ECONOMIC UPDATE

REGIONS

June 1, 2020

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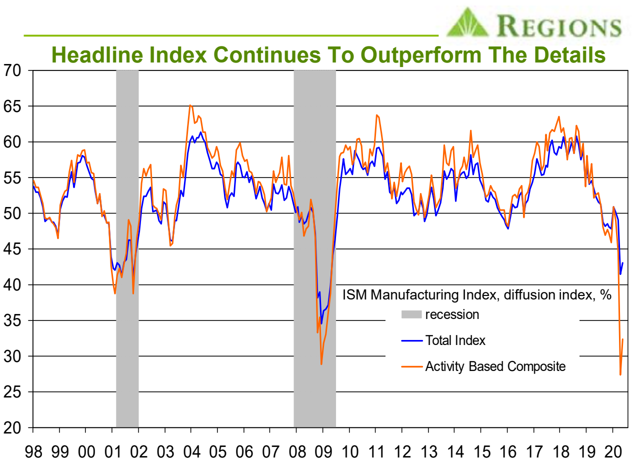
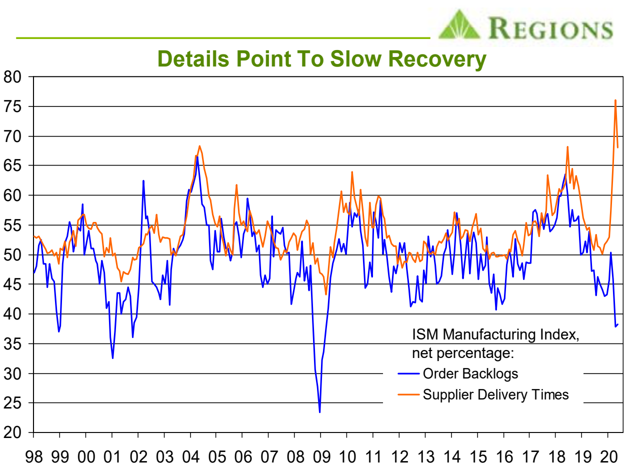
May ISM Manufacturing Index: Headline Index Continues To Outperform The Details

- The ISM Manufacturing Index <u>rose</u> to 43.1 percent in May from 41.5 percent in April
- The new orders index <u>rose</u> to 31.8 percent, the employment index <u>rose</u> to 32.1 percent, and the production index <u>rose</u> to 33.2 percent

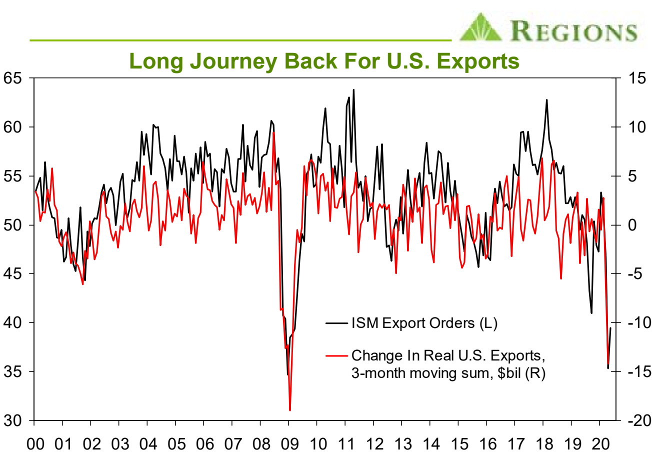
The ISM Manufacturing Index rose to 43.1 percent in May, falling short of what we (44.7 percent) and the consensus (43.8 percent) expected. While the key sub-indexes of new orders, production, and employment rose as we anticipated, the increases in the first two rose by less than we expected, accounting for our miss on the headline index. As has been the case for the past few months, the headline index outperformed the underlying details in May, thanks to how supplier delivery times are accounted for in the calculation of the headline index. The broader point is that the contraction in the manufacturing sector continued in May, but at a slower pace than was the case in April. While restrictions on economic activity have begun to ease, both in the U.S. and abroad, there are material differences in the rate at which that is taking place, across the individual states and across countries, the latter of which matters given the extent to which U.S. manufacturers rely on global supply chains and sell in global markets. Given that it was not, for the most part, until the latter part of May that restrictions began to ease, we and most others expected only limited improvement in the ISM Index in May, and that's what we got. This sets up the June data as a more meaningful gauge at which the U.S. and global economies are rebounding from a brief, but violent, downturn stemming from the COVID-19 virus and efforts to stem its spread.



Of the 18 industry groups included in the ISM's survey, six reported growth in May, with 11 reporting contraction – in April, only two of the 18 industry groups reported growth. To our earlier point, ISM noted that May appears to be "transition month" as economic activity began to come back online, but further noted that the outlook for demand remains uncertain, which could weigh on the rate at which employment and output rebound. Comments from survey respondents show that supply chain issues remain a problem; one respondent from the machinery industry group noted their firm was "looking at what really needs to be in China," which is likely taking place across firms in a wide range of industry groups.



The index of new orders rose to 31.8 percent in May, up from 27.1 percent in April but still indicative of further contraction in new orders. Four of the 18 industry groups reported growth in orders in May, while 12 reported lower orders. The production index rose to 33.2 percent in May, up from 27.5 percent in April, with four industry groups reporting higher production and 11 reporting lower output. In addition to the rate at which demand rebounds, the rebound in production will be impacted by the degree to which the manufacturing process has been changed due to new social distancing and cleaning protocols, and it will take time for firms to adapt. The employment index rose to 32.1 percent in May from 27.5 percent in April, with only two of the 18 industry groups reporting higher levels of employment and 16 reporting declines. Though the index of supplier delivery times fell to 68.0 percent in May from 76.0 percent in April, the index nonetheless points to a further slowing of supplier delivery times which, in the calculation of the ISM's headline index, acts as a positive. In other words, for a third straight month, the headline index understates the severity of the contraction in manufacturing activity. Though there are relatively few times in which the index of supplier delivery times distorts the headline index, this is one of those times. To compensate for that, we track an equally weighted composite of the new orders, production, and employment indexes which we see as a more reliable gauge of factory sector activity. Our composite rose to 32.4 percent in May, up from an all-time low of 27.4 percent in April, but short of our forecast of 35.5 percent.



Other details of the ISM data reinforce our expectation of a slow and uneven recovery in the manufacturing sector. Order backlogs contracted further in May, meaning that it will take a material and sustained increase in new orders to drive meaningful increases in employment and output. New export orders fell further in May, suggesting further downward pressure on already hard-hit U.S. exports in the months ahead.

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