

## US ISM-Services Improves — But The Details Were Weak

- ISM non-manufacturing beat expectations...
- ...entirely on current activity readings...
- ...that mask a deterioration in forward looking components
- ISM-employment supports a decent nonfarm call...
- ...but with the usual wide margin of error

### ISM non-manufacturing, balance/diffusion index, December:

Actual: 55.0

Scotia: 54.0

Consensus: 54.5

Prior: 53.9

The ISM non-manufacturing report's improvement masked several points of weakness that had markets fading the outcome. **The reason the headline improved had everything to do with current activity measures whereas forward looking gauges point to future weakness.**

Recall that the headline ISM reading applies equal weights to business activity, new orders, employment and supplier deliveries to come up with an arithmetic average that does not differentiate between the sources of improvement across these select few readings. Many other components are excluded as input to the headline ISM reading.

Therefore it was the pick-up in business activity (57.2, 51.6 prior) and supplier deliveries (52.5, 51.5 prior) that drove the headline gain. The employment gauge was flat (55.2, 55.5 prior) and everything else was weak. Note that the rise in the business activity subindex only reverses the prior month's decline and restores conditions to where they were in October.

The entire forward-looking set of production indicators deteriorated. New orders decelerated to 54.9 (57.1 prior). The order backlog contracted at a quicker pace (47.5, 48.5 prior). The 2.2 point deceleration in new orders was probably driven by softer domestic orders with an assist from softer export orders (51.0 from 52.0 prior). Total orders are seasonally adjusted, but export orders are not so we can't tell precisely.

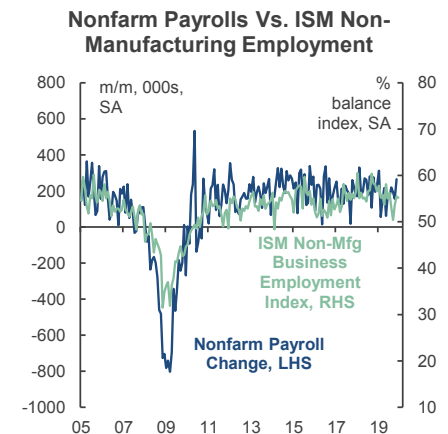
The stable employment component at 55.2 supports a decent nonfarm rise on Friday, but it throws lots of false signals with huge margins of error (chart 1).

Prices paid were unchanged and still rising at a relatively rapid clip (58.5) and that's usually just a reflection of commodity price swings and in this case particularly rising oil prices since October.

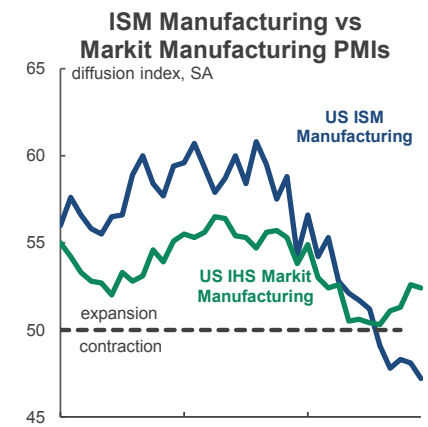
Charts 2 and 3 compare ISM and Markit gauges for the manufacturing and non-manufacturing sectors. They are headed in opposite directions for manufacturing, but ISM-manufacturing is highly correlated with manufacturing output. There is less of a disconnect in the trends between the services gauges that have registered mild improvements at least in terms of headline readings.

### CONTACTS

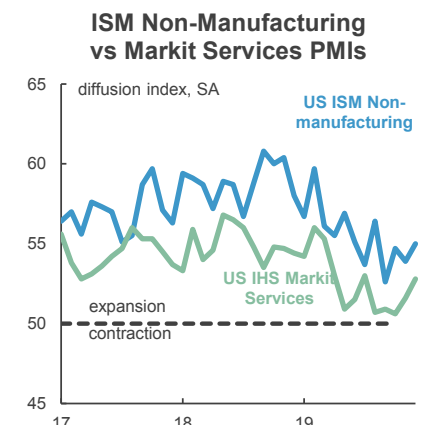
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Sources: Scotiabank Economics, ISM, BLS.



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