Comerica Economic Alert

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March ISM-MF Index, February Construction Spending, Fed Balance Sheet

Good Data Accompanies Discussion of Fed's Balance Sheet

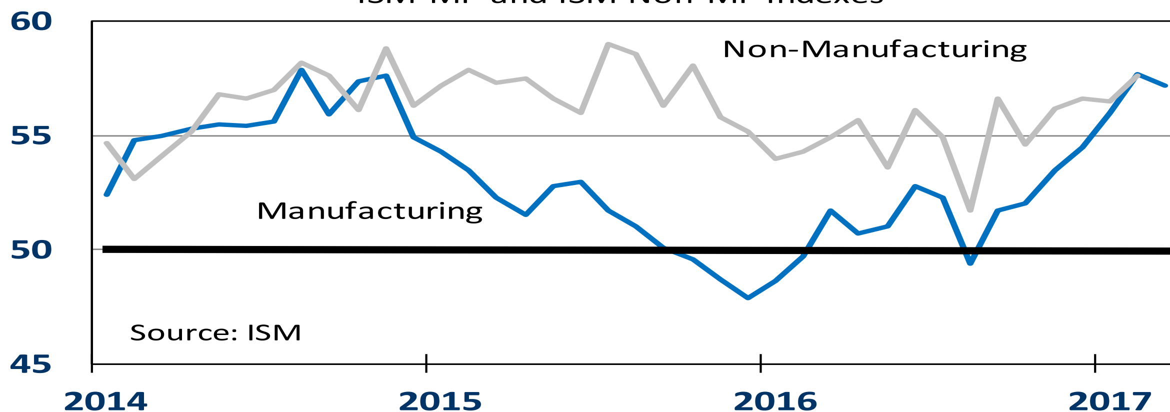
- The ISM Manufacturing Index for March decreased to a still-positive 57.2, showing improving conditions.
- Construction spending increased by 0.8 percent in March, boosted by private multi-family projects.

The ISM Manufacturing Index for March eased to a still-positive 57.2 in March, indicating ongoing improvement in the nation's manufacturing sector. The new orders sub-index shows vigorous activity, easing slightly to 64.5. The production sub-index backed off a strong February reading, to a solid 57.6 in March. The employment sub-index increased to 58.9, good news for the March employment report, due out this Friday. There is some concern that March job gains might be soft, resetting from recent better-than-expected gains. However, the ISM report indicates that manufacturing hiring may remain engaged this spring, even after the robust 28,000 net job gain in the Bureau of Labor Statistics data for February. Of the 18 reporting industries in the ISM report, 17 expanded in March. The strongest growth was in electrical equipment, appliances and printing. Anecdotal comments were positive. One comment noted that "material inflation is now clearly upon us." This sentiment was mirrored in the commodity price portion of the report, where 23 tracked commodities were up in price and none were down.

Construction spending for February increased by 0.8 percent. Private residential construction spending increased by 1.8 percent for the month, boosted by multi-family projects. Spending on private non-residential projects eased by 0.3 percent, with six out of 11 categories down for the month. Total public construction spending increased by 0.6 percent in February despite a dip in power-related projects.

Also noteworthy from Friday, the Wall Street Journal reported at the end of the day that the Federal Reserve is readying plans for balance sheet reduction. The article reports that under the emerging strategy, the Fed would increase short-term interest rates two more times this year, and then pause later in the year. During the pause in the interest rate cycle, the Fed would start winding down their portfolio "in a gradual and measured way." This back-and-forth monetary strategy is justified, according to the article, by normalizing inflation metrics. We assume that the first phase of balance sheet run-off would be to stop reinvesting maturing assets. The drop in demand for bonds could result in lower prices, pushing up bond yields. The minutes of the March 14-15 Federal Open Market Committee meeting are due out this Wednesday, April 5. We expect to see additional discussion of balance sheet operations in the Fed minutes.

Market Reaction: U.S. equity markets opened with losses. The yield on 10-Year Treasury bonds is down to 2.33 percent. NYMEX crude oil is down to $50.16/barrel. Natural gas futures down to $3.14/mmbtu.



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