

## US: ISM MANUFACTURING RISES TO CYCLE-HIGH IN FEB., CAPEX ON TRACK FOR SOLID Q1

*\*The ISM national manufacturing sentiment index increased by 1.7pts to 60.8 in February, climbing into the top 12% of values in the 70-year history of the series, despite the turbulence that plagued financial markets in early February, and indicates that real business fixed investment is on track rise at a solid pace again in Q1 (Chart 1).*

*\*The details on current activity and demand (new orders, production and employment) remained well into expansion territory. Firms continued to think that **customers' inventories are too low and more firms reported order backlogs, both suggest the need for continued rapid production growth to meet demand (Chart 2).***

*\*A growing share of firms continue to report paying higher prices for raw materials due to rising commodity and import prices and as producers are more empowered to raise selling prices in a stronger economic environment (Chart 3).*

The ISM manufacturing index tends to move closely with changes in equity markets, so the improved manufacturing optimism despite the stock market gyrations reflect improving underlying economic fundamentals (Chart 4). Other key regional manufacturing and consumer sentiment surveys reflected a similar sentiment in February.

The headwinds that stifled the industrial sector between H2 2014 and 2016 have become tailwinds. These include better global growth and the weak U.S. dollar that are increasing demand for U.S. manufactured goods, favorable pro-business policy with the shift to deregulation and tax reform, and increases in energy prices that have boosted investment/hiring in energy and energy-related sectors. Despite the increases in bond yields, financing conditions remain favorable and corporate profits continue to beat expectations.

Sustained strong real business fixed investment growth is a precursor to better productivity growth – a missing feature throughout the recovery. We expect better productivity growth to accompany stronger wage gains and constrain unit labor costs, thus enabling businesses to maintain profit margins. Sustained strong productivity gains would also lead the Fed to revise up its estimates for the natural rate of interest.

Measures of foreign trade within the report were very elevated reflecting both strong global and domestic demand – the new export orders index increased 3pts to 62.8, the highest since April 2011, and the import index jumped 2.1pts to 60.5, a cycle high (Chart 5).

Protectionist trade policy and higher input costs are key primary risks to the domestic industrial sector.

Key published comments from respondents to the ISM manufacturing survey:

**“Our business saw [an] increase in fourth quarter, and it continued in January 2018. Capex purchase deliveries are moving out globally.” (Chemical Products)**

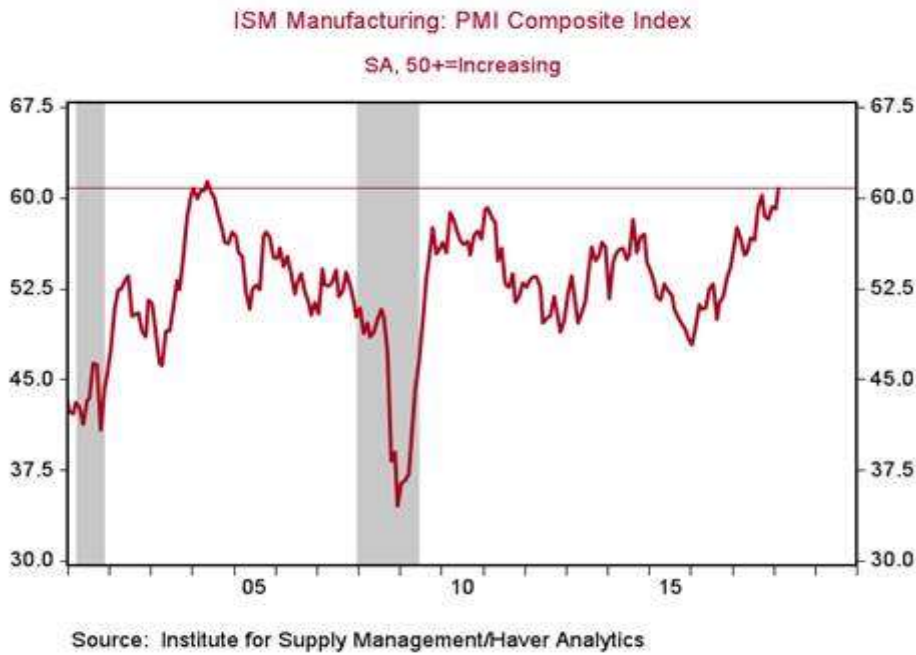
**“It seems the tax break for business is making a difference. Customers are spending more for capital equipment.” (Machinery)**

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“The weakening U.S. dollar in relationship to the yuan is starting to impact importing cost. We are starting to see more supplier price increases.” (Electrical Equipment, Appliances & Components)

“Employment is one of our biggest challenges. No labor available.” (Food, Beverage & Tobacco Products)

Chart 1: ISM Manufacturing PMI Composite Index



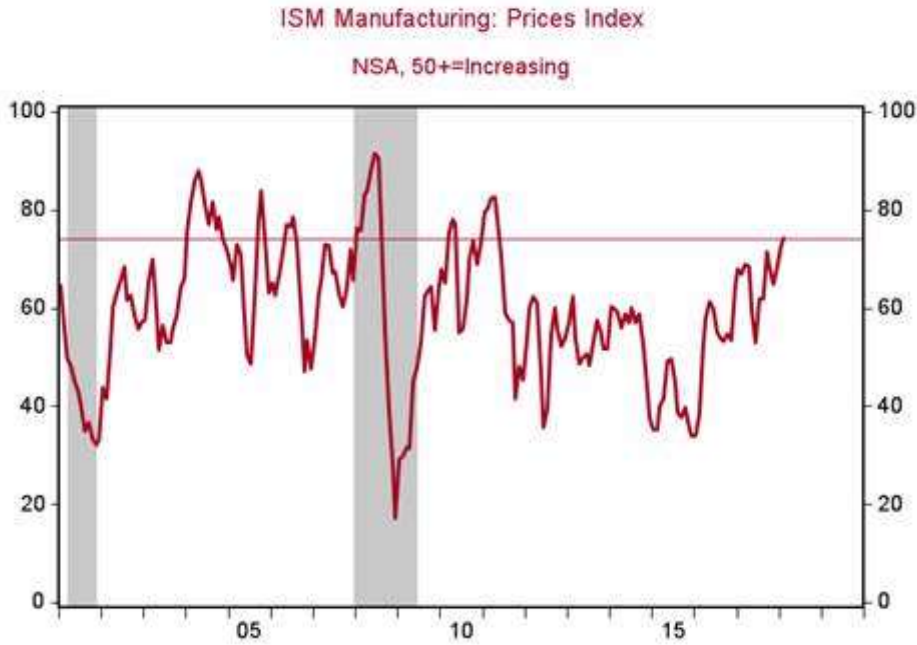
Source: Monthly data. Source: Institute for Supply Management and Haver Analytics

Chart 2: ISM Manufacturing Backlog of Orders Index



Source: Monthly data. Source: Institute for Supply Management and Haver Analytics

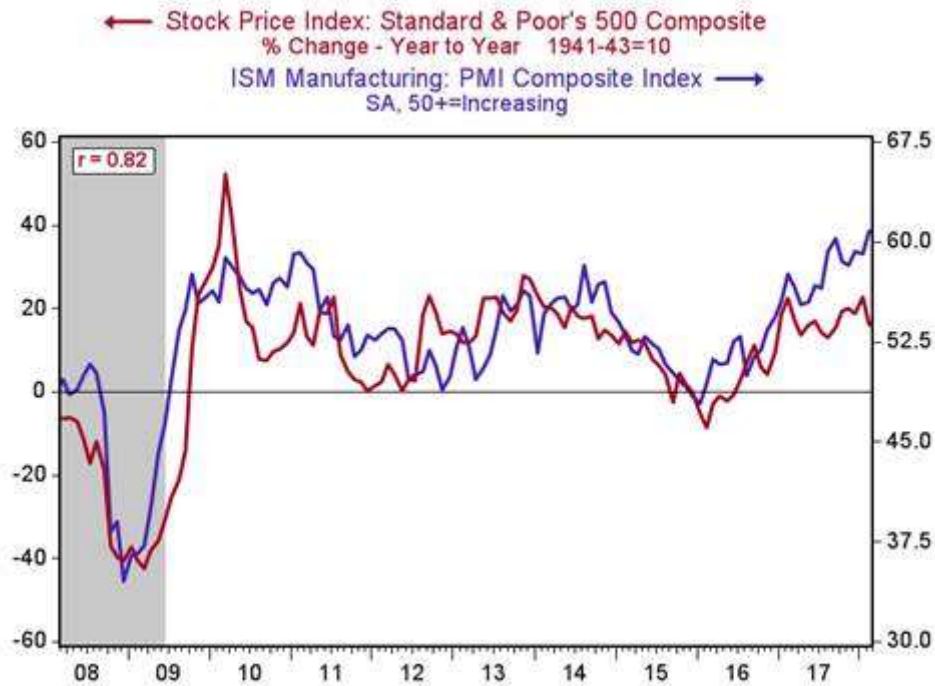
Chart 3: ISM Manufacturing Prices Index



Source: Institute for Supply Management/Haver Analytics

Source: Monthly data. Source: Institute for Supply Management and Haver Analytics

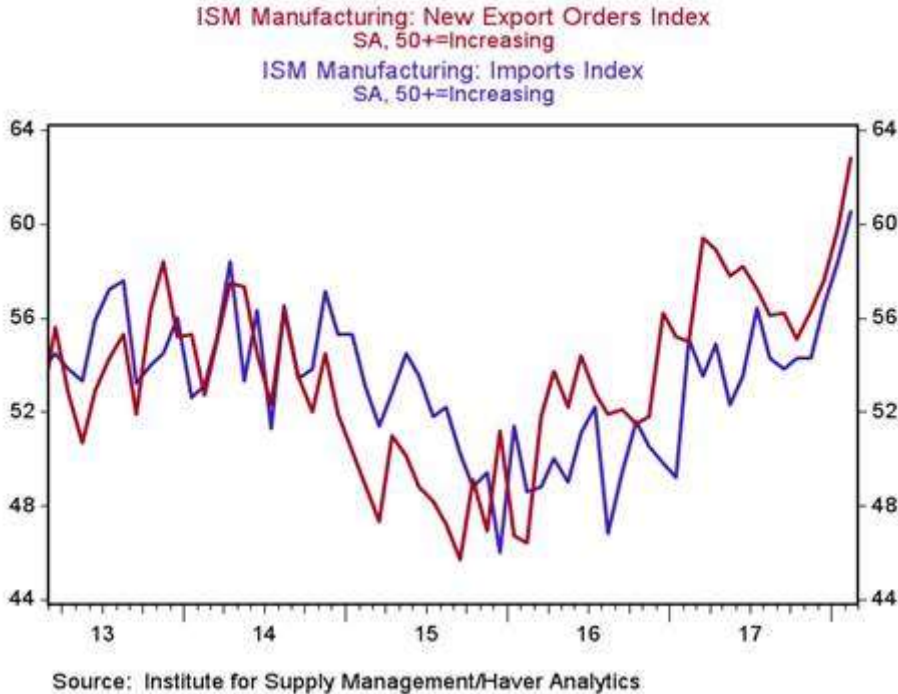
Chart 4: ISM Manufacturing Headline Index and S&P 500 (year-over-year, %)



Sources: S&P, ISM/Haver

Source: Monthly data. Source: Institute for Supply Management, Standard & Poor's and Haver Analytics

Chart 5: ISM Manufacturing New Export Orders and Imports Indexes



Source: Monthly data. Source: Institute for Supply Management and Haver Analytics

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