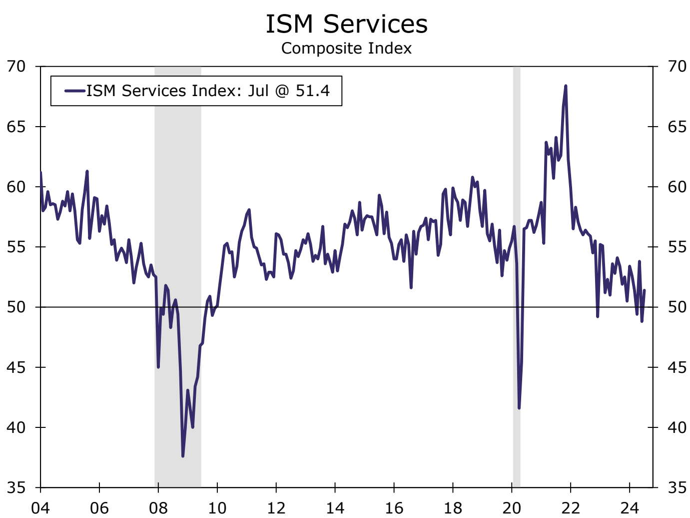
Economic Indicator — August 5, 2024

Service Sector Activity Returns to Expansion in July

Summary

At a moment when global financial markets are selling off over concerns that the U.S. economy could be on thin ice, the ISM services index is a reminder that service-sector activity remains robust. The ISM Services Index rose back into expansion at 51.4 in July.



Source: Institute for Supply Management and Wells Fargo Economics

Economist(s)

Tim Quinlan
Senior Economist | Wells Fargo Economics
Tim.Quinlan@wellsfargo.com | 704-410-3283

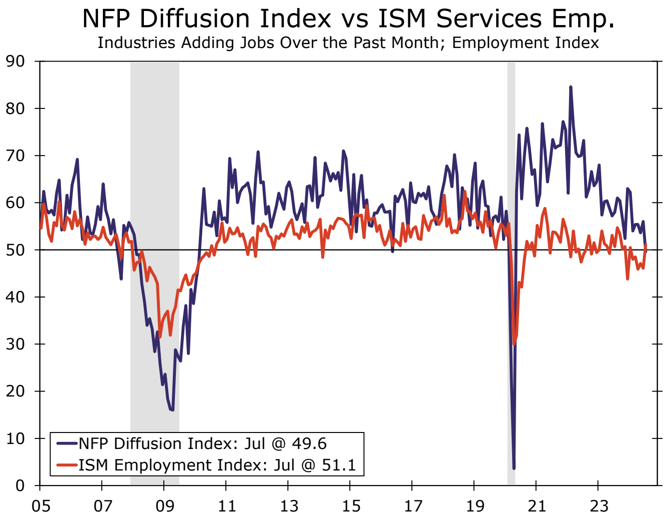
Shannon Seery Grein
Economist | Wells Fargo Economics
shannon.grein@wellsfargo.com | 704-410-0369

Service-Sector Resilience Intact?

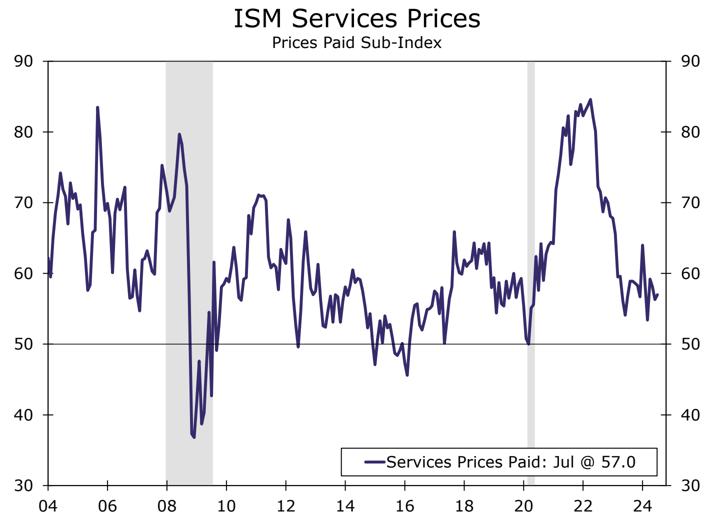
Whereas last Friday's jobs report pointed to an economy that could be slipping into recession, today's report shows the opposite. The headline index, the business activity index and four sub-components (new orders, order backlogs, employment and imports) all moved from contraction into expansion territory. In short: service sector activity regained its footing in July.

To some extent, it was not the weakness in last Friday's jobs report that was so surprising as much as it was the strength in hiring reported in the prior months. That is tough to square with the fact that the employment component of the ISM services index was below 50 for the five straight months leading into July. At first pass the employment component of the ISM looks out of step with the moderation evident in total hiring on Friday—the ISM services employment component did rebound in July to 51.1, or the highest reading since September.

While this indicator has not been a great signal for actual hiring data this cycle, it's still consistent with the moderation we're seeing in the jobs market. Even as the employment component rose back into expansion, only eight of 18 industries reported an increase in hiring last month, which is in line with the slower breadth of hiring reported elsewhere. Consider the broad diffusion metric of hiring has showed a slowing trend for the past two years (chart).



Source: U.S. Department of Labor and Wells Fargo Economics



Source: Institute for Supply Managemnt and Wells Fargo Economics

A Less Intense Focus on Price Stability

The prices index rose to 57.0 in July from 56.3 in June (chart). In adjusting our fed funds forecast over the weekend we observed how the FOMC has been focused almost entirely on bringing inflation back to its 2% target, an endeavor that has largely been successful. At last week's FOMC meeting, the statement observed how the Committee is now "attentive to risks to both sides of its dual mandate" (i.e., "price stability" and "full employment") rather than only emphasizing the "price stability" part of its mandate.

Renewed attention on the labor market notwithstanding, we think that an under-appreciated factor amid all the worry about the health of the economy is that households just keep finding ways to sustain spending. The labor market may be losing momentum, but in the latest personal income and spending report we learned that real services outlays grew 0.2% in June, the fastest pace in four months. While most of the spending on services goes toward non-discretionary categories such as healthcare and housing, consumers are still spending in other categories too. Real services spending less healthcare and housing rose *more* than broad services, up 0.24%.

Still, given the redirected focus on the labor market, the modestly higher July reading for ISM service prices does not present a significant impediment to Fed easing later this year.

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey George	Economic Analyst	704-410-2911	Aubrey.B.George@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Ali Hajibeigi	Economic Analyst	212-214-8253	Ali.Hajibeigi@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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