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February ISM Manufacturing Index: Settling In To A Slower Pace Of Growth

- > The ISM Manufacturing Index fell to 54.2 percent in February from 56.6 percent in January
- > The new orders index fell to 55.5 percent, the employment index fell to 52.3 percent, the production index fell to 54.8 percent

The ISM Manufacturing Index fell to 54.2 percent in February, falling short of our below-consensus forecast of 55.6 percent. Gauges of new orders, current production, and manufacturing payrolls slipped but nonetheless continue to indicate expansion. February marks the 30th consecutive month in which the headline index stood above the 50.0 percent break between contraction and expansion. In our weekly *Economic Preview*, we noted that we expected some of the gains reported in the January data would be given back in February, but admittedly there was more giving than we anticipated, with the headline index falling to its lowest level since November 2016. Still, the ISM Manufacturing Index shows that the long running and broad based expansion in the factory sector remains intact, but growth is simply shifting into a slower pace. This puts the ISM's index in line with many other indicators of activity in other sectors of the U.S. economy. Or, as we routinely put it, there is a distinction between slowing growth and the end of growth, and we are seeing the former not the latter. That is true of the manufacturing sector and for the broader economy.

Of the 18 industry groups included in the ISM survey, 16 reported growth in February, up from 14 in January and 11 in December, and only one industry group – nonmetallic mineral products – reported contraction. Comments from survey respondents were generally positive but do point to continued uncertainty over tariffs and broader trade policy. On the whole, comments from survey respondents point to continued growth in the manufacturing sector.

The new orders index, which has long been one of our most reliable forward looking indicators, fell to 55.5 percent in February, slightly below our forecast but still marking the 38th consecutive month of growth in new factory orders. Of the 18 industry groups included in the ISM survey, 13 reported growth in orders in February with only one (nonmetallic mineral products) industry group reporting lower orders. The current production index fell to 54.8 percent, a bit more than our forecast anticipated but, again, reflecting continued growth in output. Twelve of the 18 industry groups reported higher output in February with four reporting lower output. The employment index fell to 52.3 percent which, while indicative of further growth in factory payrolls, is nonetheless the lowest reading since November 2016. Ten of the 18 industry groups reported employment growth in February, with two reporting declines in employment and six reporting no change in head counts.

The component that stood out the most to us is the index of prices, which slipped to 49.4 percent in February and, as seen in our bottom chart, has fallen sharply over the past several months. Indeed, as recently as October the index of prices stood at over 70 percent, indicating stern upward pressure on raw materials prices, but any such pressures have clearly dissipated, with the ISM's gauge indicating falling raw materials prices for the past two months. We think this in part reflects slower global economic growth over recent months. But, we'll also reiterate a point we've made often over the past several months, which is that manufacturing activity had been boosted by firms, here and abroad, playing "time the tariffs," or, pulling orders and shipments ahead in anticipation of higher/broader tariffs. Other indicators have led us to think we are now seeing those effects unwind, though not fully. This is one reason we think that activity in the factory sector, rather than slipping into a downward spiral, is simply settling into a slower pace of growth. This, however, does not tend to happen in a straight line, so the ISM data could be quite jumpy over coming months. It is worth noting that the ISM's gauge of new export orders rose for a 36th consecutive month in February, which is consistent with our premise of continued, albeit slower, growth. With signs pointing to a fairly benign resolution of the U.S.-China trade spat, it is not unreasonable to think global growth could pick up over coming months, which would help sustain the long-running expansion in the U.S. factory sector.

