US activity was surging ahead of military action

The ISM business surveys suggest the US economy was gaining significant momentum in the early part of 2026. The concern is that higher energy costs and geopolitical and economic uncertainty could become demand destructive and take some of the wind out of the sails

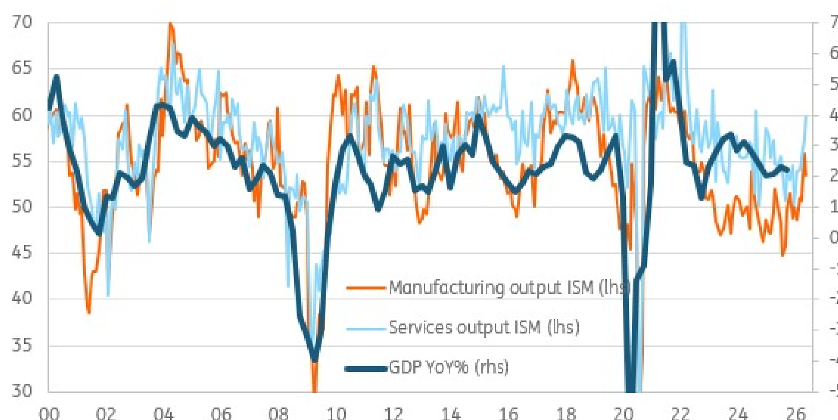
ISM surveys suggest first-quarter 2026 GDP growth could come in above 3%

ISM reports point to 3%+ GDP growth

Markets are obviously nervous about the growth implications of broadly higher energy costs and potential supply issues from the Persian Gulf, but this week's February ISM reports suggest the US economy was in great shape ahead of the military action. Today's ISM services index for February was far stronger than expected, rising to 56.1 from 53.8 – an outcome that was above every single individual forecast that went into making the consensus prediction of 53.5. Remember that 50 is the break-even level with a figure above 50 signaling growth and below 50 indicating contraction.

Business activity leapt to 59.9 from 57.4, marking the fastest rate of growth since May 2024. New orders were also very firm at 58.6 with the backlog of orders surging to 55.9 from 44.0. Employment rose more modestly to 51.8 from 50.3, but this is a very solid report.

ISM output metrics advanced 4Q and GDP growth (YoY%)



Source: Macrobond, ING

It follows on from Monday's manufacturing survey that indicated the sector may finally be turning the page on a torrid couple of years for activity. It recorded the second consecutive headline figure above 50 for the first time since late 2022 with the combination of firm new orders and a building order backlog implying production should gain momentum. The chart above suggests ISM output indices that are consistent with GDP growth in excess of 3%.

But an energy shock risks being demand destructive

Today's ISM services index appears to have given risk sentiment a lift, but caution is understandable. A long, protracted military campaign involving disrupted energy flows will lift energy costs and boost inflation readings through the summer. However, it will also squeeze consumer spending power, with households having to spend more on motor fuel, heating and electricity. The corporate sector, which is bearing the brunt of tariffs, will also face more cost increases.

The longer energy costs stay elevated, the greater the risk it becomes demand destructive, which dampens inflation pressures over the medium to longer term. The Fed will likely be nervous about headline inflation initially, but if the core metrics (excluding food and energy) start to cool, officials will likely become more comfortable cutting interest rates a couple of times in the second half of the year.

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