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March ISM Manufacturing Index: Expansion Kicks Into Higher Gear, But Headwinds Remain

- › The ISM Manufacturing Index rose to 64.7 percent in March from 60.8 percent in February
- › The new orders index rose to 68.0 percent, the employment index rose to 59.6 percent, and the production index rose to 68.1 percent

The ISM Manufacturing Index rose to 64.7 percent in March, above our forecast of 62.7 percent and the consensus forecast of 61.8 percent, marking the highest reading since December 1983. March was the tenth consecutive month in which the headline index was above the 50.0 percent break between contraction and expansion. Both new orders and backlogs of unfilled orders grew further in March, though further growth in order backlogs in part reflects shortages of key inputs to production and increasing supply chain bottlenecks that could act as a drag on the pace of growth in the factory sector over coming months. Price pressures remain intense, and it remains to be seen whether, or to what extent, rising input prices and higher shipping costs will ultimately make their way into broader measures of inflation over coming months. Still, with order books expanding faster than firms can fill them, output and employment in the manufacturing sector are poised for further growth in the months ahead.

Of the 18 industry groups included in the ISM’s survey, 17 reported growth in March with none reporting contraction, the most industry groups reporting growth since July 2018. March is the sixth consecutive month in which at least 15 of the 18 industry groups reported growth. Shortages of materials and supply chain bottlenecks are front and center in the comments by survey respondents relayed by ISM, with a number of respondents citing February’s harsh winter weather as having intensified these issues. The reality, however, is that input shortages and supply chain issues have been cited in the ISM’s survey for months and they are likely to endure for some time to come, particularly as the pace of global economic activity picks up in the months ahead.

The new orders index rose to 68.0 percent in March, the highest reading since January 2004 and the tenth consecutive month of growth in new orders. Fifteen of the 18 industry groups reported higher orders in March with only one – wood products – reporting lower orders. A separate gauge of new export orders, which does not enter into the calculation of the headline index, slipped in March but, at 54.5 percent, still shows growth in new export orders. The ISM’s production index rose to 68.1 percent in March, also the highest reading since January 2004, with 14 of the 18 industry groups reporting higher output and none reporting lower output. The employment index rose to 59.6 percent in March, with 14 of the 18 industry groups reporting higher employment. This poses an upside risk to our above-consensus forecast for job growth in manufacturing in the March employment report (to be released tomorrow).

Indicative of the degree of stress on supply chains, the index of supplier delivery times rose to 76.6 percent in March, the highest reading since April 1974 when the 1973 oil crisis was beginning to ease. Of the 18 industry groups in the ISM’s survey, 17 reported slower delivery times in March with none reporting faster delivery times. In addition to logistics challenges, ISM notes suppliers continue to face labor supply issues that are also acting as drags on delivery times. Neither logistics nor labor supply issues figure to ease to a meaningful degree in the near term, meaning that for as long as demand remains robust, which we expect will be the case, order backlogs will continue to expand. The ISM’s gauge of order backlogs rose to 67.5 percent in March, the highest on record, with 15 of the 18 industry groups reporting growing backlogs. An additional 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 and thus reinforcing the signal being sent by growing backlogs of unfilled orders. At the same time, March marks a fourth straight month in which all 18 industry groups reported paying higher prices for inputs. With producers having more pricing power than has been the case over the past several years, these higher input prices, and higher shipping costs, are likely to be passed along in the form of higher prices for intermediate and final goods.

