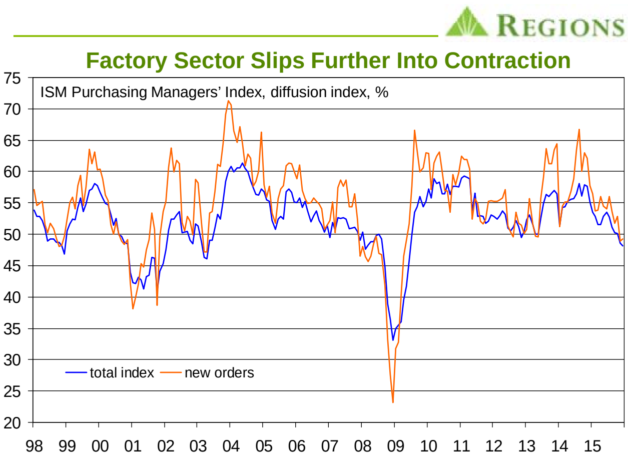
ECONOMIC UPDATE
REGIONS
January 4, 2016

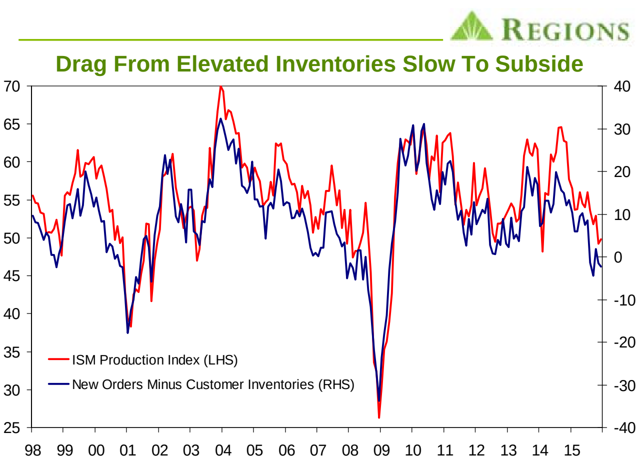
December ISM Manufacturing Index: Factory Sector Slips Further Into Contraction

- The ISM Manufacturing Index fell to 48.2 percent in December.
- The new orders component rose to 49.2 percent, the employment component fell to 48.1 percent, and new export orders increased.

The U.S. manufacturing sector slipped further into contraction in December as measured by the ISM Manufacturing Index. The index fell to 48.2 percent, its lowest level since June 2009 – the designated end of the 2007-09 recession. The index came in below the median estimate of 49.0 percent and below our 49.2 percent forecast. The production and new orders components clawed back some of their November declines but not to the extent we expected, while the employment component fell further than we expected. All in all, the combination of weak global demand, a strong U.S. dollar, scaled back capital outlays in the energy sector, and a persistent inventory overhang continues to act as a material drag on the factor sector.

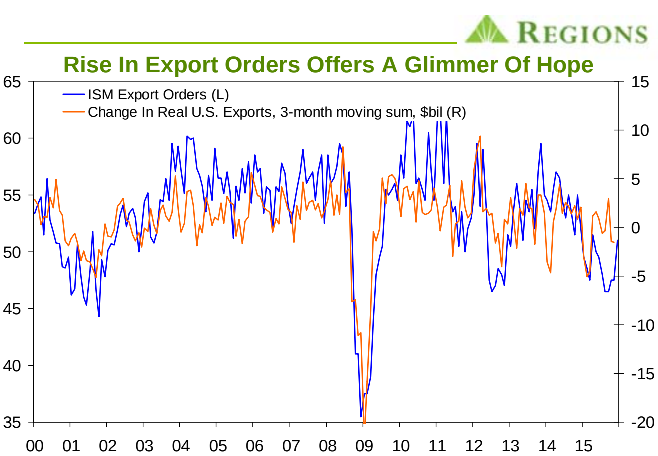


Of the 18 industry groups included in the ISM survey, six – printing and related support activities, textile mills, paper products, miscellaneous manufacturing, chemicals, and food, beverage, & tobacco products – reported growth in December, while ten industry groups reported contraction. Comments from survey respondents reflect soft sales and pricing and the lingering impact of low oil prices. Not surprisingly, transportation remains a standout in the factory sector, and one respondent noted the medical device business remains strong in the U.S. and abroad. Another common theme is lower commodities prices holding down input costs, thus helping cushion the blow to the bottom line from slower sales.



The sub-index for new orders rose modestly in December but, at 49.2 percent, indicates lower overall order volumes. Seven of the 18 industry groups reported increases in orders in November while eleven reported declines. Similarly, the sub-index for current production remains in contractionary territory despite having risen slightly in December. Seven industry groups reported a higher level of production in December with nine reporting lower production. Raw materials prices fell sharply in December, with the sub-index for prices paid falling to 33.5 percent, the lowest level since April 2009. None of the 18 industry groups reported paying higher prices for raw materials in December while 13 reported paying lower prices. This suggests the long-running trend of deflation in core goods prices will continue over coming months which will continue to weigh on retail level inflation.

Customer inventory levels are still deemed too high – the fifth consecutive month in which this has been the case – which continues to weigh on new orders and current production. Seven of the 18 industry groups reported customer inventories are too high, four reported customer inventories are too low, and the remaining six industry groups reported no change in customer inventories in December. As we have noted elsewhere the first half of 2015 saw the largest two-quarter inventory build on record in the life of the GDP data and the run-off in subsequent months has been slower than anticipated. Historically, inventory overhangs have tended to resolve quickly, but that does not appear to be the case in this instance and to the extent final sales continue to soften, the inventory overhang will persist for longer. We expect this to act as a drag on both new orders and production through Q1 2016.



If there is a glimmer of hope in the December data it is the rise in the component for new export orders, which rose to 51.0 percent after six consecutive months of falling export orders. It is, however, too soon to draw any conclusions from this regarding the course of U.S. exports of goods given how soft the global growth environment remains and what could be further U.S. dollar appreciation over coming months.

Of the three main headwinds facing U.S. manufacturers – elevated inventories, soft global demand, and scaled back cap ex in the energy sector – the inventory drag will be the first to abate. Unfortunately, the latter two will be more persistent, which in our view means the factory sector will face a challenging outlook through Q2 2016.

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