

## US: The rising risk of recession

The US ISM manufacturing index has historically been one of the best lead economic indicators and the fact all the main components are now in contraction territory is a major cause for concern. With new tariffs coming into effect and the global backdrop continuing to weaken the threat of a recession is rising, which will force the Fed into further rate cuts



Source: Shutterstock

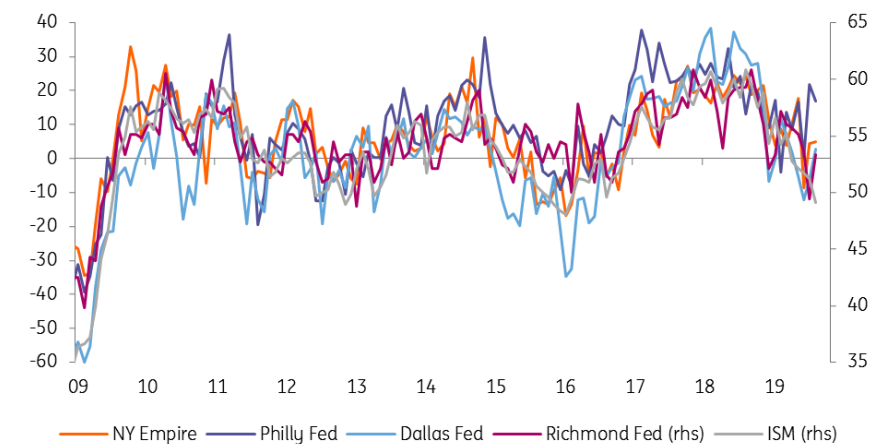
**49.1** Manufacturing ISM index

Weakest reading in over three years

### Another manufacturing miss

The ISM manufacturing index has come in at 49.1 for August versus 51.2 in July. This is the first sub-50 reading (the expansion/contraction boundary) since August 2016 and is the weakest figure since January 2016. The consensus had expected a slight rise based on the regional surveys already published and as the chart below shows, this is a clear disappointment that will provide further fuel to the market and President Trump's desire for further Federal Reserve interest rate cuts.

## The ISM is worse than what the regional indicators are suggesting



Source: Bloomberg, ING

### More weakness ahead...

Production, new orders and the employment components all fell into contraction territory and suggest the sector is feeling broad-based pain. Just 17% of America's manufacturing industry is seeing orders rise with just 22% experiencing higher production. Unsurprisingly new export orders were particularly hard hit through a combination of weaker global demand, the stronger dollar and retaliatory tariffs from China. This component fell to 43.3 - the weakest reading since April 2009 and it will almost certainly fall further.

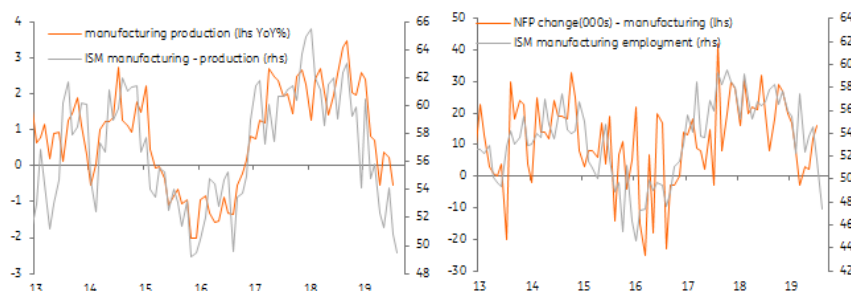
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*Just 17% of America's manufacturing industry is seeing orders rise with just 22% experiencing higher production*

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The charts below suggest that we are going to see much weaker industrial production and employment figures in upcoming releases. Manufacturing output is already down 1.6% year to date with output 5% below the November 2007 peak. It offers bad news for Friday's US jobs report too with today's ISM employment component pointing to a 10,000 contraction in manufacturing employment - this would be the first negative manufacturing jobs growth for three years.

## ISM points to weaker output and employment



Source: Macrobond, ING

### Implications for interest rates

With new tariffs having taken effect on Sunday and with more to come in October and December the risk is that the surveys move lower again in the months ahead. It is important to remember that the Institute of Supply Management suggests that a reading above 42.9 “generally indicates an expansion of the overall economy”, and given the clear strength of the consumer sector the US economy appears to be some way off a recession for now.

However, the attritional nature of the US-China trade tensions and the weakening global growth outlook is hitting sentiment while higher tariffs are putting up costs and hurting supply chains. The result is that corporate profitability is deteriorating and there is already evidence, as acknowledged by the Federal Reserve, that this is leading to weaker investment spending. There is the risk that employment growth softens more broadly (not just manufacturing) too.

Given the potential for the slowdown to spread to other sectors (weaker equity markets hurting consumer sentiment, negative yield curve curtailing credit supply from the banks, for example) and the fact other major central banks are moving in the direction of policy loosening, which is pushing the dollar higher, we look towards the Fed to offer more support to the US economy.

We expect 25bp interest rate cuts at both the September and the December FOMC meetings.

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