

Economic Indicator — May 5, 2021

Short-Handed on Labor and Materials, Service Sector Grows as Fast as It Can

Summary

Service-sector activity is slowing but not for the lack of demand. Business could be booming if service providers could just get the materials and help they need. The biggest downside risk to Friday's jobs report is the difficulty employers are having finding workers; as such we have pared down our forecast to +1.1 million from +1.2 million previously.

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Activity Held Back by Supply Shortages

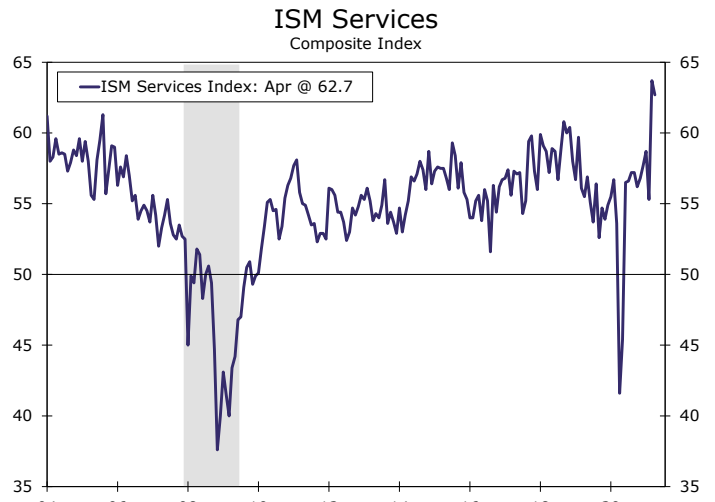
The fact that the ISM services index slipped a point to 62.7 in April from 63.7 in the prior month would ordinarily be an indication that the service sector is moderating. That is, however, not a clean read of things. To the extent that activity is slowing (the activity sub-component dropped 6.7 points in April), it is not for want of demand for services but rather the fact that service companies are short-handed on supplies and the help they need to operate. Our take is that the demand factors that drive service-sector activity are actually heating up.

The supply chain problems we have written about in recent weeks is wreaking havoc on the components that factor into the ISM's headline measure. For the services ISM, these are the components that feed into the headline: activity, new orders, supplier deliveries and employment.

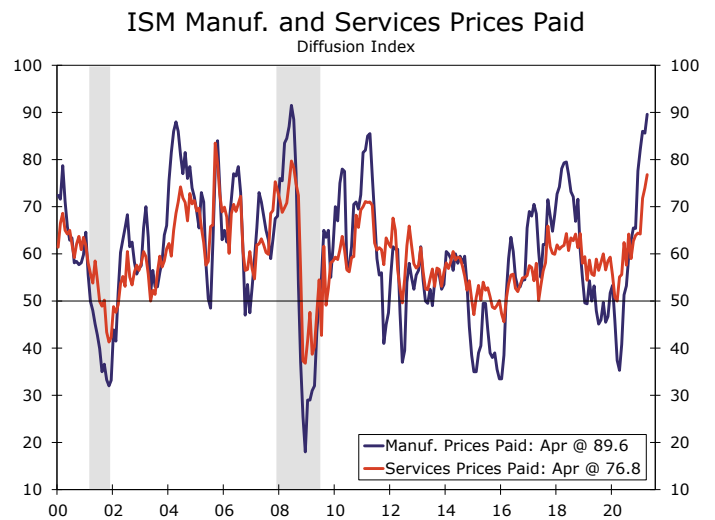
New orders slipped 4.0 points to 63.2, a number that is still quite high, but admittedly a slip from last month; but factor in order backlogs. The backlog of orders jumped 5.5 points, that's more than new orders fell, but because backlogs do not factor into the headline, there is no boost.

Supplier deliveries shot up 5.1 points to 66.1. That is the highest since the peak of the lockdowns last May, and the fourth highest reading on record. This measure rises when more firms have to wait for needed supplies. In other words, supply-side issues only got worse last month for the service sector.

As we have stressed previously, it is not just the manufacturing sector experiencing supply constraints and upward pressure on costs. Input costs in the service sector continue to rise at a rapid clip. The prices paid index jumped to 76.8 last month. The recently re-branded ISM "Services" report also includes non-service industries like construction, mining and agriculture, which are feeling the ongoing rise in prices for commodities like lumber, steel and copper, but all 18 industries reported rising costs this month, as input prices from computers to gasoline to labor were up.



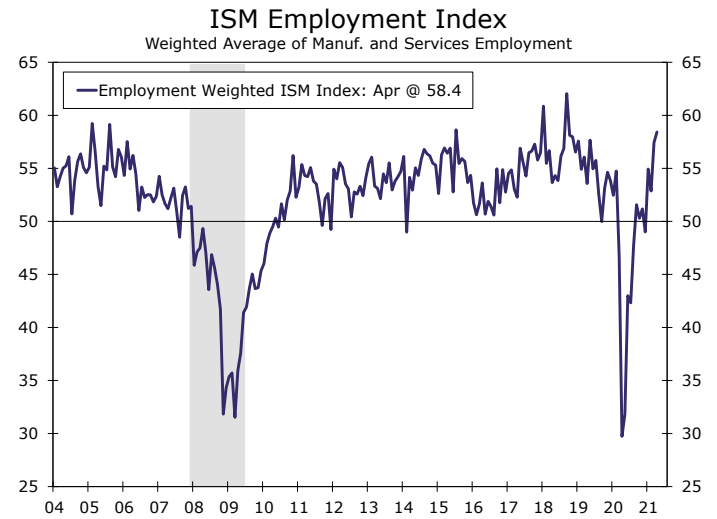
Source: Institute for Supply Management and Wells Fargo Securities



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Hiring Could Be Even Stronger

With spending soaring, employers continue to staff up to meet surging demand. The employment index rose to 58.8 in April. However, that gain was a little more tepid than our expectations, and along with the ISM manufacturing employment series falling back 4.5 points to 55.1, we have downwardly revised our call for nonfarm payrolls on Friday to a gain of 1.1 million from an initial estimate of 1.2 million. *The biggest downside risk to that call is the difficulty employers are having finding workers.* A record 42% of independent businesses in March reported having at least one position hard to fill, with comments from today's ISM Services report indicating staffing challenges carried on into April. As one respondent put it, "Consistent with the past year, labor continues to be the biggest issue we are facing. Finding and retaining labor—skilled and unskilled—is highly challenging and frustrating. As the challenges continue, we are not accepting all the work that we could if we had the labor."



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