

Economic Indicator — July 1, 2022

ISM New Orders Indicate Slowdown in Manufacturing Activity

Summary

The ISM manufacturing index slid to its lowest reading in two years amid a contraction in new orders. Details of the report demonstrate slower activity in the manufacturing sector, but also that supply problems continue to slowly ease. In short, the report piles onto weaker consumer data received this week and signals investment spending is starting to weaken too.

Economist(s)

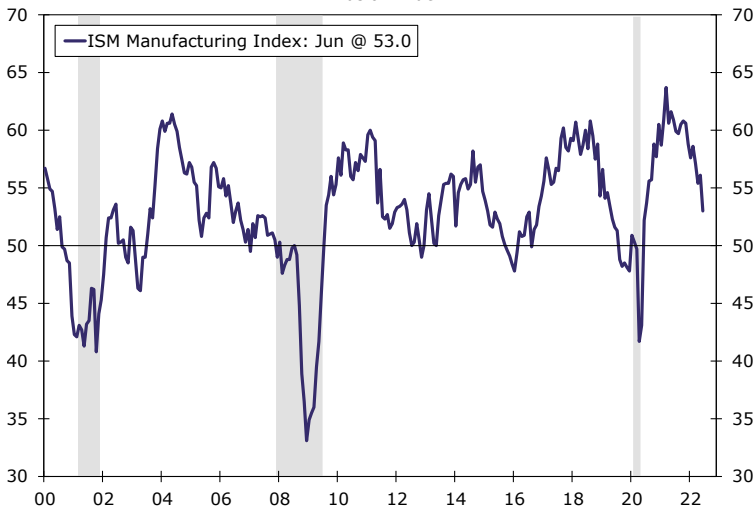
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ISM Manufacturing Composite Index
 Diffusion Index

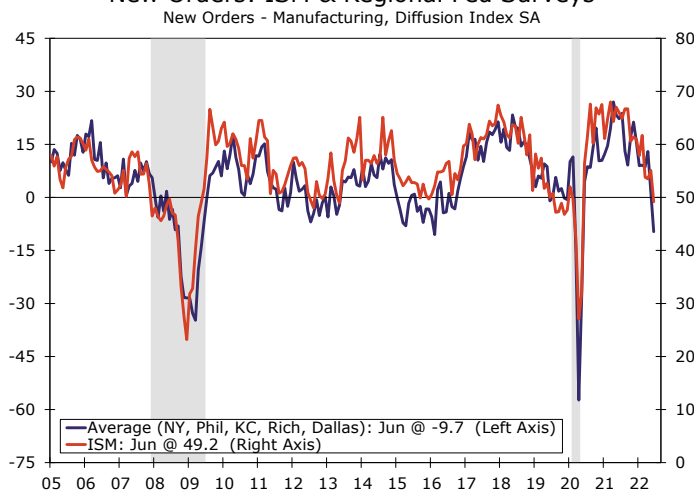


Source: Institute for Supply Management and Wells Fargo Economics

Further Evidence U.S. Economy is Rapidly Slowing

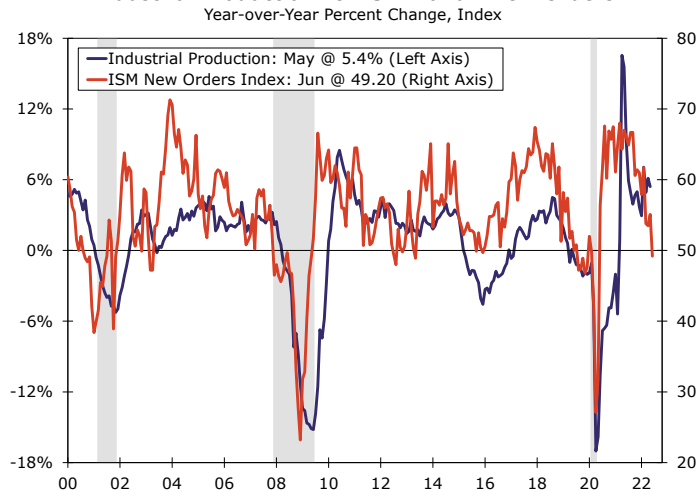
- The ISM manufacturing index slid 3.1 points to 53.0 in June ([chart](#)). Notably, this was still above the 50-threshold signaling expansion, but marked the lowest reading in nearly two years and is consistent with a slower pace of activity. There were multiple signs of supply constraints easing, but weakness on the demand side pulled the overall index lower as new orders tumbled.
- The new orders component was particularly rough. It slipped 5.9 points to 49.2, which marks the first contraction reading for since May 2020, when the economy was coming out of pandemic-related lockdowns. Weakness in new orders seemed to be broad based across many industries and across the country based on the regional Fed PMI readings released earlier this month, with four of the five surveys reporting a decline in the new orders component in June ([chart](#)).
- New orders tend to lead growth in industrial production (IP) —ISM new orders led growth in IP heading into the 2001 and the 2007 recessions ([chart](#)). In short, this contraction-territory print for new orders is not good news for activity in the sector and could foreshadow coming weakness in actual output. One potential offset today, however, is the fact that manufacturers still have a record amount of backlog to move through, which may help support manufacturing activity even amid a pullback in new demand. A respondent from the fabricated metals industry spoke to this point when referring to the pullback in new orders saying, “We are able to backfill the pushed orders from customers that want theirs earlier, so we aren't losing capacity.”
- Some selected industry comments also suggested the drop in orders had to do with high inventory levels. Inventories have continued to get rebuilt with real inventories up for the eight consecutive month in April. The two largest quarterly inventory builds on record happened in the past two quarters. Still, [we feel](#) fears of an overstocking are currently overblown today. Manufacturing inventories, in particular still remain depleted with levels about 4% below pre-pandemic levels and the real inventory-to-sales ratio not yet showing unintended inventory building.
- Improvement in inventories speaks to some improvement in supply. The positive in today's report was indication that supply problems are slowly improving with industry order backlogs (-5.5 points) and supplier deliveries (-8.4 points) both moving lower. The prices paid component also slid 3.7 points to a still-high reading of 78.5 in June.
- Manufacturing hiring continued to struggle last month with the employment component falling deeper into contraction territory at 47.3, which signals further slowing in next week's nonfarm payrolls report for June.
- In short, the June ISM piles onto weaker consumer data received this week. Investment spending is starting to weaken, which only adds to the evidence that the U.S. economy is rapidly slowing.

New Orders: ISM & Regional Fed Surveys



Source: Institute for Supply Management, Bloomberg Finance L.P. and Wells Fargo Economics

Industrial Production vs. ISM Manuf. New Orders



Source: Institute for Supply Management, Federal Reserve Board and Wells Fargo Economics

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