

US ISM-Manufacturing, Construction Further Tamp Down Fed Rate Cut Talk

U.S., ISM-manufacturing, March:

Actual: 55.3

Scotia: 54.5

Consensus: 54.2

Prior: 54.2 unrevised

- **The headline reading and all underlying details are hawkish at the margin.** Forget about rate cuts from the Fed with this kind of domestic data on top of the simultaneously released construction spending. What ISM is telling us is that the reading isn't returning to the supercharged peaks of over a year ago, but it is signalling continued growth at a more moderate pace. Indeed, ISM is running very much in line with the cycle average from 2010 onward and in fact is a touch stronger. Nothing here is consistent with recession fears in the markets. The US Treasury 2 year and 10 year yields jumped by 3bps higher after the releases and the USD appreciated on a DXY basis.
- Indeed, on the Fed and the popular linkage to ISM, note the updated chart below. The Fed has indeed eased after several prior and usually very large declines in ISM, but **not every time the ISM index wiggles**. We've seen large gyrations in the ISM headline reading across many points in time including the swoon from the summer of 2014 until the summer of 2015 and yet the Fed *began* its hiking cycle at the end of that decline and well before the ISM rebound became clear. I don't view the ISM gyrations of late as enough to motivate rate cuts and expect a decent overall picture for ISM this year.
- The headline jump of 1.2 points handily beat consensus expectations and my own slightly more positive expectations. **What surprised me the most here is the magnitude and breadth of the gains in some of the subcomponents.**
- **The employment subcomponent jumped by 5.2 points** to 57.5 which takes us back up to about where that reading was in November.
- **The new orders subcomponent jumped by almost two points** to 57.4 (55.5 prior) and while it still a lot lower than the pace of increase being registered toward the end of 2017 and 2018H1, the reading is **6.1 points higher than the trough in December**. Like stocks, most data is rebounding off of such prior lows.
- **The new orders strength is being driven by the domestic economy** that, given its sheer size, overwhelms the significance of the export sector. New export orders decelerated with the subindex dropping to 51.7 (52.8 prior).
- **Prices paid jumped by almost five full points** (54.3, 49.4 prior) and while I don't really like this gauge that follows what has already happened to input prices like energy costs, markets had been treating the swoon over the prior month as a disinflationary signal and that was premature.
- **Also note that US construction spending soared by 1% m/m in February** (-0.2% consensus) and the prior month was revised sharply higher to a 2.5% m/m gain that nearly doubles the prior estimate of 1.3%. On a two-month moving average basis, we haven't seen back-to-back gains like this since mid-2015.

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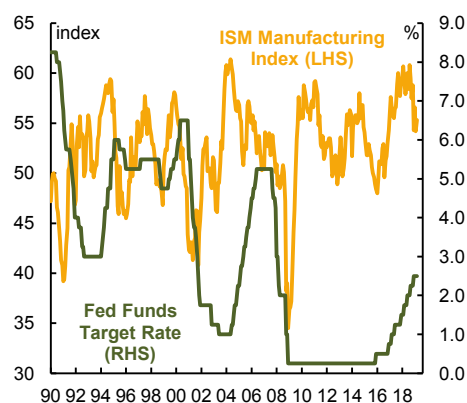
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The Fed Hasn't Eased Every Time ISM Sneezes



Source: Scotiabank Economics,
U.S. Federal Reserve Board, ISM.

- On a quarter-ago basis, construction spending is tracking a gain of 11.8% at a seasonally adjusted and annualized rate following a 7.7% drop in Q4. Expect the Atlanta Fed's 'nowcast' for US GDP growth to be revised higher today from 1.7% previously with 2% in reach.
- What drove construction spending higher was a 0.7% m/m increase in private residential construction (+1.8% prior) and a 3.7% m/m (5.8% prior) increase in public nonresidential spending. Nonresidential private spending was down 0.5% in February (+1.1% prior) and public residential construction spending was down 0.6% in February after a large 3.4% prior gain.

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