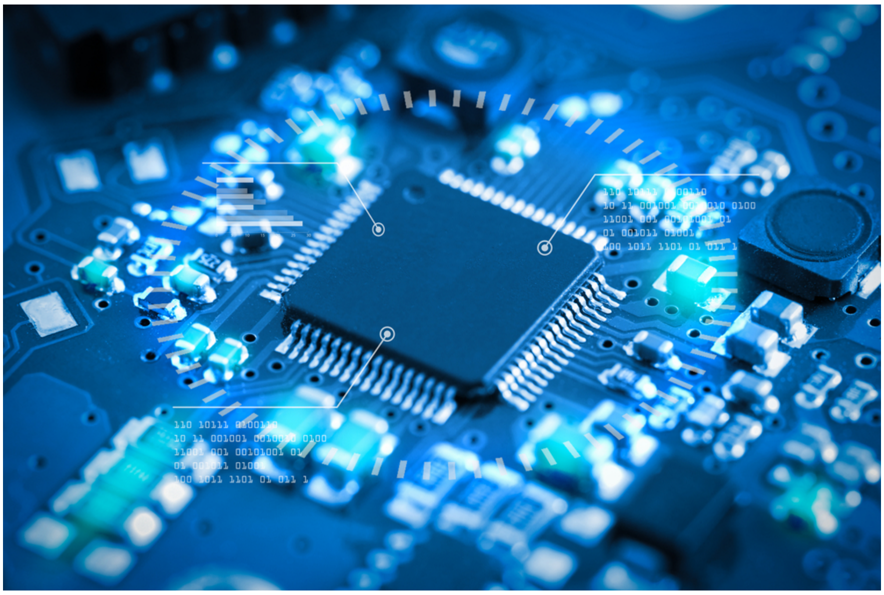
US: Hungry for chips

The manufacturing ISM fell in April as the global semi-conductor chip shortage hit output and orders throughout supply chains. With demand looking so strong and inventories so low, corporate pricing power is back and the risks of higher, more prolonged inflation becomes greater



Supply constraints hurt output and orders

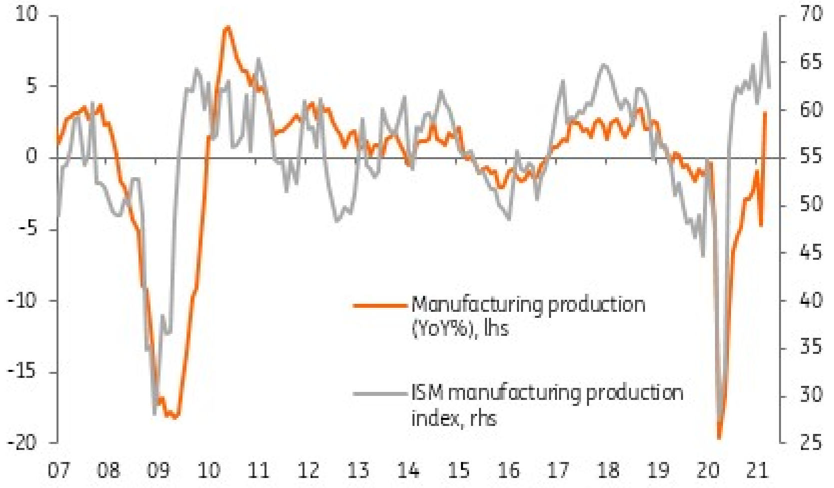
The US ISM manufacturing index has surprisingly fallen in April to 60.7 from 64.7 – the consensus was 65 and we had penciled in something a little higher given the readings from the regional surveys.

From this report it is clear that supply issues, centered on the global semi-conductor chip shortage, are constraining output growth. Auto makers have been very vocal about the difficulties this has presented and have already indicated that output could fall despite buoyant demand.

Other industries are also going to be impacted and it will have knock-on effects for companies throughout the supply chains – if you can't get enough chips, there is no point ordering other components in the same numbers

As a result, orders growth slowed and so did employment, but it is important to remember that these are still very strong levels and manufacturing will make a strong contribution to the economic expansion this year. Indeed, while the rate of growth is slowing, all 18 industries classified as being manufacturing recorded rising output levels.

US ISM manufacturing output survey versus actual official output data



Source: Macrobond, ING

Pricing power is back, risking more inflation

Assuming these supply constraints get resolved in coming months we should see a sharp bounce-back in output, orders and employment to what will be record levels. After all there is still significant stimulus fueled domestic demand in the economy with another $4tn of government spending/investment planned by President Biden. Meanwhile, export markets should strengthen as Covid containment measures are eased in response to effective vaccination programs.

The downside is that these supply-related constraints in the economy mean inflation pressures will continue to build. The ISM prices paid component rose to its highest level for 13 years, but the bigger issue for the Federal Reserve is likely to be the prospect that firms increasingly pass this onto consumers and we see higher, more persistent CPI and PCE deflator readings than the Fcentral bank is currently projecting.

Today's report showed that the backlog of orders is at an all-time high while customer inventories remain near record lows, which is the story every manufacturer wants to hear. It also means pricing power and the very real risk of inflation with surveys from the Philly Fed, the Empire manufacturing survey and the NFIB small business survey already starting to flash warning signals.

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