# ECONOMIC UPDATE

REGIONS

June 1, 2023



## May ISM Manufacturing Index: Another Tough Month For Manufacturing

- The ISM Manufacturing Index fell to 46.9 in May from 47.1 percent in April
- The new orders index fell to 42.6 percent, the employment index rose to 51.4 percent, and the production index rose to 51.1 percent

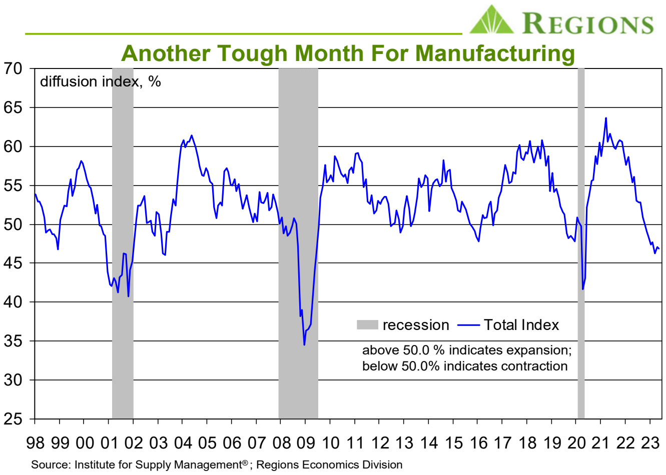
The ISM Manufacturing Index fell to 46.9 percent in May, in line with the consensus forecast of 47.0 percent but well off our forecast of 48.1 percent, marking the seventh consecutive month of contraction in the factory sector. As our forecast anticipated, both the production and employment indexes rose and were above 50.0 percent in May, but each benefitted from favorable seasonal adjustment, diminishing the signaling value of the May readings. Where our forecast went off the rails, however, was the new orders index, which we anticipated would increase but nonetheless remain below the 50.0 percent break between contraction and expansion. Instead, the new orders index fell sharply, signaling further pain in the factory sector in the months ahead, particularly at a time when the ISM's gauge of backlogs of unfilled orders fell to its lowest point since February 2009. While we had seen some hopeful signs in the details of the April data, there are no such signs in the details of the May data, suggesting declines in output and employment in the manufacturing sector in the months ahead.

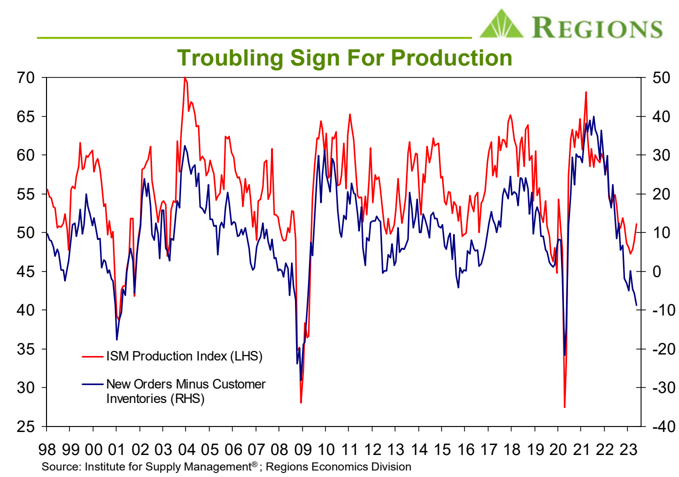
Only four of the eighteen industry groups included in the ISM's survey reported growth in May, the fewest since February, with the remaining fourteen industry groups reporting contraction. One of the industry groups reporting growth in May was transportation equipment, reflecting motor vehicle manufacturers still playing catch-up from protracted supply chain disruptions and aircraft producers continuing to book and fill new orders. As the broader economy weakens in the months ahead and motor vehicle inventories are right-sized, producers of transportation equipment could face a steep drop-off in demand. To that point, one respondent from this industry group noted that while order backlogs remain elevated, new orders are slowing. Other comments were mixed, with a few industry groups reporting demand was holding up while others noted some softening. Comments pertaining to supply chain stresses and input price pressures are in line with assessments of demand across the individual industry groups.

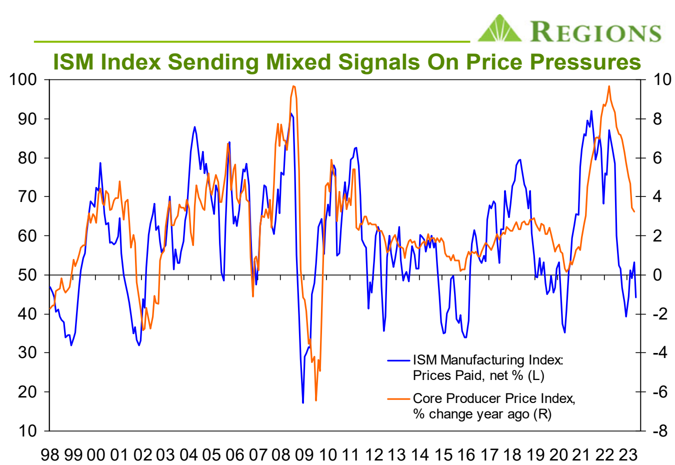
The index of new orders fell to 42.6 percent in May, with only three of the eighteen industry groups reporting growth in new orders. The decline in May more than erased the increase seen in the April data, when eight industry groups reported growth in orders. Our forecast anticipated those modest April improvements would have been built on in the May survey, but it would be closer to the case to say they were crushed instead. To our earlier point, the index of order backlogs sank to 37.5 percent in May, again the lowest reading since February 2009, with not a single industry group reporting larger backlogs in May. Another ominous sign in the May data is that customer inventory levels are, on net, deemed to be too high. We've long used the gap between the reads on the new orders and customer inventory indexes as an indicator of future production, and, barring the reads in the early months of the pandemic, as of May that gap is now at its lowest point since March 2009.

The details cited above carry much more weight with us than the reported increase in the production index, which rose to 51.1 percent in May. To that point, only seven industry groups reporting higher output in May after eleven industry groups reported higher output in April. As with the production index, the employment index also benefited from favorable seasonal adjustment in May. While the employment index rose to 51.4 percent, only five of the eighteen industry groups reported employment rising in May. Whereas earlier in the year ISM was reporting firms were holding on to workers and even doing hiring when they could find labor in anticipation of a rebound in growth over 2H 2023, those comments have been missing from the more recent surveys, which is consistent with the signals being sent by the details on orders.

The ISM's gauge of input prices reversed course in May, indicating lower input prices, but the index has been all over the map over the past several months. There is a good deal of variance in pressures on input costs across industry groups but, on the whole, there is no clear direction in the ISM data and no clear signal for pressures on finished goods prices as reported in the inflation data over coming months.

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