

US: Manufacturing's long road to recovery

The ISM index rose, but remains well below the key 50 break-even level so it merely tells us the sector is contracting at a slightly slower rate. The details are far worse and point to sharply higher manufacturing unemployment and big cuts to investment spending over the next couple of quarters, which will limit the ability of the US economy to rebound quickly



Source: iStockphoto

43.1 Manufacturing ISM index for May

Headline improvement fails to tell the whole story

The ISM manufacturing index has risen to 43.1 in May from 41.5 in April and all the important sub-components – production, new orders and employment – have improved, but they continue to tell a very painful story. One that suggests manufacturing output will fall by more than 20% with investment in the sector likely to contract through much of the rest of the year.

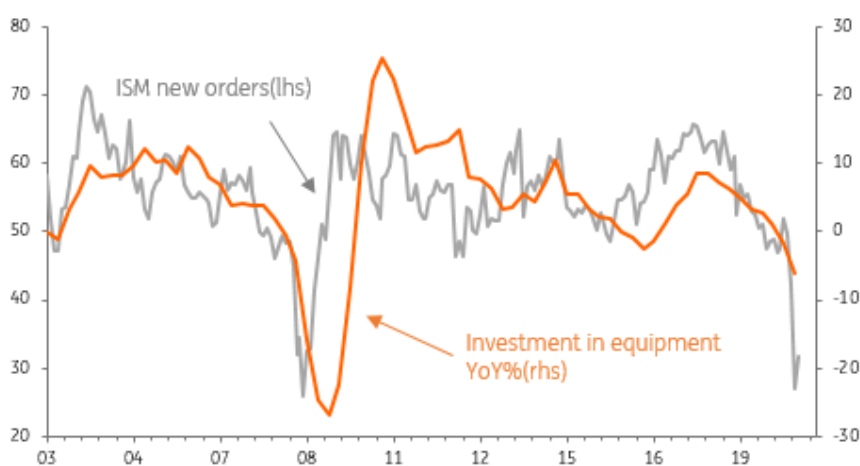
During the Global Financial Crisis the headline ISM index bottomed at 34.5 (December 2008) so hitting a low of “only” 41.5 in April doesn’t seem all that terrible. In the current crisis though the headline is being artificially inflated by the supplier delivery times component, which even after dipping back this month, is still up at 68.0.

In normal times rising supplier delivery times are interpreted as a positive signal – huge levels of demand that businesses can’t meet so supplier delivery times are extended. The component therefore boosts headline ISM. However, today, the rise in supplier delivery times is because lockdowns and temporary factory closures have disrupted supply chains, which is limiting the ability for many factories to restart production as they simply can’t get hold of parts. This is obviously very bad, yet it is still boosting the headline ISM index.

New orders and output still falling

Production improved to 33.2 from 27.5 and new orders rose to 31.8 from 27.1, but both are still massively away from the break-even 50 level. They are therefore telling us that the sector is experiencing a huge contraction, it just isn’t quite as precipitous a drop as in April when the lockdowns were at their peak. The weakness in new orders is suggesting very bad news for investment spending within the US economy, as the chart below shows. It indicates that investment in equipment could easily drop 20%, which is not unsurprising given the low levels of capacity utilization and the hit to corporate profits from the Covid-19 crisis.

ISM new orders suggest steep falls in investment



Source: Macrobond, ING

Manufacturing weakness to limit the scope for a rapid recovery

Manufacturers are being squeezed by both a collapse in demand and disrupted supply chains. With profitability under immense pressure firms are increasingly looking to cut costs, which also means more bad news for the jobs market. The ISM employment component rose to 32.1 from 27.5, but has only been lower on a handful of occasions over the past 70 years.

So far, the 40 million or so jobs lost have been concentrated in retail, travel and hospitality but the pain is clearly spreading to other sectors. Friday’s unemployment rate figure will probably come in around 20%. This will hopefully mark the peak as the re-opening process gathers momentum, but it is likely that job losses in the manufacturing sector continue over coming months.

With investment set to contract sharply over the next few quarters and manufacturing unemployment set to rise further this will certainly limit the economy's ability to bounce back strongly. We continue to doubt that the 13% or so peak-to-trough decline in US GDP we forecast will be fully recovered before the end of 2022.

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