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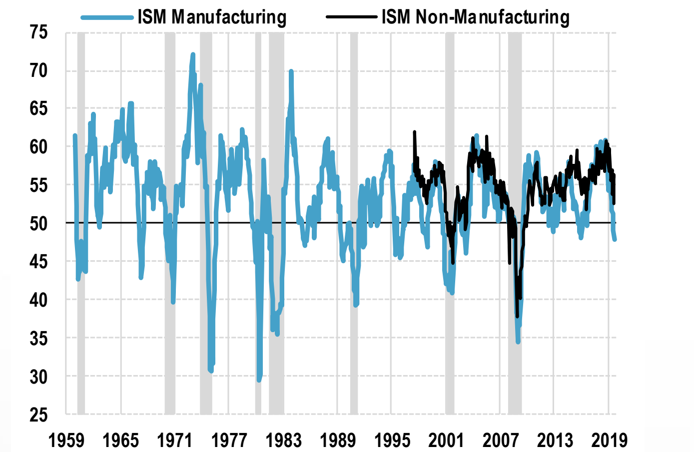
US: from big growth scare to relief

■The manufacturing purchasing managers' index of the Institute for Supply Management (ISM) has continued its decline in September, reaching 47.8%. The non-manufacturing ISM has registered a big drop of 3.8 percentage points and is now at 52.6% — a very low print for a non-recessionary period ■Against this background, bond yields have declined significantly reflecting increasing worries about recession risk, rising expectations about additional Fed easing and a greater flight to safe havens ■The labour market data for September however brought some relief. Nevertheless, we expect the Fed to continue to cut rates.

How many pieces of bad news does it take to become convinced that the cyclical environment has definitely changed? Difficult question to answer but what is clear is that a big growth scare has developed this week. Typically, it manifests itself through a drop in US treasury yields, as investors — faced with poor economic data — flee to safety. This pretty well summarises this week's experience. It started with the Institute for Supply Management's purchasing managers' index for the manufacturing sector which, for the month of September, dropped 1.3 percentage points to 47.8 percent. This puts the index firmly in recession territory as far as the manufacturing sector is concerned. The new export orders index declined 2.3 percentage points to reach a very low 41 percent reminding us that the slowdown taking place in the rest of the world is increasingly impacting the US. Until recently, one could argue that the services sector was quite resilient but the 3.8 percentage points decline in the non-manufacturing ISM index forces us to reassess this belief. The index is now at 52.6 percent which—as shown in the chart—is quite low, outside of recession periods. In combination with the very weak manufacturing ISM, this points towards a clear slowdown in GDP growth. Corporate investment is the weaker link here, given its sensitivity to uncertainty about where the economy is headed, and of course to worries about how the confrontation with China on trade will evolve. For the household sector, the labour market plays a key role in shaping confidence and expectations about the evolution of income. Household consumption is a key variable for growth, given its weight in GDP (70%) but also considering the pressure on exports and the subdued outlook for corporate investment. Against this background, the labour market report provided some welcome relief to the market and observers as 136.000 jobs were added in September and the unemployment rate declined to 3.5 % from 3.7%. Nevertheless, we think that the US economy will continue to slow in the coming quarters, forcing the Fed to cut rates further

US: ISM MANUFACTURING AND NON-MANUFACTURING



Source: Institute for Supply Management, BNP Paribas

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