Data Release: U.S. manufacturing sector turns corner in May as ISM index posts first rise since October 2014

- The Institute for Supply Management (ISM) manufacturing index rose by 1.3 points to 52.8 in May ahead of market expectations for a 52.0 print.

- Details of the report were encouraging with eight out of ten indexes subcomponents gaining on the month. New orders subcomponent extended its gain from the month prior, rising by 2.3 points to 55.8 in May. Other forward-looking subcomponents, such as the backlog of orders, also advanced (+4.0 points). Both new orders and inventories (+2.0) increased in May. As a result, the spread between the two – a leading indicator of future activity – has widened only marginally, increasing from 4.0 to 4.3.

- After four months of declines, the employment subcomponent finally edged higher, advancing by 3.4 points to 51.7 and moving back into expansionary territory.

- Performance was mixed among the trade-related subcomponents. Exports edged lower (-1.5 point) while imports gained (+1.0 point).

- The prices paid subcomponent rose by a stupendous 9.0 points, reflecting partial recovery in oil prices.

- Casting a shadow on this upbeat report is the decline in the production subcomponent (-1.5 points). Despite the decline, the subcomponent remains firmly in expansionary territory with the current reading of 54.5.

Key Implications

- This is an encouraging report, suggesting that the “green shoots” that were only tentative in April have become apparent in May. Indeed, after six consecutive monthly declines, the slowdown in U.S. manufacturing activity has finally reversed course. While the index remains 2.8 points below its year-ago level, gains in new orders and backlog orders give hope that the improvement will be sustained in the coming months.

- The report noted that while certain temporary factors, such as shipping disruptions at West Coast ports, are dissipating, others are proving to be more persistent. The rapid appreciation of the U.S. dollar has certainly not been a walk in the park for manufacturers. The dollar remains below its peak level in March, but restarted its ascent in May, and has the potential to rise further as the year progresses. This will continue to weigh on foreign demand and corporate profits from overseas sales. Some offsets to the higher dollar will come in the form of lower costs of imported intermediate goods as well as still-favorable prices of oil and other commodities, but the main source of future manufacturing growth will be domestic demand.

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