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September ISM Manufacturing Index: Settling Into A More Sustainable Pace

- The ISM Manufacturing Index fell to 55.4 percent in September from 56.0 percent in August
- The new orders index fell to 60.2 percent, the employment index rose to 49.6 percent, and the production index fell to 61.0 percent

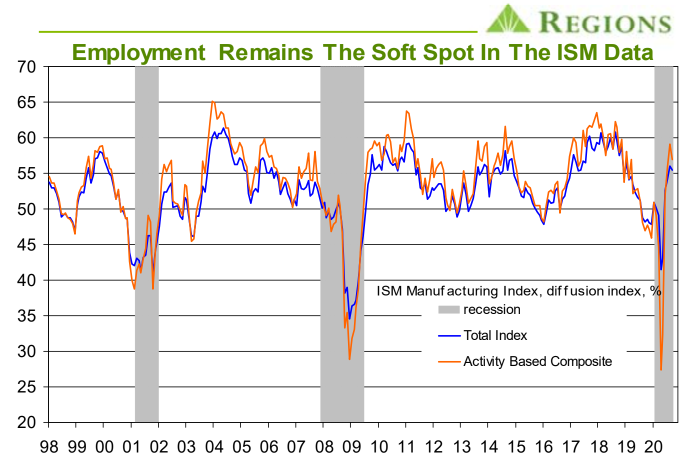
The ISM Manufacturing Index fell to 55.4 percent in September, contrary to the increase we and the consensus anticipated. Like many other data series, the ISM's gauge of manufacturing activity shows the pace of growth easing from that seen in the early months of the rebound from the deep but short-lived contraction associated with the COVID-19 virus and the efforts to stem its spread. That was a matter of when, not if, and the ISM's gauges of new orders and production show these components settled into a more sustainable pace of growth a bit quicker than our forecast anticipated. Either way, the message is the same – the rebound in the factory sector has become deeper and more entrenched with each passing month, and there is room for further growth, even if at a slower pace, in the months ahead.

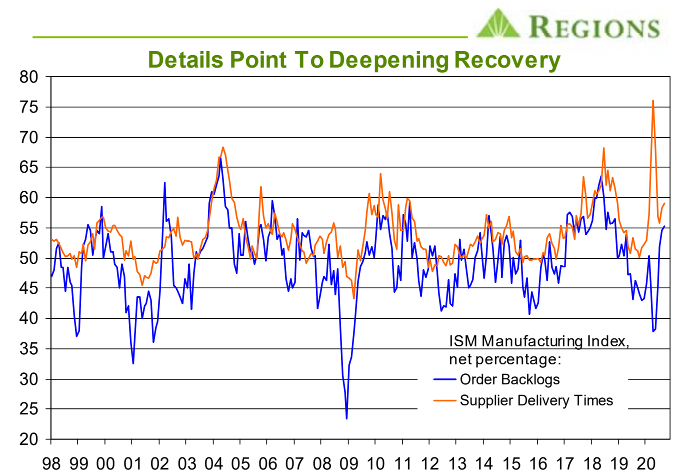
Fourteen of the 18 industry groups included in the ISM's survey reported growth in September, with four reporting contraction. Recall that in the April survey, only two industry groups reported growth, and that this number has steadily climbed from the depths of April shows a broad based recovery across the manufacturing sector. Comments from survey respondents are mostly positive, the main theme is further growth in demand though activity remains short of pre-pandemic norms. Additionally, there are comments indicating stress on supply chains and stress on supplies of raw materials. This will bear watching, as both factors could easily weigh on growth in the factory sector but at the same time could help prop up the ISM's headline index number, as slower delivery times are a positive in the calculation of the overall index.

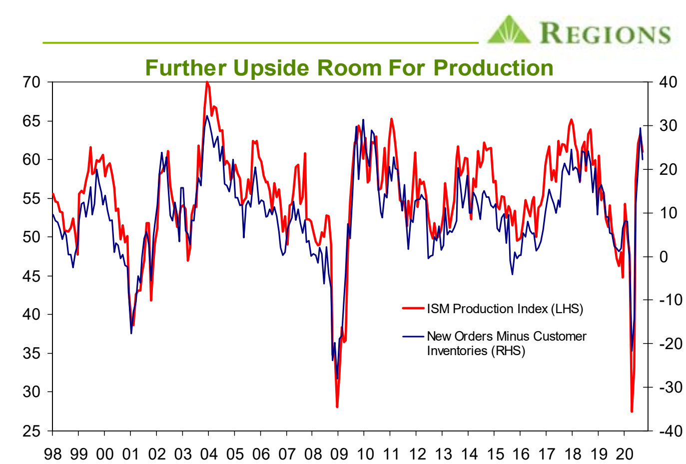
The new orders index fell to 60.2 percent in September from 67.6 percent in August, with 12 industry groups reporting higher orders and three reporting lower orders. While our forecast anticipated the new orders index would drop, the decline proved to be larger than we expected. Still, at 60.2 percent, the ISM's index is consistent with further growth in new orders and is in line with the monthly data on factory orders showing continued growth in orders for core capital goods. The ISM's gauge of production shows a similar pattern, having declined from 63.3 percent in August to 61.0 percent in September but nonetheless still indicative of growth. Fourteen industry groups reported higher output in September with three reporting lower output. Other details of the data point to the recovery in the factory sector deepening further in September. Backlogs of unfilled orders grew further, with 10 of the 18 industry groups reporting larger backlogs, while new export orders grew at a faster pace in September than in August. Still, there are signs of stress in the manufacturing sector, such as 16 of the 18 industry groups reporting slower delivery times in September. Inventories of raw materials contracted for a third straight month in September, reflecting further growth in production coupled with slowing supplier delivery times. As such, it is no surprise that the prices paid index, a gauge of whether raw materials prices are rising or falling, rose to 62.8 percent in September, the highest reading since October 2018 with 15 of the 18 industry groups reporting paying higher prices for raw materials.

The one seeming outlier in the ISM survey is the employment index, which pointed to a 14th consecutive month of lower factory payrolls, in stark contrast to the BLS's monthly employment reports, with the September employment report expected to show a fifth straight month of rising manufacturing employment. While the ISM's measure shows the pace of contraction slowing significantly, that it still shows declining job counts is more than a bit puzzling.

One detail in the ISM data we look to as a leading indicator is the gap between the indexes of new orders and customer inventories. The vast majority of industry groups report customer inventory levels are too low, suggesting further gains in new orders and production in the months ahead, reinforcing the signal being sent by growing backlogs of unfilled orders. So, while the pace may be slowing, the ISM's data point to further expansion in the factory sector in the months ahead.







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