ECONOMIC UPDATE
REGIONS
February 1, 2016

January ISM Manufacturing Index: Contraction Carries Over Into The New Year

- The ISM Manufacturing Index increased to 48.2 percent in January.
- The new orders component rose to 51.5 percent, the employment component fell to 45.9 percent, and new export orders contracted.

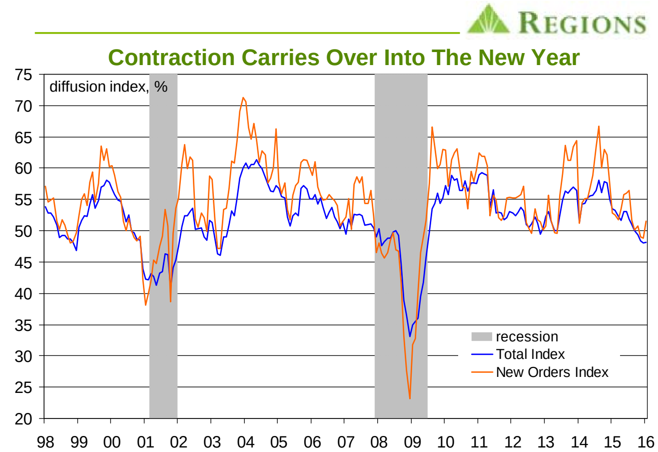
The U.S. manufacturing sector contracted for a fourth consecutive month in January as measured by the ISM Manufacturing Index. The index rose to 48.2 percent but remains below the 50.0 percent break between contraction and expansion. As is the case each January, the ISM has updated its seasonal adjustment factors and revised historical data accordingly, so January's reading comes off a revised 48.0 percent print for December 2015, which marked the lowest level of the index since June 2009 – the designated end of the 2007-09 recession. Amidst the ongoing contraction in the factory sector, the January ISM data do offer some hope – after having fallen below 50.0 percent in both November and December the production and new orders components edged higher in January, with both components rising back above 50.0 percent, though 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.

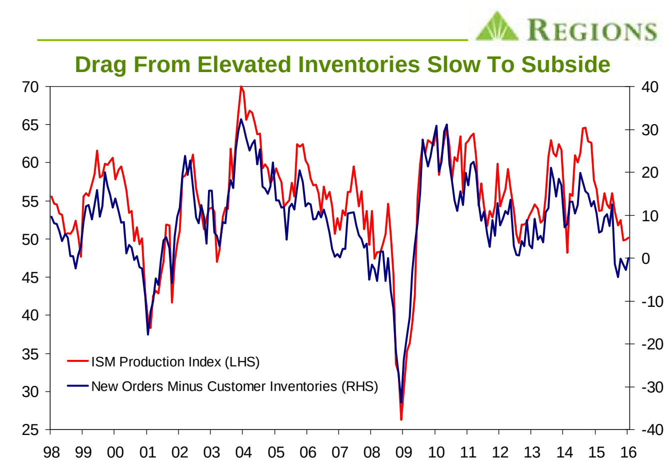
Of the 18 industry groups included in the ISM survey, eight reported growth in January, while ten industry groups reported contraction. Comments from survey respondents reflect soft sales and pricing and the lingering impact of low oil prices. One respondent in the transportation equipment industry, which has been one notable strong spot in an overall struggling manufacturing sector, noted that business remains strong but is slowing. Another common theme is lower commodities prices holding down input costs, thus helping cushion the blow to the bottom line from slower sales.

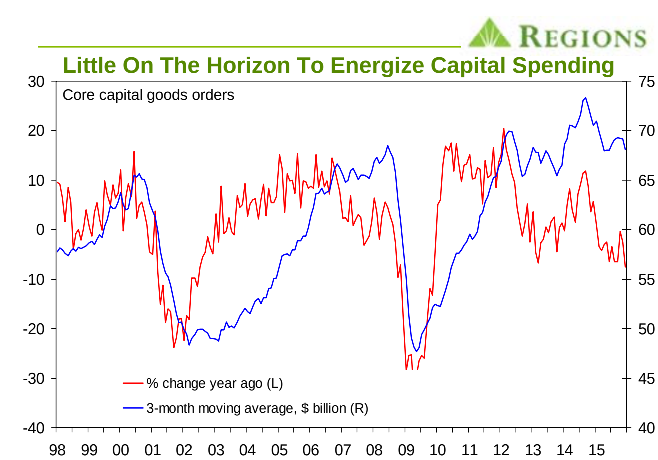
The new orders index rose to 51.5 percent in January, up from 48.8 percent in December. Eight of the 18 industry groups reported increases in orders in January while seven reported declines. The current production index edged higher to 50.2 percent in January from 49.9 percent in December, yet only six of the 18 industry groups reported rising production while eight reported lower levels of output. The employment index slumped to 45.9 percent in January, the lowest reading since June 2009, with only four industry groups reporting expanding payrolls and ten reporting lower head counts. As in December, not a single industry group reported paying higher prices for raw materials in January while 15 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 sixth consecutive month in which this has been the case – and manufacturers continue to pare down their own stocks. As we noted above, the rise in new orders in January is a hopeful sign but to the extent inventories remain elevated there will be limited pass through to production and, in turn, employment until either orders rise more strongly or stocks are pared down to a greater extent, if not some of both. While inventories took a big bite out of Q4 2015 real GDP growth, the inventory overhang is persisting longer than had been anticipated and, as such, we expect this to act as a drag on both new orders and production through Q1 2016. Another discouraging sign from the January ISM data is the growth in new export orders logged in December gave way to a contraction in January, the tenth time in the past thirteen months in which new export orders have fallen. As we frequently note, the ISM index on new export orders is a reliable indicator of trends in exports of U.S. goods in the GDP data.

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.







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