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Economics Group

Sarah House, Senior Economist
sarah.house@wellsfargo.com • (704) 410-3282
Tim Quinlan, Senior Economist
tim.quinlan@wellsfargo.com • (704) 410-3283

ISM Non-Manufacturing: Too Bad It's No Longer February

The ISM non-manufacturing index jumped to a one-year high of 57.3 in February, illustrating that economic activity was strong before concerns about COVID-19 intensified. Don't expect a repeat performance in March.

Good For Now

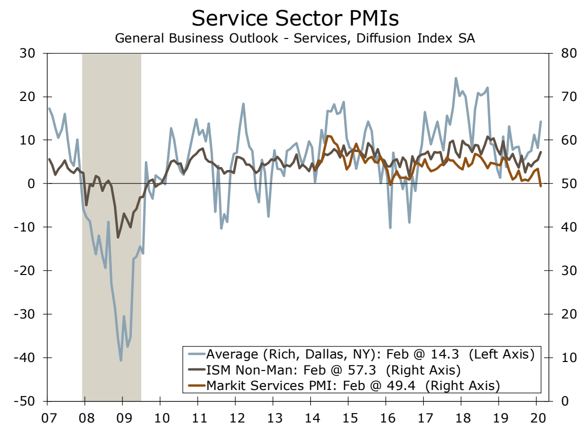
The ISM non-manufacturing index bucked expectations for a modest pullback in February, instead jumping 1.8 points to 57.3. The pickup mirrored the increase in regional service-sector surveys conducted by a number of Federal Reserve Banks, but has now diverged sharply from the Markit Services PMI, which fell to more than a six-year low in February. Some of the gap between the two national measures may be accounted for by the inclusion of the goods-producing industries of construction and mining in the ISM non-manufacturing index, both of which were up in February. But the Markit PMI headline is based on a single question of activity levels, whereas the ISM non-man headline is based on a simple average of four components.

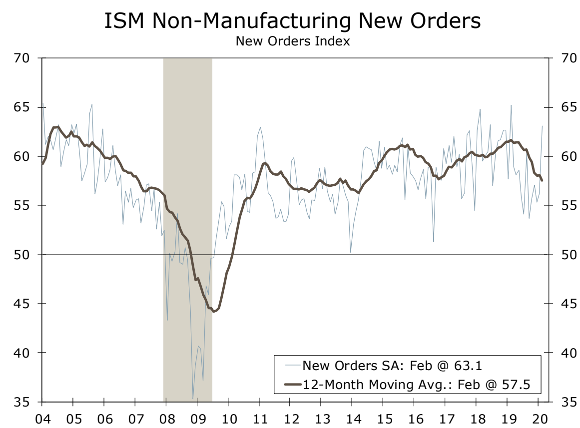
The ISM non-manufacturing corollary to the Markit headline and one component of the composite index, the business activity index, fell more than three points in February, but remained firmly in expansion territory at 57.8. Driving the ISM non-manufacturing index higher over the month was a surge in new orders (up nearly seven points to a 20-month high of 63.1) and a pickup in hiring activity. The forward looking nature of both those components suggests that broad economic activity at least had some momentum heading into March and the recent bout of volatility in financial markets.

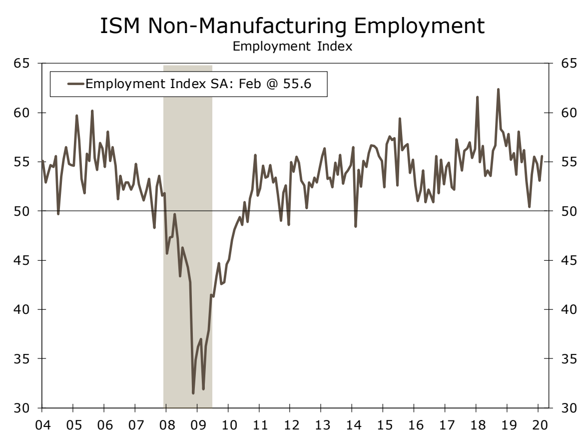
The remaining component of the ISM composite, supplier delivery times, increased modestly (up 0.7 points to 52.4). With the ISM non-manufacturing survey mostly reflecting the service-sector, the index is less exposed to supply chain disruptions than its manufacturing counterpart. Nevertheless, concerns about sourcing due to the coronavirus were still evident in the survey, although skewed toward the goods sector or industries most directly in the crosshairs of the outbreak. Respondents in the construction, mining and healthcare industries all commented on supply issues.

We still expect to see some more discernable effects of the economic costs of trying to contain the coronavirus, however, in the next few months. Shipment delays are already beginning to hit cargo volumes in the transportation sector, and there are growing reports of companies directing employees to curtail travel. Accommodation & food services, retail and arts, entertainment & recreation activity also stand to be hit if consumers decide to forgo some outings.

Some of that weakness could be offset by stronger activity in the healthcare sector if the virus were to become more widespread in the United States, but we believe the net effect would be negative for activity as households would shy away from more discretionary activity. For now though, the spillovers appear quite limited, but we will be watching the ISM non-manufacturing index closely for signs that the economic impact of the virus has extended beyond a supply shock to demand.







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

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Acting 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	Macro Strategist	(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
Erik Nelson	Macro Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

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