TD Economics

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Data Release: U.S. services sector ends the year on a lower note, but the tune remains upbeat

- The Institute of Supply Management (ISM) non-manufacturing index fell by 3.1 points in December, landing at 56.2. The headline number came in substantially weaker than expected, with median consensus forecast calling for the index to retreat to 58.0 in November.

- The slowdown was broad-based, with all index subcomponents softening on the month. The decline was led by the business activity subcomponent, which retreated by 7.2 points. Prices paid subcomponent lost a sizeable 4.9 points, falling into contractionary territory for the first time since September 2009. The rest of the major subcomponents – new orders and employment – remained firmly in the expansionary territory, despite edging lower by 2.5 and 0.7 points, respectively.

- Of the 17 non-manufacturing industries surveyed, 12 reported growth in December. The four service industries reporting contraction were Arts & Entertainment, Educational Services, Other Services, and Transportation & Warehousing. Mining activity also declined, with the weakness potentially related to the sharp fall in energy prices in recent months.

Key Implications

- This report offers little to be pleased about, with the ISM non-manufacturing index following its manufacturing counterpart and softening at year end. Nonetheless, today's disappointing print represents only a small setback as activity decelerated from exceptionally high levels seen earlier in the year.

- Looking beyond monthly volatility, service sector performance remains solid, with the headline index sitting firmly in the 50+ territory indicating expansion, which should provide a nice handoff for 2015. This notion is further corroborated by responses of survey participants, which remained upbeat about the final quarter of 2014 and in their expectations for 2015.

- Moreover, not all declines in today's report were bad news. In particular, services sector firms continued to benefit from falling commodity prices, with prices paid subcomponent down 11.9 points since its peak in May. In addition to lowering input costs for producers, falling energy prices also leave consumers with more disposable income to spend on other things - both of which bode well for the services sector.

- All in all, while both manufacturing and non-manufacturing indexes now sit below their respective cyclical highs, the underlying momentum remains robust and U.S. economy is on track to post a near-3% growth in the final quarter of 2014.

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