

Economic Indicator — May 3, 2021

ISM Manufacturing Bound by Supply Chains

Summary

The ISM manufacturing index slipped four points to a still-strong 60.7 in April. Production is being held back by a lack of input components as backlogged orders surged to a record high. The shortages are adding to existing price pressures, and manufacturers are increasingly passing costs on.

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Off the Boil, but Still Scalding

The message from today's ISM manufacturing report is that the factory sector could be running even hotter were it not for a variety of constraints. The headline measure slowed to 60.7 in April from 64.7 in March. Any figure above 50 signals expansion and a figure north of 60 signals broad and strong expansion. Still, the sharp move lower in April is not quite consistent with regional PMIs and our own discussion with manufacturers around the country.

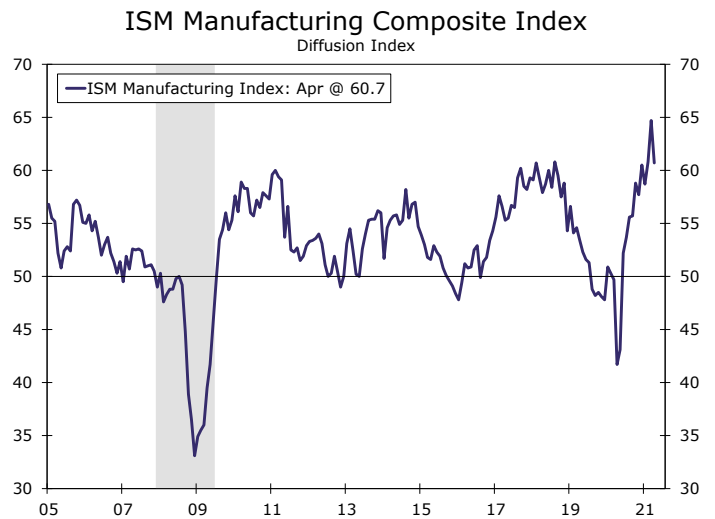
The sharpest decline among the sub-components was the 5.6-point drop in the production index. That is not a terribly encouraging sign after industrial production fell in February and only partly recouped the loss in March. Note, however, the supply chain shortages, particularly in microchips and processors, have shuttered auto assembly plants across the country.

New orders slowed to a still-blistering 64.3 in April from 68.0 in March, even as plants cannot keep up with demand. For more evidence, look no further than backlogged orders which rose to an all-time high of 68.2.

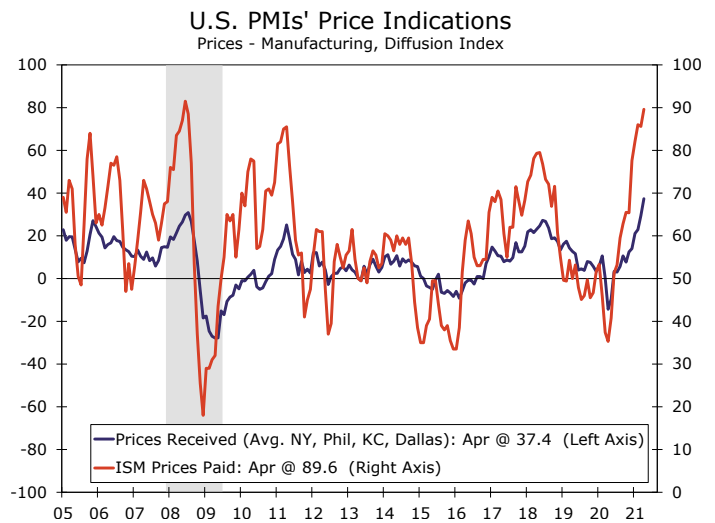
Supplier deliveries were down slightly but remained near record highs. While many industry respondents highlighted supply chain problems, our favorite came from the plastics and rubber products space: "In 35 years of purchasing, I've never seen [anything] like these extended lead times and rising prices."

Low Supply + High Demand = Price Pressure

In a sign that the weakness—as far as a 60+ reading could be considered—stems from ongoing supply issues capping overall growth, input prices moved another notch higher in April. The prices paid series rose to 89.6, the highest reading since 1979 bar two months in the summer of 2008 when oil prices were surging. Yet unlike in 2008, demand is far from wavering. That has put manufacturers in a better position to pass on costs than see their margins squeezed. The ISM does not track prices received, but regional Fed indices show the net share of manufacturers increasing selling prices eclipsing the highs of 2008 by more than six points.



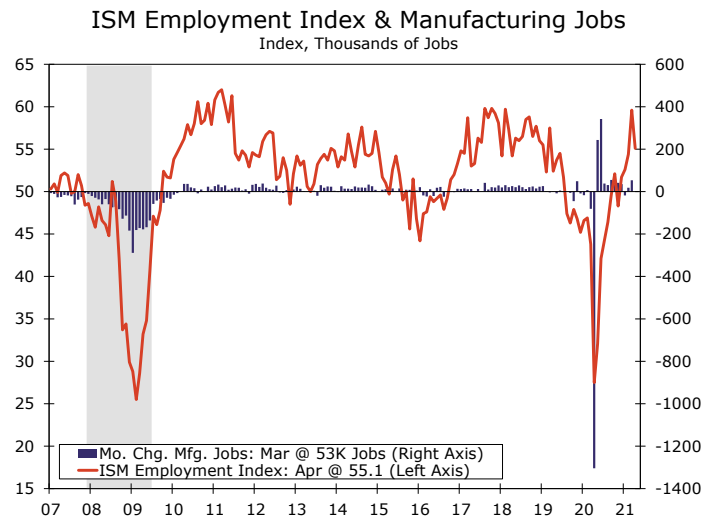
Source: Institute for Supply Management and Wells Fargo Securities



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

Who Needs Workers If Your Production Lines Are Missing Parts?

Hiring also slowed in April, with the employment index slipping to a still-strong 55.1. Comments focused more around issues securing materials and their associated cost, rather than labor issues this month, but the report's summary noted that worker absenteeism and difficulties filling open positions continued to be factors holding back overall manufacturing growth. In addition, temporary shutdowns as factories await parts and materials was also pointed to as a governing force on hiring this past month. We still look for manufacturers to add to payrolls in Friday's employment report, but the ISM employment index offers a cautionary tale that the biggest near-term impediment to hiring may be the frictions associated with booming economic growth.



Source: Institute for Supply Management, U.S. Department of Labor and Wells Fargo Securities

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