Economic Analysis

ISM indices: improvement in manufacturing industries, slower growth in non-manufacturing

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- **The ISM manufacturing index increased slightly in May to 51.3 from 50.8, indicating fewer headwinds for manufacturing going forward**
- **The ISM non-manufacturing index dropped to 52.9 from 55.7, indicating slower growth in the services sector**

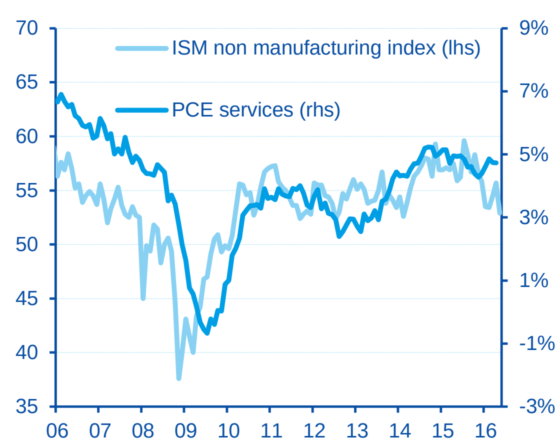
The ISM manufacturing index posted a gain in May to 51.3 from 50.8, contrary to consensus expectations for deterioration to 50.6. The index was lifted by a slowdown in delivery times in May, while the other components of the index remained roughly unchanged. The index is now in expansion territory for the third month in a row, after spending the period between October and February in the contraction zone. This indicates that growth in the U.S. manufacturing sector is picking up, despite doing so at a very modest speed. The likely reasons for the improvement in manufacturing are the relative weakening of the U.S. dollar since February, lower uncertainty about global growth compared to the previous period, and the relief that the oil and gas industry and its suppliers are getting from increased oil prices. Of the 18 manufacturing industries, 12 reported growth in May. Overall, May's manufacturing report is positive, as it confirms weaker headwinds for the sector going into the second quarter. That said, it is not likely that manufacturing will be a significant driver of growth in 2016 (Chart 1).

The ISM non-manufacturing index dropped to 52.9 from 55.7, the lowest since February 2014, indicating that the service sector might be losing some momentum after a long stretch of solid performance, which supported the sustained growth of the overall economy and drove job creation. The business activity, new orders, and employment subcomponents of the composite non-manufacturing index posted declines, while the supplier deliveries and price indices posted gains. The employment index dipped into the contraction zone, which coincides with the weak jobs report in May (see our employment publication), which confirms that the risks to the labor market recovery have increased. Of the 18 non-manufacturing industries, 14 reported growth in May, more than in the previous two months. In sum, while the service sector is still well in expansion territory, the drop in the composite index is unwelcome and could indicate a slowdown in consumer spending on services (Chart 2), which could negatively affect GDP growth in the second quarter.

Chart 1
ISM manufacturing new orders index, manufacturers' shipments and orders (Index SA and YoY% change)

Source: ISM, Census Bureau and BBVA Research

Chart 2
ISM non-manufacturing index, and personal consumption on services (Index SA and YoY% change)



Source: ISM, BEA and BBVA Research

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