Service sector slowdown adds to worries on US growth prospects

Broad-based weakness in the ISM services index coupled with an upward trend in jobless claims suggests that the pieces are falling into place regarding a September interest rate cut from the Federal Reserve. The Fed is signalling just one cut this year, the consensus and market expects two, but we continue to see the risk of three rate cuts in 2024

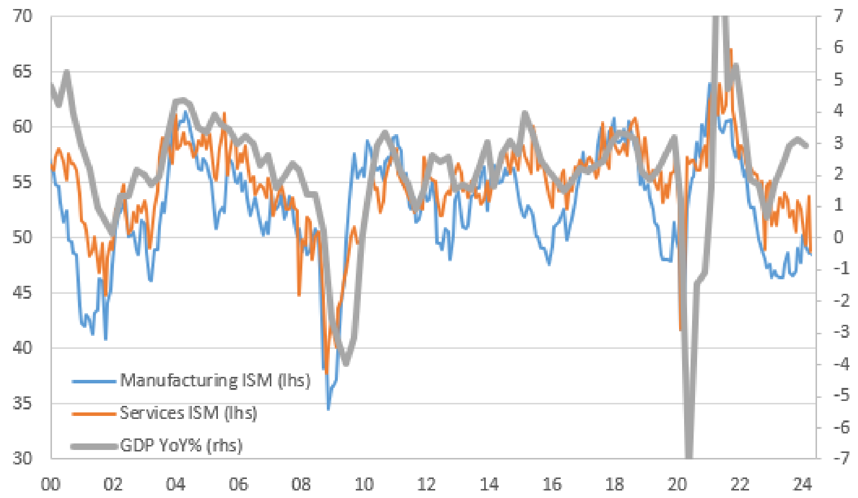
Softening data intensifies downturn fears

Today's data has offered more evidence of a cooling economy and softening jobs market. Initial claims continue trending higher, albeit slowly, while continuing claims rose to their highest level since November 2021. This suggests that while firing rates remain low, if you do unfortunately lose your job it is becoming much harder to find a new position. However, the really eye-catching release is the truly dismal ISM services index for June. It dropped to 48.8 from 53.8 (consensus 52.7).

This is below all the individual forecasts submitted to Bloomberg and is the worst outcome for four years when we were still in the middle of the pandemic, which shows how dire businesses are feeling. New orders plunged to 47.3 from 54.1, business activity collapsed to 49.6 from 61.2 while employment fell to 46.1 from 47.1 (remember 50 is the break-even level with anything above being expansion and below being contraction).

The one bit of good news is prices paid slowed to 56.3 from 58.1, offering further evidence of weakening price pressures. The chart below shows that both the manufacturing and service sector ISM's are in contraction territory. This is a significant story as historically these have been the best lead indicators for changes in the economic cycle and suggest downside growth risks are intensifying.

ISM surveys versus YoY GDP growth

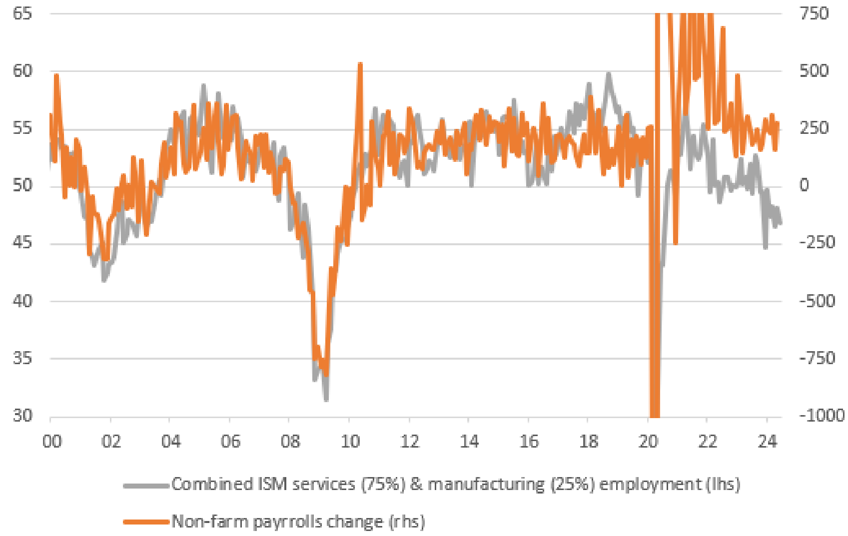


Source: Macrobond, ING

Data increasingly backing the case for interest rate cuts

This certainly boosts the case for a September interest rate cut from the Federal Reserve as it ticks all the boxes of weaker growth, slowing inflation and a deteriorating jobs market. The Fed doesn't want to cause a recession if it can avoid it and if the data starts allowing them to move policy to a slightly less restrictive position we think they will take that opportunity. With regards to Friday's jobs report, if we combine the manufacturing and service sector ISM employment numbers (and weight them 25%/75%), we are at levels historically consistent with non-farm payrolls FALLING 175k, not rising 190k as the consensus predicts for Friday. With ADP also looking soft and the homebase and NFIB employment numbers at weak levels we see downside risk to our own forecast of 175k.

ISM employment components points to downside risk for non-farm payrolls



Source: Macrobond, ING

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