UNITED STATES

Manufacturing ISM drops back below 50

HIGHLIGHTS

• May’s decline by the ISM manufacturing index was its third straight monthly drop, taking it from 50.7 to 49.0, its lowest point since the recession officially ended in 2009.
• Most of its components are down. The biggest retreats come from current production, the backlog of orders and new orders.
• The employment component was relatively stable, losing only 0.1 points to go to 50.1.
• Prices paid trimmed 0.5 points, going to 49.5.
• The two components associated with inventories were the only ones to rise.

COMMENTS

This further drop by the ISM manufacturing index is of course bad news. A pullback was foreseeable, as several regional indexes (the Philadelphia and New York Federal Reserve indexes) had eroded in May, although the Chicago PMI index was up. However, the ISM had not been expected to pull back this much and the consensus was even predicting a slight rise to 51.0. Our forecast called for 50.3.

This is not the first time since the start of the recovery that the manufacturing ISM drops below 50, the cut-off between growth and contraction in manufacturing activity. In November 2012, at 49.9, the index was not yet very concerning, however. At 49.0, it still is not pointing to a real GDP contraction, but a rebound will have to come soon.

The production component dropped 4.9 points, which does not augur well for manufacturing’s performance in May and June. New orders retreated by 3.5 points, pointing to weaker growth by business investment following the annualized 4.6% increase in the first quarter of 2013. The fact that the new orders component deteriorated and the business inventories component advanced suggest that output could remain soft in the near term.

Implications: The manufacturing ISM declined more than forecast. Its drop below 50 confirms that business is being plagued by some fears, in contrast with the upswing in consumer confidence. U.S. economic growth should remain fairly soft in the spring.

Francis Généreux
Senior Economist