

## US NATIONAL BUSINESS SENTIMENT MIXED IN MARCH

**\*The Institute for Supply Management's (ISM) measure of national non-manufacturing sentiment fell more than expected in March (-2.4pts to 55.2) but remained positive in the expansionary territory, while its manufacturing index remained elevated (-0.5pt to 57.2)**

*\*Unlike other regional manufacturing surveys, the ISMs cover sentiment for the full month, so some reaction to the healthcare policy reform failure was at least partially captured in the surveys*

*\*Other hard data have been slow to respond to the improved sentiment, but it appears to be impacting hiring with ADP reporting another robust 263k private payroll growth in March*

The details of the ISM non-manufacturing report were softer than expected – although still pointing to expansion – especially on employment and current business activity, some of which may be due to the uncertainty surrounding the recent healthcare policy reform failure (see Chart 1). A couple survey respondents pointed to the uncertainty stemming from health care:

- *"The details of the revisions to the Obamacare program are of great interest to us. There is a large amount of future uncertainty with what will happen. Meanwhile, the business continues." (Finance & Insurance)*
- *"Health care changes can affect our business. Uncertainty is making us hold on many projects." (Health Care & Social Assistance)*

The non-manufacturing employment subindex dropped 3.6pts to 51.6, the lowest since August 2016, pointing to a possible slowing in service sector job growth in the official March government jobs report on Friday (see Chart 2). Contrasting this, the ISM manufacturing survey showed a jump in employment.

The weaker-than-expected read on non-manufacturing sentiment points to how quickly firms are able to react to policy missteps and the possible impact on broader economic activity, especially in the healthcare sector which accounts for a large share of the US economy.

The details of the March ISM manufacturing survey were robust on measures of current activity and demand, with the new orders index posting one of its strongest readings in the recovery with all 18 manufacturing industries reporting increases (see Chart 3). Manufacturing activity has not picked up as quickly as some would have thought given the optimistic sentiment, but now is on an encouraging upward trend. We project business fixed investment to grow 6%+ (annualized) in Q1, its fastest quarterly increase since 2014.

*The ISM manufacturing prices index increased by 2.5pts to 70.5, as 47% of respondents reported higher raw material prices. While this price index has consistently increased since **oil prices bottomed out early 2016, March's rise despite the decline in energy prices suggest that there are growing broader price pressures** (see Chart 4). It is likely that firms are feeling more comfortable passing prices onto customers in an environment of growing economic optimism. Two respondent comments to the survey provide some evidence of this occurring:*

05 April 2017

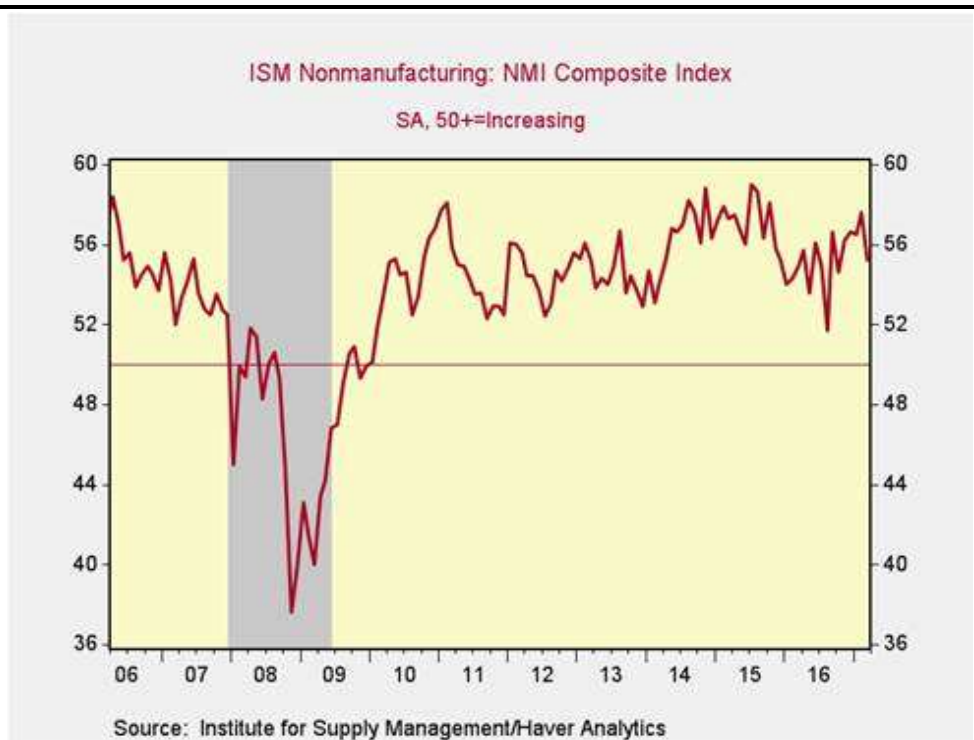
- "Starting to see some prices creeping up. We are raising our sales prices as well." (Food, Beverage & Tobacco Products)
- "Overall, material inflation is now clearly upon us." (Paper Products)

With the Fed's preferred measure of inflation, the PCE deflator, now exceeding 2%, evidence of broader price pressures in industry and tightening labor market, the Fed must continue on its policy normalization path.

The measures of trade within both the ISM manufacturing and nonmanufacturing reports were strong, providing further evidence of a strengthening global economy (see Chart 5). Indeed, the latest Q4 data on US corporate profits show that profits from the rest of the world are growing faster than domestic profits (see "[US corporate profits rose modestly in 2016 Q4](#)", March 30, 2017). This bodes well for export-related industries which have been a major source of drag on growth in recent years.

Although the strong sentiment has yet to feed through to most measures of "hard" economic data in a significant way, strong gains in employment is the one major exception. The goods sector and small businesses, in particular, which have reacted most positively to prospects for deregulation and tax reform, have ramped up hiring recently. ADP today reported that employment in the goods sector rose by 82k in March and that small businesses accounted for 118k new jobs, almost half of the total private payroll growth (see Chart 6).

Chart 1: ISM Nonmanufacturing: Composite Index



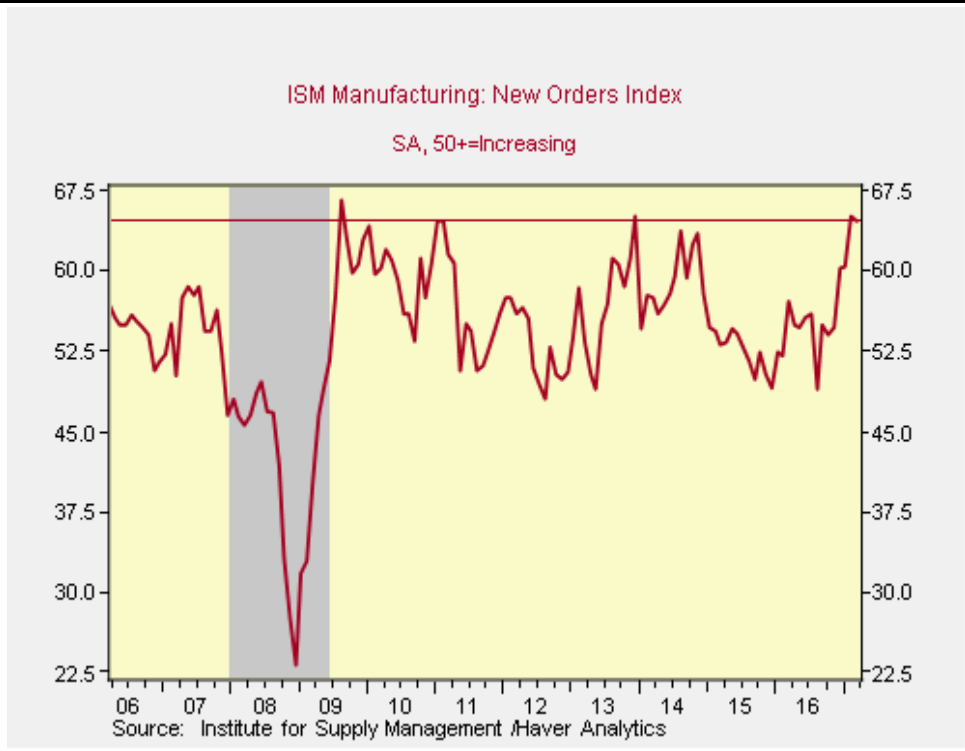
Source: Monthly data. Source: Institute for Supply Management and Haver Analytics

Chart 2: ISM Nonmanufacturing: Employment Index



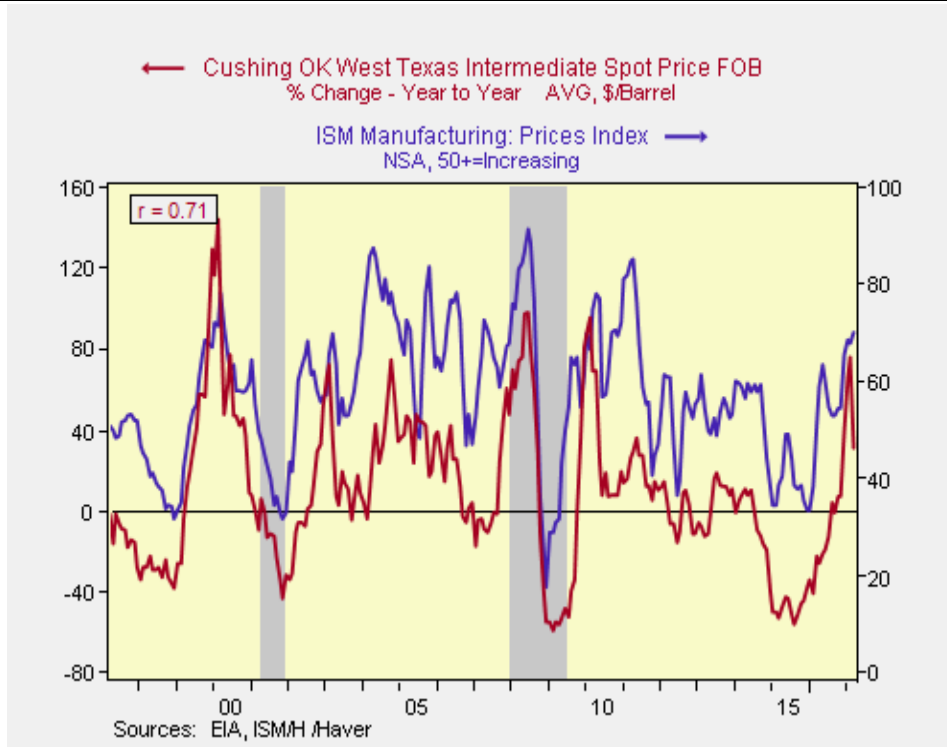
Source: Monthly data. Source: Institute for Supply Management and Haver Analytics

Chart 3: ISM Manufacturing: New Orders Index



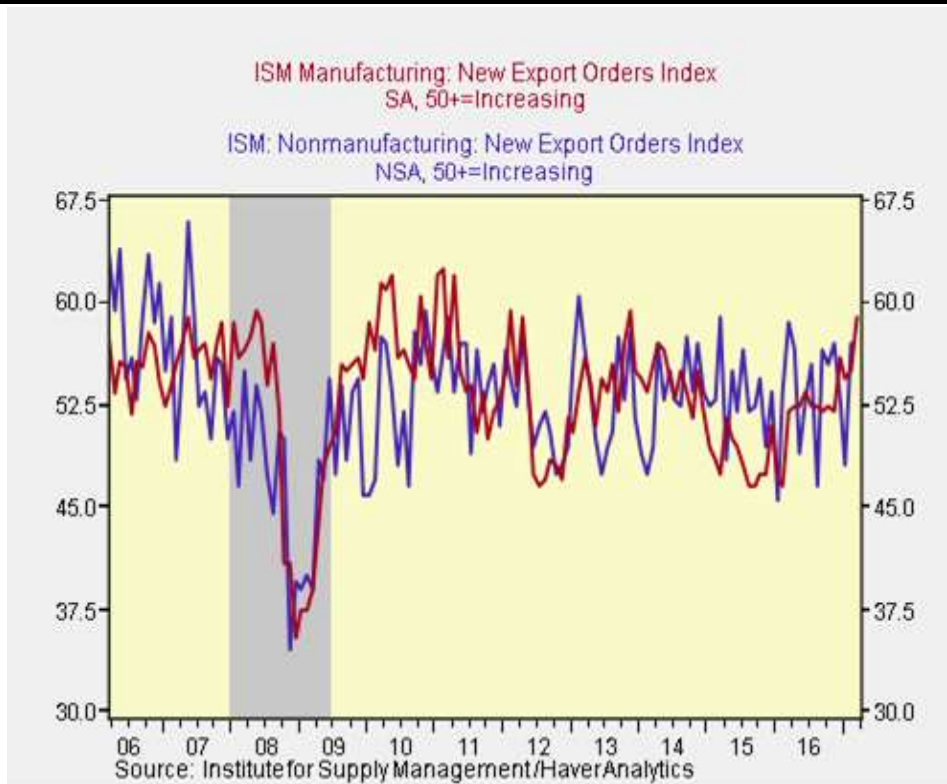
Source: Monthly data. Source: Institute for Supply Management and Haver Analytics

Chart 4: ISM Manufacturing Prices Index vs WTI Crude Oil Prices (Year-over-year, %)



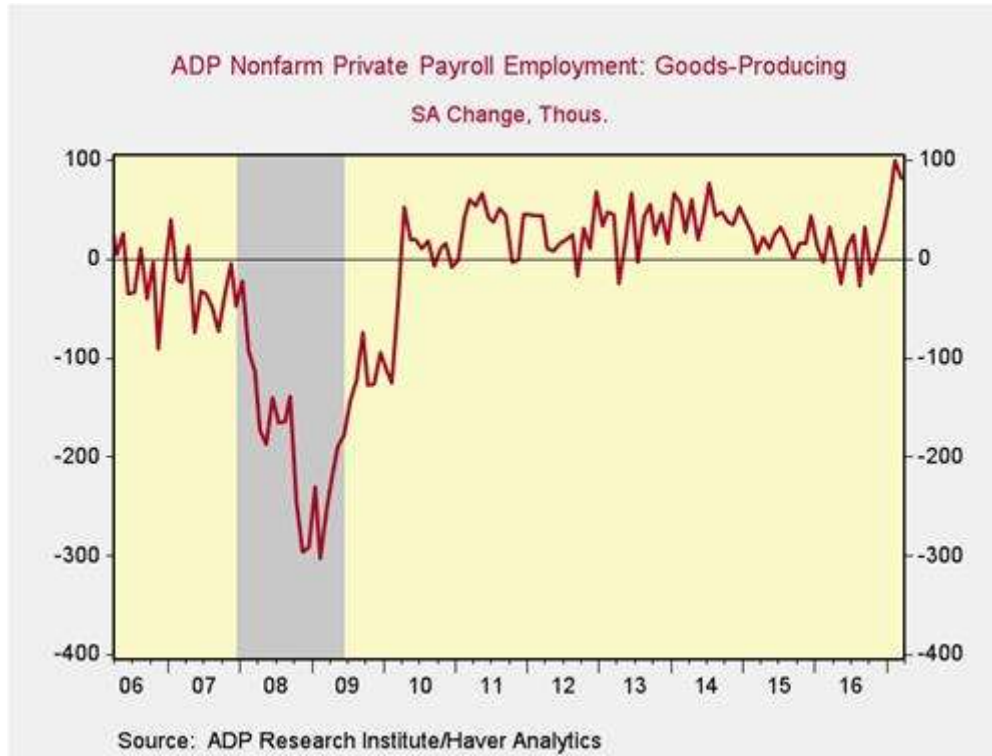
Source: Monthly data. Source: Energy Information Administration, Institute for Supply Management and Haver Analytics

Chart 5: ISM Manufacturing and Nonmanufacturing New Export Orders Indexes



Source: Monthly data. Source: Institute for Supply Management and Haver Analytics

Chart 6: ADP Nonfarm Private Payroll Employment: Goods-Producing Sector (Month-over-month change)



Source: Monthly data. Source: ADP Research Institute, Moody's Analytics and Haver Analytics

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