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Economics Group

Sarah House, Senior Economist
sarah.house@wellsfargo.com • (704) 410-3282
Shannon Seery, Economic Analyst
shannon.seery@wellsfargo.com • (704) 410-1681

ISM Non-Manufacturing Index Signals Slower Growth

At 53.9, the ISM non-manufacturing index remains in expansion. The details of this report suggest the service sector continues to hold up better than manufacturing, though signs of tariff-related pressure are evident.

Resilient But Not Immune

The ISM non-manufacturing index declined 0.8 points to 53.9 in November (top chart). While the index has been in a trend decline since the start of the year, the deterioration has not been as abrupt as its manufacturing counterpart, and more notably the non-manufacturing index has remained in expansionary territory. While the service sector is not immune to trade-related uncertainty, there is still limited evidence of a more pronounced spillover of weakness from the manufacturing sector. In other words, the service sector should continue to expand.

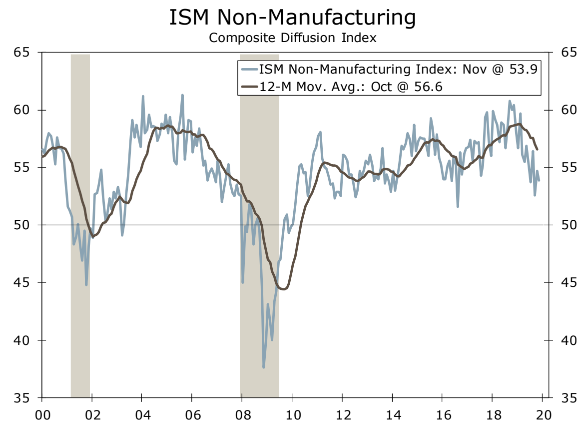
Current conditions faltered in November. The largest retrenchment came in the business activity component, which declined 5.4 points, to 51.6, its lowest level this cycle. Perhaps the best indication that the service side of the economy is holding up, however, is the forward-looking new orders component. New orders rose 1.5 points in November, and the gap between manufacturing and non-manufacturing orders remains fairly wide at 10 points (middle chart).

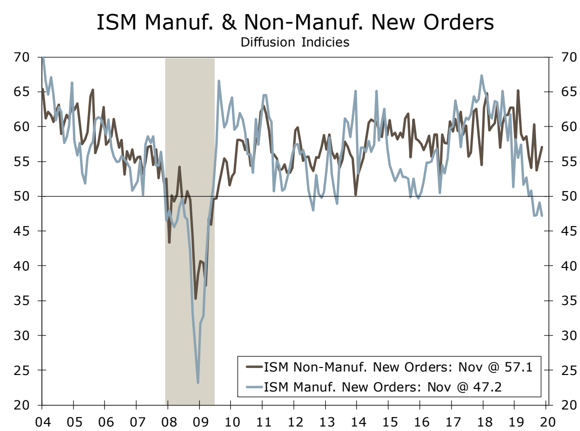
Another welcome development was the 1.8-point gain in the employment component, which pushed the index up to 55.5, the highest level in five months (bottom chart). The employment component is a good indication of near-term payroll growth, with this month's bounce suggesting our estimate for Friday's employment report of 190,000 net new jobs remains reasonable.

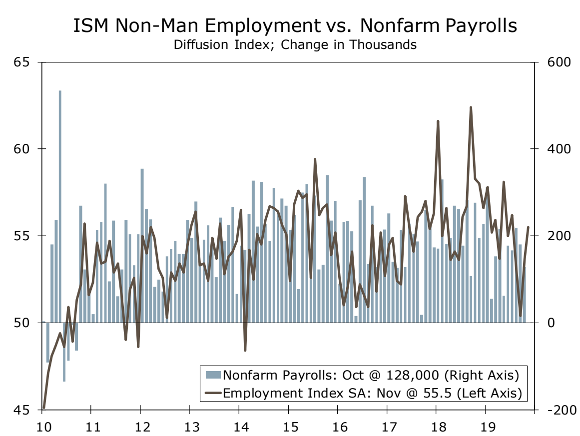
The service sector as a whole remains resilient to the continued trade skirmish, but as we previously mentioned, it is not immune as some effects from trade-related uncertainty have surfaced. Several respondents highlighted cost pressure specifically linked to tariffs. The prices paid component has been inching higher in recent months and rose 1.9 points to 58.5 in November. Imports have also wobbled recently. The import index remained in contraction for the third straight month, as the 3.5-point decline in November pushed the index to 45.0, which rivals only July 2012 (44.5) for the lowest level since the start of 2009.

This report does not materially change anything for the Fed. The FOMC signaled it will be on hold for at least its meeting next Wednesday and we expect that remains the case. The Fed cited that a "material" deterioration in the outlook as a requisite for another cut, and we do not expect the recent moves in the ISM indices justify that at this point.

We expect consumer spending to slow to about a 2% annualized pace over the next few quarters. That still-solid pace of spending coupled with an expected rebound in the housing market should support the service sector. As such, we expect the service sector to continue to expand, but it will likely at a slower pace.







Source: Institute for Supply Management, U.S. Department of Labor 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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