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April ISM Manufacturing Index: Welcome To The “Season Of Contradictions”

- › The ISM Manufacturing Index rose to 47.1 percent in April from 46.3 percent in March
- › The new orders index rose to 45.7 percent, the employment index rose to 50.2 percent, and the production index rose to 48.9 percent

The ISM Manufacturing Index rose in April but, at 47.1 percent, signals a sixth straight month of contraction in the factory sector. April’s headline index came in above what we and the consensus expected, but the details are somewhat of a mixed bag. New orders and production fell further in April, but the ISM’s gauge of employment pushed back above the 50.0 percent mark. Comments from survey respondents across industry groups were also a mixed bag, and while that is not in and of itself surprising, it does suggest that the broad manufacturing sector as a whole will continue to face challenging conditions in the months ahead.

Five of the eighteen industry groups included in the ISM’s survey reported growth in April, down from six in March, while eleven reported contraction. As indicated above, comments from survey respondents relayed by ISM are a mixed bag. While some noted that supplier delivery times continue to come down, one firm in the miscellaneous manufacturing group noted order backlogs continue to grow due to rising orders and lingering supply chain constraints. Some noted customers are becoming more resistant to price increases, which bears noting given that the sharp declines in input costs reported over the final months of 2022 have reversed course, indicating firms in at least some manufacturing industry groups could be facing margin pressures over coming months. Unlike the March survey, there were no mentions of the banking system in the comments relayed by ISM. We do, however, sympathize with a survey participant in the primary metals industry group, who noted being in a “season of contradictions” in which things seemingly change by the day, and further noted that “it’s hard to make projections at the moment,” to which we can only say welcome to our world.

New orders contracted for the tenth month in the past eleven, but what is noteworthy here is that the index of new orders rose from 44.3 percent in March to 45.7 percent in April. What makes this noteworthy is that, as we noted in this week’s *Economic Preview*, the seasonal factor used to adjust the new orders index is tougher in April than in any other month of the year. While not having access to the raw data, which ISM does not report, it is reasonable to think that the weakness in new orders reported in the seasonally adjusted data for April is a bit overstated, particularly given that eight industry groups reported higher order volumes and six reported lower order volumes – recall that in March only five industry groups reported rising order volumes. Another survey component with a notably tough April seasonal factor is the production index which, like the new orders index, rose in April despite remaining in contractionary territory. It is of note here that eleven of the eighteen industry groups included in the ISM’s survey reported higher output in April, the most in a year, with five reporting lower output levels. Again, our sense is that the seasonally adjusted data are at least to some extent overstating the weakness in the factory sector. That is by no means to suggest that the factory sector is humming along, but only to suggest that, as we expect will be the case with much of the economic data for the month of April, the seasonally adjusted data are making things look worse than is actually the case.

One note of caution, however, is that firms on net are now reporting that customer inventory levels are too high for the first time since June of 2017. Though ISM notes that customer inventories are at “the low end of the too high level,” the takeaway here is that the gap between the new orders index and the customer inventories index has pushed further into negative territory. We’ve always used this gap as an indicator of future production with negative readings an ominous sign for output growth. With new order still soft and order backlogs shrinking further, it will be hard for production to gain much traction in the months ahead.

Also worth noting is that, after having plummeted over the back half of 2022, the prices paid index has been above the 50.0 percent mark in two of the past three months. ISM notes input markets are becoming more balanced, but the firming in the prices paid index suggests core goods disinflation, let alone deflation, is by no means a lock.

