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Economics Group

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ISM: The Bellwether Tolls

ISM fell only slightly to 49.1, but that has a lot to do with supplier deliveries shooting higher amid widespread supply chain disruption. Orders and employment tell the real story; both are at their lowest since 2009.

Not-So-Bad Headline Owes Much to Quirk with Deliveries

The ISM is a time-tested bellwether for the manufacturing sector and due to its long history, it is a favorite input for econometric models. In the month of March it came in at 49.1, a level that might ordinarily suggest only modest contraction. This measure surveys purchasing managers in the factory to put a finger on the pulse of a number of key metrics like deliveries, orders, employment and inventories.

In March, supplier deliveries shot up to 65.0. Among the different components of the ISM, supplier deliveries is the only one that is an inverse indicator (top chart). The idea here is that deliveries slow down as the economy improves. More plainly: it's tough to get the stuff you need to run your factory when the economy is really humming. But that's not what is happening here; the slow supplier deliveries are occurring amid a drop off in arrivals at the nation's top trading ports and is instead a reflection of supply-chain constraints. Since this component makes up a fifth of the calculation for the headline ISM, it essentially acted as a life preserver to an indicator that otherwise would have been sinking much faster.

Other Major Components Flashing Red

The new orders component of the ISM dipped to 42.2 indicating the fastest pace of contraction in bookings since 2009 (middle chart). Like many things right now, it is not clear how bad this measure will get with many factories temporarily shuttered during the crisis. The low point in orders in the prior cycle was 25.9, reached December 2008.

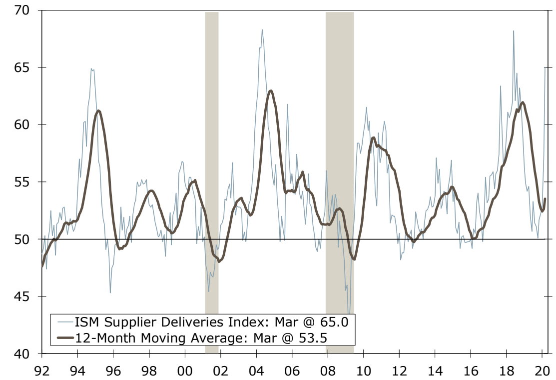
The employment component also touched a level not seen since 2009 coming in at 43.8. Following last week's surge in jobless claims this does not come as much of a surprise, though the fact that it is not worse suggests that perhaps after a few quarters of weak capital spending, factories are already running pretty lean. Whether that translates to fewer layoffs in the sector remain to be seen, but a shift to automation throughout this cycle may also help keep pink slips from flying.

We have seen steep declines in other purchasing manager surveys from the various regional Federal Reserve branches. We typically would apply a three-month moving average to the lines in the bottom chart to smooth the volatility a bit, but this time we deliberately did not do that in order to reveal the sharp declines that occurred in March.

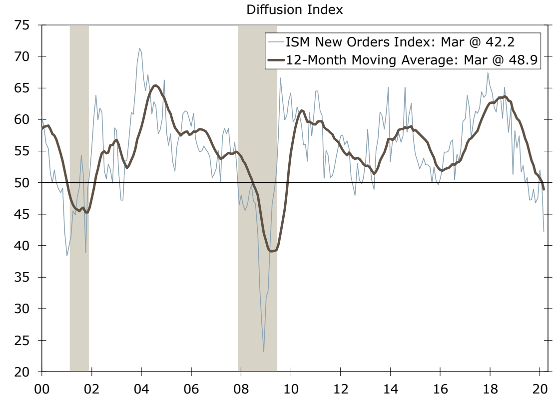
V for Victory, V for V-Shaped Bottom

Today's news comes on the heels of a Presidential address last night that warned of the devastating human cost of COVID-19. But those same dire projections also show the case counts coming down sharply in the spring months which would be consistent with our forecast of growth returning by the end of the year and manufacturing picking back up early next year.

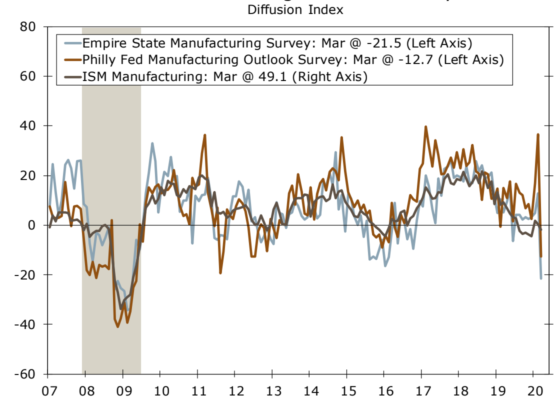
ISM Supplier Deliveries Index
Diffusion Index



ISM New Orders Index
Diffusion Index



ISM and U.S. Regional Fed Surveys
Diffusion Index



Source: Institute of Supply Management, Federal Reserve System and Wells Fargo Securities

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