

## US data confirms the cooling narrative

The ISM manufacturing data suggests the sector continues to contract while job opening numbers point to a slower pace of hiring. Friday's jobs report will be key this week though, with the composition of jobs growth almost as important as the payrolls number itself in determining the prospect for rate cuts in 2024



### Data provides an important test for recent market moves

Financial markets responded aggressively to the Federal Reserve's dovish signals at the December FOMC meeting when their individual dot plots pointed to three rate cuts in 2024. This gave market participants the confidence to ramp up the pricing of potentially even more aggressive easing coming through, helped additionally by a very soft core PCE deflator print. Markets are now anticipating six 25bp moves, starting as soon as March.

We have been predicting 150bp of interest rate cuts in 2024 for some time, but we remain a little nervous that the market has moved so far so quickly even though the jobs market remains tight and the activity story right now remains pretty solid. March still looks a little early to us for the first rate cut – we favour May – and this week's data flow will be important in gauging the potential timing of a first rate cut.

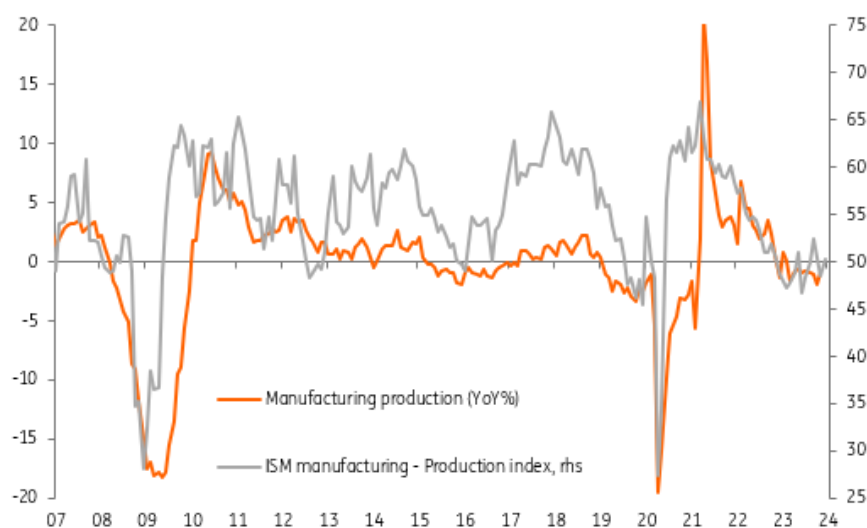
### Manufacturing continues to languish

Today's reports aren't especially conclusive though. The US ISM manufacturing index improved more than expected in December to stand at 47.4 versus the 47.1 consensus forecast and up from

46.7 level recorded in November. Nonetheless, this remains a weak report. It is the 14th consecutive sub-50 print – 50 is the breakeven level – indicating the sector has been contracting since the fourth quarter of last year. The details show production rose to 50.3 from 48.5, so there is a very modest increase in output given it is above 50, but new orders softened to 47.1 from 48.3 and the backlog of orders series also remained weak, suggesting production is likely to drop back below 50 again next month. As the chart below shows, it suggests ongoing stagnation is the most likely path ahead for the sector.

Employment rose to 48.1 from 45.8, but this is still below that 50 breakeven level so merely indicates that the pace of job shedding slowed in December. The good news is that prices paid fell back quite sharply to 45.2 from 49.9, suggesting very little inflation threat from the sector, giving the Fed the room to respond flexibly to incoming activity data.

## US ISM manufacturing index and official manufacturing output YoY%



## The jobs market remains key and further softening looks likely

Separately, the November JOLTS report data that showed the number of job openings fell to 8.79m in November from 8.852m in October. There were quite a lot of revisions, but the main takeaway is that the level is weaker than the consensus expectation of 8.821m and the trend shows businesses are becoming more cautious on hiring in general with the number of job openings at their lowest since early 2021. Admittedly, there are still significant numbers of vacancies, but hiring rates slowed to the lowest level since July 2020 and the quit rate – a measure of people willing to leave their job and used as a gauge to see how confident workers are they can find better-paid work elsewhere – dropped to its weakest reading since 3Q 2020. Consequently, it appears workers are noticing businesses are becoming more reluctant to hire staff.

None of this is likely to shift the consensus expectation for payrolls on Friday very much, which currently stands at 171k versus the 199k increase seen in November. Perhaps the key story to watch though will be the composition of employment gains. In fact, in the January to November 2023 period just three sectors – leisure and hospitality, private education and health services and government – have accounted for 81% of all the jobs created year to date. We don't expect this

story to change much in the December report. That isn't a particularly positive story for growth as none of these sectors are what we would deem to be indicators of a dynamic private sector looking to expand rapidly. This is likely to keep the market gunning for rate cuts.

## Author

### James Knightley

Chief International Economist

[james.knightley@ing.com](mailto:james.knightley@ing.com)

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