ECONOMIC UPDATE
REGIONS
August 1, 2016

July ISM Manufacturing Index: Continued Modest Expansion, But Ongoing Concerns

- The ISM Manufacturing Index fell to 52.6 percent in July.
- The new orders component fell slightly to 56.9 percent, the employment component fell to 49.4 percent, and new export orders rose.

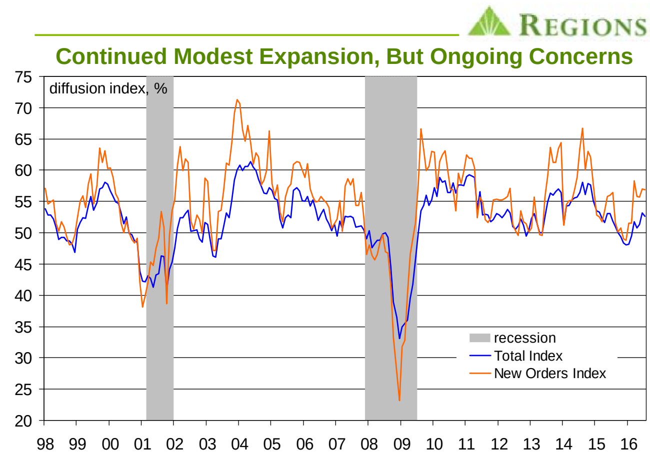
The ISM Manufacturing Index registered 52.6 percent in July, down from June's reading of 53.2 percent but still indicative of expansion in the factory sector. July's print was below the consensus estimate of 53.0 percent but a bit above our forecast of 52.4 percent. July marks the fifth consecutive month in which the headline index was above the 50.0 percent break between expansion and contraction which, while encouraging, does not by any stretch imply all is well with manufacturing. Indeed, the details of the July survey do raise some red flags, and the ISM index has painted a less dark picture of the manufacturing sector than have other indicators. All in all, then, we still see the signals being sent by the ISM Manufacturing Index to be somewhat tentative.

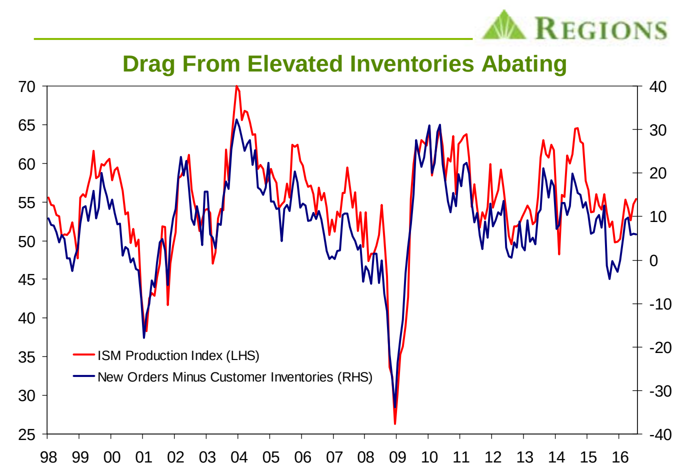
Of the 18 industry groups included in the ISM survey, 11 reported growth in July while 7 reported contraction. Included in this latter group are transportation equipment, machinery, and primary metals. Comments from survey respondents were mixed, with respondents from computer & electronic products, nonmetallic mineral products, and fabricated metals indicating stronger demand while respondents from transportation equipment and machinery pointed to softer demand. Brexit was mentioned but only to note that thus far there has been no impact, which does not come as a surprise given the actual exit process has not yet begun.

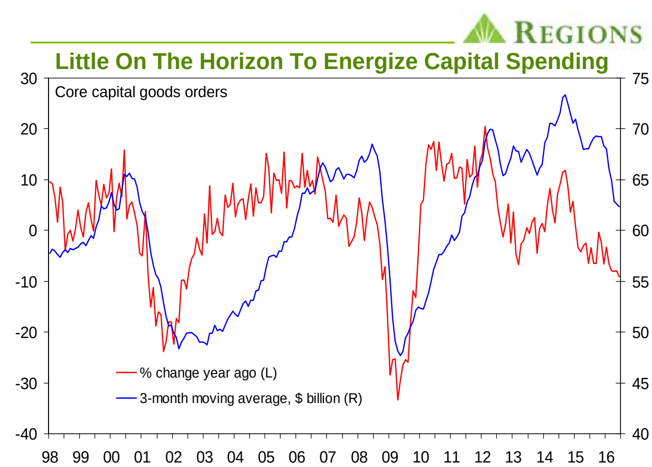
As has been the case in recent months, the components for current production and new orders were strong in July. New orders did dip from 57.0 percent in June to 56.9 percent in July, but 12 of the 18 industry groups reported higher orders. Machinery and transportation equipment were among the industry groups reporting lower order volumes in July. The component for current production rose to 55.4 percent in July from 54.7 percent in June, though the split is less encouraging – 9 of the 18 industry groups reported rising production in July while 6 reported lower levels of production with both machinery and transportation equipment in the latter group.

After nudging above the 50.0 percent mark in June the employment index reversed course in July, falling to 49.4 percent, which marks the eighth time in the past ten months this component has been below 50.0 percent. Eight industry groups reported higher job counts in July with seven reporting decreased employment. Another cause for concern is the sharp decline in order backlogs, with the index for this component falling to 48.0 percent in July from 52.5 percent in June. In general, growing order backlogs are seen as a positive sign, indicating firms are taking on orders faster than they can fill them, but in slower times order backlogs will clear. In July six industry groups reported greater order backlogs while ten industry groups reported diminished backlogs. While supplier delivery times lengthened in July, they did so only marginally. The inventory picture was mixed in July. Firms on balance reported holding lower stocks of raw materials while customer inventories were deemed to be too high, though the gap between new orders and customer inventories is supportive of growth in current production.

It is useful to keep in mind the ISM Manufacturing Index is a diffusion index, i.e., it can signal the direction of activity but tells us nothing as to the intensity of that activity. This helps account for the different signals being sent by the ISM's index and other indicators. For instance, we 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, hovering at levels last seen in mid-2011, while growing pressures on profit margins along with slow and uneven global growth suggest producers of capital goods will remain pressured over coming quarters. As such, the ISM Manufacturing Index notwithstanding, 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