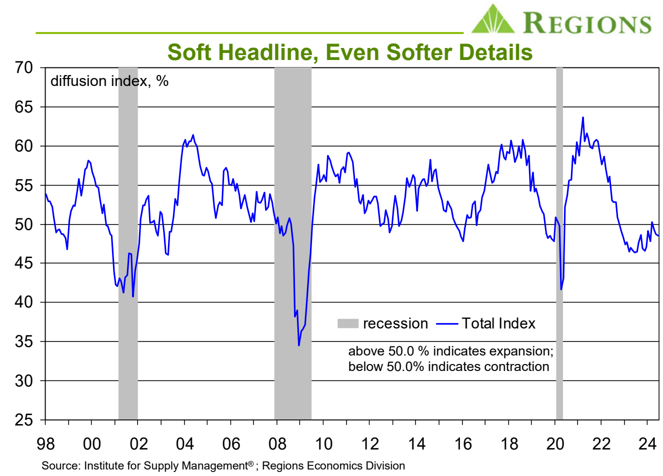
ECONOMIC UPDATE
REGIONS
July 1, 2024

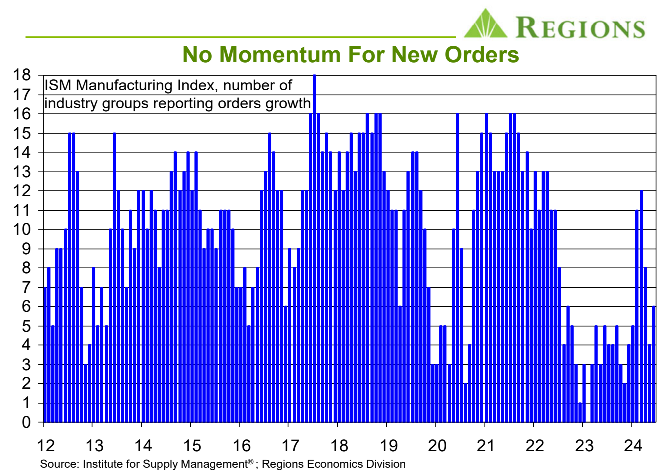
June ISM Manufacturing Index: Soft Headline, Even Softer Details

- The ISM Manufacturing Index fell to 48.5 percent in June from 48.7 percent in May
- The new orders index rose to 49.3 percent, the employment index fell to 49.3 percent, and the production index fell to 48.5 percent

The ISM Manufacturing Index fell to 48.5 percent in June from 48.7 percent in May, lagging what we (49.6 percent) and the consensus (49.1 percent) expected. June marks the third straight month with the headline index back below the 50.0 percent break between contraction and expansion after what had been a run of sixteen straight months below that threshold was broken in March. Though the nature of the ISM's diffusion index rules out anything on the order of a definitive conclusion, it does appear that we have an answer to the question we first posed upon the release of the March survey, i.e.., whether that foray above the 50.0 percent line marked a genuine turning point for the manufacturing sector or was simply a head fake deflecting attention away from ongoing weakness. The June data are further evidence of the latter, and that evidence goes well beyond the soft headline print as most of the underlying details suggest deteriorating conditions in the factory sector. We'll also note that the June seasonal factors were somewhat favorable, which factored into our above-consensus forecast. That the seasonal factors for the July data will be punitive is a somewhat ominous signal given the weakness in the June data. We had for some time been pointing to the back half of 2024 as a period in which firming global growth and increased domestic cap ex would be tailwinds for the manufacturing sector, and while we also noted that we expected growth in the manufacturing sector would be halting and uneven, even that is beginning to look like a reach at this point.

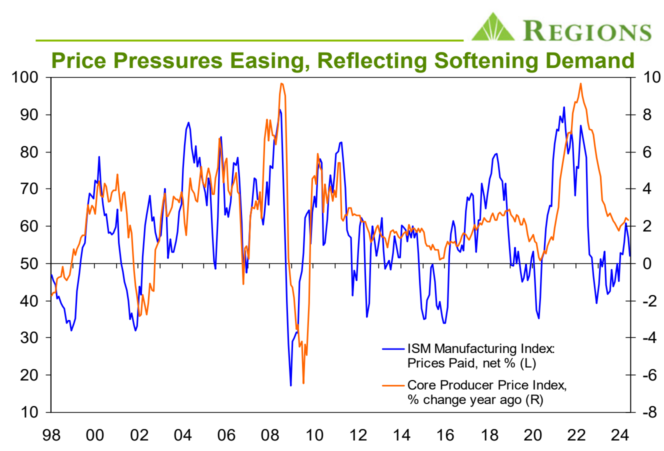


Of the eighteen industry groups included in the ISM's survey, eight reported growth in June, up from seven in May but below the nine that reported growth in March and April. If there is a main thread in the comments from survey respondents relayed by ISM, it is that softening demand is leading firms to cut production and pare down inventories. That, in turn, is weighing on head counts. Moreover, a producer of transportation equipment noted abrupt order cancellations, a reminder that booking an order doesn't necessarily translate into production. If underlying demand is truly as soft as the June survey suggests, order cancellations could become increasingly common over coming months.



Though rising to 49.3 percent from 45.4 percent in May, the new orders index points to ongoing declines in new orders. Six of the eighteen industry groups reported growth in orders in June, up from four in May, but the firm level details are even softer. The increase in the percentage of firms reporting lower orders was larger than the increase in the percentage of firms reporting higher orders. At the same time, backlogs of unfilled orders contracted further in June, the twenty-first straight month of contracting backlogs. The combination of contracting orders and thinning order backlogs is causing firms to become more focused on inventory control, as reflected in the sharp drop in the inventory index, which fell from 47.2 percent in May to 45.4 percent in June.

The metrics noted above follow through to the ISM's gauges of employment and output. The production index slipped to 48.5 percent in June, ending a three-month run of readings above 50.0 percent, though as we noted during that span the firm-level splits were less favorable than the production index suggested. The employment index fell to 49.3 percent in June after having wandered above the 50.0 percent line in May. More telling is that the firm-level splits show a jump in the percentage of firms reporting lower levels of employment in June. While we'll note that the ISM's employment index does not necessarily align with the BLS's count of manufacturing payrolls in the monthly employment reports. Still, the ISM's details on orders, order backlogs, and inventories, make a plausible case for contracting, not expanding, manufacturing employment.



In this week's *Economic Preview*, we noted that the ISM's prices paid index indicating rising prices for non-labor inputs seemed somewhat at odds with the headline index having slipped back below 50 percent. As we suspected, there are signs of convergence in the June survey. Though the prices paid index registered 52.1 percent, that is down sharply over the past two months and fewer firms are reporting paying higher prices for non-labor inputs. In other words, the prices paid index is falling back in line with the rest of the main components, as opposed to convergence in the opposite direction.

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