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.

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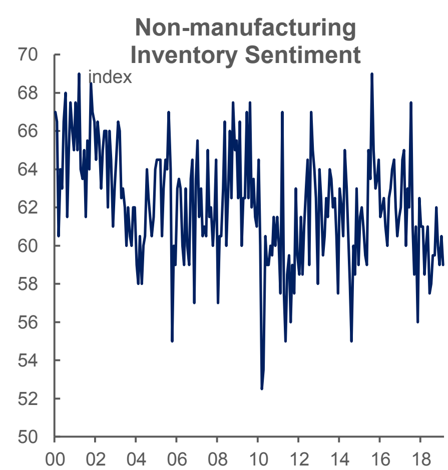
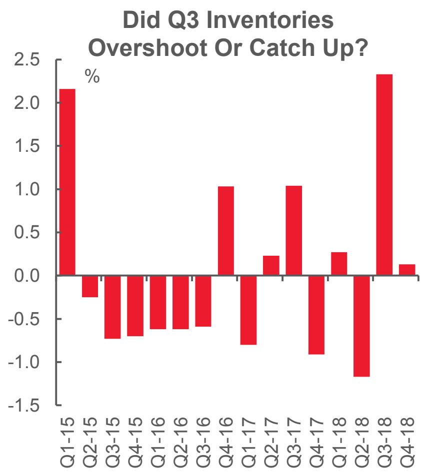
Sources: Scotiabank Economics.



Sources: Scotiabank Economics.

- 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.

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