Economic Update

February 5, 2025

ISM Services Fell to 52.8 in January 2025, Undershooting Expectations but Still Expansionary

- **The ISM Services PMI fell to 52.8 in January 2025**
- **Business Activity declined to a still-healthy reading of 54.5**
- **Service industry hiring edged up modestly to 52.3 to open the new year**
- **Cost pressures for services providers eased, though are still elevated, falling to 60.4 in January 2025**

The ISM Services PMI fell to 52.8 in January 2025, from 54.0 in the month prior. The January result aligns with conditions reported by U.S. services providers through 2024, with the first half of last year averaging a topline ISM Services PMI index result of 51.5 which then rose to a 53.3 average for the second half of the year. All components of the ISM Services report point to health in the U.S. economy's services sector, though the data currently lack any suggestion that a renewed vigor for this sweeping economic base is on the cards for the first half of the new year.

The ISM Services PMI diffusion index indicates the net percentage of service providers who are experiencing expanding or contracting activity across various categories, with a reading above 50 revealing net expansion across services sectors.

The ISM Services PMI report's Business Activity component index declined marginally in January 2025, falling to 54.5. Though still firmly in expansionary territory, as has been the case since mid-2024, this move does represent the largest decline in the current conditions gauge of the report since June 2024 (-9.7 index points monthly change). New Orders among service industry businesses also fell in the January 2025 ISM Services PMI report, declining to 51.3 – the New Orders component index's lowest reading since June 2024 (47.8). Falling job openings and heightened volatility in overall hiring numbers in recent months may be dampening consumer demand for the recreational spending that bolsters services activity recently and for the coming months.

The ISM Services PMI's Employment component index rose in January 2025, and at 52.3 posting its highest result since September 2023 (52.4). January is the fourth consecutive month of the Employment sub-index posting a result above the breakeven threshold of 50, after languishing in contractionary territory throughout the first half of 2024 and indeed through September of last year. Some respondents to the ISM Services PMI survey reported seeing "more and better-qualified candidates" for job openings, even as they acknowledge the broader slowdown in the U.S. job market. What appears to be greater balance in service industry hiring to open the new year could be set to relieve some of the above-average pressure that wage growth across service sectors has pummeled businesses' bottom lines since the middle of last year.

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Service providers' cost pressures revealed some easing in the January 2025 ISM Services PMI report. The Prices component of the overall index fell to 60.4 from 64.4 in December (which was the highest mark in nearly two years). Service providers are expressing some concern that tariff policy is injecting price pressure into their calculus, according to quotes from the ISM's release. Should tariff rhetoric continue to fail to manifest as actual implementation, businesses that raised prices preemptively could face consumer demand fallout as household budgets seek out greater value.

The December 2024 ISM Services PMI report indicates continued stability across services industries entering the new year. This solid footing across the largest industrial footprint for the U.S. economy supports PNC's expectations of two (2) 25 basis point rate cuts from the Fed in 2025. This path would move interest rate costs faced by businesses closer to neutral, but acknowledges the reality that the U.S. economy is still performing well and does not require an exceptional pace of policy easing in order to maintain that condition. Risks remain that inflation could be sustained above the Federal Reserve's target of a 2% average for some time given economic health and still-strong wage growth. So long as current conditions reports such as the ISM Services PMI continue to demonstrate modest expansion, the slower pace of Fed policy easing will prove to be justified given their continued fight to finally hit their target according to their inflation-fighting mandate.

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