Economic Indicator — March 3, 2021

Drop in Orders Leads Key Service Sector Gauge Lower

Summary

The ISM Services Index slipped to its slowest pace of expansion since May 2020. New orders dipped 9.9 points, perhaps due to the fact that long-depleted inventories have at last been re-stocked. On balance a disappointing report, but not without some bright spots.

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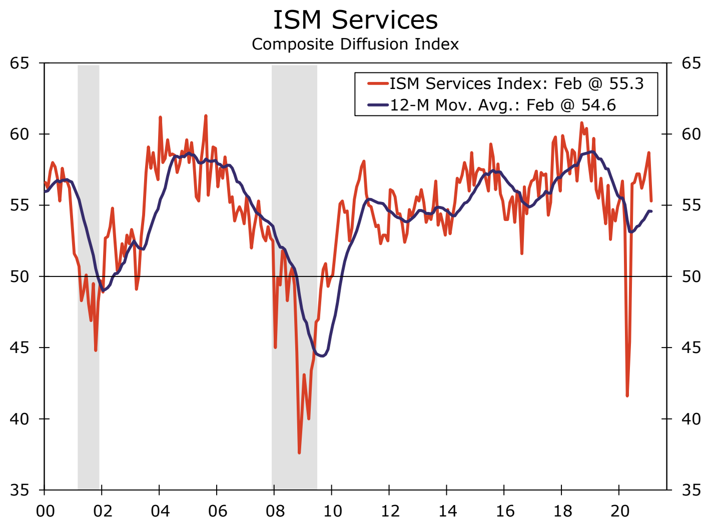
Just When Things Were Going So Well

The slump in service sector activity is jarring after a run of better-than-expected economic indicators in recent weeks. There is no one-off factor here that cushions the blow. The new orders component slumped 9.9 points and at 51.9, remains in expansion territory, but only barely so.

In last week's personal income and spending report, we saw most of the strength was concentrated in durable (+8.4%) and non-durable goods spending (+4.3%), whereas services outlays increased only 0.7%.

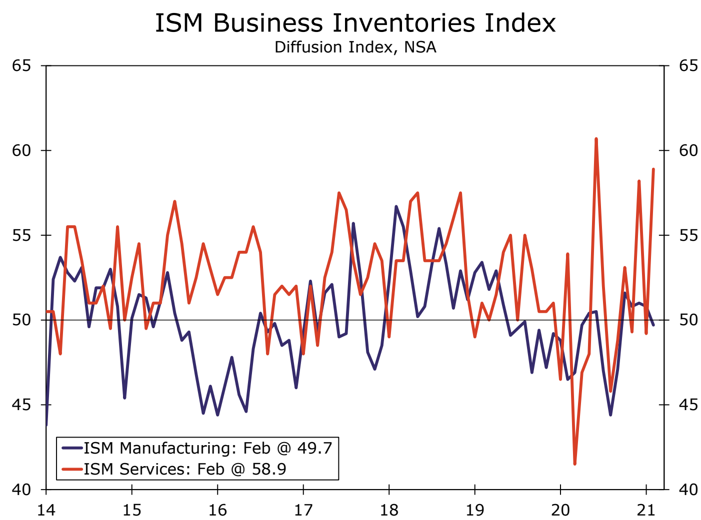
We are convinced that a surge in services spending is coming and given the rapid decline in new COVID cases throughout February, we thought we would see some indication of that improvement in today's report. But, perhaps the only tepid growth in service spending should have tipped us off that February might be too early for signs of major growth in the service sector.



Source: Institute for Supply Management and Wells Fargo Securities

At Last...Some Inventory to Work With

One problem throughout this pandemic has been the ability of businesses to get their hands on what they need. This is as true in manufacturing where factories can't get needed materials, as it is in the service sector where shortages have forced businesses to improvise or to find new suppliers. The inventory change moved from contraction to expansion in February and now sits at its highest level since June. Some selected comments from the report included: “Increasing on-hand inventories to meet new business demands” and “Increasing stock of appliances since they are in short supply to meet our needs.” The higher inventories may explain some of the softening in orders this month.



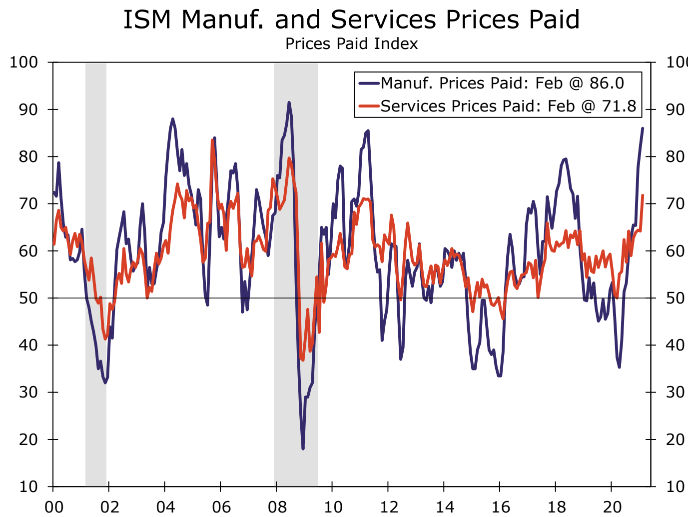
Source: Institute for Supply Management and Wells Fargo Securities

Don't Look Now, But Here Comes Another Sign of Inflation

The services prices paid index shot up 7.6 points to 71.8, the highest since September 2008. We are undeniably at an inflection point in terms of rising prices, but as we often say with extreme reading in these surveys: take it with a grain of salt. A diffusion index captures the *breadth* of change rather than the *magnitude* of it. So, this reading need not imply runaway inflation; what it does say is that prices are rising across the service sector. To that point, 16 out of 17 industries surveyed reported higher prices.

The run-up in services prices is not as widespread as it is on the manufacturing side of the economy.

The employment component slipped to 52.7 from 55.2 in January. While that is still consistent with modest payroll growth, it may cause forecast expectations for this Friday's February jobs report to wilt a bit.



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