ECONOMIC UPDATE

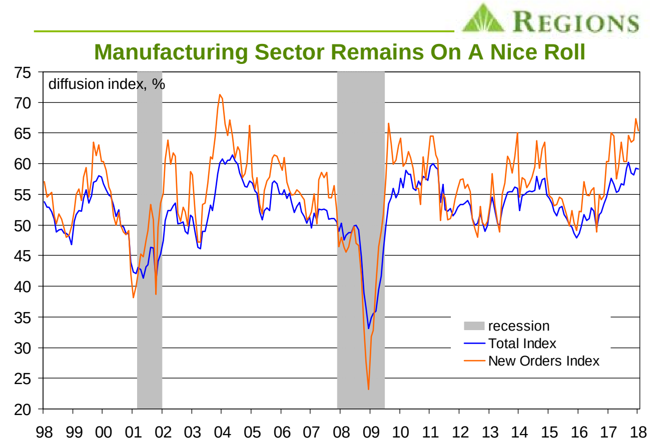
REGIONS

February 1, 2018

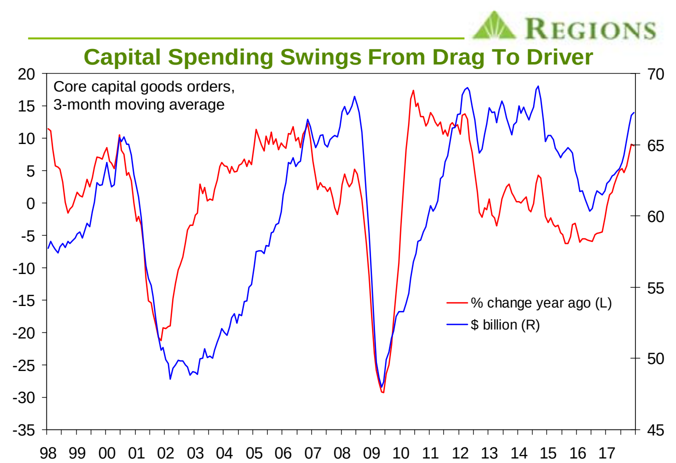
January ISM Manufacturing Index: Manufacturing Sector Remains On A Nice Roll

- The ISM Manufacturing Index fell to 59.1 percent in January from 59.3 percent in December
- The new orders component fell to 65.4 percent, the employment component fell to 54.2 percent, and new export orders rose.

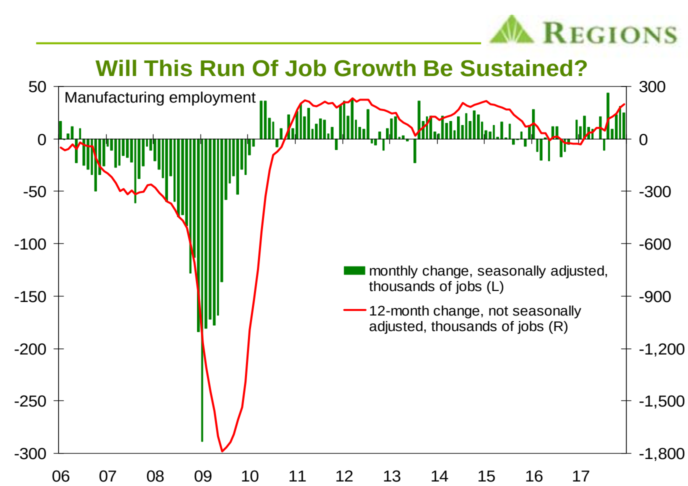
The ISM Manufacturing Index fell to 59.1 percent in January, besting the 58.6 percent print we and the consensus expected. The January release incorporates the annual revisions to the seasonal adjustment factors used by ISM, hence the recent historical data have been restated – the headline index for December is now reported to be 59.3 percent rather than the 59.7 percent initially reported. Still, the revisions do not alter the basic story – the manufacturing sector remains in the midst of a steady and increasingly broad based expansion that we expect will persist through 2018. Indeed, as 2018 kicks off, the main challenges facing most of the manufacturing sector include how to fill steadily growing order books and how to unclog backed up supply channels. In other words, the kinds of challenges firms want to be facing.



Of the 18 industry groups included in the ISM survey, 14 reported expansion in January with four reporting diminished activity. As has been the case over the past several months, comments from survey respondents were mostly upbeat. One common theme has been the strength of demand, both domestic and foreign, and today's survey points to increasing levels of capital spending across several industry groups. On the whole, the comments point to continued steady growth in the manufacturing sector in 2018.



Our forecast for the headline index was premised on a few key components – new orders, current production, and employment – settling back from their lofty year-end 2017 levels but nonetheless reaming at levels consistent with steady expansion. This was mostly correct, but the index of new orders fell less, from 67.4 percent in December to 65.4 percent in January, than our forecast anticipated. Of the 18 industry groups in the survey, 13 reported higher order volumes in January. Despite the slight decline in January, the level of the new orders index remains notably elevated, with January marking the eighth consecutive month in which the new orders index was at or above 60.0 percent. While we have not been surprised by growth in new orders, we have been a bit surprised by the persistent strength of the growth in new orders. In line with the steady growth in new orders, the index of current production has also been strong, and this remains the case despite it easing to 64.5 percent in January from 65.2 percent in December, with 11 industry groups reporting higher output levels and only 2 reporting lower output levels. With new orders and current production having been so persistently strong, it follows that employment in the factory sector has risen steadily over recent months. The ISM's gauge of employment fell to 54.2 percent in January, but has now remained above the 50.0 percent mark, indicting growth in manufacturing payrolls, for 16 consecutive months, in line with the growth in manufacturing payrolls seen in the monthly employment reports.



Other components of the ISM data indicate further tightening in the manufacturing sector. For instance, the backlog of unfilled orders rose to 56.2 percent in January and order backlogs have now expanded in twelve consecutive months. At the same time, supplier delivery times slowed further in January. And, as would be expected given steadily rising levels of demand, price pressures for raw materials used in manufacturing have built steadily, with the prices paid index hopping up to 72.7 percent in January, with all 18 industry groups reporting having to pay higher raw materials prices. Finally, survey respondents continue to assess customer inventories as being too low, suggesting production cannot keep pace with growth in demand.

The U.S. manufacturing sector remains in the midst of a steady and broad based expansion. The details of the ISM survey point to further growth in production and employment as well as stepped up investment. While a slowdown in motor vehicle sales and U.S. trade policy pose downside risks, the broad based expansion is likely to endure over coming quarters.

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