ECONOMIC UPDATE

REGIONS

March 1, 2018

February ISM Manufacturing Index: Factory Sector Showing No Signs Of Fatigue

- The ISM Manufacturing Index rose to 60.8 percent in February from 59.1 percent in January
- The new orders component fell to 64.2 percent, the employment component rose to 59.7 percent, and new export orders rose.

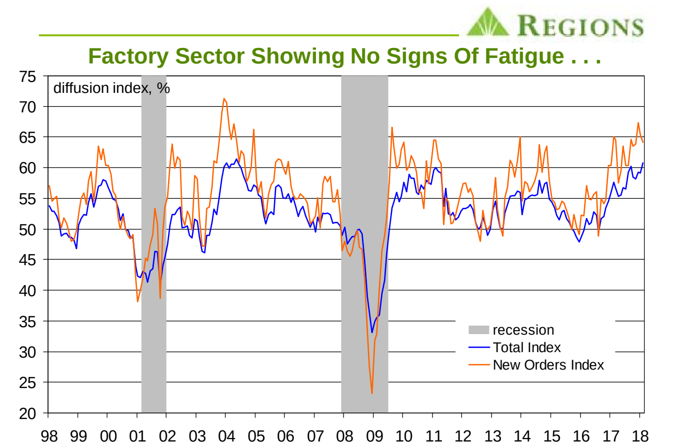
The ISM Manufacturing Index rose to 60.8 percent in February, thrashing our above-consensus forecast of 58.8 percent and leaving the headline index at its highest level since May 2004. More significantly, the ISM's February report on the manufacturing sector is another illustration of a point we often make – for any given data release, the headline number is the least important number as the real story is in the underlying details. The components of the top-line index show the manufacturing sector remains in the midst of a steady and broad based expansion that we expect will persist through 2018. Indeed, at present the main challenges facing most of the manufacturing sector include how to fill steadily growing order books and how to unclog backed up supply channels. In other words, the kinds of challenges firms want to be facing. This is not to say, however, there are not clouds forming on the horizon, most notably changes in U.S. trade policy that are likely to prompt counter measures from U.S. trading partners that could have an adverse impact of domestic manufacturing.

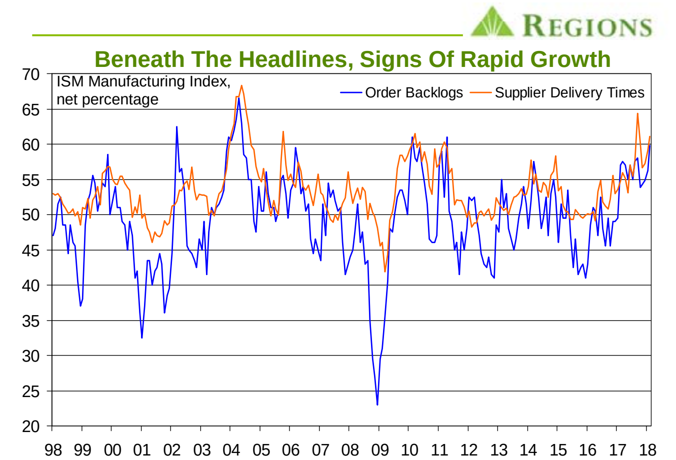
Of the 18 industry groups included in the ISM survey, 15 reported expansion in February January with two reporting diminished activity. As has been the case over the past several months, comments from survey respondents were mostly upbeat. One common theme has been the strength of demand, both domestic and foreign, and the February survey points to increasing hiring and capital spending across several industry groups. On the whole, the comments point to continued steady growth in the manufacturing sector in 2018.

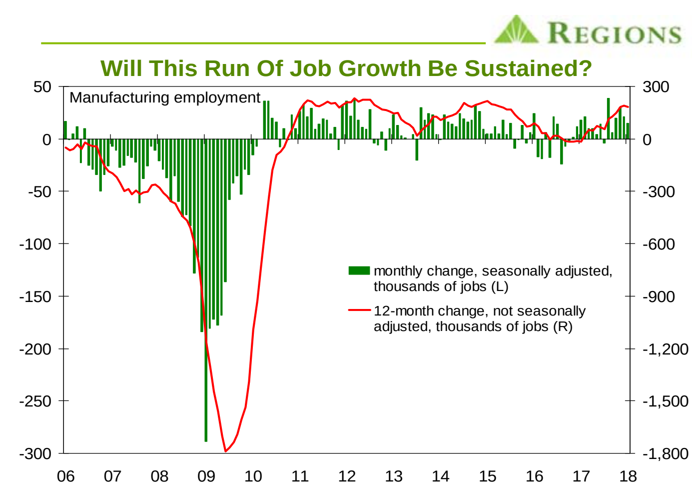
We see the gauge of new orders as being the most significant of the beneath the headlines details in the ISM's data as it helps shed light on the paths of hiring and production in the months ahead. In February, the index of new orders slipped a bit but, at 64.2 percent, continues to point to solid growth in new orders. Fifteen of the 18 industry groups reported higher order volumes in February with only the apparel, leather, & allied products group reporting a decline in orders. The index of current production fell to 62.0 percent in February, but again remains firmly in expansionary territory; 14 of the 18 industry groups reported higher production in February with only two reporting lower production.

Our forecast anticipated the declines in the current production and new orders indexes reported in the February data, yet still fell short of the mark. This is a reflection of the sharp increases seen in the other components that feed into the headline index – order backlogs, supplier delivery times, and employment, the first two of which we show in our middle chart. The index of order backlogs jumped to 59.8 percent in February, the highest since April 2011 and the 13th consecutive month of growing order backlogs, which is the manufacturing sector equivalent of running faster but falling further off the pace. By the same token, supplier delivery times slowed further, with the index of delivery times rising to 61.1 percent – excluding the spike in September 2017 when the hurricanes clogged up supply chains, this is the highest reading on the delivery times index since March 2010. It was noted that many firms have been increasing inventories of raw materials over the past several months as a means of preventing slower delivery times from throttling production in the face of solid demand growth. The employment index rose to 59.7 percent in February, the 17th consecutive month in which the index indicates rising employment counts, which is consistent with the steady job gains seen in the monthly employment reports. Finally, survey respondents continue to judge customer inventories as being too low, pointing to further growth in new orders and production over coming months.

Clearly, the stars have aligned for the U.S. manufacturing sector, with rising capital spending, the tax bill, and stronger foreign demand all acting as tailwinds. Our main concern at present is that trade policy threatens to become an even stronger headwind.







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