

Favour ADP's Nonfarm Signal Over The One In ISM-Services

- The US service sector accelerated a touch in January
- Details were mixed as new orders and business activity picked up...
- ...but employment and supplier deliveries cooled
- ADP should be emphasized over ISM-employment...
- ...and it points to material upside risk in Friday's jobs numbers

ISM non-manufacturing, balance/diffusion index, January:

Actual: 55.5

Scotia: 55.3

Consensus: 55.1

Prior: 54.9 (revised from 55.0)

The service sector registered a modest improvement in growth readings during January, but not by enough to materially move the dial on the outlook. Multiple market measures from Treasury yields to the USD and the S&P500 largely shook off the release as a broad risk-on tone continues to be driven by other considerations.

The headline ISM-services gauge edged about a half point higher which is constructive but pales by comparison to the 3.7 point jump in Monday's ISM-manufacturing reading. The service sector is much larger and hence the data is usually less noisy than it is for the manufacturing sector.

The details to the headline reading are mixed. New orders moved up by 0.9 to 56.2, signaling a faster pace of growth in the order book.

The employment sub-index was weaker, however, as it fell 1.7 points to 53.1. The employment subindex is loosely correlated with the monthly change in nonfarm payrolls but the connection is so noisy as to be of minimal use. See chart 1.

What probably overrides that observation, however, is that ADP payrolls surprised much higher which may point to some upside to nonfarm payroll expectations on Friday. ADP can throw a lot of false signals and it conflicts with the ISM employment sub-index this time. It's still worth considering that for ADP's 291k reading to be followed by the current consensus estimate for only about 150k on private nonfarm payrolls would be a pretty rare occurrence. Since ADP revised its methodology to more closely track private nonfarm payroll changes in October 2012, ADP has had an overshoot of that magnitude—or more—only 6% of the time. See chart 2 and in this case particularly the far right tail of the distribution.

The 3.9 point jump in the business activity reading to 60.9 also supports the headline gain.

The prices paid index decelerated which largely just reflects commodity market movements. This index was 55.5 versus 59.3 previously.

Recall that the headline ISM reading applies equal weights to business activity, new orders, employment and supplier deliveries to come up with an arithmetic average that does not differentiate between the sources of improvement across these select few readings. Many other components are excluded as input to the headline ISM reading. Therefore the headline improvement was driven by the jump in business activity and the smaller rise in new orders but offset by the slower employment gauge and the deceleration in supplier deliveries.

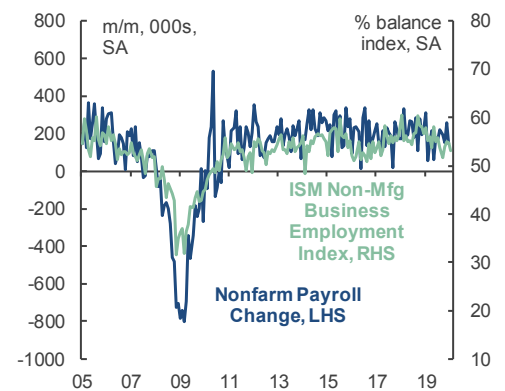
CONTACTS

Derek Holt, VP & Head of Capital Markets Economics
416.863.7707

Scotiabank Economics

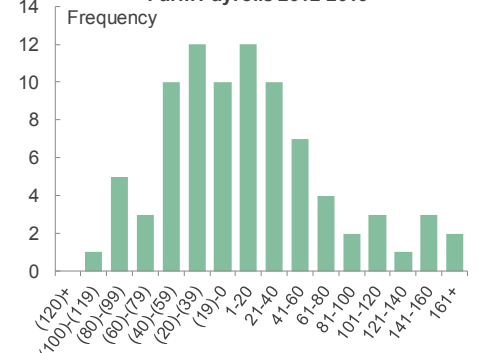
derek.holt@scotiabank.com

Nonfarm Payrolls Vs. ISM Non-Manufacturing Employment



Sources: Scotiabank Economics, ISM, BLS.

Differences Between Initial ADP And Private Non-Farm Payrolls 2012-2019



000s; parentheses indicate negative values; positive values indicate ADP overshoots

Sources: Scotiabank Economics, BLS, ADP.

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