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## August ISM Manufacturing Index: A Dog Of A Report From The Dog Days Of Summer

- > The ISM Manufacturing Index fell to 49.4 percent in August.
- > The new orders component fell to 49.1 percent, the employment component fell to 48.3 percent, and new export orders rose.

The ISM Manufacturing Index slipped onto contractionary territory in August, with the top-line index falling to 49.4 percent, down much further than our below consensus forecast of 51.9 percent. While the headline is bad, the details are even worse. In our weekly *Economic Preview*, we noted our surprise at the vigor shown by the components for new orders and current production of late, and that we expected both to ease a bit in August. We got way more than we bargained for; both components not only declined but slipped below the 50.0 percent break between expansion and contraction. Moreover, already below that 50.0 percent break, the employment component fell further in August. Prior to the decline in August, the ISM Manufacturing Index had been indicating moderate growth in the factory sector for five months, but in our monthly write-ups during that span we repeatedly noted the ISM index was at odds with other gauges of manufacturing activity. The August print narrowed many of those disparities, but in a very discouraging manner.

Of the 18 industry groups included in the ISM survey, only six reported growth in August, down from 11 in July. This is quite a swing from July's survey, in which 11 industry groups reported growth in activity. Comments from survey respondents were mixed, and do not offer any consistent theme that would account for the sharp swing from expansion to contraction. One respondent from the machinery industry offered that there seemed to be a "a general, albeit slight, loosening" of capital budgets, which is consistent with what to us remains an uninspired outlook for capital spending. We've had a dim outlook for business capital spending for some time and the August ISM data do nothing to brighten our view.

The index for current production fell from 55.4 percent in July to 49.1 percent in August, with 8 industry groups reporting increased production and 8 reporting declines. Over time, the ISM's production index has largely moved in tandem with the manufacturing component of the industrial production index, though the former is prone to large fluctuations as seen in the middle chart. But, over recent months the ISM's production index has been giving off much more positive vibes than those given off by the industrial production data. While that gap narrowed somewhat in August, it still remains larger than we'd expect, so now it is a matter of whether the ISM gauge will slip further or the industrial production gauge will improve.

The new orders component of the ISM index does not offer much encouragement, as it fell from 56.9 percent in July to 49.1 percent in August. Only six industry groups reported growth in new orders in August while nine reported lower order volumes. To the extent the ISM's gauge of new orders is a precursor to the monthly Commerce Department report on core capital goods orders, this suggests the bounce in the latter in July was just that, a one-off bounce. As our bottom chart shows, even with that increase in July the dollar volume of core capital goods orders remains at levels last seen in early 2011. The ISM also reports backlogs of orders fell further in August which, coupled with the steep decline in new orders, does not bode well for growth in production going forward.

Only 5 of the 18 industry groups reported higher job counts in August, and the ISM's employment index fell to 48.3 percent, the eighth time in the past nine months the index has been below 50.0 percent, belying the positive numbers seen in the past few monthly employment reports. There is at least one ray of hope in the August ISM data – new export orders rose for a sixth consecutive month after a prolonged period of weakness. Still, exports alone are not enough to carry the manufacturing sector.

Despite the ISM's headline index having held above 50 percent over the prior five months we had cautioned it was too soon to declare all is well in the manufacturing sector. The August ISM Manufacturing Index is a stark reminder of that.

