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Economics Group

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ISM Manufacturing: Can the Bounce Last?

The ISM manufacturing index improved to 56.0 in August as production and new orders picked up. But confidence in the recovery appears weak, as manufacturers continue to cut employment.

Manufacturers Aren't Fully Invested in Their Own Rebound

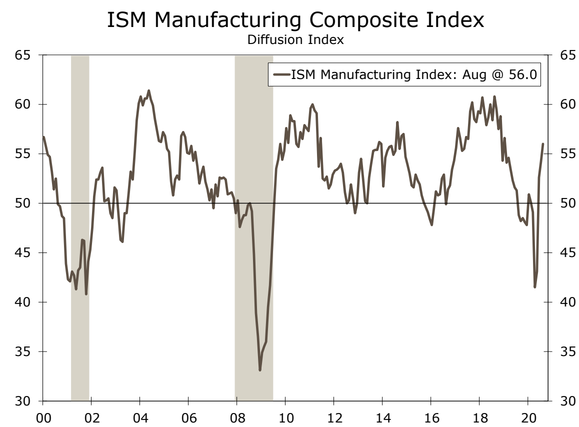
The factory sector's recovery continued to hum along in August with the ISM manufacturing index rising to 56.0. That marked the highest level for the index since late 2018. But while the recovery may be broadening, the report raises a number of caution flags regarding the sustainability of the recovery.

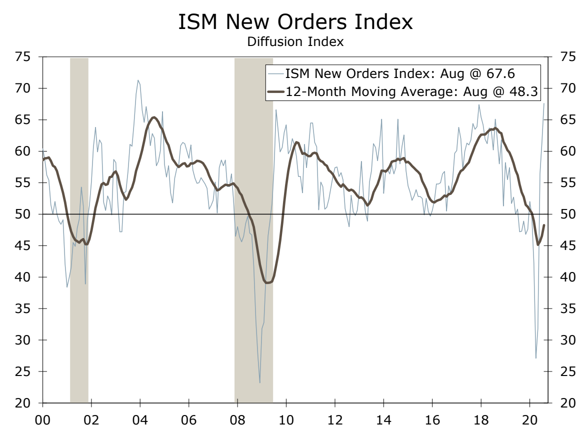
Let's start with the good news. The current production index notched another gain, climbing to 63.3. Even more impressive was another leap in new orders this month to a 17-year high of 67.6. Backlogs of orders subsequently rose faster, while respondents reported supplier delivery times increasing at a faster pace last month. Meanwhile, inventories fell more quickly—not a bad sign considering the pickup in production and new orders.

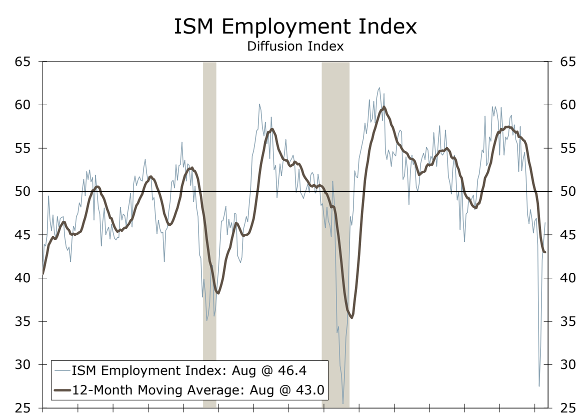
But it is worth once again reminding our readers that the ISM is a diffusion index, which measures the breadth of companies reporting a change in direction, not the degree of change or overall level. Despite the high reading on new orders, the employment component, at 46.4, is consistent with manufacturers continuing to lay off workers. The need to further pare back employment, even if at a slower rate as seen in August, highlights that overall demand remains weak and manufacturers are not fully convinced that the recovery is durable.

In addition, a gap has emerged within the manufacturing sector that mirrors the broader recovery. Some areas like durable goods spending have already recovered, especially those related to housing, as working from home has morphed into working ON home. For example, a fabricated metals producer shared that "Current sales to domestic markets are substantially stronger than forecasted…Retail and trade customer markets are very strong." Another respondent from the wood products industry observed "Homebuilder business continues to be robust…and will only be held back by supply issues across the entire industry." Yet manufacturers tied to services hit hard by the pandemic continue to struggle, as highlighted by a transportation respondent sharing that the "airline industry continues to be under great pressure."

In the near term, the manufacturing sector's prospects continue to look good relative to many parts of the service sector. The ongoing need to social distance has shifted spending away from in-person services toward goods. But looking ahead, as the pandemic drags on, lingering softness in sales and an uncertain global outlook will weigh on capital spending, so manufacturers—even those tied most tightly to goods spending—are hardly in the clear. Many manufacturers themselves are holding back capital investment for the remainder of this year, according to today's report. While the August ISM points to another month of growth, there is still a ways to go before production fully recovers.







Source: Institute for Supply Management and Wells Fargo Securities

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