TD Economics

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Data Release: U.S. service sector activity levels off in October

- The Institute of Supply Management (ISM) non-manufacturing index pulled back in October for the second straight month, falling by 1.5 points to 57.1. Today's headline surprised to the downside, with the consensus expecting a smaller drop to 58.0 (from 58.6 in September).

- The losses were fairly broad-based, with three out of four core sub-components moving lower on the month. The new orders sub-component extended its slide to three months in October with a decline of 1.9 points. Reflecting the trend in this forward-looking indicator, business activity also moderated (-2.9).

- The employment sub-component was the single piece of good news in today's release, rising 1.1 points to a new post-recession recession and extending its winning streak to six months.

- Prices paid for materials and services decelerated in October for the fifth straight month, bringing the sub-index to the lowest level since June 2012.

- Sixteen out of eighteen non-manufacturing industries surveyed reported growth in October. Among them, construction, retail trade and wholesale trade, and agriculture posted the best performance. Meanwhile, arts & entertainment and finance & insurance were the only industries reporting a contraction.

Key Implications

- On the surface, the details of today's report appear to be on the soft side, but they must be placed in context. Despite the pullback, the index remains above its year-ago level and is firmly in expansionary territory. Moreover, given the brisk growth in several of the sub-indexes in the preceding months, some payback was expected to materialize. Comments from survey respondents echo this sentiment, suggesting that overall business conditions remain favorable even as activity appears to be levelling off from the strong pace set in the prior months.

- The gain in the employment sub-component offers further affirmation that business activity and hiring in the service sector continues to advance at a healthy clip. Given that non-manufacturing industries accounted for approximately 95% of all new jobs created this year, the excellent print on employment sub-index alongside a robust ADP job report points to another solid payroll gain this Friday.

- Given the sharp drop in oil prices in recent months, the deceleration in prices paid sub-component was not surprising, but the degree to which it has slowed is worth noting. We expect inflation to continue to drift down over the coming year, reflecting the impact of the higher dollar and generally falling commodity prices. For more on the outlook for inflation please see our special report.

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