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TD Economics

Data Release: Service sector activity stabilizes in February

- The Institute for Supply Management's (ISM) non-manufacturing index was nearly unchanged in February, edging down by 0.1 points to 53.4. The headline print was better than expected, with the consensus forecast calling for a decline to 53.1.

- The underlying details were mixed, with only half of the index's ten subcomponents improving on the month. Following a sharp pullback in the prior month, business activity (+3.9 pts to 57.8) rebounded strongly in February. The level of inventories (+1.0 pts to 52.5) and the sentiment towards the current level of inventories (+0.5 pts to 62.0) also rose slightly for the surveyed businesses.

- International trade indicators strengthened substantially, emerging from contractionary territory. Export orders gained 8 points to 53.5, while imports rose by an even larger 9.5 points to 55.5.

- News were less encouraging elsewhere. The employment subcomponent declined by 2.4 points to 49.7, slipping into contractionary territory for the first time in two years. New orders have edged lower (-1.0 pts to 55.5) while backlog of orders remained unchanged on the month. Prices paid subcomponent declined by 0.9 pts and remained in contractionary territory.

- Of the 18 non-manufacturing industries surveyed, 14 reported growth – up slightly from 10 in the month prior, but unchanged from a year ago. Output contracted in Mining; Arts, Entertainment & Recreation; and Retail Trade.

Key Implications

- Today's report is moderately encouraging, marking the smallest decline in the headline index in four months. It suggests that headwinds to service sector activity may be beginning to ease.

- One of these easing headwinds pertains to weak international demand, with may be on the mend given the large increases in export and import subcomponents – both of which are now above their year-ago levels.

- A decline in the forward looking new orders subcomponent is disappointing, but activity continues to grow at a good clip. More worrying is the employment sub-index which suggests that some weakness in employment may be materializing. The pace of private service sector hiring has been decelerating since last October and does not bode well for tomorrow's employment report. Still, some slowdown in hiring is to be expected given the anecdotal shortages of workers found in the most recent Beige Book as well as overarching demographic factors.

- Pockets of weakness undoubtedly remain, particularly in the mining and supporting services industries, but the bulk of the service sector industries continues to fare well helped along by strength in domestic demand and low input costs. Alongside the recent slew of better-than-expected indicators, including the ISM's manufacturing cousin, this morning's report helps cement our view that U.S. economy is finding its rhythm after the lackluster performance at the end of 2015.

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