Economic Indicator — October 5, 2022

ISM Services Signals Still-Solid Pace of Activity

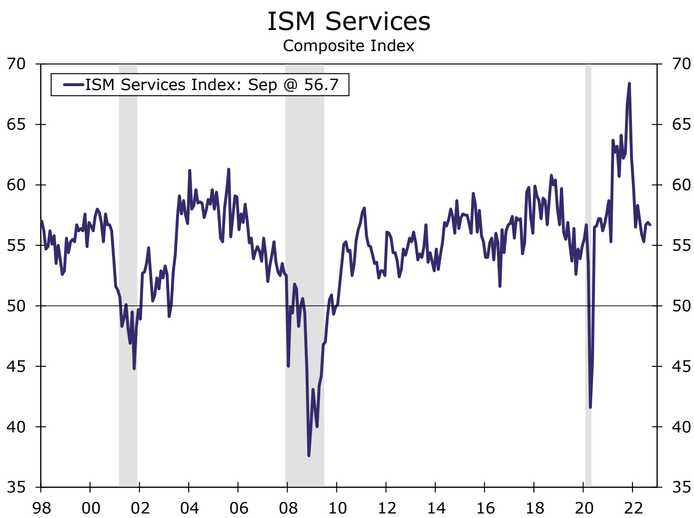
Summary

The ISM Services Index declined modestly in September, but at 56.7 it is still consistent with expansion in the sector. Most of the details indicate just that: continued growth with some modest give back in the pace of activity. Easing supply chains continue to provide some relief, and a rebound in the employment component signals another steady month of hiring.

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



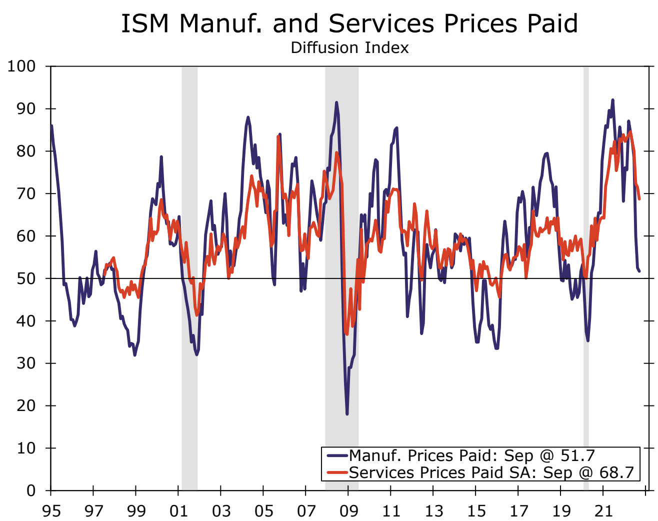
Source: Institute for Supply Management and Wells Fargo Economics

Service Sector Resilience

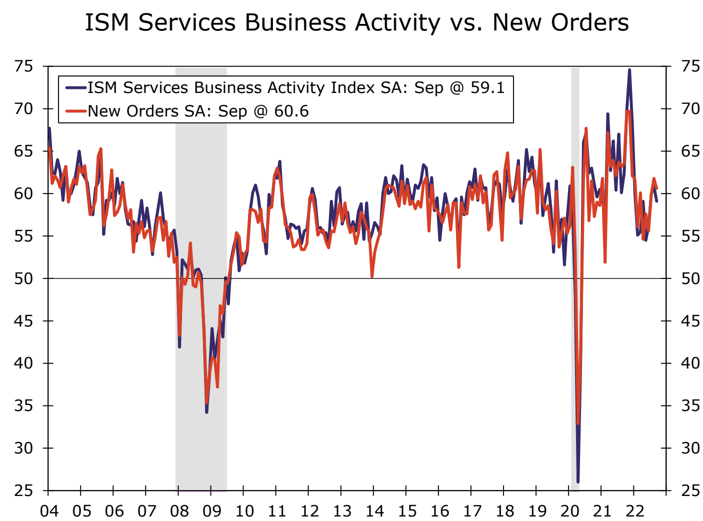
Service sector activity remained solid in September. The headline reading on the ISM Services Index declined, signaling a slower pace of activity last month, but at 56.7 it was higher than the consensus expectation and still signals expansion (chart). Most major components of the index declined last month, with the employment index being one of the lone bright spots. The employment component rose 2.8 points to 53.0, marking the highest reading in six months. Squaring this with the pullback in the manufacturing employment counterpart indicates another solid but slightly slower gain in hiring last month compared to August.

Labor shortages remain prevalent throughout the sector and selected industry comments from the health care & social assistance and professional services industries specifically mentioned labor as a challenge that is limiting activity. The current state of the labor market is perhaps best summarized by a respondent who said, "Cannot find qualified applicants—they require greater incentives because they have choices." Still-elevated job openings and solid wage gains are luring workers away and contributing to hiring and retention challenges.

Continued upward pressure on wages is perhaps partly behind the more modest decline in the prices paid component for services industries compared to manufacturing. The prices paid component slid 2.8 points to 68.7, whereas the counterpart in the manufacturing ISM currently sits at 51.7 (chart). Labor represents a larger share of expenses in service-providing industries, and thus may be keeping upward pressure on costs to a greater extent than in manufacturing. Still, the 68.7 reading marks the lowest in over a year and demonstrates some price reprieve for the sector from easing supply chains. The decline in supplier delivery times and order backlog more explicitly demonstrate that supply has begun to move more smoothly throughout the economy.



Source: Institute for Supply Management and Wells Fargo Economics



Source: Institute for Supply Management and Wells Fargo Economics

Business activity and new orders both declined but the two components remain at levels consistent with a strong pace of activity. The 1.8 point decline in the business activity index to 59.1 is in part expected and consistent with a pull back in activity after a surge in services consumption this summer. Two of the three industries who reported a *decrease* in growth last month specifically cited seasonal factors weighing on slow September activity, but outlooks remain favorable. A respondent from the entertainment & recreation industry said "September is one of our slowest months of the year. We are gearing up to have a very busy fourth quarter and are seeing some signs of relief in our supply chain." While new orders declined to 60.6, both of these indicators came off their highest readings for the year in August and are still running ahead of their prior six-month averages through September (chart).

In the ISM manufacturing write up earlier this week, we discussed how inventory management is in part dictating activity in the sector. This is also true for services, but to a slightly less extent. It's labor, rather than physical inputs, that is the biggest constraint on capacity.

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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
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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