Soaring US services clouds the Fed rate cut story

The ISM services index hit a 14-month high with surging output, orders and employment, but this contradicts the relative softness seen in other business surveys. Meanwhile, job openings numbers cooled more than anticipated, reinforcing the low hire, low fire narrative for the US jobs market that will also be seen in Friday's payrolls data

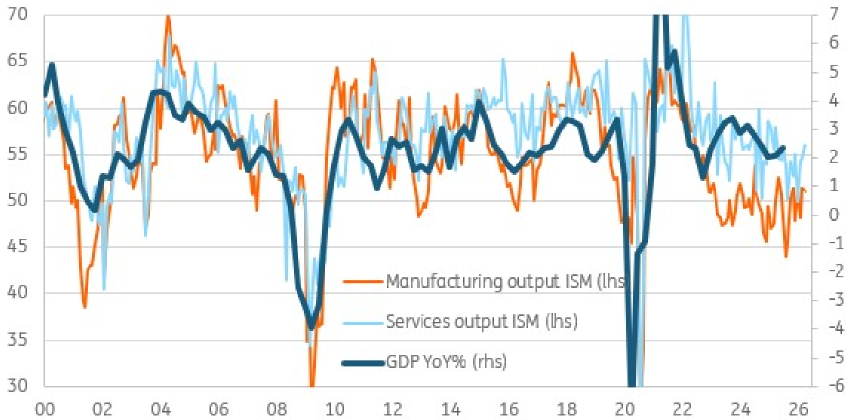
Services ISM beats all expectations for December

December's US service sector ISM index is remarkably strong, rising to 54.4 from 52.6 and above the 52.2 consensus prediction - in fact it was above all predictions in the market and is the strongest reading since October 2024. This is a purchasing managers' index where participants are asked what is happening within their business for a number of metrics - output, orders etc with a number above 50 being expansion and below 50 contraction.

Business activity rose to 56.0 from 54.5 while the employment component rose to 52.0 from 48,8, the first expansion reading since May. New orders jumped to 57.9 from 52.9 with the only area of notional weakness being in the backlog of orders that dropped to 42.6 from 49.1. With the prices paid component remaining very elevated at 64.3, this points to ongoing inflation pressures emanating from the sector.

So all in a very strong report, which in itself would suggest the Federal Reserve can safely sit on its hands for a while. The slight problem is that it contrasts starkly with weaker regional Fed surveys of the service sector seen in recent weeks, while yesterday's S&P global purchasing managers' index actually cooled. The chart shows the relationship between the output ISM measures for services and manufacturing versus GDP growth.

ISM output measures versus GDP growth (YoY%)



Source: Macrobond, ING

But the jobs story remains consistent with low hire, low fire

Separately, we had the JOLTS report (Job Openings and Labor Turnover statistics). It showed a surprisingly large dip in job vacancies to 7.15mn from a downwardly revised 7.45mn (consensus 7.65mn), but the lay-off rate dropped to 1.1% from 1.2% while the quit rate picked up marginally to 2% from 1.9% so it is all fully consistent with the low hire/low fire economy that was also illustrated earlier today with the ADP private payrolls report posting a 41,000 increase in employment in December. For reference, the consensus for Friday's non-farm payrolls report has ticked a little higher to 70k over the past week. This would leave payrolls growth trending around the 40k mark for the past six months – in line with the ADP report. So again it is a cooling, rather than collapsing jobs market. 10Y yields have ticked a couple of basis points higher on the back of these reports, but it hasn't really done anything to turn around the slight risk-off attitude in markets today. Markets are still happy pricing 60bp of Fed rate cuts this year.

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