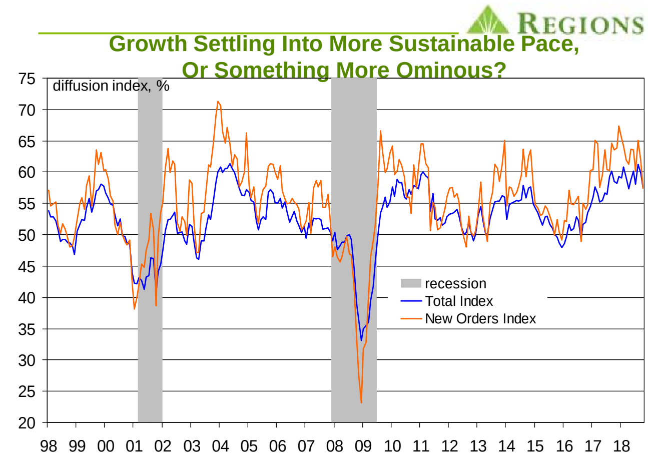
ECONOMIC UPDATE
REGIONS
November 1, 2018

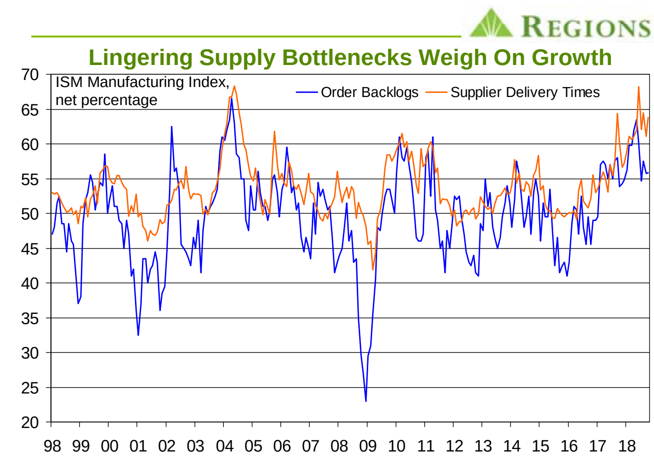
October ISM Manufacturing Index: Settling In, Or Something More Ominous?

- The ISM Manufacturing Index fell to 57.7 percent in October from 59.8 percent in September
- The new orders index fell to 57.4 percent, the employment index fell to 56.8 percent, the production index fell to 59.9 percent

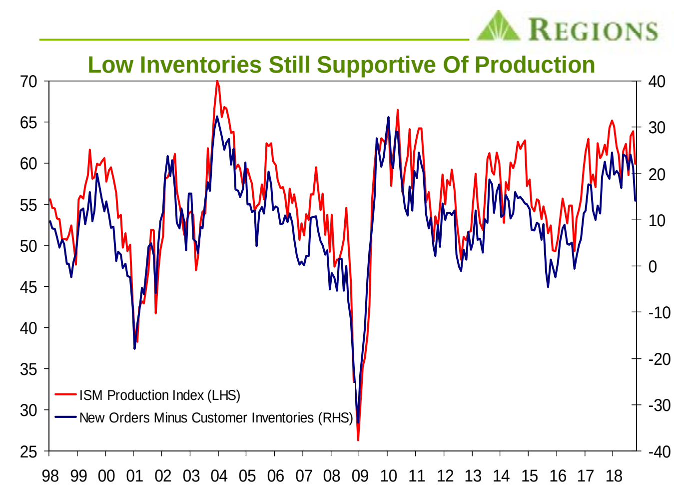
The ISM Manufacturing Index fell to 57.7 percent in October, shy of our below-consensus forecast of 58.6 percent but nonetheless the 26th consecutive month in which the headline index stood above the 50.0 percent break between contraction. That, in a nutshell, pretty much sums up the October report – how you feel about it will depend on whether you wish to focus on the fact that the headline index and all of the sub-indexes continue to signal growth in the manufacturing sector, or whether you wish to focus on the fact that the October reads on the headline index and most of the sub-indexes are lower than has been the case in recent months. Put differently, the question surrounding the October report is whether it is signaling something relatively benign, i.e., that growth in the factory sector is settling into a more sustainable pace, or whether it is signaling something more ominous, i.e., that the run of growth in the factory sector is coming to an end. As for us, while we are fully cognizant of the downside risks, such as an uncertain global growth outlook and the adverse effects of tariffs, we'll go with the benign interpretation of the October data.



Of the 18 industry groups included in the ISM survey, 13 reported expansion in October, with four industry groups reporting contraction. So, while the expansion in the factory sector remains broad based, the October data suggest it is a bit less so than has been the case over the past several months. Comments from survey respondents from several different industry groups pointed to negative effects from tariffs, including tariffs leading to higher costs that will be passed on to the cost of goods sold. While survey respondents continue to point to strong growth in demand, there were some who noted that backlogs of unfilled orders had begun to slim down, and supplier delivery backlogs continue to weigh on the ability of firms to fill orders.



The new orders index, one of our most trusted forward looking indicators, fell to 57.4 percent in October, the lowest reading since November 2016. Of the 18 industry groups included in the ISM survey, 11 reported higher order volumes in October while five reported lower order volumes. Other components that go into the calculation of the headline index show a similar pattern, i.e., a lower index value and fewer industry groups reporting growth. For instance, the current production index fell from 63.9 percent in September to 59.9 percent in October with 13 of the 18 industry groups reporting growth in output and three reporting lower levels of output. The index for employment slipped from 58.6 percent in September to 56.6 percent in October, with 11 industry groups reporting payrolls had increased and two reporting declines. Again, each sub-index points to further growth but at a slower pace than has been the case over the past several months. That firms, on the whole, continue to assess customer inventories as being too low suggests room for further growth in orders and output over coming months. Moreover, with backlogs of unfilled orders rising once again in October (the 21st consecutive month of larger backlogs), there is little reason to think production and/or employment will begin to contract any time soon.



As we noted above, the October ISM report is open to interpretation, so here's how we interpret what the ISM data are saying. We think the lofty levels of new orders and current production seen over the past several months to some extent reflect firms, here and abroad, playing the game of "time the tariffs," a game that has clearly impacted data on trade and inventories over this same time span. For instance, foreign buyers stepping up orders of U.S.-made goods in order to get ahead of retaliatory tariffs being placed on goods made in the U.S. have likely led to new orders being stronger than would have otherwise been the case. It could be that these effects are fading, hence the message of continued growth but at a slower pace than has been seen over the past several months. This is a question that will be answered over time but, at least as we see it, the details of the October ISM report offer no evidence that the end of the long-running expansion in the factory is at hand.

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