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TD Economics

Data Release: Nonmanufacturing sector momentum retreats in May as employment and prices send mixed signals

- The Institute for Supply Management's (ISM) non-manufacturing index weakened in May, falling 0.6 points to 56.9. The headline print came in slightly below market consensus which called for a more modest pullback to 57.1. Nonetheless, the index remains well in expansionary territory.

- Survey details were a mixed bag, with half of the sub-indicators deteriorating on the month and the other half improving. Business activity (-1.7 to 60.7), new orders (-5.5 to 57.7), imports (-4.5 to 48.5) and new export orders (-11 to 54.5) all weakened on the month. But perhaps the most striking pullback was that of the prices paid sub-index (-8.4 to 49.2) which fell into contractionary territory for the first time in 14 months.

- Not all was bad news however. In an encouraging twist the employment sub-index improved by a massive 6.4 points to 57.8, after having flirted with the 51-point threshold in the prior two months. Backlog of orders, inventories and inventory sentiment also improved on the month.

- Despite the pullback, comments on business conditions and the overall economy remained positive. Moreover, all but one of the 18 non-manufacturing industries reported growth in May, with educational services being the only exception.

Key Implications

- While its manufacturing cousin recorded a small uptick in May, the ISM nonmanufacturing index disappointed by falling slightly below market consensus. The performance among the ten sub-indicators was evenly split, but the declines were certainly more pronounced. Yet, despite the pullback the index is still well in expansionary territory, while industry comments remain largely sanguine and almost all industries still reported growth in May.

- The most troublesome aspect of the report is the prices paid sub-index which saw a sharp turn downward and moved into contractionary territory for the first time in fourteen months. A similar pullback was recorded in last week's manufacturing survey prices sub-index. Although the latter remains well above the 50-point threshold, both are lower from year-ago levels and point to receded inflationary pressures. On the other hand, the significant improvement in the employment sub-index is a very welcome development which helps ease some of concerns related last week's below-consensus payrolls report.

- Overall, we believe that today's report is unlikely to prevent the Fed from going ahead with its interest rate hike at next week's meeting, with market consensus still pricing in a June move. That said, alongside a few other soft reports of late, it diminishes the probability of additional rate hikes during the rest of the year.

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