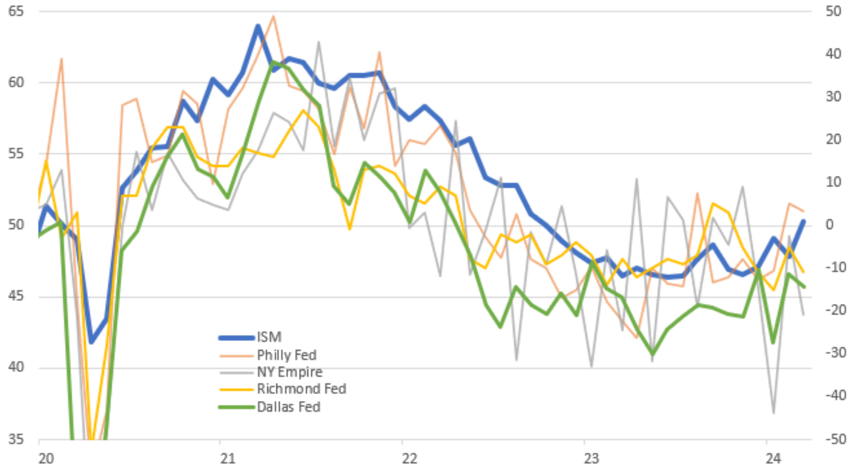
The return of US manufacturing growth lifts optimism

The ISM manufacturing index surprised everyone by moving into growth territory for the first time since late 2022 with production jumping, new orders rising and inflation pressures increasing. Markets interpreted that as reducing the chances of meaningful Fed rate cuts, but construction was much weaker and there are a lot of jobs numbers still to come

US ISM surprises repeats the surprise strength seen in China

The February reading of the ISM manufacturing index has unexpectedly risen above the break-even 50 level – the first time it has happened since September 2022. By moving into expansion territory the survey offers hope that the manufacturing sector is finally stabilising after nearly 18 months of contraction and follows on from an upside surprise in Chinese manufacturing PMIs over the weekend. This may well be the key reason why the ISM performed so well since, as the chart below shows, the regional surveys we got beforehand fell. However, there are no regional surveys covering the US west of the Rocky mountains and that is presumably where the strength was focused, replicating the performance of Asian surveys.

ISM outperformed the regional surveys



Source: Macrobond, ING

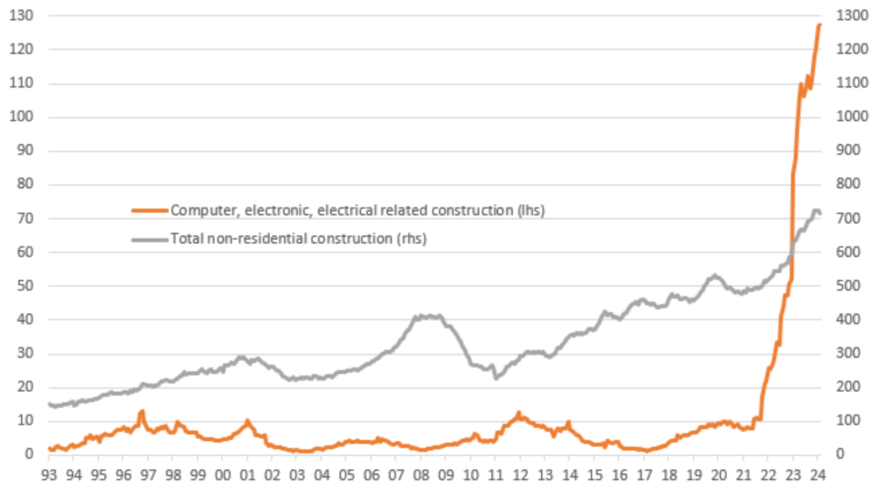
The headline reading of 50.3 was up from 47.8 and was also well ahead of the consensus expectation of 48.3. In fact, it was stronger than every forecast in the Bloomberg survey with production jumping to 54.6 from 48.4 and new orders recovering to 51.4 from 49.2. The backlog of orders remains soft at 46.3 while employment was in contraction territory (sub-50) for the sixth straight month, but those two components are being overlooked by the market that is focusing on growth. The market is also looking somewhat nervously at the price paid component that rose to 55.8 from 52.5, likely reflecting the run up in energy costs over the past couple of months.

Construction was disappointing though

Construction spending didn't match the performance of the ISM report though with spending falling 0.3% month-on-month in February rather than rise 0.7% as expected by the market consensus – in fact, this report was weaker than every single forecast submitted to Bloomberg for their consensus calculation. Residential spending rose 0.7% MoM, led by a 1.4% increase in single family home construction. However, nonresidential construction fell 1% after dropping 0.5% in January.

Commercial space spending fell for the third straight month, but office construction is surprisingly holding up despite the oft repeated stats about excess capacity in the sector. In year-on-year terms office construction spending is still up 5.7%. It may be that the long construction times is behind the residual strength, but we would imagine this will become more and more of a drag over the next year. The clear winner remains construction activity tied to computer, electronic and electrical construction activity with government support targeting the reshoring of semi-conductor chip fabrication continuing to make traction.

Construction spending $bn



Source: Macrobond, ING

Markets remain cautious on the prospect of rate cuts

Markets are focused on the ISM report though with 10Y Treasury yields up 10bp on the back of the return of manufacturing growth and higher inflation readings from the sector. There are 20 or so individual Federal Reserve speeches this week and the market is likely thinking that today's outcome will make officials wary of committing to significant policy easing. Nonetheless, there are also a lot of jobs numbers through the week, culminating in Friday's non-farm payrolls figures and unemployment rate. It could be a choppy week of trading ahead.

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