ECONOMIC UPDATE

REGIONS

July 2, 2018

June ISM Manufacturing Index: Beneath The Lofty Headline Number, Cause For Concern

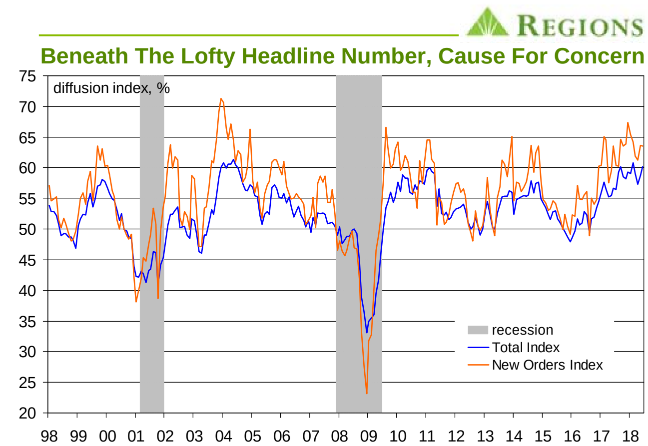
- The ISM Manufacturing Index rose to 60.2 percent in June from 58.7 percent in May
- The new orders component fell to 63.5 percent, the employment component fell to 56.0 percent, and new export orders rose.

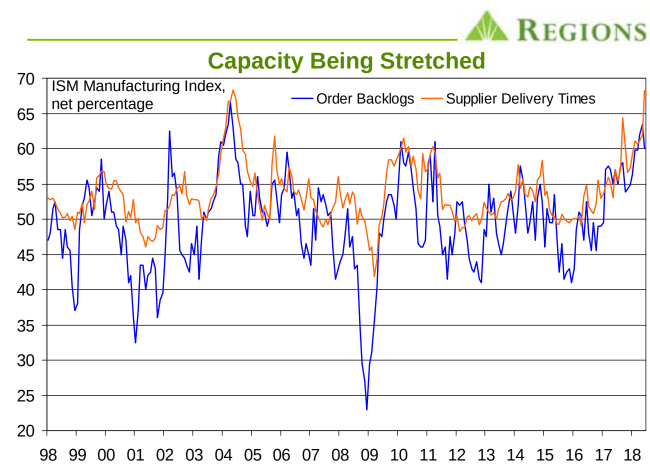
The ISM Manufacturing Index jumped to 60.2 percent in June from 58.7 percent in May, easily besting our above-consensus forecast of 59.3 percent. June marks the 22nd consecutive month in which the headline index has been above the 50.0 percent break between contraction and expansion. While the details of the June data point to the steady growth in the factory sector seen over the past several quarters being sustained, the headline number on the June report overstates the case a bit, as significantly slower supplier delivery times are responsible for almost the entire increase in the headline index. Moreover, trade policy, specifically tariffs, looms as a dark cloud on the horizon according to survey respondents, though at this point it seems the main risks are more to the breadth and intensity of the robust expansion in the factory sector than to the expansion itself.

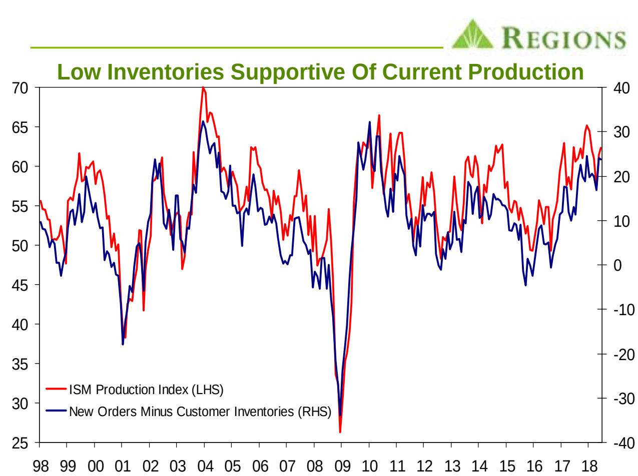
Of the 18 industry groups included in the ISM survey, 17 reported expansion in June with no industry group reporting contraction. As we have noted previously, over the past 22 months in which the headline index has indicated growth in manufacturing activity, the number of industry groups reporting growth in a given month has risen steadily – in September 2016, the first month the headline index climbed back over the 50.0 percent mark, only seven industry groups reported a higher level of activity. It is in this sense that the ongoing expansion can be considered to have become increasingly broad based. But, ISM notes that "respondents are overwhelmingly concerned about how tariff related activity is and will continue to affect their business." Tariffs have directly increased input prices, which are filtering through the production pipeline in the form of higher prices for intermediate and final goods. One respondent noted plans for shifting production away from the U.S. to Canada in order to avoid tariffs on goods bound for China, while another respondent noted that planning for the effects of tariffs is stealing a considerable amount of time away from more productive activities. It is worth noting that tariffs are not the only issue confronting manufacturers. Transportation bottlenecks appear to be worsening and this is contributing to sharply higher transportation costs, described by one respondent as "going through the roof."

This can be seen in the continued slowing of supplier delivery times. The index of delivery times jumped to 68.2 percent in June, the highest since May 2004, and 15 of the 18 industry groups reported they faced slower supplier delivery times in June. To our earlier point, had the index of supplier delivery times held at its May level, the headline index would have been 58.9 percent – still strong to be sure but likely more reflective of the underlying health of the factory sector than the actual read of 60.2 percent. The index gauging growth in orders for factory goods slipped to 63.5 percent in June from 63.7 percent in May, but nonetheless the 30th straight month of growth in new orders. In May, 16 of the 18 industry groups reported growth in new orders, with only one group – apparel, leather, & allied products – reporting lower orders. Backlogs of unfilled orders grew larger in June, though at a slightly slower pace than in May. Reflecting the combination of ongoing strength in new orders and growing backlogs of unfilled orders, the gauge of current production rose to 62.3 percent in June, with 16 industry groups reporting increased production during the month and only one industry group – again, apparel, leather, & allied products – reporting lower output. The ISM data show factory employment rose further, with June 21st straight month of rising manufacturing employment. June also marked the 21st consecutive month in which firms deemed customer inventory levels as too low, which suggests further growth in orders, production, and employment in the months ahead.

For now, the U.S. manufacturing sector remains on an impressive roll. Solid growth in both domestic and foreign demand suggests this will remain the case, but our main concern is that trade policy could become a meaningful headwind to growth.







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