

## ISM surveys point to softer US jobs and growth numbers ahead

The ISM activity indicators suggest that manufacturing is in recession and service sector output is becoming a little more sluggish. In the near term their employment components indicate the likelihood of slowing hiring while the tightening of lending conditions and higher market interest rates indicate the threat of a major slowdown can't be ignored



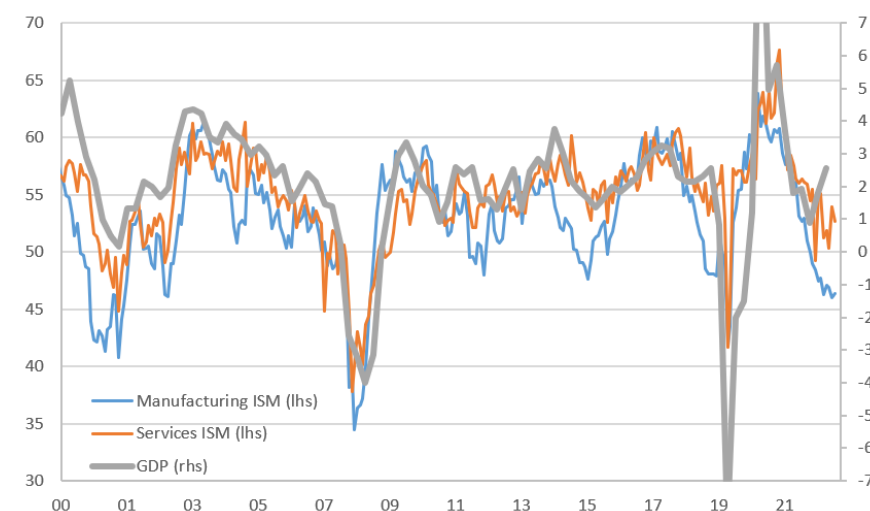
### ISM indices suggest weaker growth than the GDP report

The US survey data and official activity reports have been somewhat contradictory through much of the year. Official data is looking robust, highlighted by upward revisions to first quarter GDP and a stronger-than-expected second quarter GDP print and of course very firm jobs numbers. Yet business sentiment, be it the National Federation of Independent Business small business optimism or the Conference Board's CEO optimism surveys are both in recession territory while the ISM reports are both pointing to weaker activity than has been officially reported.

Monday's manufacturing ISM headline did rise, but remains below the break-even expansion/contraction level with all of the main components in contraction territory. Now we have

had services index, which unfortunately was softer than hoped, slowing to 52.7 from 53.9. As the chart below suggests, historically the manufacturing and service ISM at these levels are consistent with the economy expanding at a roughly 0-1% year-on-year rate, not the 2.6% rate the GDP report indicates.

## ISM indices versus GDP growth YoY%



Source: Macrobond, ING

## Weaker labour indicators a key theme within the ISM

Looking at the details we see new orders are at 55.0, down from 55.5 while business activity slowed to 57.1 from 59.5, but to be fair both are good numbers. However, the employment component slowed quite sharply to 50.7 from 53.1. This is significant as we look towards tomorrow's US jobs report. We have a softish ISM services employment signaling little change in service sector employment levels, the weakest ISM manufacturing employment for three years, signalling significant job losses in that sector (44.4 versus the 50 break-even level), the S&P PMI employment consistent with sluggish growth and an ADP report pointing to a booming private sector jobs market (although we can only describe the predictive power of the ADP report for non-farm payrolls as poor at very best).

The majority of economists would admit if they can forecast within 30k of the outcome then they've done well so we can't really say anything other than the numbers are broadly in line with the consensus forecast of around 200,000 jobs added in July. The unemployment rate is likely to come in at 3.6%, with a risk of 3.7%, but with broadening evidence that pay pressures are subsiding, we look for average hourly earnings slowing to 0.3% month-on-month/4.2% YoY from 4.4% YoY in June

## Tight lending conditions and market developments point to the Fed at the peak

An outcome broadly in line with this would continue to favour a September pause from the Federal Reserve after July's 25bp rate hike, but with the Fed keeping alive the possibility of a final rate move in either November or December should the data justify it. We don't think the Fed will carry through with it and the current 5.25-5.5% range will mark the top for Fed funds.

The move higher in Treasury yields only adds to our conviction that the Fed won't need to hike further. We are approaching 4.2% for the 10Y in the wake of the Fitch downgrade and the Treasury funding announcement and it could go higher. This, coupled with the stronger dollar and rising market volatility is tightening monetary conditions and will put up mortgage rates and corporate borrowing costs. Monday's Federal Reserve Senior Loan Officer Opinion survey showed a further tightening of lending conditions, which in combination with higher interest rates, will be toxic for bank lending and a clear headwind for economic activity – hence our view that recession risks cannot be ignored.

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