U.S. Flash

Manufacturing Activity Contracts on Weak New Orders and Output

- **The ISM Manufacturing Index fell to 49.0 in May, the lowest level of the recovery**
- **New orders and production plummeted from +50 to 48.8 and 48.6, respectively**
- **Employment remained mostly unchanged, hovering just above 50 for the second month**

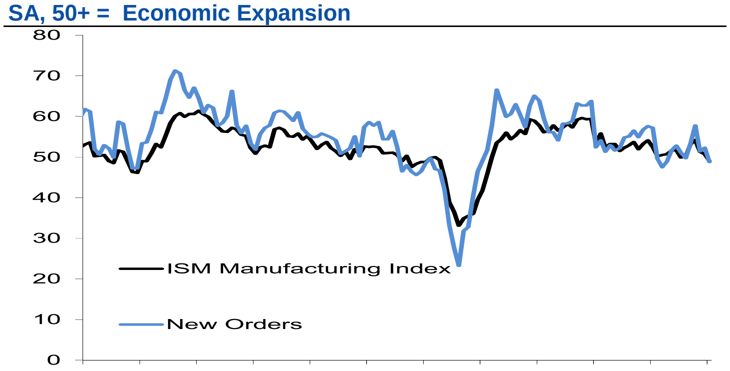
Falling below 50 in May for the first time since last November, the ISM manufacturing index posted its lowest monthly figure since June 2009 and a look at the underlying factors doesn't bode well for upcoming releases. The breakdown of the index showed a weak state for manufacturing activity in May as the new orders component, which in April increased to 52.3, fell to 48.8 – the lowest level since last July. Given that the current manufacturing outlook remains pessimistic, the fall below 50 does little to strengthen the sector's resolve as inventories decline at a slower pace. With inventories climbing to 49.0 in April from 46.5, the situation looks difficult as increased inventory could lead to reduced production in the future as firms try to get rid of existing stockpile. The prequel to new orders, current production, also fell dramatically. The component fell below 50 to 48.6 which is its lowest reading in four years as output continues to falter on weaker domestic and global demand. However, there was some solace from the employment index which declined only slightly from 50.2 to 50.1 in May, relatively minimal compared to the rest of the components. This is relatively good news as employers seek to keep talent and have a bright enough outlook to not halt hiring altogether. Still, manufacturing employment usually makes up only a small percentage of the monthly employment report, so modest growth here is not necessarily suggestive of positive jobs data for the month.

Turning to the global portion of the index, new export orders continued to expand but at a significantly slower pace, falling 3pts to 51 as demand for U.S. manufactured goods takes a pause after a strong rally since late 2012. Imports, which have shown signs of declining since the beginning of the year, decelerated slightly by 0.5pts to 54.5. Assessing the two, the picture is quite similar to recent international trade reports with exports showing some increase but nothing significant and global trade continues to trend downward for 1H13.

For the industry, this is the report most pundits have been waiting for as many leading indicators have been showing signs of a manufacturing lull in 2Q13. While one month of data is seldom indicative of a trend, we do not expect the ISM index to return to growth immediately but remain close to the 50 threshold on either side of the index until later in the year when we expect activity to recover. As for employment optimism, it is likely that most of the current workers will remain employed despite the lull since the industry would be weary to be caught short handed if the recovery happens sooner than expected.

Chart 1

ISM Manufacturing Index & New Orders
SA, 50+ = Economic Expansion



Source: Institute for Supply Management & BBVA Research

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