

## Two Reasons To Doubt The Improvement In US ISM-Services

- ISM-services beat expectations...
- ...with solid underlying details
- Does a synchronous improvement in global PMIs...
- ...reflect an improving global economy...
- ...or order front-running as Brexit, tariffs were pushed out well into the month
- ISM's and Markit's PMI gauges remain at odds

### ISM non-manufacturing, % balance/diffusion index, October:

Actual: 54.7

Scotia: 53.0

Consensus: 54.7

Prior: 52.6

Chalk up another PMI that improved as there is a global upswing in play across the US, China and UK of late. **US ISM-services posted a headline improvement that was buttressed by underlying details.**

Before turning to the details, **there may be two major concerns regarding data quality.**

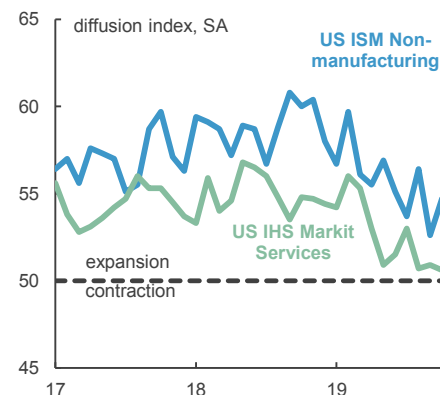
**One is that it is not clear whether global PMIs are improving because of genuine improvement in the global economy, or because of order front-running ahead of uncertainties such as the state of US-China trade negotiations and Brexit.** The Brexit deadline was only pushed out to January 31<sup>st</sup> on October 19<sup>th</sup> after which a UK general election was called for December 12<sup>th</sup>. The threatened US tariff hike against US\$250 billion of imports from China that was due to be imposed on October 15<sup>th</sup> was only suspended on October 11<sup>th</sup>. If purchasing managers were uneasy toward the state of the environment coming into the month and the potentially higher tariffs, then it may well have been rational to front-run orders and get items in transit ahead of potentially further major disruptions to world trade. A test of this may come if renewed dips are experienced across global PMI readings in subsequent rounds.

**Second is the mixed picture being offered by different sources for US purchasing manager's indices.** As shown in charts 1 and 2, the manufacturing and service PMIs produced by ISM and Markit are materially at odds with one another. Markit's gauge for services is weaker and did not improve, while Markit's gauge for manufacturing did not fall as far as ISM's. Which one do we believe? Markit, perhaps not unexpectedly, says their gauges are best. They have a case. The Markit people show evidence (e.g. [here](#)) that their gauges are better correlated with actual output measures in part because they use unequal weights across the components whereas ISM just takes an arithmetic average of the underlying components. Markit's gauges also employs double the sample size, require an 80% response rate (ISM doesn't say what theirs is), are less skewed toward the largest companies, and only ask respondents to report on their US operations whereas ISM doesn't have this requirement and can be skewed by factors influencing operations abroad.

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### ISM Non-Manufacturing vs Markit Services PMIs



Sources: Scotiabank Economics, ISM, IHS Markit.

### ISM Manufacturing vs Markit Manufacturing PMIs



Sources: Scotiabank Economics, ISM, IHS Markit.

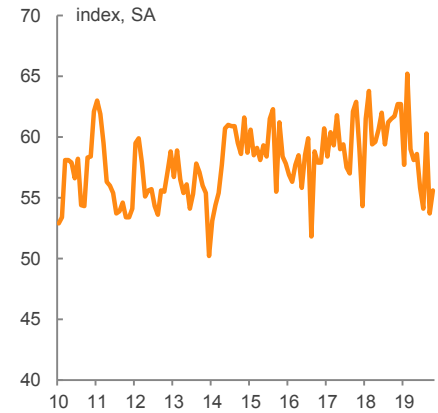
Overall, I think it's prudent to treat the improvements across global and (some) US PMIs with a grain of salt.

Nevertheless, for now, **the underlying details behind ISM-services were fairly robust**. We already largely knew that the employment subcomponent would pick up based upon nonfarm payrolls, and it rose by 3.3 points to 53.7.

But the order book accelerated by almost two points to 55.6 so it's growing faster. That was all through domestic orders as the export book softened. One month's improvement is welcome, but chart 3 shows that much further evidence is required before ringing the all clear.

Inventories cooled which is welcome relief. The order backlog also fell and so it's possible this drove a transitory pick-up in production.

#### US ISM Non Manufacturing New Orders Index



Sources: Scotiabank Economics, ISM.

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