ISM: Manufacturing Activity Contracts Again

Mike Schmidt. Associate Editor, Manufacturing Business Technology

It’s been a tough few months for U.S. manufacturing, and it could be more of the same for at least the rest of 2012.

While overall economy grew for the 39th consecutive month in August, economic activity in the manufacturing sector contracted in August for the third time since July 2009, according to the latest Manufacturing ISM *Report On Business.*

Bradley J. Holcomb, CPSM, CPSD

“Manufacturing has kind of tapped on the breaks, because they don’t know what exactly lies ahead for the rest of the year,” said Bradley J. Holcomb, CPSM, CPSD, chair of the Institute for Supply Management Manufacturing Business Survey Committee.

“It’s more like a wait-and-see attitude,” he added.

Manufacturing contracted in August as the PMI registered 49.6 percent, a decrease of 0.2 percentage point when compared to July’s reading of 49.8 percent. A reading above 50 percent indicates that the manufacturing economy is generally expanding while a reading below 50 percent indicates that it is generally contracting. A PMI in excess of 42.6 percent, over a period of time, generally indicates an expansion of the overall economy.

“We’re kind of in a holding pattern here with three months in a row at just a touch under 50,” said Holcomb, who noted that a lack of new orders and demand is holding the PMI down below 50.

Production, New Orders, & Backlog of Orders

Since new orders drive production, there is a direct correlation between the performances of the ISM New Orders Index and ISM Production Index. Both underwhelmed again this month. New Orders came in at 47.1 (down 0.9 percentage points since July) and Production registered 47.2 in August (down 4.1 percentage points when compared to the 51.3 percent reported in July, indicating contraction in production for the first time since May 2009).

Furthermore, the ISM Backlog of Orders Index registered 42.5 percent in August, which is 0.5 percentage point lower than the 43 percent reported in July.

“We see that the backlog of orders is down to its lowest level since September of 2011,” said Holcomb. “When you see the backlog contracting for five months in a row, which means production has been utilizing the backlog. But it’s not available anymore to the same extent. You’ve got a double-whammy with new orders and the backlog finally catching up to production.”

Prices

Meanwhile, no index saw more movement this past month than the ISM Prices Index, which registered 54.0 in August. That marked an increase of 14.5 points from July’s mark of 39.5. This is the first month the index has reflected an increase in the price of raw materials since April 2012, when the Prices Index registered 61 percent. This is also the largest month-over-month increase since September 2005.

“That was a real surprise to me; particularly the extent of it,” said Holcomb. “We’d been down dramatically the two months prior and I did not expect this to jump back up.”

Holcomb pointed to a number of factors (drought, freight rate, fuel prices, among others) that drove the ISM Prices Index back up above 50.

Employment

Then there’s the ISM Employment Index, which has seen decrease after decrease over the course of the past several months. It registered 51.6 percent in August, which is 0.4 percentage point lower than the 52 percent reported in July. However, it is down more than five percentage points since May.

“I certainly see the potential for a few bumps or dips in the road ahead,” said Holcomb of unemployment. “It would be difficult to maintain high levels of unemployment without new orders and production. There’s still that residual optimism that keeps employment up, but that’s going to be tested over the course of the next few months.”

In his role as the Chair of the Institute for Supply Management Manufacturing Business Survey Committee, Bradley J. Holcomb writes the monthly Manufacturing

ISM Report on Business based on the survey results of approximately 350 professionals across 18 different industry sectors. The Report on Business is released on the first business day of each month, and features the PMI Index as its key measure. For more information on the Institute of Supply Management, visit www.ism.ws *[1].*

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