US: Manufacturing magic

The ISM manufacturing index has surged back into positive growth territory. The Phase One trade deal between the US and China has lifted much of the gloom hanging over the sector with businesses responding positively. Unfortunately, this may be a small window of good news as coronavirus concerns start to cloud the outlook

Source: Shutterstock

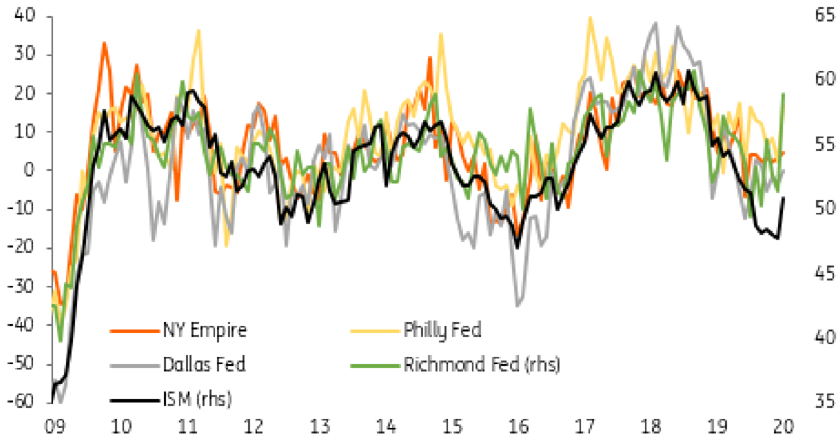
50.9 ISM manufacturing reading for January

vs 48.5 consensus

This ISM manufacturing index has jumped more than expected in January, rising to 50.9 from 47.8 in December, leaving the index at its strongest level since July. The gains were led by a hefty ten point rise in the production component to 54.3 - the highest since last April - and a 4.4 point increase in new orders to 52.0. This is a very positive and welcome development, but as the chart below shows, the ISM continues to lag behind many of the closely followed regional surveys - maybe there will be more upside in the months ahead...

It seems likely that the Phase One trade deal with China has generated a positive lift for the sector by giving some certainty that there will be no-more tariffs, at least in the near term. Businesses therefore appear more willing to put plans into action, generating the uplift in orders and output.

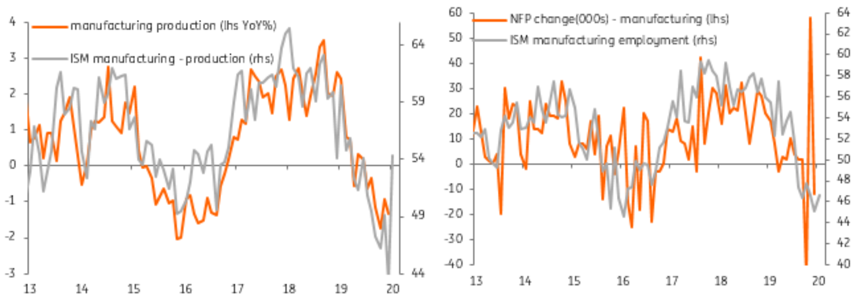
ISM continues to underperform regional surveys



Source: Macrobond, ING

The left-hand chart below suggests that we should be looking for a big jump in manufacturing output in 1Q20, despite worries about what Boeing's cessation of 737-Max production means for hundreds of supplier companies. On the other hand, the improvement in orders and output have not translated into a major turnaorund in job prospects within the sector. While the employment component rose, it remained well below the 50 break-even level, thereby consistent with further job losees for Friday's labour report - note the volatility caused late last year by the strike action at GM car production facilities.

ISM manufacturing index versus output and employment



Source: Macrobond, ING

Despite this positive news for what has been a rather beleagured sector through 2019, we have to be cognisant of the risks. At the very least, the latest developments surrounding the coronavirus outbreak is likely to pose challenges for the sector. We know that production in China is being impacted and this could have adverse implications for US supply chains in coming months while there are worries about what it might mean for global demand in general, which could make manufacturers more cautious. The more the virus spreads, the more likely it starts to impact consumer and business behaviour, which implies downside risks for activity. As such, while today's report is very good news, we are nervous that the risks to activity in general remain skewed to the downside with manufacturing looking particularly vulnerable.

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