# ECONOMIC UPDATE

REGIONS

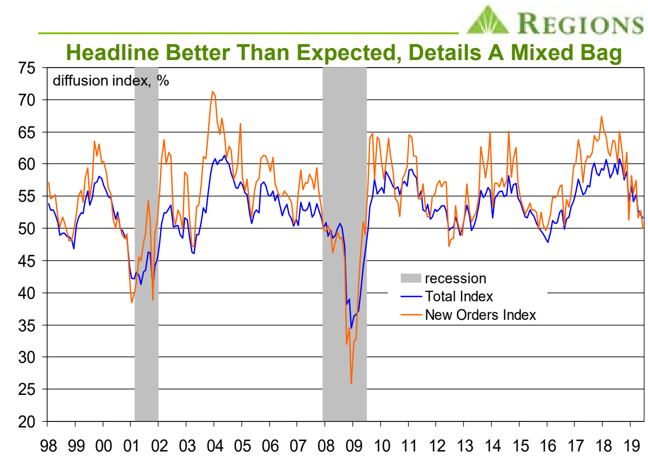
July 1, 2019



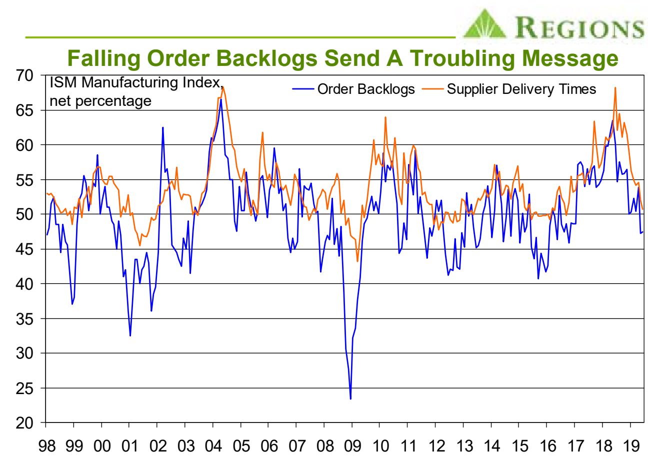
## June ISM Manufacturing Index: Headline Better Than Expected, Details A Mixed Bag

- The ISM Manufacturing Index fell to 51.7 percent in June from 52.1 percent in May
- The new orders index fell to 50.0 percent, the employment index rose to 54.5 percent, the production index rose to 54.1 percent

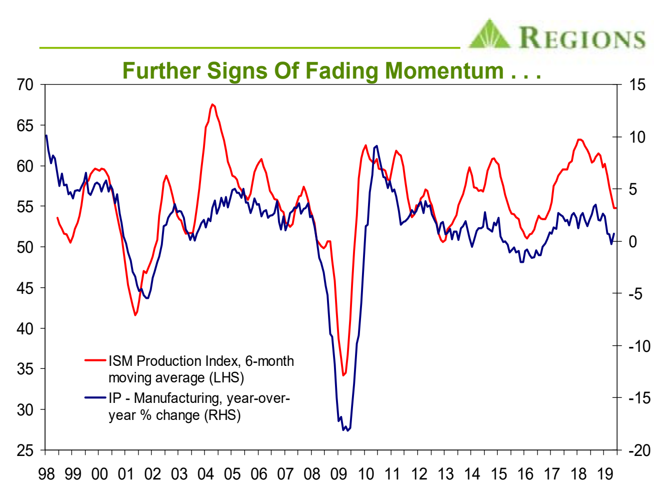
The ISM Manufacturing Index fell to 51.7 percent, better than we (50.8 percent) and the consensus (51.0 percent) expected, marking the 34th straight month in which the headline index was above the 50.0 percent break between contraction and expansion. That said, at 51.7 percent in June, the headline index stands at its lowest level since September 2016 and some of the details of the June survey, such as new orders and backlogs of unfilled orders, are to us clear warning signs that, despite the relief of the headline index being a bit better than anticipated, activity in the manufacturing sector is likely to soften further in the months ahead. We have for some time been pointing to three headwinds confronting the manufacturing sector – an inventory overhang, trade policy, and a decelerating pace of motor vehicle sales – and the impacts of these headwinds are clear in the ISM survey and other manufacturing data. That the U.S. and China have agreed to talk further by no means eliminates trade policy as a drag on the manufacturing sector.




Of the 18 industry groups included in the ISM survey, 12 reported growth in June with five reporting contraction, indicating that growth across the factory sector has become considerably less broad based than had been the case over prior quarters. Keep in mind that the ISM's June survey was being conducted amidst considerable trade tensions, including the threat of broader tariffs on imports from China and the threat of tariffs on imports from Mexico, and those tensions color the comments from survey respondents. Aside from tariff-related comments, it is interesting that assessments of demand vary across industry groups, which applies not only to current demand but also to demand in 2020. That it seems more hit or miss across individual industry groups goes to our point that while the manufacturing sector continues to expand, the expansion is less broad based now than had been the case.




The new orders index fell to 50.0 percent in June, indicating neither expansion nor contraction and matching our on-the-fence forecast. Ten of the 18 industry groups reported growth in new orders while six reported contraction (in May, twelve industry groups reported expansion and four reported contraction). June marks the first month since December 2015 in which the ISM survey did not show growth in new orders, which we place considerable importance to given that the new orders index has long been one of our most reliable forward looking indicators of economic activity. Along with the run of growth in new orders ending, the backlog of unfilled orders contracted further in June, with the index of unfilled orders at 47.4 percent – prior to May, the backlog of unfilled orders had grown for 27 straight months. In June 12 industry groups reported smaller orders backlogs with only 6 reporting larger backlogs. Without a rebound in new orders, diminishing backlogs of unfilled orders threaten employment and output in the factory sector, but the June ISM data say we're not there yet. Indeed, each of these components came in better than our forecast, which accounts for our miss on our forecast of the headline index. The current production index rose to 54.1 percent in June, while the employment index rose to 54.5 percent. Another sign of a slowing pace of overall activity in the factory sector is that suppliers are becoming less pressed on delivery times. At 50.7 percent, delivery times continued to slow in June, but this compares to a read of 68.2 percent last June and is the lowest reading on this index since September 2016. It is also worth noting that assessments of customer inventory levels are becoming more balanced, and the spread between the current production index and the customer inventory index, which is a useful indicator of future production, is narrower than at any point since November 2016.




Even absent ongoing trade disputes, the factory sector would have been hard-pressed to sustain the pace of growth seen over the prior two years. The danger now is that the expansion in the factory sector will end before it otherwise would have, and a better than expected June headline number does not change that.

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