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October ISM Manufacturing Index: Manufacturing Meanders Along An Uncertain Path

- > The ISM Manufacturing Index rose to 51.9 percent in October from 51.5 percent in September.
- > The new orders component fell to 52.1 percent, the employment component rose to 52.9 percent, and new export orders rose.

The ISM Manufacturing Index rose to 51.9 percent in October from 51.5 percent in September. As has been the case for the last several months, however, the details of the October report are mixed and do little to alter our view that the manufacturing sector is muddling along with little reason to expect a material and sustained pickup in activity over the near term.

Of the 18 industry groups included in the ISM's survey, ten reported growth in October, up from seven in September, but at the same time eight reported contraction in October. Comments from survey respondents were mostly on the upbeat side, with several industry groups pointing to rising sales, though one respondent from the primary metals industry noted considerably slower conditions and one from the transportation equipment industry commented that customers are pressing for price breaks. This month's survey included a special question on the Hanjin Shipping Company bankruptcy which, for the vast majority of respondents, has had little or no impact on their business while 0.8 percent reported a "large material impact."

After having risen sharply in September, the index for new orders settled back a bit in October. At 52.1 percent, the index still shows new orders increasing, but at a slower pace. Of the 18 industry groups in the survey, however, only eight reported higher orders in October with eight reporting lower order volumes. At the same time, order backlogs fell further in October, with 11 industry groups reporting slimmer backlogs while only five reported greater backlogs. With backlogs generally fading, there is some downside risk to production over coming months in the absence of more meaningful and sustained growth in new orders than is apparent in the ISM data.

As it is, the index for current production in the ISM data has been running a bit ahead of other indicators, most notably the manufacturing component of the Industrial Production Index published by the Federal Reserve. As measured in the industrial production data, manufacturing output has been flat-to-lower on an over-the-year basis for the past several months even as the ISM data show at least modest growth. In October, the current production index reported by the ISM rose to 54.6 percent from 52.8 percent in September. Nine of the 18 industry groups reported growth in production in October with four reporting lower levels of output. Going forward we'll be watching to see whether the ISM gauge of production will slip or the industrial production gauge will improve.

One might take the ISM's reading on customer inventories – deemed too low in October – as a hopeful sign for production levels going forward, but we're not inclined to do so. After what has been a prolonged inventory correction, we're more inclined to think firms will remain fairly disciplined on inventories barring evidence of meaningful and sustained acceleration in demand growth, and at present there is little evidence such a pickup is in the works. October marked the 16th consecutive month in which manufacturers' inventories of raw declined, a sign that manufacturers themselves see little evidence of materially faster demand on the horizon.

After three months of contraction the ISM's employment index jumped back above 50 percent in October, rising to 52.9 percent, the highest reading since June 2015. Eleven of the 18 industry groups reported higher job counts in October, which suggests at least modest gains in manufacturing payrolls in the October employment report due this Friday.

The ISM's headline index indicates modest growth in the manufacturing sector, but the underlying details continue to send mixed signals as to the breadth, intensity, and duration of that growth. As such, coming months will see the manufacturing sector meander along an uncertain path waiting for a clear direction to emerge.

