Manufacturing Slipped Further in December Amidst Lean Inventories

Easing Tariff Uncertainty Hints at Stabilization

- **Manufacturing PMI®: 47.9 (–0.3 pts) —** the lowest reading of 2025; **10th straight month** in contraction.
- **New Orders: 47.7 (+0.3 pts)** — still contracting, but marginally firmer; early stabilization, not a turn.
- **Production: 51.0 (–0.4 pts)** — still expanding but losing momentum as demand remains soft.
- **Employment: 44.9 (+0.9 pts)** — contracting at a slower pace; firms still managing headcount.
- **Supplier Deliveries: 50.8 (+1.5 pts)** — back to slower deliveries after one month "faster"; pockets of constraint persist.
- **Inventories: 45.2 (–3.7 pts)** — sharp drop; restocking is not happening yet.
- **Prices: 58.5 (unchanged)** — sticky cost pressure, still dominated by metals and tariff-affected inputs.
- ***ISM at 47.9 is roughly equivalent to +1.6% annualized real GDP. Core GDP is running about a percentage point higher, helped by continued strong capital spending.***

Lean Inventories Persist as Confidence Limits Growth

The ISM Manufacturing PMI® slipped to **47.9 in December**, the lowest reading of 2025 and the **tenth consecutive month of contraction**. As with prior months, the sub-50 reading reflects the **breadth of softness**, not a collapse in activity. Manufacturing remains a drag on overall growth, but the level of the PMI is still consistent with **continued overall economic expansion**, reinforcing our view that the U.S. economy

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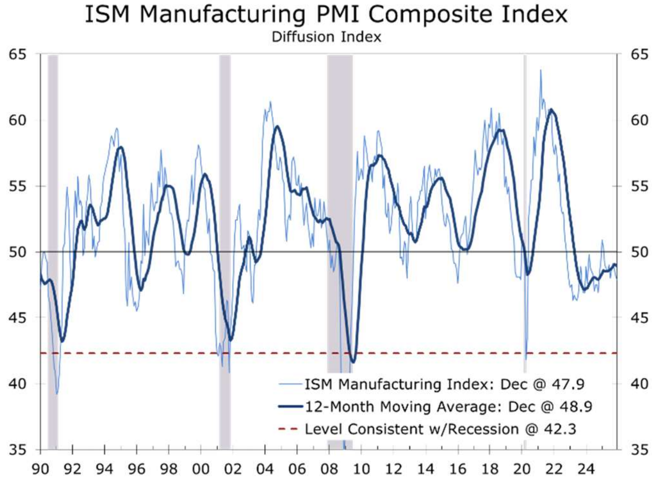
What stands out in December's report is not deterioration, but **hesitation**. Capacity is adequate, supply chains have largely normalized, and production continues to expand modestly. Yet firms remain reluctant to take risks, particularly when it comes to inventories, hiring, and forward purchasing. This posture closely mirrors the themes laid out in our 2026 outlook, where policy uncertainty and cost visibility matter as much as demand itself

Demand is not collapsing, but it is not strong enough to restore confidence.

Demand indicators remain in contraction, but the pace of decline moderated. **New Orders (47.7)**, **Backlog of Orders (45.8)**, and **New Export Orders (46.8)** all improved modestly from November, suggesting that demand is **stabilizing at low levels rather than continuing to weaken**. At the same time, **Imports fell sharply to 44.6**, signaling a deliberate pullback in purchasing and a continued preference for flexibility over volume.



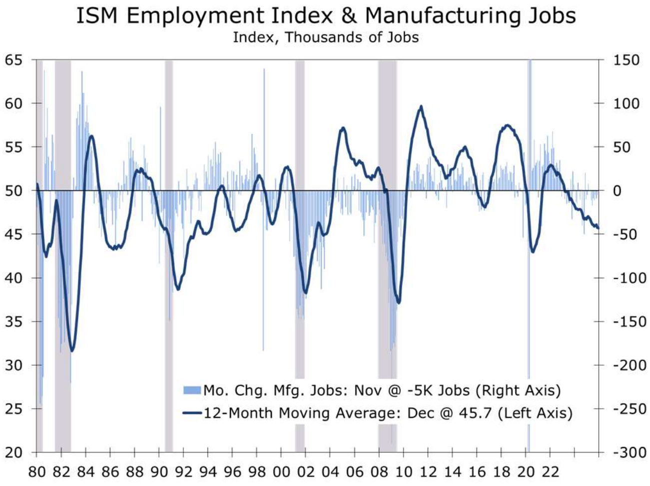
Source: The Institute for Supply Management

Despite soft orders, **Production remained in expansion at 51.0**, though momentum eased. Output continues to be supported by execution on existing programs and selective capital spending, particularly in electronics and electrical equipment. This dynamic aligns with our outlook that the current cycle is **capital-led rather than demand-led**, with growth concentrated in productivity, automation, and targeted investment rather than broad restocking or consumer-driven expansion.

This remains a business cycle defined by capital discipline, not labor expansion.

Labor conditions reinforce that interpretation. The **Employment Index rose to 44.9**, indicating that contraction slowed but hiring did not resume. Firms continue to manage headcounts carefully, relying on attrition and selective reductions rather than expansion. Manufacturing is adjusting gradually to a more capital-intensive model, one that supports output without requiring significant labor growth.

The most important signal in the December report lies in inventories. **Manufacturers' Inventories fell sharply to 45.2**, while **Customers' Inventories dropped further into "too low" territory at 43.3**. Historically, this combination has been a reliable setup for a restocking cycle. Yet firms are still choosing restraint, running lean inventories and pulling back on imports rather than rebuilding stock.



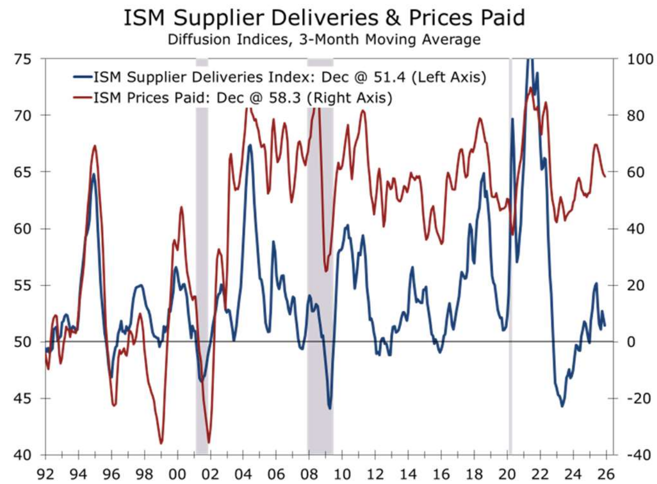
Source: Institute for Supply Management and Bureau of Labor Statistics

This divergence confirms a key conclusion of our 2026 outlook: **the inventory cycle is deferred, not broken**. The ingredients for replenishment are present, but the trigger—greater confidence in policy, pricing, and demand visibility—has yet to emerge. When restocking does arrive, it is likely to be **selective**, not broad and immediate.

Inventories are lean, but confidence remains the binding constraint.

One major determinant on the timing of an inventory rebuild is costs. Cost pressures continue to shape behavior. The **Prices Paid Index held at 58.5**, with gains driven primarily by metals and tariff-affected inputs. This remains a cost-push environment rather than a demand-driven inflation story. Persistent input costs, combined with limited pricing power, continue to compress margins and discourage aggressive inventory rebuilding, even as logistics conditions improve.

For policymakers, December's ISM report supports a message of patience. Manufacturing is not generating renewed inflation pressure, nor is it weak enough to force urgent easing. The report fits squarely within our broader 2026 framework: **lean inventories, cautious managers, resilient execution, and a restocking cycle waiting on confidence and clarity on tariffs.**



Source: Institute for Supply Management