ECONOMIC UPDATE

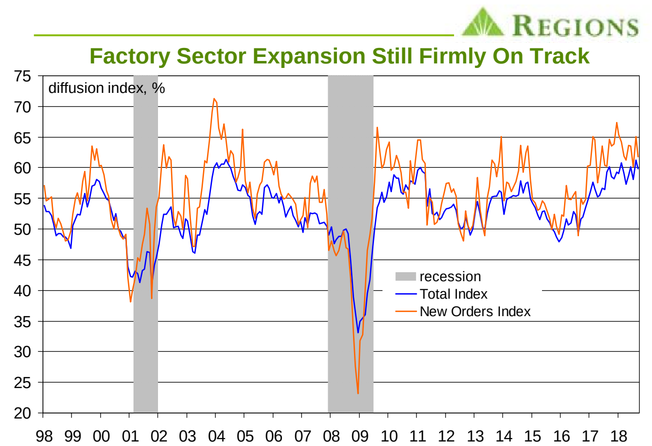
REGIONS

October 1, 2018

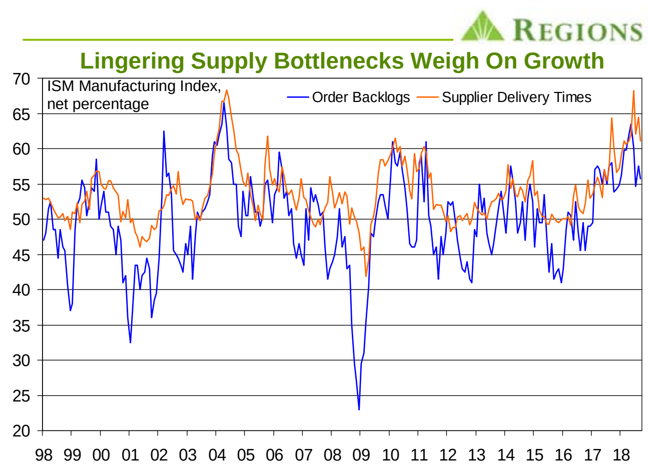
September ISM Manufacturing Index: Factory Sector Expansion Still Firmly On Track

- The ISM Manufacturing Index fell to 59.8 percent in September from 61.3 percent in August
- The new orders component fell to 61.8 percent, the employment component rose to 58.8 percent, and backlogs of unfilled orders rose

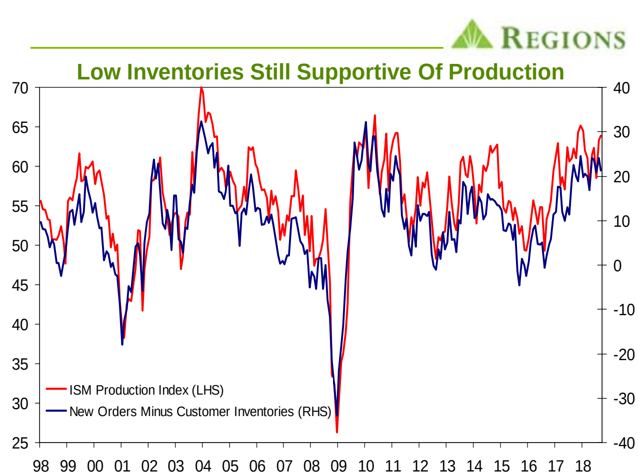
The ISM Manufacturing Index fell to 59.8 percent in September, below both the consensus forecast of 60.1 percent and our forecast of 60.6 percent, but the headline index nonetheless remained above the 50.0 percent break between contraction and expansion for a 25th consecutive month. In our weekly *Economic Preview* we noted that over recent months the headline index has surprised us to the upside, which meant that at some point there was bound to be payback. We also noted, however, that even if that payback came in the September data, it would not alter the bottom line, i.e., the expansion in the factory sector remains firmly on track. The miss on the headline index notwithstanding, nothing in the details of the September data contradicts that view. And, while trade remains a downside risk, we'll continue to note, as we have for the past several months, that the main risks from trade 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, 15 reported expansion in September with only the primary metals industry reporting contraction, which likely reflects the adverse effects of ongoing trade spats. As has been the case for some time now, the expansion in the factory sector remains notably broad based. Comments from survey respondents center on a few key themes – still-solid growth in demand, disruptions from trade policy, and increasing difficulty in finding skilled labor. The reported effects of tariffs varied but include inciting a rush to build inventories ahead of the imposition of additional tariffs, putting upward pressure on prices, impeding export opportunities, and diminishing the supply of inputs and hence increasing lead times on deliveries. Still, there is a difference between disrupting the expansion and derailing the expansion and, though causing some disruptions, tariffs are not at present widely seen as threatening the expansion in the factory sector.



In our preview of the ISM Manufacturing Index we noted the key components to watch would be new orders and current production. While we expected some payback in the new orders index after it jumped from 60.2 percent in July to 65.1 percent in August, the decline in September was greater than we anticipated, with the new orders index falling to 61.8 percent. More relevant, however, is that at 61.8 percent the new orders index indicates continued growth in new orders, and in September 12 of the 18 industry groups reported growth in orders while three industry groups reported lower order volumes. The current production index rose to 63.9 percent in September, the highest reading thus far in 2018, with 14 industry groups reporting increased output and none reporting lower output. Backlogs of unfilled orders rose further in September but at a slower pace than had been the case over prior months. The backlog of orders index fell to 55.7 percent from 57.5 percent in August, but September was nonetheless the 20th consecutive month in which backlogs of unfilled orders grew. With ongoing growth in new orders, further increases in production, and further growth in unfilled orders, it is not surprising that firms continue to take on additional workers. The employment index rose to 58.8 percent in September, with head counts rising in 12 of the 18 industry groups. Firms continue to assess customer inventories as being too low, which is a sign that orders and production will continue to increase over coming months. Another sign of firms having difficulty in keeping up with demand growth is that supplier delivery times slowed further in September, with the supply chain clogged up by labor shortages and transportation bottlenecks. This is one factor contributing to steadily rising backlogs of unfilled orders amongst producers of goods.



The details of the September ISM report on manufacturing offer no evidence that the long-running expansion in the factory sector is running out of steam. To be sure, supply constraints, both inadequate labor supply and slowing deliveries of materials, are a source of stress, and while trade remains a source of considerable uncertainty, demand growth remains solid, thus sustaining the expansion in the factory sector.

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