

Mixed messaging on US data still argues for a Fed delay until May

The US data continues to refuse to convincingly break one way or another. This will leave members of the Federal Reserve unconvinced there is enough evidence to justify cutting interest rates as soon as March. We favour a May start point, but when the cuts come we believe they will be significant

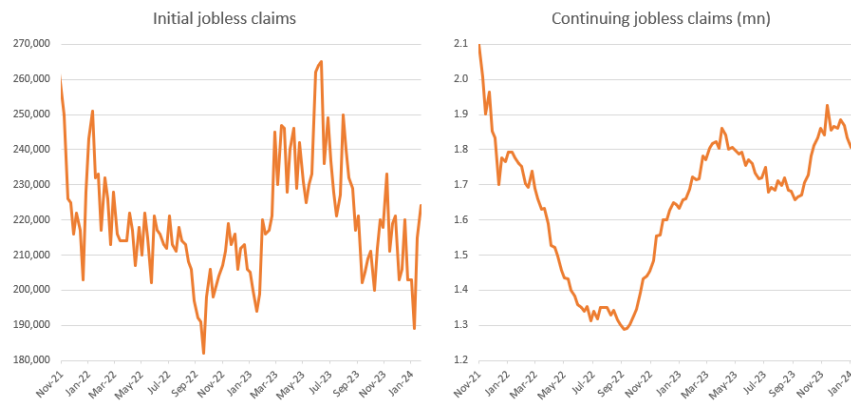


Some dovish news

In the wake of Jerome Powell's pushback against the prospect of a March interest rates cut – [see our Fed meeting reaction here](#) – the market is now only pricing around 9bp for that meeting, effectively a 37% probability of a cut, having been near enough 100% priced at the start of the year. Today's data hasn't shifted that at all, but there are some interesting stories.

On the dovish side, that could be used to argue for a March cut, we see that fourth quarter productivity was stronger than expected at 3.2% and consequently unit labour cost growth was more benign, growing just 0.5%. This is a nice combination that suggests little inflation emanating from the business sector, which was also evident in yesterday's softer employment cost index. We also note the uptick in jobless claims. Initial claims rose 224k last week from 215k the previous week (consensus 212k) while continuing claims rose to 1898k from 1828k (consensus 1839k). Both are trending higher, but not hugely so – effectively further evidence of a cooling, but not collapsing, jobs market.

Jobless claims numbers are creeping higher again



Source: Macrobond, ING

But also some stronger data

On the more hawkish side that argues for a delay on rate cuts we have a surprisingly strong manufacturing ISM index for January, rising to 49.1 from 47.1. This is still below the breakeven 50 level, as it had been for the previous 14 months, but is a signal that the rate of decline is slowing. Meanwhile construction spending for December rose 0.9% month-on-month after a 0.9% increase in November, which brings the series into line with the strong data seen within last week's fourth-quarter 2023 GDP report. Residential construction jumped 1.4% with the rise in home prices through the second half of last year and lower mortgage rates boosting home builder sentiment while non-residential rose 0.4% MoM. A bit of a slowdown, but it is still up 20.1% year-on-year with the CHIPS act, designed to incentivise domestic investment in chip fabrication, a big support factor in what has been going on.

Nominal construction spending (Feb 2020 = 100)



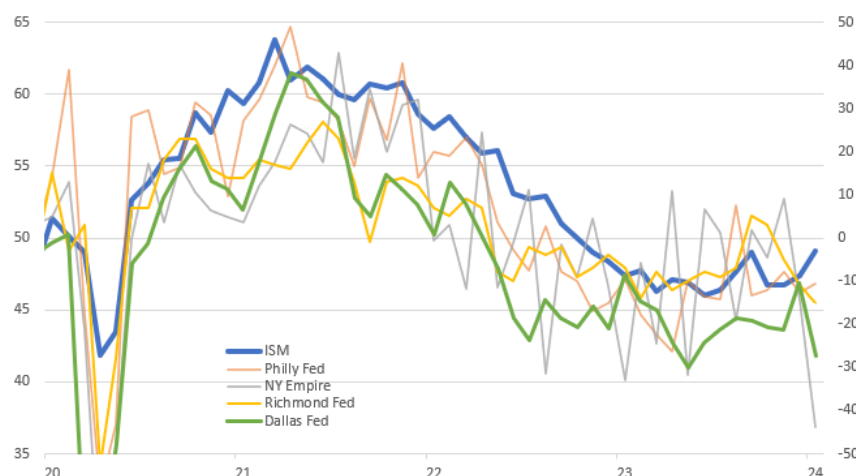
Source: Macrobond, ING

The ISM is a surprise because all of the regional manufacturing indicators have been so weak and pointed to a deterioration. Now, there isn't a regional survey covering West of the Rockies, but we can use the Chinese PMI as a partial proxy and that too was weak. The details show orders

improved from 47 to 52.5, which is the first number in growth territory since May 2022. However, the backlog of orders is very weak at 44.7 and output is little changed, coming in at 50.4. Employment remains in the doldrums at 47.1 suggesting jobs are being shed.

Unfortunately the prices paid component jumped to 52.9 from 45.2, which is the highest since April last year, but for context we had readings of 90+ at the peak of the supply chain strains in 2021, so today's number in no way threatens a resurgence of price pressures in itself.

ISM stronger than regional surveys implied



Source: Macrobond, ING

Fed to wait until May, but will then cut rates significantly

All in, we remain happy with our call that the Fed will wait until May before cutting interest rates. By May we think ongoing subdued core inflation measures will give the Fed the confidence to cut with the policy rate getting down to 4% by the end of this year and 3% by mid-2025. This will merely get us close to neutral territory – the Fed's view is that 2.5% is likely the long-term average. If the economy enters a more troubled period and the Fed needs to move into 'stimulative' territory there is scope for much deeper cuts than we are forecasting and the market is pricing.

Author

James Knightley

Chief International Economist

james.knightley@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s),

as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.