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# TD Economics

**Data Release: U.S. services sector activity surprises on the upside, improves in February**

- The Institute for Supply Management's (ISM) non-manufacturing index topped market expectations which called for a flat reading and rose 1.1 points to 57.6 in February – the highest level since October 2015.

- The vast majority of sub-indicators recorded an improvement on the month. Business activity rose 3.3 points to 63.6 – the highest level since 2011. New orders improved 2.6 points to 61.2, along with new export orders which rose 9 points to 57 – reversing the losses in the prior two months.

- The employment index also staged a decent showing, rising 0.5 points to 55.2. Meanwhile, the prices paid index retreated 1.3 points to 57.7 but remained near a two-year high.

- Inventories, backlog of orders and inventory sentiment all improved on the month, while the supplier deliveries index ticked down – pointing to fewer delivery hurdles ahead.

- Comments from survey respondents, while still exhibiting some uncertainty, were largely positive. All but two of the 18 non-manufacturing industries reported growth in February, with real estate & leasing and information the only exceptions.

**Key Implications**

- This is a very healthy report. The nonmanufacturing index surprised on the upside and is now at the highest level since late-2015, with the headline print accompanied by comments which continue to point to a positive outlook on business conditions, hiring, and the economy overall. Along with its manufacturing cousin which rose for the sixth straight month in February, both ISM surveys continue to paint a solid picture for U.S. economic momentum.

- The details of the report provide additional comfort. Particularly encouraging is the business activity sub-index which is at the top of the range exhibited in the post-recession period. This was followed by improvements in inventories and orders. In addition, the employment sub-index also remained above the post-recession average. The latter is reflective of continued improvement in the labor market while the uptick, alongside very healthy initial claims reports, bodes well the next Friday's employment report. Lastly, the prices paid sub-index which remains near a two-year high, corroborates the notion of rising inflationary pressures across nonmanufacturing sectors.

- Taken together with recent data releases, the report points to improving economic growth and rising inflationary pressures in the U.S. economy, and barring any downside surprises in the near-future, is likely to motivate to Fed to raise rates at its next policy decision meeting in mid-March. Fed officials have made this notion quite clear in recent speeches, with hawkish rhetoric as of late from even the more dovish members of the Committee. The Chair and Vice Chair are slated to speak later this afternoon, and we expect them to corroborate the view that March is very much live, and arguably, likely. At this point, the relevant question is less so "when the next hike will take place" but rather how many the Fed will manage to implement this year, with markets paying close attention to the speeches for any clues.

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