US manufacturers fight on

Supply disruptions and labour shortages continue to hurt US manufacturing, but rising output and order books highlight the resilience of the sector. Construction also positively surprised, but will come under pressure as the housing boom slows

Manufacturing resilience underscored by surprise ISM rise

The August ISM manufacturing index rose to 59.9 from 59.5 (consensus 58.5), which was higher than any of the 61 economists surveyed by Bloomberg were expecting. Certainly the regional manufacturing surveys had been suggesting we would likely get a fall while the historical relationship with the Chinese manufacturing PMI, which typically leads the ISM by around 3 months, has also indicated we were set for a fairly chunky fall – although that may well be depressed by specific local restrictions.

Chinese PMI suggests downside risks ahead for ISM

* Chinese PMI temporarily plunged to 35.7 in February 2020 in reaction to pandemic

Source: Macrobond, ING

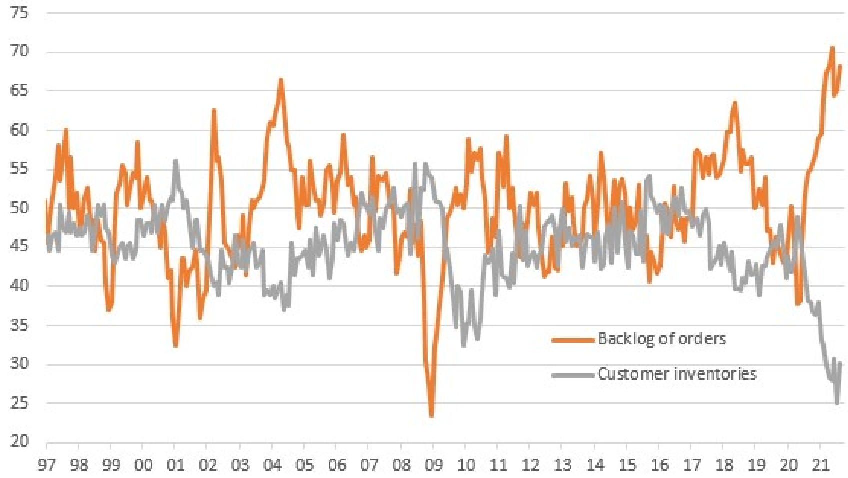
Full order books and desperate customer points to lingering inflation

The production index rose to 60.0 from 58.4 and new orders increased to a 3-month high at 66.7 – anything above 50 is in expansion territory and the further above 50 the faster the growth. This a surprise primarily given the well-publicised supply chain issues hitting the sector. The survey suggests that there has been some easing of these strains with inventory levels increasing at their fastest rate since November 2018, but we doubt this is a sustainable story given the general news flow hasn't been great on this topic while freight costs continue to surge higher.

In any case the manufacturing sector continues to struggle to keep pace with the scale of demand. The backlog of orders continues to surge with the index at 68.2 – the second highest reading of all time. This means supplier delivery times continue to lengthen with customers increasingly desperate for stock as indicated by another steep contraction in their inventories.

With such a backlog of orders, new orders coming in all the time and the knowledge that customers are getting desperate given such low inventory numbers, manufacturers increasingly know they have pricing power and can pass higher costs on. This is one of several factors that lead us to forecast consumer price inflation remaining above 5% through to early 2022.

ISM order backlogs and customer inventories = corporate pricing power



Source: Macrobond, ING

Where are the workers?

Despite all this demand, employment fell deeper into contraction territory (49.0). Manufacturers can't find workers to fill vacancies and they themselves are having staff be poached by other firms. Consequently, if you want to hire and retain workers it looks increasingly likely that companies will have to pay more.

The conventional narrative is that labour shortages may become less of a constraint from this month as childcare issues ease and expanded unemployment benefits conclude fully. We don't think there is any guarantee of that given evidence to suggest a significant step-up in people taking early retirement in the past year. To us, the risks are skewed towards a longer period of elevated costs for employers as they hunt for suitable employees.

Either way, today's report supports our call for a sub-consensus payrolls growth figure tomorrow, which if is the case will support Jerome Powell's more cautious stance on QE taper timing with a November announcement more likely than September.

Construction rebounds, but housing could soon be a drag

Meanwhile, construction spending surprisingly rose 0.3% month-on-month in July versus the 0.2% gain the consensus forecast. Residential construction rose 0.5% while non-residential posted a 0.1% gain – only the second monthly increase since January 2020. This offers hope that the sector is starting to bottom out, which is great news and with more infrastructure spending on the way, this can really recover strongly next year.

The outlook for residential construction is less positive. New home sales peaked in January at an annualised rate of 993k, but since then have fallen to 708k as of July while housing starts have declined 11.1% since their March peak. With house prices having jumped nearly 20% over the past year, affordability is not what it was while the uncertainty over Covid's resurgence and what this means for returning to offices may also depress residential activity in coming months.

Construction spending levels versus pre-pandemic

Source: Macrobond, ING

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