ECONOMIC UPDATE

REGIONS

October 3, 2016

September ISM Manufacturing Index: A Better Headline On Top Of Mixed Details

- The ISM Manufacturing Index rose to 51.5 percent in September from 49.4 percent in August.
- The new orders component rose to 55.1 percent, the employment component rose to 49.7 percent, and new export orders rose.

After slipping on the wrong side of the 50.0 percent break between expansion and contraction in August, the ISM Manufacturing Index rebounded in September, rising to 51.5 percent. This is easily ahead the consensus forecast of 50.2 percent. The sharp declines in new orders and current production that dragged the headline index down in August reversed in September, with both coming in above 50.0 percent. Still, while the headline index indicates moderate expansion for the factory sector, this is not as broad based as we would like to see, and the employment index remained below 50.0 percent, indicating further contraction, albeit at a slower pace, in factory payrolls. All in all, we'd rather have the headline index above 50.0 percent than below it, but the bottom line is that the manufacturing sector still faces challenging conditions.

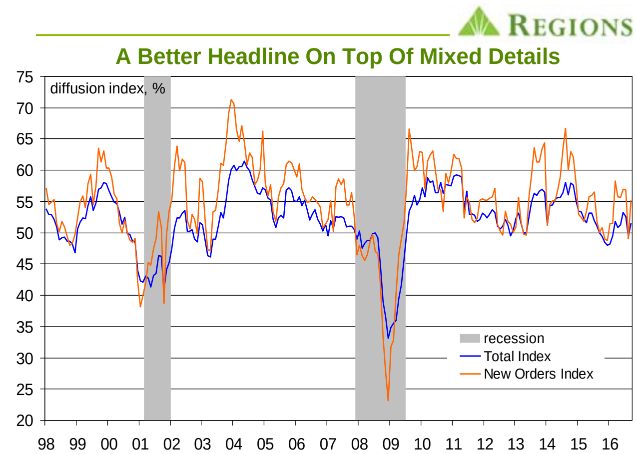
Despite the improvement in the headline index, only seven of the 18 industry groups included in the ISM survey reported growth in September, up marginally from six in August and still below the eleven reporting growth in July. Comments from survey respondents were generally favorable, with a general theme of steady, if still somewhat slow, growth in sales. One respondent in the transportation equipment industry noted some concern over the Hanjin Shipping bankruptcy, with the potential for lower global shipping capacity to lead to higher shipping costs. One respondent from the machinery industry pointed to slowly improving conditions with increasing sales and sales leads. Along with slight improvement in core capital goods orders over recent months this offers some hope that capital spending is at least stabilizing though unlikely to turn into a significant support for broader economic growth any time soon.

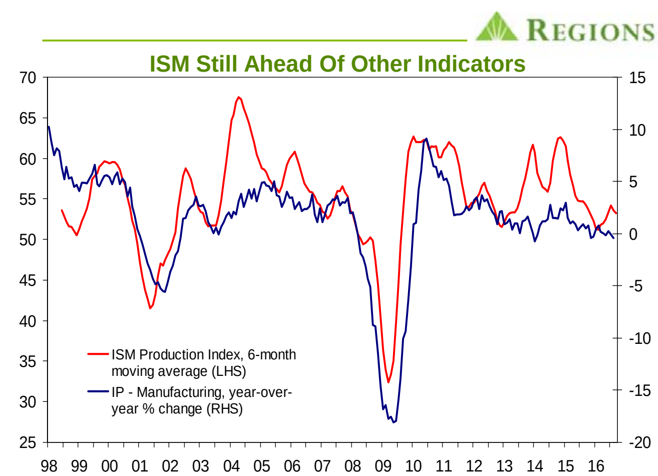
The index for current production improved to 52.8 percent in September after having fallen to 49.1 percent in August. Across industry groups, however, September was a mixed bag, with ten industry groups reporting higher levels of production and eight reporting lower levels. As seen in our middle chart, the ISM's production index has largely moved in tandem with the manufacturing component of the industrial production index over time. The industrial production data have shown manufacturing output down on a year-on-year basis over recent months, and while the ISM production index indicates ongoing growth in output, the pace of that growth is slowing. As such, going forward we'll be watching to see whether the ISM gauge will slip further or the industrial production gauge will improve.

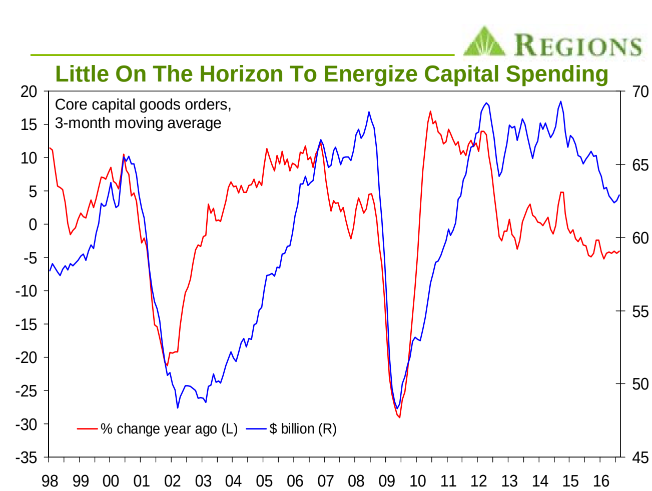
The index for new orders rebounded smartly from its sharp decline in August and now stands at 55.1 percent. Of the 18 industry groups included in the ISM survey, nine reported rising orders in September with six reporting lower order volumes. As noted above, recent months have seen modest gains in core capital goods orders, but as seen in the bottom chart the dollar volume of orders remains in line with levels last seen in 2011. The ISM also reports backlogs of orders fell further in September, which suggests that production is likely to slump over coming months in the absence of more meaningful, and sustained, increases in the volume of new orders.

Only 7 of the 18 industry groups reported higher job counts in September and while the ISM's employment index rose to 49.7 percent it remains below 50.0 percent, indicating at least modest contraction in overall manufacturing payrolls. The September survey also suggests manufacturers continue to pare down inventories of raw materials and that customer inventories are deemed too high, which we think could act as a drag on new orders over coming months. Additionally, new export orders rose for a seventh consecutive month in September, which is in line with what has been improvement in exports of goods reported in the monthly trade data.

The improvement in the ISM's headline index number in September is encouraging. But, the details raise concerns as to the breadth of that improvement, making the September report less promising than the increase in the headline index implies.







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