which marked the thirty-second straight month in which order backlogs diminished. Though not included in the calculation of the headline index, it is worth noting that not only did export orders contract for a third straight month, but they did so at the fastest rate since the onset of the pandemic and, barring the pandemic period, the fastest rate since the 2007-09 recession. As ISM notes, it does appear that foreign countries imposing retaliatory tariffs on U.S.-made goods is weighing on export orders.

Though rising modestly, the production index again pointed to declining output, with weaker order books and dwindling order backlogs weighing on production. That is reflected in the steep drop in the inventories index, as firms do not want to be weighed down by elevated inventories of inputs which may not be needed, with ISM noting that firms' efforts to stockpile inputs to avoid tariff-related price increases has largely run its course. If there is a silver lining in the cloudy May survey, it is that firms see their customers as holding inventory levels that are too low, suggesting that with some clarity on the policy front, providing tariffs are not prohibitive, demand could pick up which, in turn, would be supportive of orders, production, and employment. It is also worth noting that, despite orders and output contracting, input prices over the last three months have risen at a pace last seen in mid-2022, reflecting the impact of higher tariffs throughout supply chains.





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