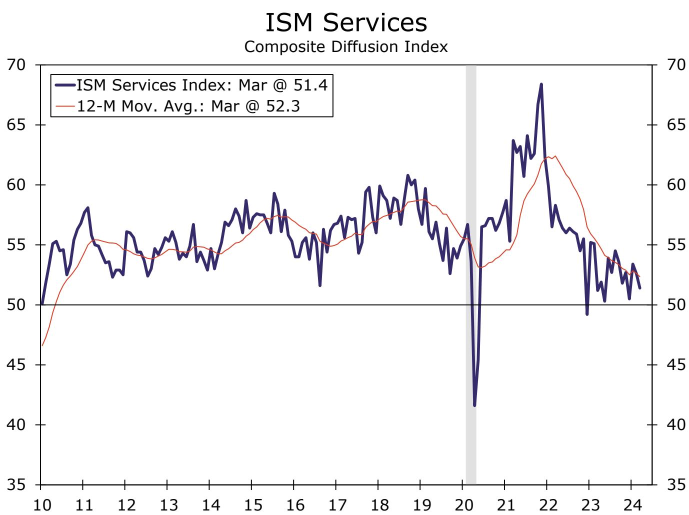
Economic Indicator — April 3, 2024

Is a Struggling Service Sector a Sign of Progress?

Summary

A cooling in service-sector activity was on display in the March ISM Services report. The prices paid index dropped to a four-year low and the employment index stood in contraction territory for the third time in four months.



Source: Institute for Supply Management and Wells Fargo Economics

Economist(s)

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

Shannon Seery Grein
Economist | Wells Fargo Economics
shannon.grein@wellsfargo.com | 704-410-0369

Some Improvement on Prices

The ISM services index came in at 51.4 in March, signaling a more modest pace of expansion in the service sector (chart). The narrative of a booming service sector amid struggles for manufacturing is giving way to a more balanced state of activity. Monday's manufacturing ISM surprised on the upside; today's services ISM surprised on the downside. The upshot is the narrowest gap between services and manufacturing since 2022.

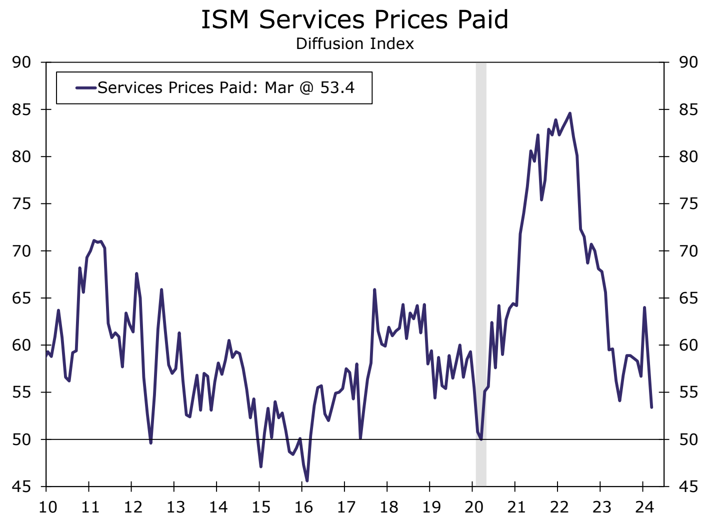
The eye-catching development in the details is how the prices paid component dropped more than five points to 53.4 (chart). A challenge for the Federal Reserve has been the way robust spending on services has slowed progress in bringing down services inflation. On that basis, the drop in the prices paid component is encouraging, at least at face value. The prices paid index dropped to its lowest reading since March 2020; however, the fact that 13 industries are still reporting an increase in prices suggests that even with some stabilization in the rate of price growth, inflation is still a concern.

The biggest overall move among sub-components was a 5.5 point drop in order backlogs to a seven-month low of 44.8. That was an even larger drop than the regular new orders index which fell 1.7 points to come in at 54.4 in March.

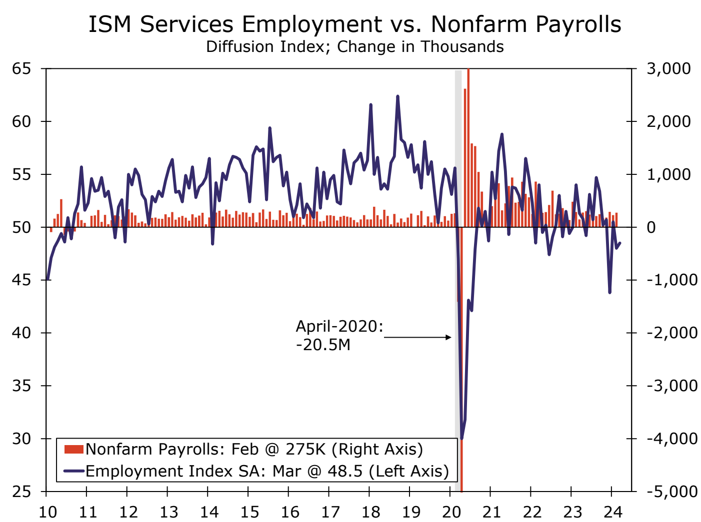
One of the lone increases in this report came from the employment component, which rose a half a point to 48.5 (chart). That suggests the breadth of service sector hiring improved last month, but below 50 it's still consistent with layoffs in the sector. We get the full March employment report on Friday, and we expect employers continued to add jobs at a decent clip last month despite the ISM services employment component signaling contraction. The labor market is moderating and hiring has become less widespread in recent months, which the ISM is capturing. But we still expect employers are adding jobs on net.

While demand for labor has subsided, job openings remain elevated and layoffs remain in check according to high-frequency data on jobless claims. Seven service industries reported no change in employment in March, and we suspect that certain industries continue to face challenges finding qualified/skilled labor while others face issues with attrition, both of which were mentioned in the accompanying ISM release.

Getting inflation in check remains the top priority for the Fed, but as inflation has moderated, the balance of risks has shifted. With the momentum in the service sector clearly slowing, policymakers now seek to slow service-sector activity just enough to quell price pressure without creating a wave of layoffs in the sector. Today's report points to progress on that front.



Source: Institute for Supply Management and Wells Fargo Economics



Source: Institute for Supply Management, U.S. Department of Labor and Wells Fargo Economics

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

Via The Bloomberg Professional Services at WFRE

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	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior 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 Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey George	Economic Analyst	704-410-2911	Aubrey.B.George@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

Required Disclosures