ECONOMIC UPDATE

REGIONS

October 2, 2023

September ISM Manufacturing Index: Better, But Not This Much Better, And Still Not Good

- The ISM Manufacturing Index rose to 49.0 percent in September from 47.6 percent in August
- The new orders index rose to 49.2 percent, the employment index rose to 51.2 percent, and the production index rose to 52.5 percent

The ISM Manufacturing Index rose to 49.0 percent in September, topping our forecast of 48.7 percent and easily ahead of the consensus forecast of 47.9 percent. Despite the improvement, September marks the eleventh straight month in which the headline index is below the 50.0 percent break between contraction and expansion, and while many are taking encouragement from September's print being the highest since last November and suggesting a slowing pace of contraction, we're not quite so convinced. As we noted in this week's *Economic Preview*, the September seasonal factors are on the generous side and, as such, could bias the seasonally adjusted sub-indexes of new orders, production, employment, and inventories higher and, as each of these sub-indexes factors into the calculation of the headline index, the latter could be biased higher as well. While we can't, absent access to the raw data, know whether, or to what extent, that actually proved to be the case, we'll note that other indicators of the level of activity in the factory sector, such as supplier delivery times, order backlogs, export orders, and input prices, suggest ongoing softness with no meaningful turn in sight. That interpretation is reinforced by the majority of industry groups reporting contraction in September. So, while not totally dismissing the improvement in the top-line index and key components seen in September, we're not willing to read as much into that as many others apparently are. With elevated energy prices, higher interest rates, a strong U.S. dollar, listless global growth, and the possibility of a protracted strike by UAW workers, we see the risks to the factory sector as remaining weighted to the downside.

Five of the eighteen industry groups included in the ISM's survey reported growth in September, matching August as the most in any month since April but, as noted above, eleven industry groups reported contraction. Comments from survey respondents were mixed, with some noting steady demand and others pointing to soft conditions, but if there was a common thread in the comments it was concern over costs both from a customer perspective and from an input cost perspective. The latter is interesting given what has been a string of input price declines, at least as indicated in the ISM's survey, but on the whole cost concerns reflect uncertainty over the near-term outlook.

The index of new orders rose to 49.2 percent in September from 46.8 percent in August, but this nonetheless marks the thirteenth straight month in which new orders have contracted. Moreover, only five industry groups reported order growth in September. As seen in our middle chart, the breadth of orders growth has been notably narrow for quite some time, far more so in the early phases of reopening and over the course of the expansion that prevailed in the years ahead of the pandemic. At the same time, order backlogs contracted further in September, the twelfth straight month in which that was the case. As we've often noted, contracting new orders and thinning order backlogs set up a weak profile for production and employment. That said, the production index rose to 52.5 percent in September, with ten industry groups reporting higher output, one of which was the transportation equipment industry group, with growth there not likely to persist amid the UAW strike. The employment index rose to 51.2 percent, with seven industry groups reporting higher head counts and eight reporting lower. ISM did note that hiring freezes were more prevalent in September than in August, though the use of attrition and layoffs to manage payrolls was less pronounced.

In addition to thinning order backlogs, more rapid supplier delivery times are a sign of soft conditions, and the index of delivery times eased further (indicating faster delivery times) in September, which weighed on the headline index. Input prices declined further in September, with twelve of the eighteen industry groups reporting paying lower input prices. New export orders fell in September, marking the thirteenth decline in the past fourteen months, while import volumes fell for the eleventh straight month, which is noteworthy in that imports of intermediate capital goods used in domestic production account for a sizable share of total imports into the U.S. As such, sagging import volumes are an indication of weakness in production amongst U.S. firms.

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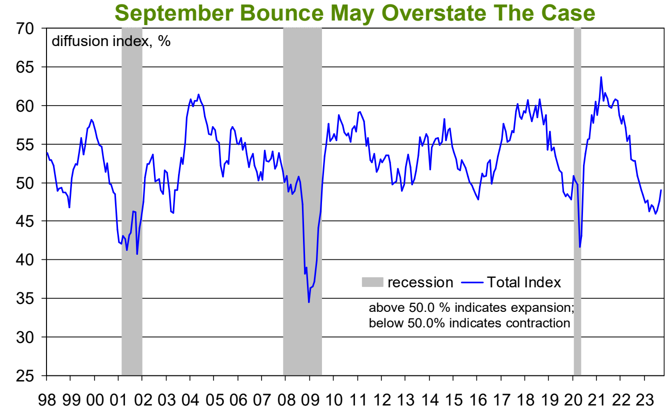
September Bounce May Overstate The Case



Source: Institute for Supply Management®; Regions Economics Division

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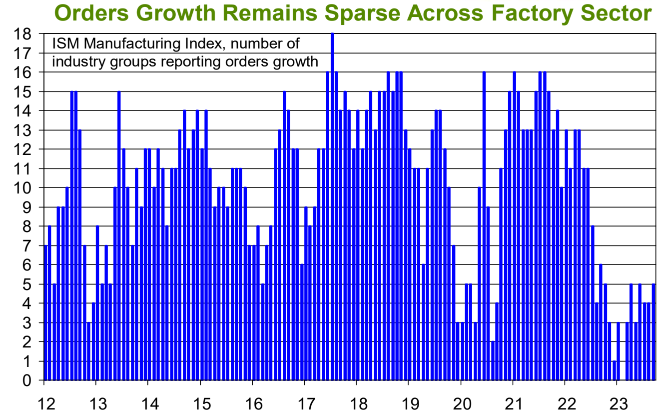
Orders Growth Remains Sparse Across Factory Sector



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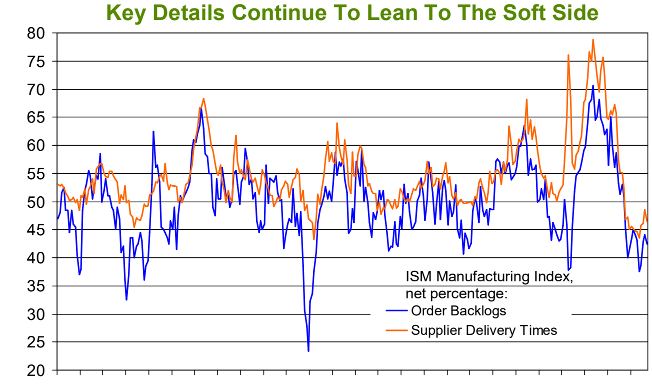
Key Details Continue To Lean To The Soft Side



Source: Institute for Supply Management®; Regions Economics Division

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