Economic Indicator — July 3, 2024

# Service Providers Spark Concern in June ISM


## Summary

The ISM services index slipped into contraction for the second time in three months, sparking concern for service-sector resilience. But the outturn may overstate current weakness as the details are more consistent with a moderating rather than contracting sector.



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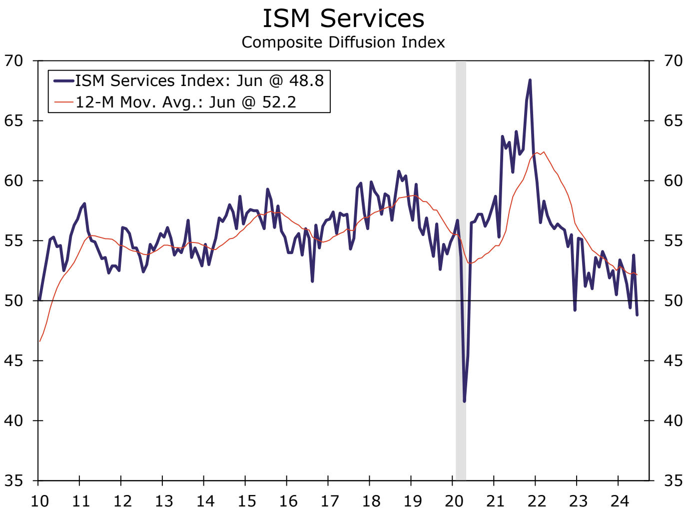



Source: Institute for Supply Management and Wells Fargo Economics

## Stalling More Than Sinking

The services-side of the economy may be starting to lose its footing. The ISM Services Index slipped 5.0 points to a contractionary reading of 48.8 in June (chart). This marks the second time in three months that the index is flashing signs of contraction and makes the April reading below 50 look less like an outlier. On a three-month average basis, the ISM Services Index now sits on the cusp of contraction (chart).

The drivers of weakness were also broad and are somewhat concerning. The Business Activity Index, a measure of current conditions, plunged nearly 12 points. While this likely in part reflects payback from a reading north of 60 in May, the below 50 (49.6) index value for June isn't a great development. New orders also slipped into contraction territory for the first time in a year and a half. That said, for the second straight month 10 of 18 industries reported an increase in new orders while three reported a decrease, though the industry mix shifted. The drop in the index reflects a smaller share of *respondents* reporting higher orders, while a larger share reported the same or lower order activity.

The mood music is changing, but we expect the overall ISM overstates current weakness. The select respondent comments in the release struck a tone of caution and generally mentioned slower or softer activity relative to a month or year ago, but there is little indication the tide is turning fast.

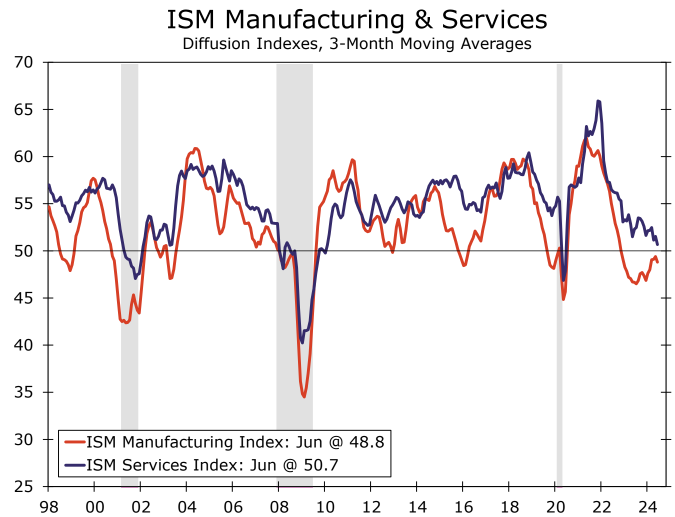
Ultimately, an optimist looks at this release and sees much of what the Fed is fighting for. Service-sector activity is cooling and giving way to a moderating labor market and ultimately softer price pressure.

The ISM employment components do not move one-for-one with broader hiring data, but they still offer their signal and are consistent with the more concentrated hiring picture today. While hiring remains robust, most data suggest the labor market is moderating, the ISM included. The ISM services employment component fell to 46.1 in June and has now been in contraction in five of the first six months of the year. Earlier this week we also learned the ISM Manufacturing Index employment component fell to 49.3 in June.

We'll get the full employment report on Friday, and we now forecast employers added around 185K net new jobs last month (downwardly revised from an estimate of 200K prior to this week's labor market data). While this is a pace still historically consistent with a sturdy labor market, it's a demonstrated moderation from the breakneck pace of recent months consistent with cooler demand for workers.

The most positive development in this release is the nearly two-point drop in the Prices Paid Index to 56.3 (chart). This is still consistent with higher prices paid in the services sector, but a majority of respondents are reporting the same prices paid. We're also moving in on the pre-pandemic cycle average reading closer to 54.0.

While this is a continued step in the right direction in the fight against inflation, we're not out of the woods. Respondents still mentioned higher prices, with a few referring to higher fuel or gas prices and a couple mentioning higher freight costs, which has once again become a concern.



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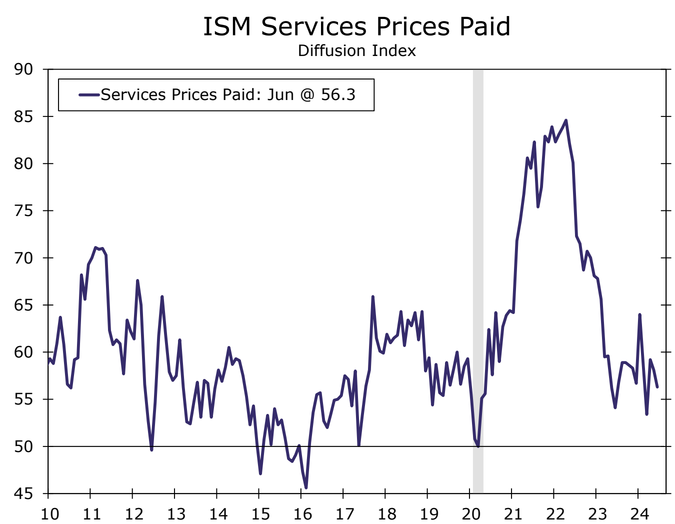

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