Economic Indicator — August 4, 2021

Despite Headwinds, A Record Pace of Service Sector Expansion In July

Summary

The service sector continued to expand full-throttle in July, with the services ISM hitting a new record high of 64.1. While stronger hiring suggests labor constraints eased at least slightly, supply problems extend well beyond the manufacturing sector. With supplies and labor both in short supply, input costs are rising further with the prices paid measure hitting its highest level in more than 15 years.

Economist(s)

Sarah House
Senior Economist | Wells Fargo Securities, LLC
sarah.house@wellsfargo.com | 704-410-3282

Tim Quinlan
Senior Economist | Wells Fargo Securities, LLC
tim.quinlan@wellsfargo.com | 704-410-3283

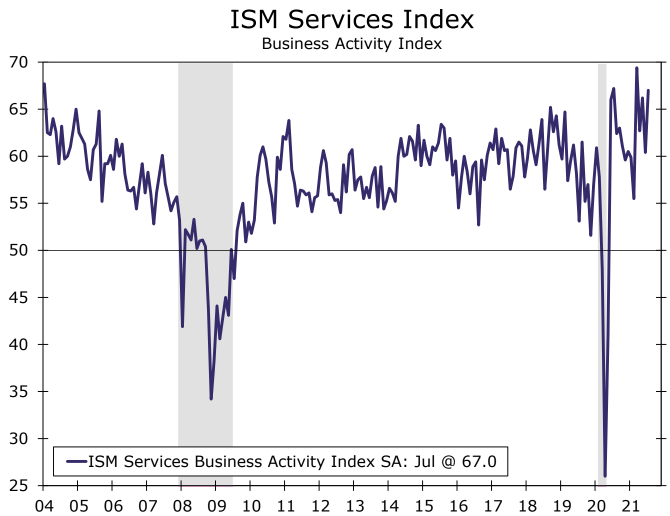
Services Activity On Fire in July, but Will it Last?

Amid hand-wringing about the peak of growth having passed and worries about the reopening of the service economy, the ISM Services index for July set a new record high. With the exception of inventory measures, all other components are in expansion territory and most moved higher in July.

Business activity is humming, with the subindex adding 6.6 points to 67.0, just a few notches below the 69.4 print in March when stimulus checks burned a hole in consumers' pockets and drove this component to an all-time high.

The biggest change of any component was a 15.1 point leap for new export orders. While this does not factor into the headline, it does signal a rebound for service exports which could eventually help narrow the trade deficit and add to growth.

In a sense, there are two seemingly contradictory problems occurring at the same time. The first is that demand for services has come back online faster than the ability of firms to staff-up and source needed parts and materials. The second is the slow realization that COVID has gone from something people thought was largely behind us to the problem that just won't go away. Rising case counts and the particularly virulent Delta variant are threatening to disrupt the recreation renaissance we have been counting on to drive a services spending boom this summer. Through July at least, the service sector is still cranking at full throttle.

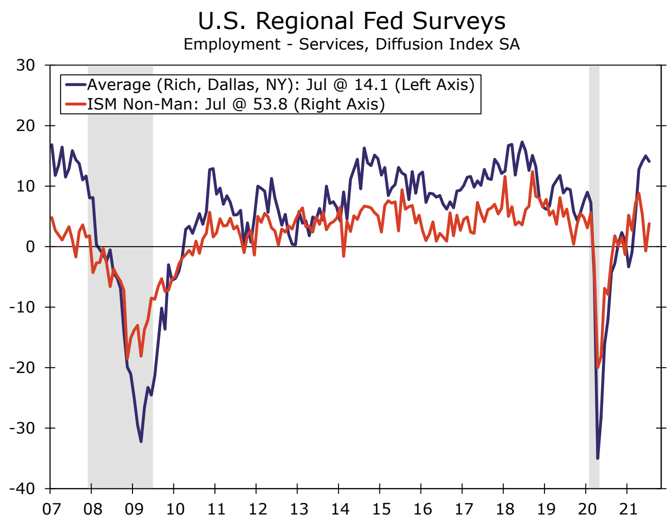


Source: Institute for Supply Management and Wells Fargo Securities

Hiring Catches Up, but Still Stymied by Availability of Labor

If there were some signs of supply constraints easing a bit in today's report, it was for labor. The employment index jumped 4.5 points in July. However, in comparison to readings on activity, new orders and supplier deliveries, the employment index remains well within its historical range at 53.8. In other words, businesses still seem to be having trouble finding workers to meet the rapid rise in services activity.

The ISM services reading on employment has not jibed with other PMI's in recent months. Today's gain puts it more in line with the signal from the regional Fed surveys, so it is unlikely that services hiring accelerated as much as the rise in the employment index single-handedly implies. Earlier this morning, the ADP report offered a warning shot that private hiring will not easily pick up further from its recent pace. Private hiring according to ADP rose 330K, less than half the pace of June. We look for nonfarm payrolls in Friday's July jobs report to increase by 865K, which would be roughly on par with June. While there are some signs that momentum stalled in July such as a flattening trend in initial jobless claims, government hiring is likely to be lifted by favorable seasonal factors amid fewer layoffs this year.



Source: Federal Reserve System, Institute for Supply Management and Wells Fargo Securities

Specific Mention of a Pressure Gauge Component

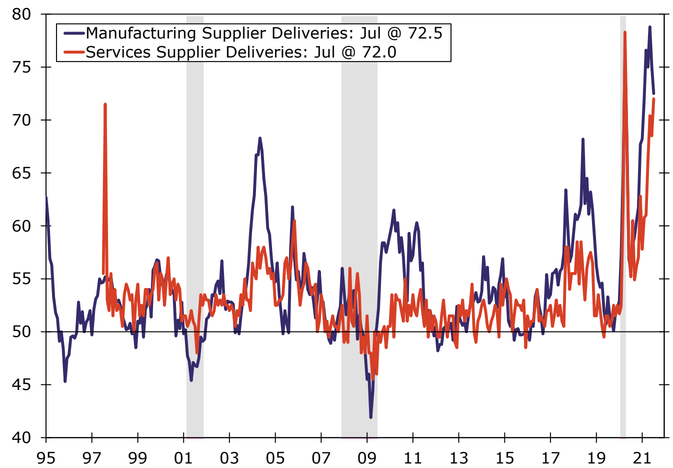
Last week we published a four-part series on supply chain dynamics and the various these logjams are impacting the economy. These issues were also on display in today's ISM services report. In fact, one of the components we selected to include in our new Pressure Gauge is the ships at anchor off the West Coast. We find a direct reference to that in the selected comments in today's report from a business involved in wholesale trade who said "Ocean freight costs have created a negative impact to our business. The congestion at (the ports of) Long Beach/Los Angeles and Seattle have increased lead time by 15 days."

The supplier deliveries component shot up to 72.0, the second highest reading on record that was exceeded only by the height of last year's lockdowns. Amid questions about when supply chain pressures will ease, this measure is saying wait times are actually getting longer.

No surprise then that against that backdrop we find the only components not in expansion territory are the inventory measures. The sentiment around inventories is that they are too low; the relevant index here rose slightly but at 40.3, it still remains historically low. Inventories have been drawn down for the better part of the past two years. That sets up the change in inventories to be additive in the second half even without a major restocking taking place. All we'd need to see is a slower rate of inventory depletion. That may be good for GDP numbers, but it is cold comfort for businesses that still cannot source needed materials.

In the meantime, the supply chain ranging from input goods to labor continue to push costs higher. The prices paid component rose to its second highest reading on record, signaling broad relief on inflation is not yet within view.

ISM Supplier Deliveries



Source: Institute for Supply Management and Wells Fargo Securities

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@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
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	International Economist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economist	(704) 410-1681	shannon.seery@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Nicole Cervi	Economic Analyst	(704) 410-3059	nicole.cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	(704) 410-1437	sara.cotsakis@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

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