



Economics Group

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ISM Manufacturing: Could Have Been Worse

Despite heightened uncertainty over trade policy in June, manufacturing activity continued to expand with the ISM easing only slightly to 51.7. We suspect growth will remain modest in the second half of the year, however.

Hangin in There, But Watch New Orders

For all the negative headlines surrounding the trade and growth environment in June, the manufacturing sector hung in there. The ISM manufacturing index edged only modestly lower in June, shedding 0.4 points. That was a bit stronger than even our above-consensus call and kept the index in expansion territory at 51.7. Nevertheless, there were a few pockets of weakness that signal activity is likely to keep struggling in the near term.

On the plus side, production improved over the month, with the index up nearly three points to 54.1. The employment index also edged higher for a second straight month. That said, at 54.5, it is consistent with only modest additions to factory payrolls. We expect to see continued softness in hiring at manufacturers in Friday’s employment report as the industry contended with a deteriorating trade dialogue in the run-up to the survey week in addition to the weak global environment more broadly.

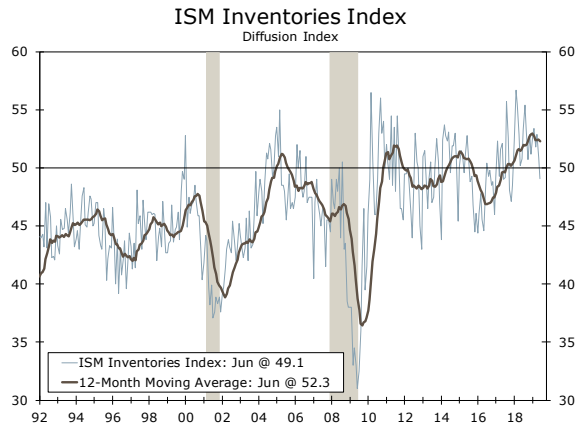
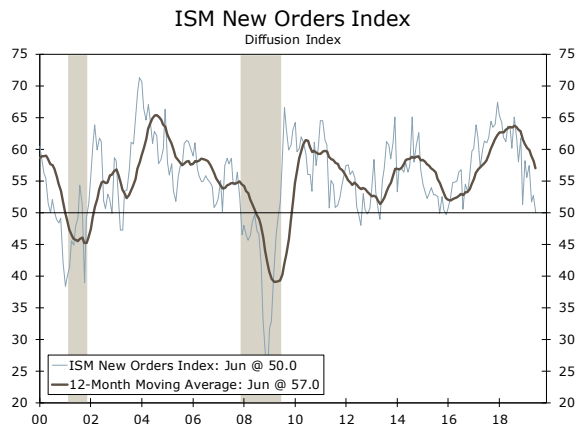
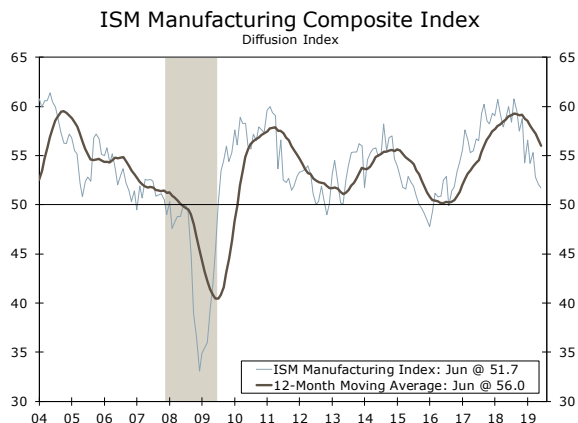
The recent upping of trade tensions that we suspect had at least some adverse impact on hiring also looks to have weighed on new orders. New orders barely skirted a contractionary print and, at 50.0, hit a three-and-a-half-year low. Along with another outright decline in backlogs (47.4) and slowing supplier delivery times (50.7), production growth in the next few months looks set to remain modest.

Elevated inventories also give room for manufacturers to fill orders without ramping up production. However, there are signs of stockpiles getting right-sized in today’s report with the inventory index falling to 49.1. While that may be favorable for the health of the manufacturing sector, it supports our expectation that inventories are set to be a drag on Q2 GDP growth.

Truce, Not Resolution

Notably, the June survey spanned another period of heightened trade tensions. While tariffs with Mexico have been nixed, the threat looks to have contributed to the factory sector’s softness in June, with two respondents commenting on them specifically. An escalation in the trade war with China looks less likely after this weekend’s meeting between Presidents Trump and Xi, which also suggests some of June’s weakness should be discounted.

However, we suspect a complete resolution with China is likely some ways off. Therefore, while manufacturers’ worst fears about an all-out trade war with China developing imminently have been allayed, uncertainty about the structure of future trading relations continues to linger. Let us not forget that nearly half of imports from China, most of which are intermediate goods, remain subject to 25% tariffs. As a result, we suspect factory activity will continue to struggle in the second half of the year.



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