ECONOMIC UPDATE

REGIONS

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December ISM Manufacturing Index: Factory Sector Facing Stiff Headwinds In 2023

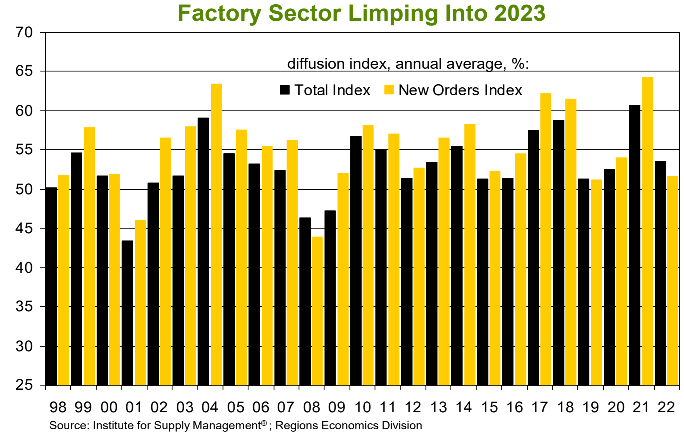
- The ISM Manufacturing Index fell to 48.4 percent in December from 49.0 percent in November
- The new orders index fell to 45.2 percent, the employment index rose to 51.4 percent, and the production index fell to 48.5 percent

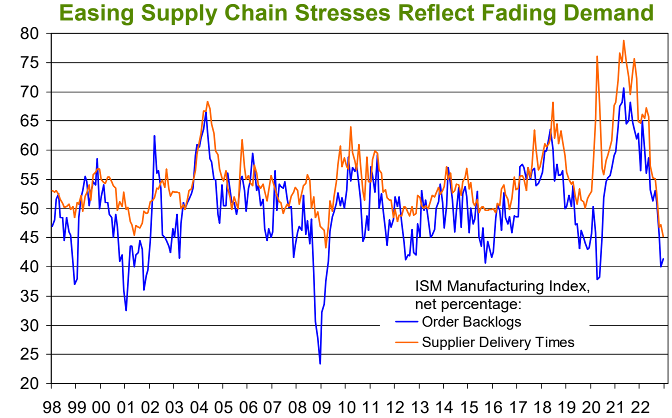
The ISM Manufacturing Index fell to 48.4 percent in December, between what we (48.3 percent) and the consensus (48.5 percent) expected, marking a second straight month below the 50.0 percent break between contraction and expansion after a 29-month run of growth. The dip below that 50.0 percent break, however, is simply an extension of patterns we have been pointing to for some time, i.e., the expansion having become increasingly slower and less broadly based. New orders for manufactured goods continue to contract, and that includes new export orders, reflecting steady deterioration in domestic and foreign demand, and what were once sizable backlogs of unfilled orders have been significantly pare down. This foreshadows further weakness in output and employment in the manufacturing sector in the months ahead. Reflecting the sharp pullback in demand, prices for non-labor input prices fell further in December while supplier delivery times once again shortened. December's decline puts the ISM's headline index below the 48.7 percent threshold it says to be consistent with growth in the broader economy, though given that the ISM Manufacturing Index is the first piece of December data to be released it is too soon to know whether other indicators will send the same signal. We tend to doubt that but, either way, the next several months will be challenging for the manufacturing sector.

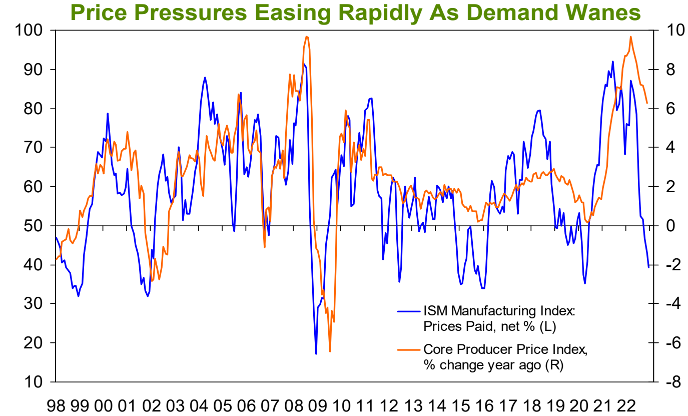
To our earlier point about the expansion in the factory sector becoming increasingly less broad based, recall that from 2021 through mid-2022, on average sixteen of the eighteen industry groups reported expansion in a given month. That number tailed off over the back half of 2022, to the point that only two – primary metals and petroleum & coal products – of the eighteen industry groups included in the ISM's survey reported expansion in December, while thirteen industry groups reported contraction. That carries through to the slide in both the headline index and the index of new orders. While the latter averaged 51.6 percent for 2022 as a whole, new orders contracted in six of the last seven months of 2022, meaning that the factory sector comes into 2023 facing meaningful headwinds. That is consistent with the general themes of comments from survey respondents relayed by ISM. While some point to further easing in supply-side bottlenecks, softening demand and increased uncertainty around the economic outlook are taking a toll on manufacturers across a wide range of industry groups.

Only three of the eighteen industry groups reported growth in new orders in December, with eleven reporting declines, which leaves the new orders index at 45.2 percent, the lowest reading since May 2020. The index of new export orders fell to 46.2 percent, marking a fifth straight month of contraction with only five industry groups reporting increased export orders. At the same time, backlogs of unfilled orders shrank further in December, the third straight month of contraction after a 27-month run of expansion. Only two of the eighteen industry groups reported larger order backlogs while twelve reported smaller backlogs. Large backlogs of unfilled orders had acted as somewhat of a buffer to protect firms from lower current orders, but that buffer is now basically gone meaning that should new orders continue to contract, the impacts on employment and output will be felt much more acutely. As it is, the production index fell to 48.5 percent in December, ending a 30-month run above the 50.0 percent threshold with only four industry groups reporting higher output. While the employment index rose to 51.4 percent, only five industry groups reported employment growth in December while six reported declines in employment. The employment index has jumped around over the past several months, but ISM notes that companies are now adding layoffs to hiring freezes and attrition as a means of managing head counts amid weakening demand.

The prices paid index fell to 39.4 percent in December, marking a third straight month of falling prices for non-labor inputs, with only one industry group reporting paying higher input prices. Over the past nine months, the prices paid index has fallen by 47.7 percentage points, and the ongoing slide in the ISM's gauge suggests that core inflation on the producer level will continue to slow in the months ahead.







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