June 1, 2017

TD Economics

Data Release: The expansion in U.S. manufacturing activity remains stable in May

- The Institute for Supply Management (ISM) manufacturing index registered a 0.1 point uptick in May to 54.9. This was better than the consensus forecast of a decline to 54.5 from April's reading of 54.8. May was the ninth consecutive month of expansion for the U.S. manufacturing sector.

- Moves in the subcomponents of the index were split evenly, with half of the ten subcomponents rising and the other half falling in the month. Some of the biggest moves higher included customers' inventories (+4.0 to 49.5), new orders (+2.0 to 59.5), and employment (+1.5 to 53.5). The subcomponent that recorded the largest decline in the month was prices (-8 to 60.5), while other subcomponents (supplier deliveries, backlog of orders, new export orders, and imports) all registered declines of 2.0 points and remained firmly in expansion territory.

- The greater uptick in new orders relative to inventories pushed the spread between the two – useful as a leading indicator of activity – up to 8 from 6.5 in April. This is consistent with the view that manufacturing activity should continue to expand at its current or slightly faster pace in upcoming months.

- Of eighteen manufacturing industries, fifteen reported growth in May, two reported contractions, and one was unchanged. Nonmetallic mineral products, furniture and related products, and plastic and rubber product industries all registered the strongest rates of expansion in the month. The two industries that reported contraction in output in May are apparel, leather and allied products, and textile mills.

Key Implications

- This morning's data confirms that the U.S. manufacturing sector continues to perform well in the second quarter of the year. Almost all subcomponents (with the exception of customers' inventories) remain firmly in expansionary territory, and the partial recovery in new orders and employment from large declines in April can be interpreted as a sign of a resilience. Comments by survey respondents remained broadly positive, and have moved to include concerns about finding qualified labour as well as citing rising prices and political environment as sectoral challenges.

- Although the U.S. manufacturing sector is still expanding, it will continue to face a number of challenges. Elevated policy uncertainty both globally and domestically, particularly concerning any upcoming changes to U.S. trade agreements, could affect demand for U.S. manufactured goods. Short of this, exporters will continue to face competitiveness pressures from the elevated level of the U.S. dollar, which have eased recently, and foreign demand that may be on the wane.

- Increasingly there are signs that global demand growth has peaked. After a strong expansion in the first four months of the year, a slowing Chinese economy appears to be affecting its East Asian trading partners. The overnight release of the Caixin Purchasing Managers' Index (PMI) for China revealed that the Chinese manufacturing sector pulled back in May – the first decline in 11 months. Furthermore, PMI's for Taiwan, Thailand, Vietnam, and Malaysia all recorded much softer manufacturing activity in May, suggesting that weakening Chinese demand is beginning to have knock on effects on some of China's neighbouring trade partners.

- Still, there are some bright spots concerning second quarter global economic activity worth noting. This morning's May PMI's for advanced economies suggests that the Euro Area should continue to see broad growth near 2.0% (q/q annualized) in the second quarter – almost double trend pace – and Japanese manufacturing activity continues to expand at a rapid pace. Moreover, unlike the weak prints in East Asia, the news from Latin America was more positive. The Brazilian economy appears to have exited recession in the first quarter, and the May PMI data shows a modest expansion in the manufacturing sector in the second quarter. Nevertheless, volatility in trade data could see Brazil fall back to contraction in the second quarter, and political uncertainty could still act to derail its economic recovery.

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