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US Economics | North America

Some weak July data but we still expect a soft landing

Payrolls and manufacturing ISM were weak. We don't think payrolls spells real weakening—could be weather, could be just noise. The Fed would need less than 100k in August payrolls to consider a 50bp cut. We survey recent indicators -- which are worrying and which are not.

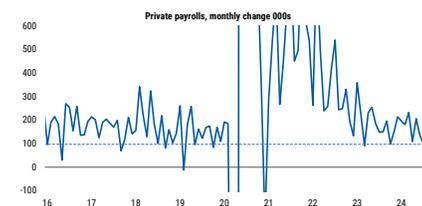
The weak employment and ISM reports along with the rise in jobless claims in July do not necessarily signal further deterioration. We run through a range of recent, weaker indicators to see whether the recent deteriorations are unusual enough to be significant. In short: they're not. In the past year, employment measures slowed similarly several times without subsequent deterioration. The Sahm rule is exaggerating deterioration because of labor supply. The manufacturing ISM index was below its July level for most of last year without broad weakening in the economy. The June drop in the ISM services index is contradicted by the June and July S&P services measure. More troubling: the narrowness of employment gains in July: Only about 1/2 of industries reported increases in employment in July.

A single slower print in payrolls doesn't mean much for growth. Last year, March and October private payrolls were similar to this July's pace. In 2018-19, seven months out of 24 were similar. Both were periods of solid growth. ([Exhibit 1](#))

New claims for unemployment insurance benefits have risen sharply enough for concern, but their rise is smaller than last year's, and even last year's rise did not signal broad weakness. ([Exhibit 3](#))

The rise in continuing claims is too small and short-lived to yet signal real weakness. There has been a 70k rise over the past two months. Before the 2008 recession they rose 250k over six months. ([Exhibit 4](#))

Exhibit 1: A single slower payrolls print can be noise, or weather, or nothing. Another one would be concerning.



Source: BLS, Morgan Stanley Research

Exhibit 2: The narrowing in employment gains is rare except at times of weakening.



Source: BLS, Morgan Stanley Research

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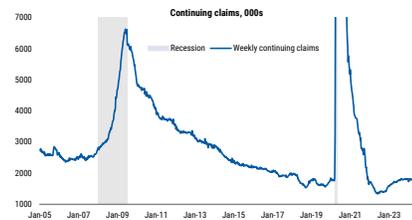
The breadth of the slowing in payrolls in July is more troubling. This was the first month of the current expansion with such narrow gains. In the last two expansions, the payrolls diffusion index was only so low at the start of the expansions when payrolls were still weak. (Exhibit 2)

Exhibit 3: The rise in new jobless claims is smaller than last year's and last year's rise did not signal broad weakness



Source: Department of Labor, Morgan Stanley Research

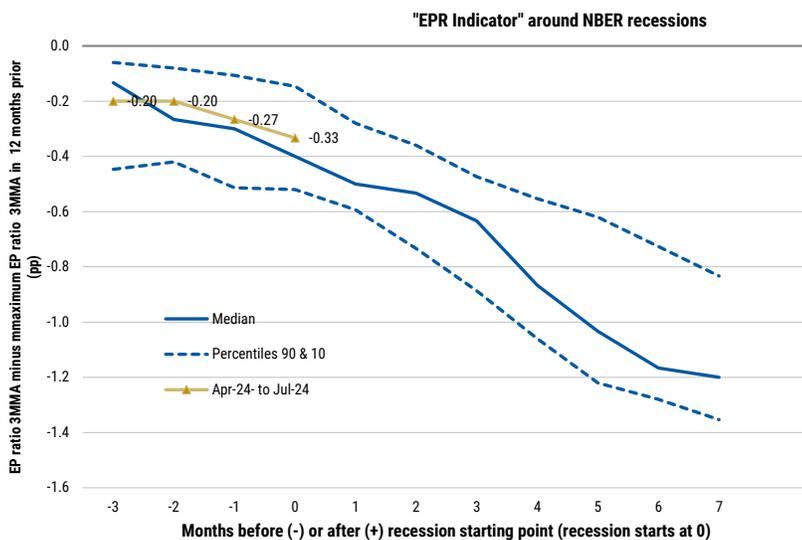
Exhibit 4: Continuing claims have to rise on a more sustained basis to signal trouble



Source: Department of Labor, Morgan Stanley Research

The July employment report triggered the Sahn Rule. But some of the rise in the unemployment rate has been because of greater labor supply rather than weaker labor demand. In July, faster labor force growth contributed 0.17 pct pt of the 0.20 pct pt rise in the unemployment rate. Before past slowdowns, it's been weaker labor demand rather than more labor supply that drove weakness. To control for labor supply, we focus on the employment-population ratio, which has deteriorated less than it did before past recessions. It has not broached the ½ point declines that in the past signaled recession. (Exhibit 5)

Exhibit 5: The employment/population ratio has fallen over the past year but is not as weak as before past recessions



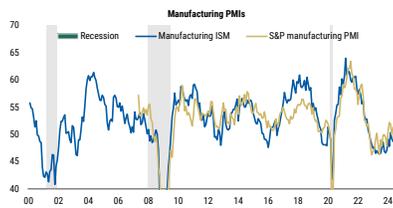
Source: BLS, Morgan Stanley Research

Last summer, the manufacturing ISM index averaged lower than its July reading without factory weakness broadening into the rest of the economy. In 2019, too, manufacturing weakness did not spread much. And the S&P manufacturing index

casts some doubt on the ISM as it has been strengthening on net. ([Exhibit 6](#)

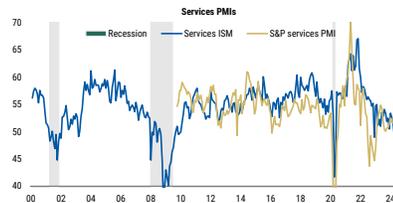
The services ISM index got attention in June for its decline and for weakness in its employment component. But the services ISM index rebounded to above 50 in July, and the employment component, at 51.1, rose to its highest level since last September. At little above 50, the levels of the index look consistent with slowing but not with a serious slump. And the ISM index has diverged from the S&P services measure, which did not show as much softness in June or July and has been trending up since 3Q last year. ([Exhibit 7](#))

Exhibit 6: Except for the July ISM, manufacturing surveys had generally improved from last year



Source: ISM, S&P Global PMIs, Morgan Stanley Research

Exhibit 7: The ISM services index rebounded in July to signal slow growth. The S&P services index is stronger and trending up.



Source: ISM, S&P Global PMIs, Morgan Stanley Research

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