U.S. ISM NON-MANUFACTURING INDEX SURPRISES TO UPSIDE

*The U.S. ISM Non-Manufacturing Sentiment Index increased by 2.7pts to 56.4 in August (consensus: 54.0), its highest level since May, suggesting that activity in the non-manufacturing sector (which accounts for a large majority of U.S. economic activity) continues to expand solidly despite the slump in manufacturing, slower global growth, and heightened uncertainties (Chart 1).

*Survey details were mixed -- 16 non-manufacturing industries reported growth, in line with its recent average, but only 4 of 10 sub-indexes increased (Chart 2).

*Published comments of survey respondents were positively skewed, reflecting expectations for solid sales momentum as the holiday season approaches, but concerns about the adverse impact of tariffs remained prominent (see below).

The ISM composite index, which combines the ISM manufacturing (declined by 2.1pts to 49.1 in August) and non-manufacturing sentiment indexes based on their respective sector weights in GDP, increased by 2.2pts 55.6 in August, a level historically associated with real GDP growth around 2.8%, well above our forecast for real GDP growth (Chart 3).

The ISM non-manufacturing business activity index jumped by 8.4pts to 61.5, the highest level since February, and the new orders index increased by 6.2pts to 60.3 (Chart 4). Both measures suggest that activity is expanding relatively rapidly. According to the ISM report, respondents commented that “Sales are improving” and “Delayed projects are starting to become active again.”

The employment index declined by 3.1pts to 53.1 in August, contrasting ADP/Moody’s Analytics estimate of a robust 187k increase in non-manufacturing payrolls in August. Still at 53.1, the employment index is reflective of continued U.S. job growth (Chart 5).

The new export orders and imports indexes both declined by 3pts to 50.5 in August, consistent with softer global growth and declining global trade. Although the majority of respondents to the non-manufacturing survey do not actively perform or track foreign trade, the indexes are consistent with global trends.

The non-manufacturing sector is less exposed to the global headwinds and trade uncertainties and more reflective of domestic economic conditions. As long as the non-manufacturing sector remains resilient to external headwinds, we forecast continued GDP growth.

Key published comments from respondents to the survey:

- “Tariffs are affecting the cost of goods on all items imported from China. We’ve experienced a 10-percent increase on Chinese ingredients, which kicked in on August 1.” (Accommodation & Food Services)

- “The advertising specialties industry continues to remain robust, despite the escalation of tariffs on apparel and other related promotional products. Many suppliers bought deep into inventory to avoid price increases; however, pricing effects from the tariffs are trickling into the supply chain. Clients are still converting quotes into orders, and we are still on track for a record sales year.” (Management of Companies & Support Services)
“Trading volumes slowed, despite an extra day in the month for financial market activity. The competitive landscape for financial services continues to be challenging, with new lower cost offerings from competitors and new startups. At the end of the month, the federal funds rate was lowered to 2.25 percent, which affects company revenues.” (Finance & Insurance)

“Summer doldrums appear to be over, and the fourth quarter will be solid, with higher-than-expected revenues.” (Professional, Scientific & Technical Services)

“Construction markets remain busy. Projects that were delayed are trying to get back on track.” (Real Estate, Rental & Leasing)

“Our summer load factor was high, and as we transition to the holiday season, we are forecasting a high load as well.” (Transportation & Warehousing)

**Chart 1: ISM Non-Manufacturing Composite Index**

![Chart showing ISM Nonmanufacturing: NMI Composite Index](chart1)

Source: Institute for Supply Management/Haver Analytics

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

**Chart 2: Number of Non-Manufacturing Industries Reporting Growth**

![Chart showing Nonmanufacturing Industries Reporting Growth](chart2)

Source: Institute for Supply Management/Haver Analytics

Source: Monthly data. Source: Institute for Supply Management and Haver Analytics
Chart 3: ISM Composite Index vs. Real GDP Growth (year-over-year, %)

ISM Composite Index
SA, >50=Increasing

Real Gross Domestic Product
% Change - Year to Year SAAR, Bill.Chn.2012$

Sources: ISM/H, BEA/Haver

Source: Monthly and Quarterly data Source: Institute for Supply Management, Bureau of Economic Analysis and Haver Analytics

Chart 4: ISM Non-Manufacturing New Orders and Business Activity Indexes

ISM: Nonmanufacturing: New Orders Index
SA, 50+=Increasing
ISM: Nonmanufacturing: Business Activity Index
SA, 50+=Increasing

Source: Institute for Supply Management/Haver Analytics

Source: Monthly data. Source: Institute for Supply Management and Haver Analytics
Chart 5: ISM Non-Manufacturing Employment Index vs. Actual Private Non-Manufacturing Job Growth

Source: Institute for Supply Management/Haver Analytics

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6