ECONOMIC UPDATE

REGIONS

April 3, 2017

March ISM Manufacturing Index: Factory Sector Continues To Expand

- The ISM Manufacturing Index fell to 57.2 percent in March from 57.7 percent in February.
- The new orders component fell to 64.5 percent, the employment component rose to 58.9 percent, and new export orders rose.

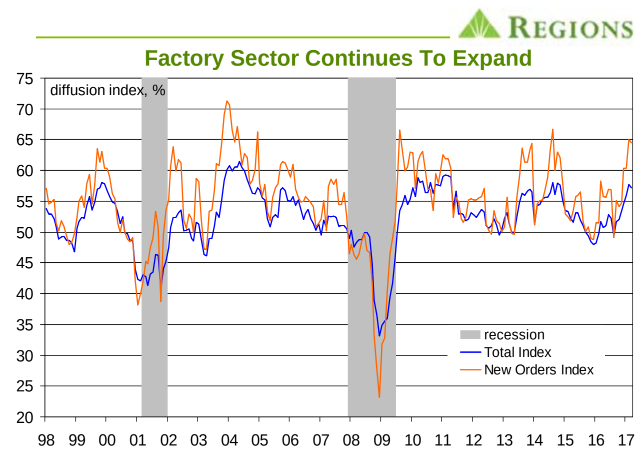
The ISM Manufacturing Index slipped to 57.2 percent in March, in line with the consensus forecast and ahead of our forecast of 56.4 percent. March marks the seventh consecutive month in which the headline index was above the 50.0 percent break between expansion and contraction in the factory sector, and the underlying details as well as comments from survey respondents are generally positive. The ISM's gauges of employment and new export orders both hit multi-year highs in March. Sentiment amongst U.S. manufacturers has clearly improved over recent months on expectations of faster growth in the broader economy, though it remains an open question as to whether or not actual performance will live up to those higher expectations.

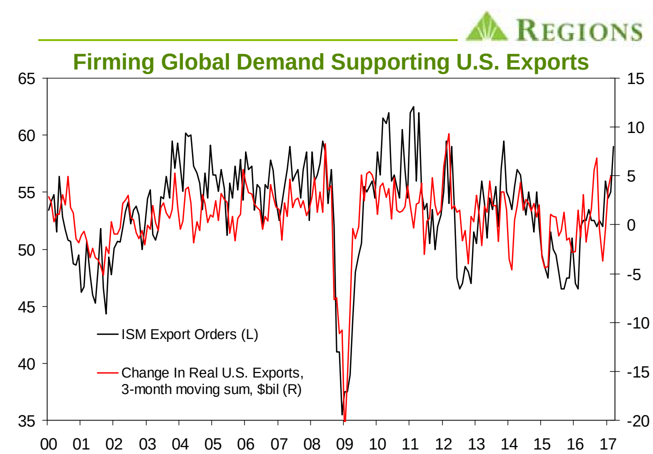
In light of what has been considerable discussion of late about the gaps between the "soft" data and the "hard" data, we think it useful here to point out that the ISM's index is a diffusion index and, as with any diffusion index, can tell us the direction of change but not the intensity of that change. In other words, that the headline index has been above the 50.0 percent mark for the past seven months tells us little, if anything, about the intensity at which the manufacturing sector is expanding. Other measures, i.e., "hard" data, such as new orders for core capital goods and the manufacturing component of the industrial production data, have been increasing over recent months, but at a still-measured pace. This is simply a caution against using the ISM data to draw broader conclusions about the rate at which the broader economy is expanding.

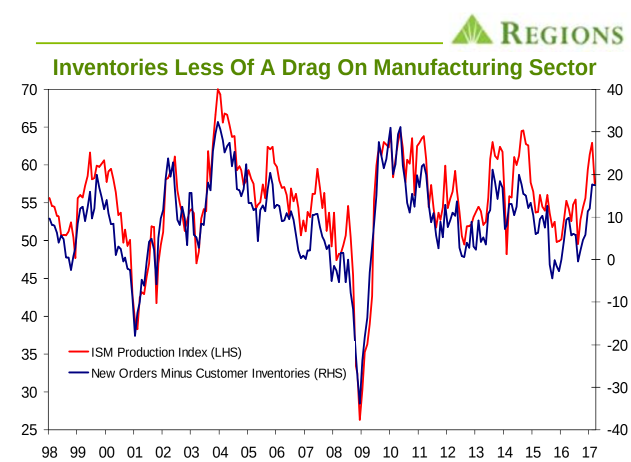
The expansion in the manufacturing sector has become increasingly broad based over the past seven months, at least as captured in the ISM's survey. In March, 17 of the 18 industry groups included in the ISM's survey reported growth while none reported contraction. Comments relayed to the ISM point to improving orders and a favorable business outlook. One notable comment came from the transportation equipment industry group, which was characterized as "flat" by one respondent who also noted the outlook for 2017 as a whole looks flat. This is consistent with the notion that auto sales have hit their cyclical peak and are unlikely to move higher. That said, it wasn't that long ago when motor vehicle production was one of the very few areas of the U.S. manufacturing sector exhibiting signs of life, and it is encouraging that at present the expansion in the manufacturing sector is so broad based.

Our forecast was predicated on the gauges of new orders and current production falling back in March after rapid run-ups over the prior few months, a call that proved half right. The index of current production fell from 62.9 percent in February to 57.6 percent in March. The index of new orders held up much better than we had expected, falling to 64.5 percent in March from 65.1 percent in February, with all 18 industry groups reporting higher orders. Our miss here is entirely responsible for our miss on the headline index. The index of employment jumped to 58.9 percent in March, the highest reading since June 2011, with 14 of the 18 industry groups reporting higher head counts in March. Growing order backlogs – the ISM's gauge hit 57.5 percent in March – are prompting firms to take on more workers, and the strength of new orders suggests firms will be hard pressed to catch up over coming months. New export orders increased in for a 13th consecutive month in March, and this is one instance in which the hard data, i.e., growth in real U.S. exports, has kept pace with the soft data. There are clear signs of firming global economic growth, which is clearly benefitting U.S. manufacturers. Firming global demand is one reason price pressures, at least for commodities and raw inputs, are rising at a rapid clip. In March, the ISM's gauge of prices paid hit 70.5 percent, the highest since May 2011.

The U.S. manufacturing sector is on a nice roll. While we don't doubt this expansion will continue in the months ahead, the pace at which it will do so remains highly uncertain, with much riding on the evolution of fiscal, regulatory, and trade policy.







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