

Economic Indicator — December 5, 2022

ISM Services Gets Lift from Surging Business Activity, Orders Cool

Summary

A surge in business activity lifted ISM services to a consensus-defying print of 56.5 in November. Employment crossed back into expansion territory, wait times shortened and prices came down slightly. Only a drop in orders sullied an otherwise encouraging report for the service sector.

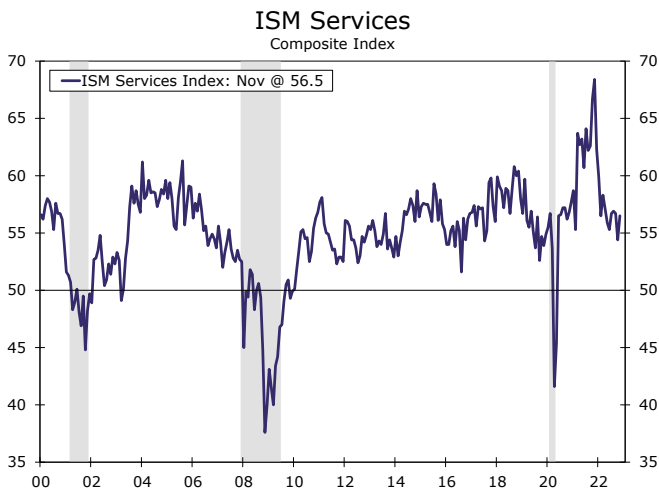
Economist(s)

Tim Quinlan

Senior Economist | Wells Fargo Economics
 Tim.Quinlan@wellsfargo.com | 704-410-3283

Shannon Seery

Economist | Wells Fargo Economics
 Shannon.Seery@wellsfargo.com | 332-204-0693



Source: Institute for Supply Management and Wells Fargo Economics

Improved Business Activity, but Keep an Eye on Orders

Defying expectations for a slower pace of growth, the ISM services index rose 2.1 points to 56.5 ([chart](#)). The service sector continued to grow in November and at a quicker pace than last month. The outturn was higher than any of the 60 forecast estimates submitted to Bloomberg.

The ISM suggests service-sector activity is holding up better than manufacturing, but the gain in the headline number does not mean that all categories are improving. The better-than-expected gain was due almost entirely to a 9.0 point gain in the business activity index, which marks the largest one-month gain since March 2021. This component is also now at its highest reading in almost a year, signaling current activity remained widespread through November. Only one industry, finance and insurance, reported a decrease in business activity last month.

Of the four components that comprise the headline number, three boosted the headline (business activity rose, employment improved and wait times shortened within supplier deliveries). The only headline-feeding decline was in the new orders component, though this should not be glossed over. This key leading indicator slid for the fourth-consecutive month to 56.0 ([chart](#)). This still marks expansion but is consistent with lost momentum and could foreshadow a more significant slowdown is yet to come.

Restrictive Policy is Working, but Will Take Time

Amid all the hand-wringing about slowing in the service sector, it is important to recall that while policymakers would like to avoid a recession, slower activity is actually the intended outcome.

Recall that as recently as April, the prices paid component of the services ISM at 84.6 was at its zenith in figures going back to the 1990s. The top-end range of the fed funds rate at the time was just 0.50%. Over the past five meetings, the Fed has lifted the top-end of the policy rate today to 4.00%, and [we expect](#) another 50 bps hike at next week's FOMC meeting.

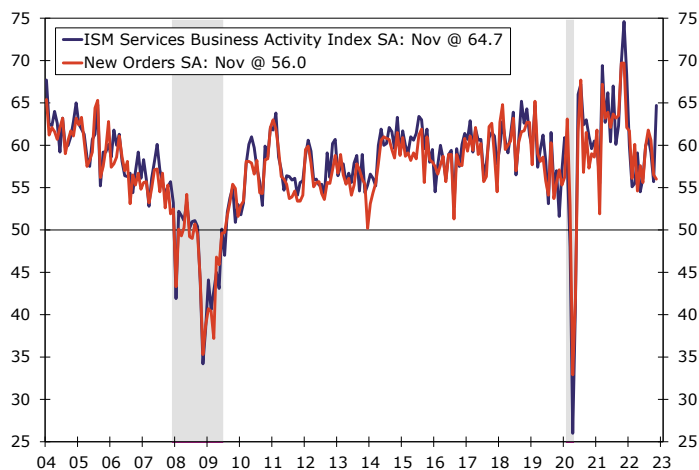
While the intended slowdown in activity has been more muted than manufacturing, so has the impact on prices. The ISM services prices paid component declined last month, but at 70.0, price pressure still remains hot and speaks to the different pricing dynamics of service-providers and manufacturers. This is the largest gap on record for the two indices ([chart](#)). Even as we see a reprieve in goods prices, the slow descent in the larger-services sector speaks to the fact that it will take time for inflation to return to target and that the Fed still has work to do in its fight against inflation.

Supply Chain Relief, Labor Remains a Challenge

Even with activity remaining robust, the broad easing in supply chains is showing up in the service sector. The index of supplier delivery times slipped to its lowest reading since lockdowns in February 2020, signaling shorter wait times last month. This index is the only one that is an inverse indicator, meaning the decline here also helped to improve the composite ISM index last month. Further evidence of supply improvement came from the fifth consecutive monthly decline in order backlog.

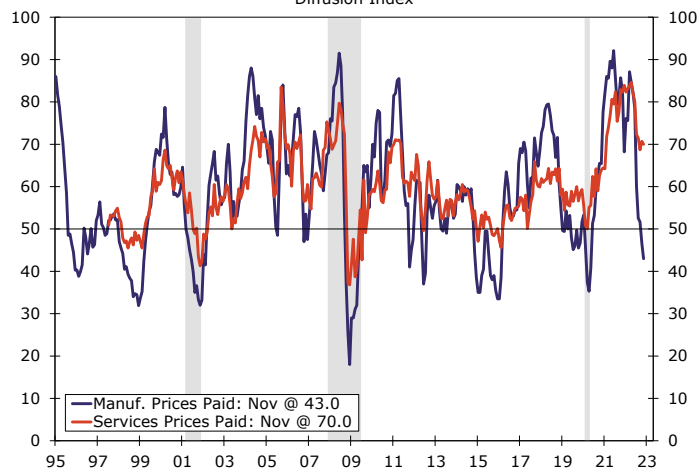
The pace of hiring also improved in November, with the index moving back above the 50-threshold that designates expansion from contraction. But the component has teetered between expansion and contraction all year as service-providers continue to point to staffing issues. [Last week](#) we learned employers added workers at a robust clip in November, as the labor market remains hot.

ISM Services Business Activity vs. New Orders



Source: Institute for Supply Management and Wells Fargo Economics

ISM Manuf. and Services Prices Paid
Diffusion Index



Source: Institute for Supply Management and Wells Fargo Economics

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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@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
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Economist	212-214-8984	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
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Seery	Economist	332-204-0693	Shannon.Seery@wellsfargo.com
Nicole Cervi	Economic Analyst	704-410-3059	Nicole.Cervi@wellsfargo.com
Jessica Guo	Economic Analyst	212-214-1063	Jessica.Guo@wellsfargo.com
Karl Vesely	Economic Analyst	704-410-2911	Karl.Vesely@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	704-410-1437	Jeremiah.J.Kohl@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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