ECONOMIC UPDATE

REGIONS

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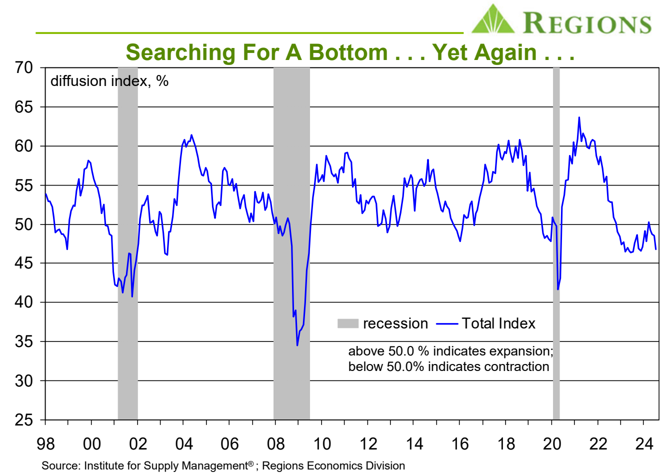
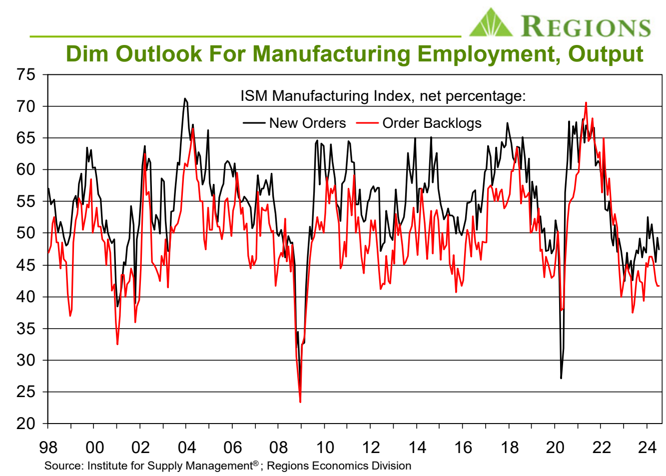
July ISM Manufacturing Index: In Search Of A Bottom . . . Yet Again . . .

- The ISM Manufacturing Index fell to 46.8 percent in July from 48.5 percent in June
- The new orders index fell to 47.4 percent, the employment index fell to 43.4 percent, and the production index fell to 45.9 percent

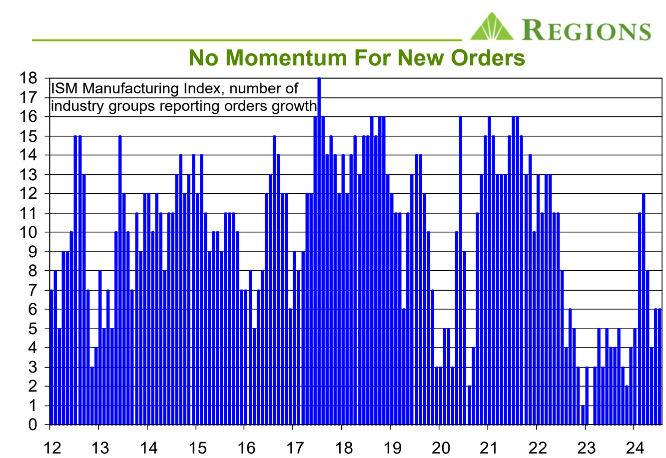
Well, we didn't expect much, but we at least expected more than this. That's about the best way we can summarize our reaction, at least the printable part, to the results of the ISM's July survey of the manufacturing sector. The ISM Manufacturing Index fell to 46.8 percent in July from 48.5 percent in June, below the 48.8 percent print we and the consensus forecast anticipated. July marks the twentieth month in the past twenty-one in which the headline index was below the 50.0 percent break between contraction and expansion, a run interrupted only by March's short-lived foray into expansionary territory. Moreover, both the underlying details – firm level and industry level – of the July survey and the comments from survey respondents paint an even bleaker picture of the factory sector than does the drop in the headline index. 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, only five reported growth in July, down from eight in June and the fewest in any month since January. Comments from survey respondents are striking, as a common theme is weakness in orders, with some noting that weakness going beyond normal seasonal weakness. Continued softening in order books and dwindling order backlogs contribute to manufacturers trimming purchases of raw materials, likely contributing to the weakness seen in commodity prices of late, and scaling back head counts, as evidenced in the decline in the ISM's gauge of factory employment. Unlike the June survey, there are no comments specifically pointing to order cancellations, but if underlying demand is truly as soft as the past two surveys suggest, order cancellations could become increasingly common over coming months.



The new orders index fell to 47.4 percent in July from 49.3 percent in June, with only six of the eighteen industry groups reporting growth in orders, matching June's count. The firm level details, however, are more troublesome, with a sharp increase in the percentage of firms reporting declines in orders and a decline in the percentage of firms reporting higher orders. ISM notes that "confidence in the future economic environment" has slipped to the lowest level since the recovery from the pandemic began, and unless and until confidence begins to recover it is unlikely that there will be broad based and sustained growth in new orders. At the same time, the backlog of unfilled orders shrank further in July, and has now contracted for twenty-two straight months. To the extent that new orders continue to decline, order backlogs will be pared down at a faster rate and, as this occurs, the demand for inputs and the demand for labor begins to fade in what can, should it persist for long enough, become a somewhat vicious circle.



Given the paths of new orders and order backlogs, it is no surprise that the production index fell to 45.9 percent in June and, more tellingly, this reflects a sharp increase in the percentage of firms reporting lower output and a sharp decline in the percentage of firms reporting higher output. This flows through to the employment index, which fell to 43.4 percent in July, the lowest reading since June 2020. July saw a sharp increase in the percentage of firms reporting lower employment, while on the industry level only two of the eighteen industry groups reported increased head counts.

It is worth noting that the index of supplier delivery times showed delivery times slowed in July; in the calculation of the ISM's headline index, slower delivery times add to the headline index, and in July this addition equaled six-tenths of a point. Whereas slower delivery times are typically associated with rising demand, our suspicion is that in this case slower delivery times reflect what have been growing stresses on supply chains which is clearly not a positive for the factory sector. The prices paid index remained above 50.0 percent in July, with input price pressures becoming more broadly based, with a rising percentage of firms reporting paying higher prices for non-labor inputs. This is clearly at odds with the softening in demand reported in the past two surveys.

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