TD Economics

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Data Release: U.S. service sector kicks off the year on a solid footing

- The Institute for Supply Management (ISM) non-manufacturing index crept up by 0.2 points to 56.7 in January from an upwardly revised reading of 56.5 in December. The headline number came in slightly above expectations, with median consensus forecast calling for a 56.4 reading.

- Despite the modest uptick in the headline number, details of the report were somewhat mixed. On the upside, business activity rebounded strongly, gaining 2.9 points and rising to 61.5. New orders sub-component also moved higher, edging up by 0.3 points.

- However, other sub-subcomponents looked less encouraging. The employment sub-component, in particular, lost a sizeable 4.1 points, falling to 51.6 – its lowest level since April 2014. Backlog of orders (-0.5), exports (-1.0) and imports (-3.5) sub-components also backtracked during the month. Last but not least, low oil prices continued to weigh on prices paid sub-subcomponent, which fell further into contractionary territory, declining by 4.3 points. Similarly, low oil prices also continued to weigh on the mining sector, with the industry reporting another contraction in activity during January.

Key Implications

- While the U.S. manufacturing sector has been showing some signs of deceleration, the U.S. service sector activity has so far remained upbeat. A pickup in business activity and new orders registered in January is particularly encouraging and points to an increasing level of confidence among service sector firms.

- However, a slide in employment sub-component, which comes on top of a below-expectations print in today's ADP jobs report, is disappointing. U.S. service sector remains a key driver of job creation in the U.S., accounting for 84% of all new private sector jobs last year. While it is not a perfect predictor, the employment subcomponent of the ISM non-manufacturing index is highly correlated with monthly changes in payrolls, making it an important gauge of labor market performance. Today's results suggest that the upcoming payrolls report, slated to be released this Friday, may not be another blockbuster. Still, given the robust momentum of the U.S. economy, we expect hiring to remain healthy, with headline number coming in close to the market consensus for a 230k gain.

- Some of the weakness in the employment subcomponent this month could be chalked up to the slowdown in the mining sector, where both hiring and investment activity has been hindered by low oil prices. Nonetheless, low energy prices provide a boon to many non-energy industries, such as transportation, retail, manufacturing, accommodation & food and others, which will likely more than pick up the slack from the slowing mining sector. As such, the overall impact of low oil prices on job growth will likely be slightly positive.

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