ECONOMIC UPDATE

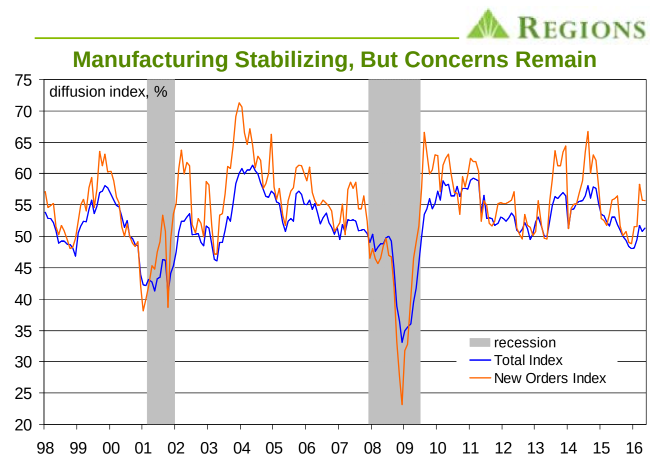
REGIONS

June 1, 2016

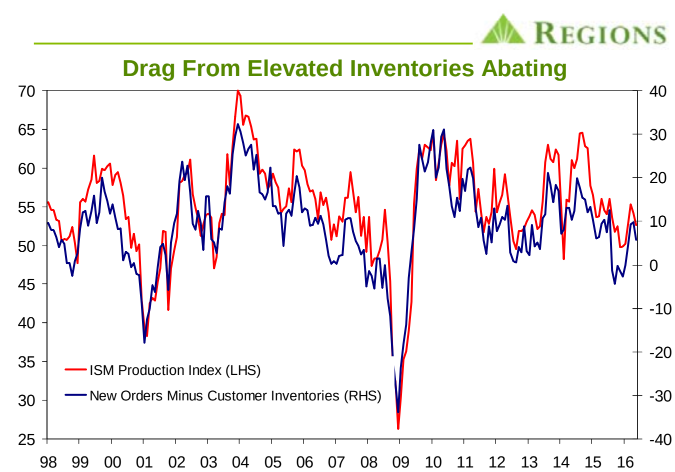
May ISM Manufacturing Index: Manufacturing Sector Stabilizing But Concerns Remain

- The ISM Manufacturing Index rose to 51.3 percent in May.
- The new orders component slipped to 55.7 percent, the employment component was unchanged at 49.2 percent, and new export orders rose.

The ISM Manufacturing Index unexpectedly rose to 51.3 percent in May, easily above the consensus estimate of 50.4 percent. This marks the third consecutive monthly advance following a run of five straight monthly declines. While this is encouraging, it this does not by any stretch suggest all is well with manufacturing. Moreover, the underlying details of the ISM report suggest the jump in the headline index was somewhat overstated. So, while we'll take the three months of the headline index being above the 50.0 percent break between expansion and contraction, we still see the signals being sent by the ISM Manufacturing Index to be somewhat tentative.

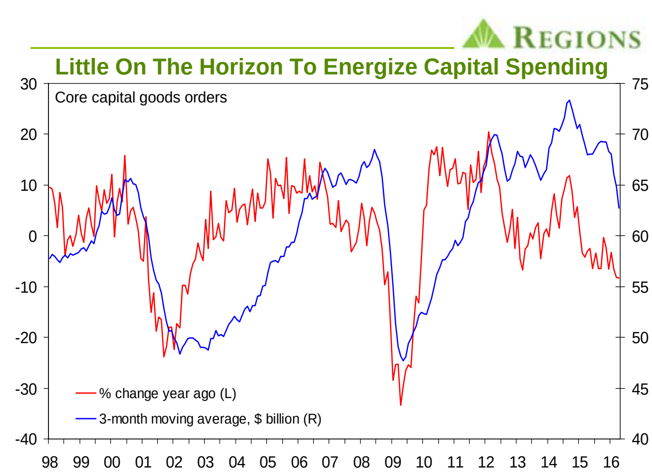


Of the 18 industry groups included in the ISM survey, 12 reported growth in May, compared to the 11 that did so in April, while six industry groups reported contraction. Included in this latter group are transportation equipment, chemical products, petroleum & coal, and furniture & related products. Comments from survey respondents suggest stable to slightly higher demand in a number of industry groups, with some cautionary notes from transportation equipment and plastic & rubber products. Depending on the industry in question, China is either a support – in the case of chemical products – or a drag – in the case of computer and electronic products.



The new orders index edged slightly lower in May, settling at 55.7 percent compared to April's reading of 55.8 percent. Of the 18 industry groups in the survey, 14 reported growth in new orders in May while four reported lower order volumes. While the current production index fell to 52.6 percent in May from 54.2 percent in April, 12 of the 18 industry groups reported increased levels of production.

One detail we found a bit odd is the jump in the supplier deliveries index, which hit 54.1 percent in May from 49.1 percent in April. This suggests a material slowdown in the pace of supplier deliveries to manufacturers in May, and is the primary factor behind the magnitude of the increase in the headline index. Still, only six of the 18 industry groups in the survey reported slower delivery times in May, with two reporting faster delivery times and ten reporting no change. As such, we think the jump in the supplier delivery index somewhat overstates the case and in turn somewhat exaggerates the movement in the headline index. The employment index remained at 49.2 percent in May, indicating a slight contraction in payrolls in the manufacturing sector. New export orders expanded for a third consecutive month in May, but the lack of breadth – only six of the 18 industry groups reported higher export orders – leaves us lacking conviction as to any call that global economic growth is back on the right track.



We also remain concerned about what is a steadily dimming outlook for business capital spending and, in turn, what that implies about the prospects of producers of capital goods. New orders for core capital orders remain weak, and growing pressures on profit margins along with slow and uneven global growth suggest producers of capital goods will remain pressured over coming quarters.

The prices paid index rose to 63.5 percent in May, its highest reading since June 2011. Thirteen industry groups reported paying higher input prices in May, and May marks the third consecutive month in which raw material prices have risen. This could reflect a weaker U.S. dollar as well as steady growth in demand being coupled with cutbacks in capacity amongst suppliers. Either way, the extent to which these higher input prices make their way through to higher prices on the retail level remains to be seen.

The recent run of over-50 percent prints on the headline index is encouraging. That said, we remain concerned over capital spending at home and the pace of growth abroad. As such, it is too soon to declare all is well in the factory sector.

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com