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Rising Manufacturing Orders Signal Future Economic Growth

The Institute of Supply Management (ISM) conducts a monthly survey that focuses on the manufacturing industry. The survey asks supply chain managers from over 400 manufacturing companies and 20 different industries about new orders, production levels, employment, inventory, and prices. Investors and economists follow the survey closely because it can provide context about broader economic conditions.

The survey question about new orders asks if orders increased or decreased compared to the prior month. Readings above 50 indicate orders increased, while readings below 50 indicate orders decreased. Why do new orders matter? It’s because purchasing decisions must be made in advance to meet future manufacturing needs. If orders rise and a company expects to increase production, it must buy the required raw materials and other manufacturing inputs months ahead. As a result, rising orders are viewed as a positive for the economy.

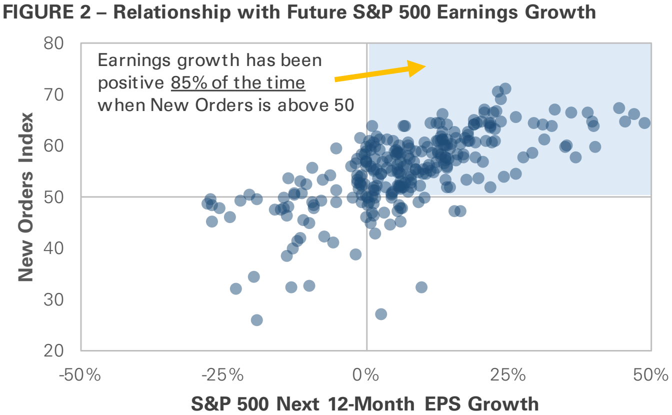
Figure 1 graphs the New Orders sub-index from the ISM survey. The index dropped below 30 as the economy shut down during the pandemic, which signaled a sharp decline in orders. As the economy reopened and manufacturing activity resumed, order activity increased. The New Orders index rose above 50 in June 2020 and remained above 50 until July 2022, which signaled an extended period of rising orders and economic expansion. However, the rate of growth for new orders slowed during 2022 as the Federal Reserve raised interest rates. The New Orders index dropped below 50 in September 2022 and remained below that threshold until December 2023, signaling a slowdown in orders and manufacturing activity.

The far-right side of Figure 1 shows the New Orders index climbed above the key 50 threshold in January 2024, the first time in 16 months. The rise above 50 indicates that manufacturing activity may be starting to expand again, but it also provides insight into corporate earnings. Figure 2 compares the New Orders sub-index against the S&P 500’s year-over-year earnings growth. In general, earnings growth tends to be stronger when the New Orders index is higher. If the New Orders index remains above 50 in expansion, it could be a positive signal for the economy and earnings.

FIGURE 1 – Manufacturing New Orders Index

Source: ISM. Data from March 2014 to March 2024.

FIGURE 2 – Relationship with Future S&P 500 Earnings Growth



Source: Federal Reserve, ISM. Data from January 2000 to March 2024.