

Economic Indicator — June 1, 2023

ISM: Just About Every Measure of Activity Slowing... Except Hiring

Summary

Today's May ISM shows the fastest rate hikes in a generation are slowing just about everything in the manufacturing sector except the pace of hiring. For the Fed, falling prices and slowing activity without denting the labor market could diminish some urgency on their part to tighten further.

Economist(s)

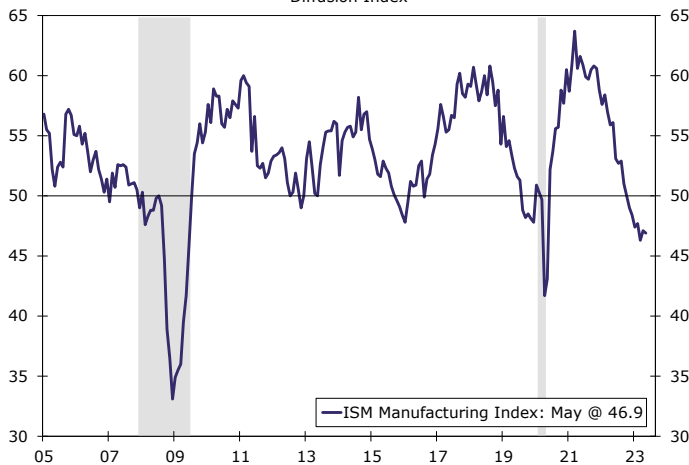
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ISM Manufacturing Composite Index
 Diffusion Index



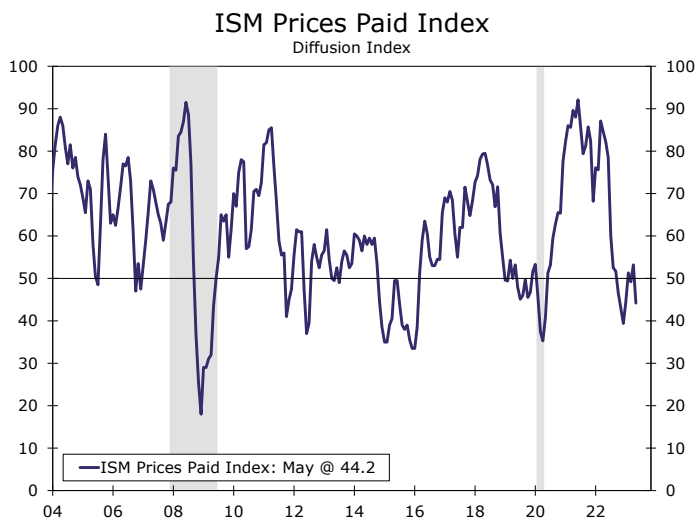
Source: Institute for Supply Management and Wells Fargo Economics

Clear Signs of Recession in Manufacturing Sector

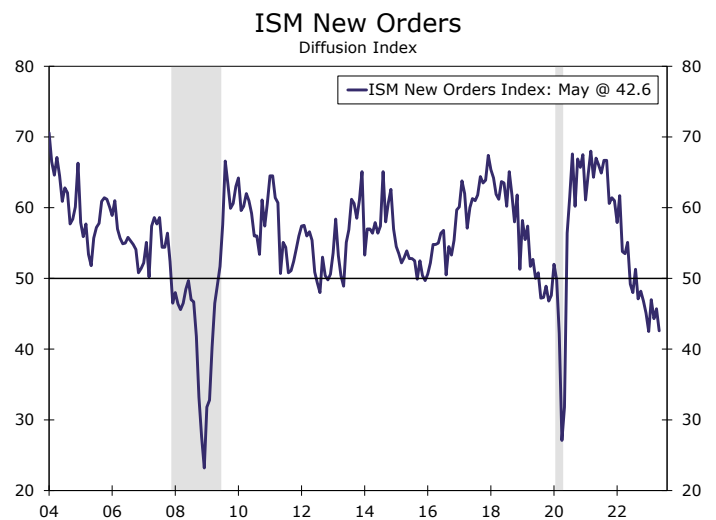
Some parts of the economy, such as consumer spending and the labor market, have appeared at times in this tightening cycle to be impervious to the effects of rate hikes from the Federal Reserve. The manufacturing sector has long demonstrated that it has no such Kevlar.

May notches the seventh straight month of contraction for the bellwether ISM, a run that is rarely seen outside of recession ([chart](#)). That said, we know from conversations with manufacturing clients and from the industry sector-level data in the ISM that not all industries are in free fall. This may explain why the prices paid index, with its on-again, off-again readouts have been inconclusive about the direction of price pressures. Prices paid has literally been in contraction one month and expansion the next every month so far this year. Still, the dip in May takes it to a fresh 2023 low and also marks the biggest sequential decline since July 2022 ([chart](#)). This development may diminish some of the Fed's urgency to deliver yet another rate hike at its upcoming meeting later this month.

Prices are not the only piece of the picture where the latest activity straddles the line between expansion and contraction. The employment component has registered three months in expansion territory and two in contraction so far this year. While cooling prices may stay the Fed's hand for now and some other measures captured in today's report signal a deterioration in factory activity, employment—somewhat incongruously—is gaining ground. The May print of 51.4 may not take your breath away, but it is enough to mark the fastest pace of factory hiring since last August.



Source: Institute for Supply Management and Wells Fargo Economics



Source: Institute for Supply Management and Wells Fargo Economics

On balance, the May ISM report is bad news for the manufacturing sector. Activity is slowing under the weight of tighter policy and that is crimping new demand. The new orders index slipped to 42.6, marking the ninth consecutive month below the 50-breakeven point designating expansion from contraction ([chart](#)). The fact that the production index rose back into expansion territory after five months of contraction signals current activity is somewhat holding up and that the sector is not in free fall. Order backlog, however, also slipped to the lowest reading since March 2009. This is consistent with the widespread improvement in supply chains, but also potentially indicates some cancellation in previously placed orders. Supplier deliveries have also shortened, reaching their lowest reading since 2009, further signaling a stall in activity.

Despite an ongoing debate around if the U.S. economy is tracking toward recession, the signs of contraction are clear for manufacturing. The aggressive pace of Fed tightening is slowing activity as higher borrowing costs and increased uncertainty sap the appeal of taking on new capital investment.

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