

US ISM Services Beats; A Closer Look At Inventory Sentiment

US ISM non-manufacturing, February:

Actual: 59.7

Scotia: 57.0

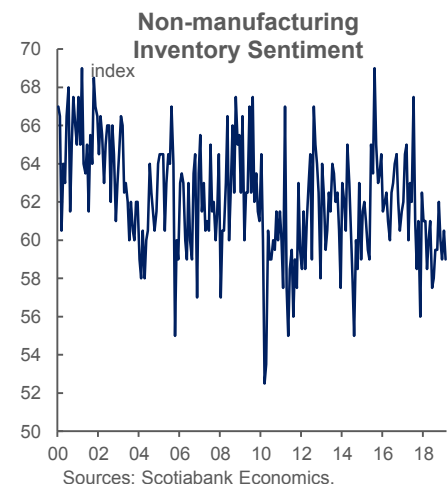
Consensus: 57.4

Prior: 56.7

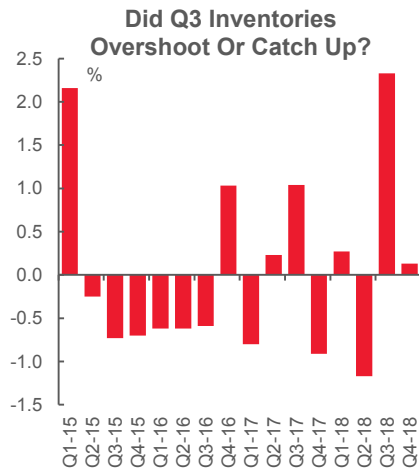
- The bulk of the US economy recorded an accelerated pace of growth during the month of February. The strong beat on ISM-services is supported by strong underlying details ([here](#)).
- ISM's new orders sub-index jumped to 65.2 which is the strongest reading since way back in August 2005 (see chart). The rise was driven by both the domestic and foreign order books. New export orders rose to 55, up 4.5 points.
- The employment sub-gauge eased a bit to 55.2 (57.8 prior) but is still solid.
- Relatively little incremental activity is perceived to have gone to inventory in February. The inventory change sub-index was only 51 from 49.0 prior which indicates slight growth in balances.
- Nevertheless, overall inventories are perceived to be too high but be careful here. The separate inventory sentiment sub-gauge slipped but is still high at 59.0 (60.5 prior). As the accompanying chart shows, purchasing managers think inventories are too high at most points in the cycle as readings in the low 50s are rare and they never say inventories are too low! The present reading is toward the low end of the historical range. ISM's underlying details show that 24% of respondents said their inventories were too high, 6% said they were too low, and 70% said they were about right. One-in-four purchasing managers saying that their inventories are too high doesn't sound particularly alarming to me and so there isn't much breadth being signalled here.
- **Further to the inventories point, there is some concern that the Q3 surge last year positions an overshoot on inventories that must correct lower. I'm less concerned and not only for the sentiment points referenced above.** As argued in the Global Week Ahead ([here](#)), inventories have been a drag on growth more often than not for years. Further, inventories were a large drag on GDP growth in Q2 after minimal contribution in Q1. It may well be that the 2.3 percentage point contribution to GDP growth from inventories in Q3 before a negligible inventory effect on growth in Q4 was a restocking effect. As GDP growth came on stronger than most anticipated, it depleted inventories over H1 and **requiring restocking into the second half of the year**. Please see chart on the following page for the inventory contribution to GDP growth by quarter over recent years.
- Last, note that prices paid eased by five points to 54.4. That's a ten point drop from the recent high in November and takes it back to where it was in mid-2017. I still don't think it's a great indicator and likely reflects already known market prices like oil/gasoline for instance and by contrast to sentiment toward broader based prices. Please see chart on the following page.

CONTACTS

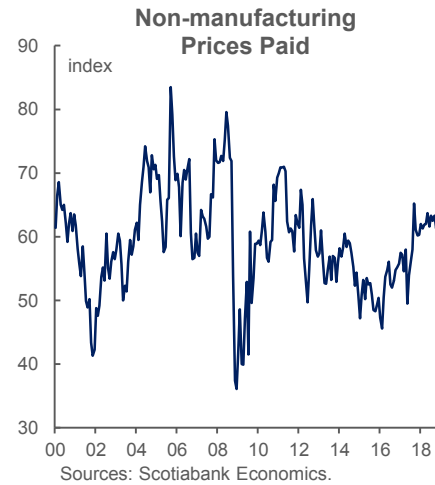
Derek Holt, VP & Head of Capital Markets Economics
416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com



- Separately, US new home sales were somewhat weaker than expected including revision effects for a modest disappointment. The December release was delayed due to the government shutdown. December's sales gain of 16.9% m/m was revised down to 9.1% m/m and that explained all of the beat to December's expectations. December's sales climbed 3.7% m/m (-8.7% consensus). Overall, the level of home sales disappointed expectations by 37,000 units over the two combined months.



Sources: Scotiabank Economics, BEA.



This report has been prepared by Scotiabank Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

These reports are provided to you for informational purposes only. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap or any other transaction. The information contained in this report is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap within the meaning of U.S. Commodity Futures Trading Commission Regulation 23.434 and Appendix A thereto. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a “call to action” or suggestion that you enter into a swap or trading strategy involving a swap or any other transaction. Scotiabank may engage in transactions in a manner inconsistent with the views discussed this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

Scotiabank, its affiliates and any of their respective officers, directors and employees may from time to time take positions in currencies, act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to securities or related derivatives. As a result of these actions, Scotiabank may receive remuneration. All Scotiabank products and services are subject to the terms of applicable agreements and local regulations. Officers, directors and employees of Scotiabank and its affiliates may serve as directors of corporations.

Any securities discussed in this report may not be suitable for all investors. Scotiabank recommends that investors independently evaluate any issuer and security discussed in this report, and consult with any advisors they deem necessary prior to making any investment.

This report and all information, opinions and conclusions contained in it are protected by copyright. This information may not be reproduced without the prior express written consent of Scotiabank.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotiabank, together with “Global Banking and Markets”, is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including, Scotiabanc Inc.; Citadel Hill Advisors L.L.C.; The Bank of Nova Scotia Trust Company of New York; Scotiabank Europe plc; Scotiabank (Ireland) Limited; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Scotia Inverlat Casa de Bolsa S.A. de C.V., Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank group and authorized users of the Scotiabank mark. The Bank of Nova Scotia is incorporated in Canada with limited liability and is authorised and regulated by the Office of the Superintendent of Financial Institutions Canada. The Bank of Nova Scotia is authorised by the UK Prudential Regulation Authority and is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia’s regulation by the UK Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorised by the UK Prudential Regulation Authority and regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority.

Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., and Scotia Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Not all products and services are offered in all jurisdictions. Services described are available in jurisdictions where permitted by law.