



## Economics Group

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# Service Sector Still Shines While Manufacturing Slumps

*The ISM non-manufacturing survey firmly in expansion territory at 59.1 feels completely out of step with the ISM manufacturing survey just two days ago. In this report, we explain why and look at the upside for jobs.*

### Split-Level Theme Is Not Going Away

The ISM non-manufacturing index came in better than expected on balance for the month of October. The headline figure of 59.1 was a 2.2 point gain and bested consensus expectations for 56.5. The business activity index (also known as the production index) rose 2.8 points to 63.0. The largest change from the prior month was revealed in new orders, which improved 5.3 points to 62.0.

Perhaps the biggest takeaway from today's survey of non-manufacturing purchasing managers is the growing divergence between activity in the service sector, which is near current cycle highs, and the manufacturing sector, which is on the razor's edge between expansion and contraction. The top chart plots both of these key surveys over the past 17 years or so and it is clear while they do not always move in lockstep, they are rather closely correlated over time; that relationship has changed over the past 12 months or so.

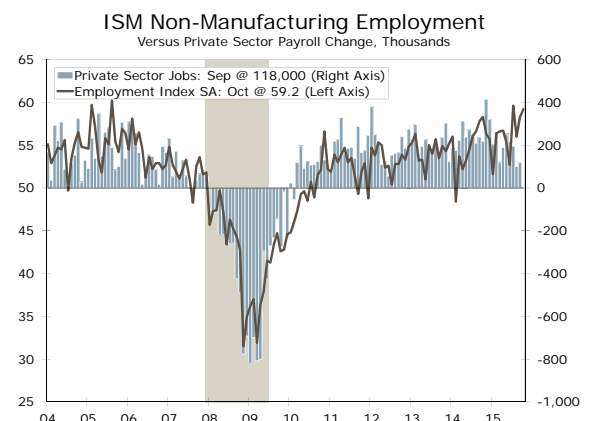
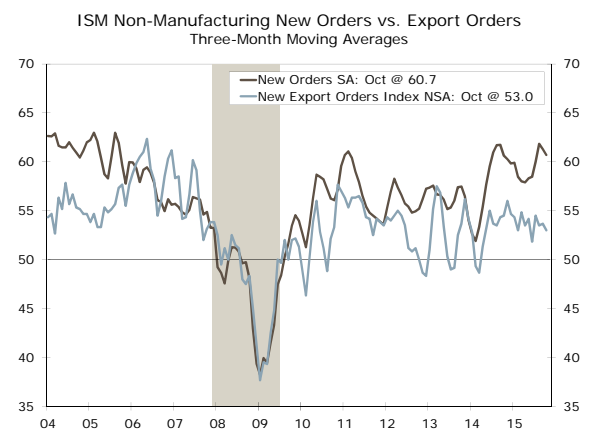
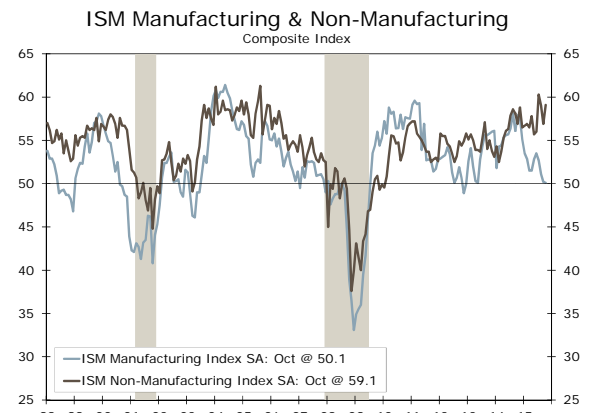
### Why the Big Difference?

The divergent paths for the service sector versus the manufacturing sector over the past 12 months are the function of a number of different variables. One key change in the economic landscape between now and a year or so ago is the much lower price environment for oil and other commodities. The surging investment in mining and fracking operations during the boom times for the oil industry helped keep manufacturers busy building pipes, drills and tankers trucks. That was upended when oil prices fell by more than half. At the same time, consumers were able to reap the savings which helped underpin service sector expansion. Consider as an example this comment from a respondent in wholesale trade in the current month's report: "Overall our business continues to grow at an unprecedented rate. We believe it to be in direct correlation to the price of gas giving the consumer more expendable income."

Another changing factor is the strong U.S. dollar and only tepid growth overseas. The middle chart looks at both the new orders and the export orders component of the non-manufacturing survey. Exports are soft for the service sector as well, but that apparently does not lead to the same broad-based weakness we see in the factory sector.

### The Manufacturing/Services Divide in the Labor Market

Earlier this week we learned that the employment component of the manufacturing ISM slipped into contraction territory. Yet, today we learned that the same measure for the service sector rose to the second highest level in the past decade. As the bottom chart shows, over time, this measure is a good proxy for private sector job growth and augurs well for Friday's jobs report.



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