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Economics Group

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ISM Non-Manufacturing Has Much to Say About Outlook

The ISM Non-Manufacturing Index came in at 55.2 in January. The six month average is 55.0, so is this a snoozer report? Absolutely not. A choppy rotation in subcomponents offer clues to future growth drivers.

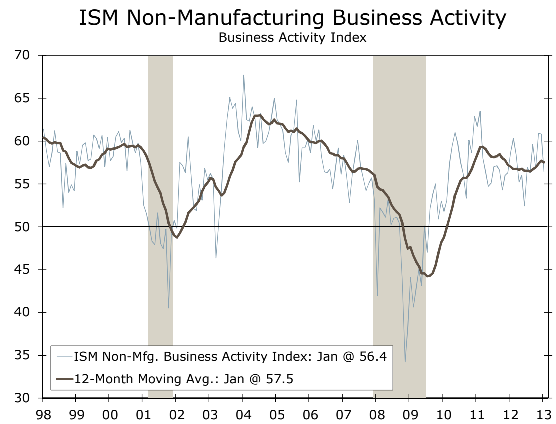
Concern Over the Fiscal Cliff? It's in There, Just Hiding

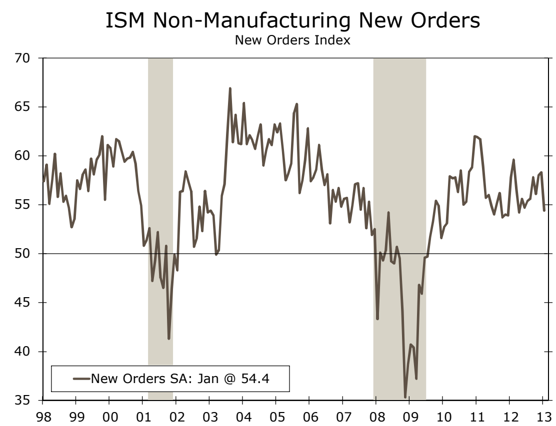
Today's 55.2 reading for January does not do much to inflate or diminish financial market expectations for the service sector's contribution to future economic growth. The average level for this index over the past six months is 55.0 and last month's somewhat euphoric initial reading of 56.1 was dialed back to 55.7 after revisions. But, that does not make this a dud report.

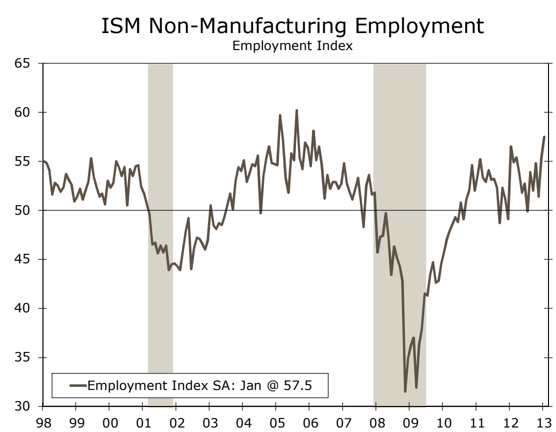
If there is anything surprising in recent ISM non-manufacturing surveys, it is that we have seen little evidence of a response to the uncertainty and frustration over the fiscal cliff and debt ceiling that has been so easy to identify in other reports. The most recent Beige Book has numerous citations of business uncertainty over fiscal concerns. In the past several months, the NFIB's small business survey showed taxes and regulation supplanting poor sales as the primary concern for small businesses. In the factory orders report earlier this week, we learned that core capital goods orders fell in December after rising solidly in the two prior months. Yet, business confidence and activity in the service sector, at least according to the headline reading in this report, have been surprisingly untrammeled by concern over gridlock in Washington. A more careful analysis of the underlying details, however, shows that there has actually been a fair amount of volatility in the subcomponents of the index. A rather choppy rotation in terms of which components are rising and which are falling belie what could easily be mistaken for "steady as she goes" growth.

Not only did the headline reading slip, the business activity index, also known as the production index, fell 4.4 percentage points in January—the second straight monthly decline. At 56.4, this index is still in expansion territory, but certainly signals a slower pace of output than it did when this component was riding high at 60.9 in November. New orders are expanding at a slower pace as well, as the new orders subcomponent fell 3.9 percentage points in January. Meanwhile order backlogs remain mired in contraction territory, raising doubt about orders in the pipeline. Perhaps this explains why service sector businesses are drawing down stockpiles. The inventories index slipped into contraction during the month as well.

That said, there were nearly enough positives in this report to offset the negatives. As we saw in last week's jobs report, the labor market continues to heal. The employment component surged to 57.5—the fastest pace of jobs expansion we have seen since before the recession. While orders may be weakening domestically, a healing global economy may provide some offset. Export orders jumped 6 percentage points to 55.5. Bottom line: The slow growth economy trudges on, the job market continues to heal and exports may help offset a weak domestic business spending environment.







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