ECONOMIC UPDATE
REGIONS
January 3, 2019

December ISM Manufacturing Index: A Lump Of Coal For The Factory Sector

- The ISM Manufacturing Index fell to 54.1 percent in December from 59.3 percent in November
- The new orders index fell to 51.1 percent, the employment index fell to 56.2 percent, the production index fell to 54.3 percent

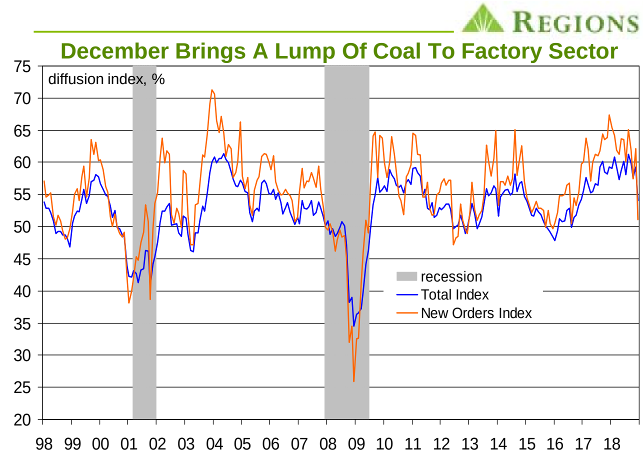
The ISM Manufacturing Index tumbled to 54.1 percent in December, even weaker than our below-consensus forecast of 56.9 percent. All of the main components weakened in December, with the index for new orders posting its biggest decline in four years while the decline in the headline index was the largest monthly decline since October 2008. To be sure, the magnitude of the decline in the headline index comes as somewhat of a shock, but it helps, or at least it should help, to consider that even with the steep decline December marks the 28th consecutive month in which the headline index stood above the 50.0 percent break between expansion and contraction. Moreover, each of the key components that feed directly into the headline index remain above that 50.0 percent mark, as does the gauge of new export orders.

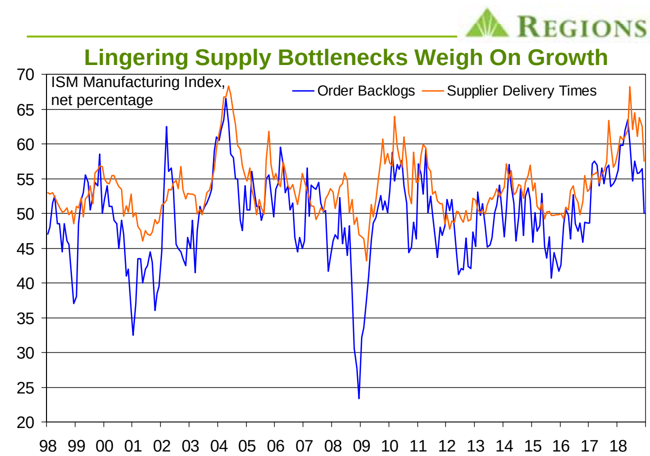
We have repeatedly pointed out over the past several months that the data on manufacturing and trade have been skewed by firms, both domestic and foreign, playing the game of "time the tariffs." In other words, firms have been pulling orders and shipments forward in anticipation of additional/more punitive tariffs, which has bought firms time to try to reconfigure supply chains in an effort to avoid tariffs. We've noted that at some point this would stop and there would be payback in the data. So, the most relevant question at this point is exactly what December's steep decline in the ISM's headline index is telling us – is it payback for the artificially high prints over the past several months, which would reflect growth in manufacturing settling into a more sustainable pace, or is it a more ominous signal of a deteriorating global growth environment. We think it is more the former than the latter, though at this point it's hard to have a high degree of confidence in our assessment.

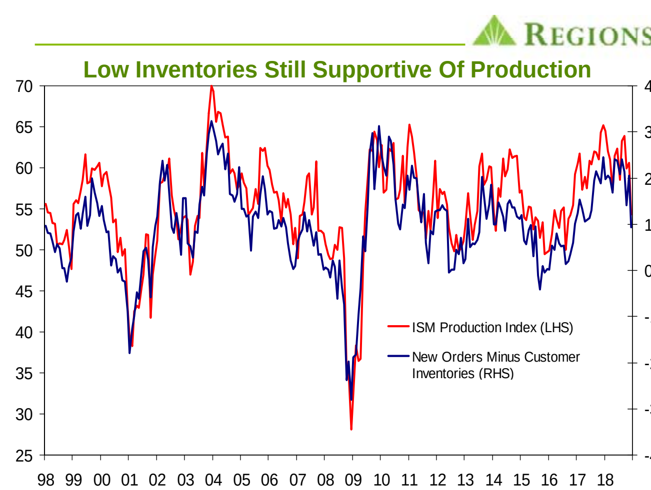
One thing we have been noting over the past several months is how broad based the expansion within the broad manufacturing sector has been, but that was not the case to nearly the same degree in December. Eleven of the 18 industry groups included in the ISM survey reported growth in December, with six reporting contraction. As has been the case over the past several months, the ill effects of tariffs were the main theme of comments from survey respondents in December. At the same time, higher input prices continue to weigh on survey respondents.

The index for new orders plummeted to 51.0 percent in December from 62.1 percent in November; only six industry groups reported growth in new orders in December, with five reporting lower order volumes and seven reporting no change in orders. Our forecast anticipated a decline in new orders, but not nearly as steep a decline as was actually reported. The same is true of the index of current production, which fell to 54.3 percent in December from 60.6 percent in November. Still, ten of the 18 industry groups reported rising production in December with four reporting lower levels of production. Though falling in December, the employment index fell by less than our forecast anticipated and, at 56.2 percent, continues to point to rising employment in the factory sector. Nine of the 18 industry groups reported growth in employment in December, with three reporting lower head counts. December saw sharp declines in the indexes measuring supplier delivery times – still slowing but at a less pronounced pace – and backlogs of unfilled orders – no longer rising. These components have been signals of just how stretched manufacturers have been over recent months to simply keep pace with growth in demand, which goes to our point about the impact of trade policy on the timing of orders and shipments. Finally, though having narrowed, the gap between new orders and customer inventories continues to signal growth in manufacturing output over coming months, consistent with – though by no means definitive proof of – our assessment of growth settling into a more sustainable pace.

Any definitive answer to this question will be months in coming. But, if nothing else, the December ISM Manufacturing Index shows the need for clarity on the trade front.







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