Implications of the U.S. Services PMI Divergence

24 October 2022 – By Lucy Hager

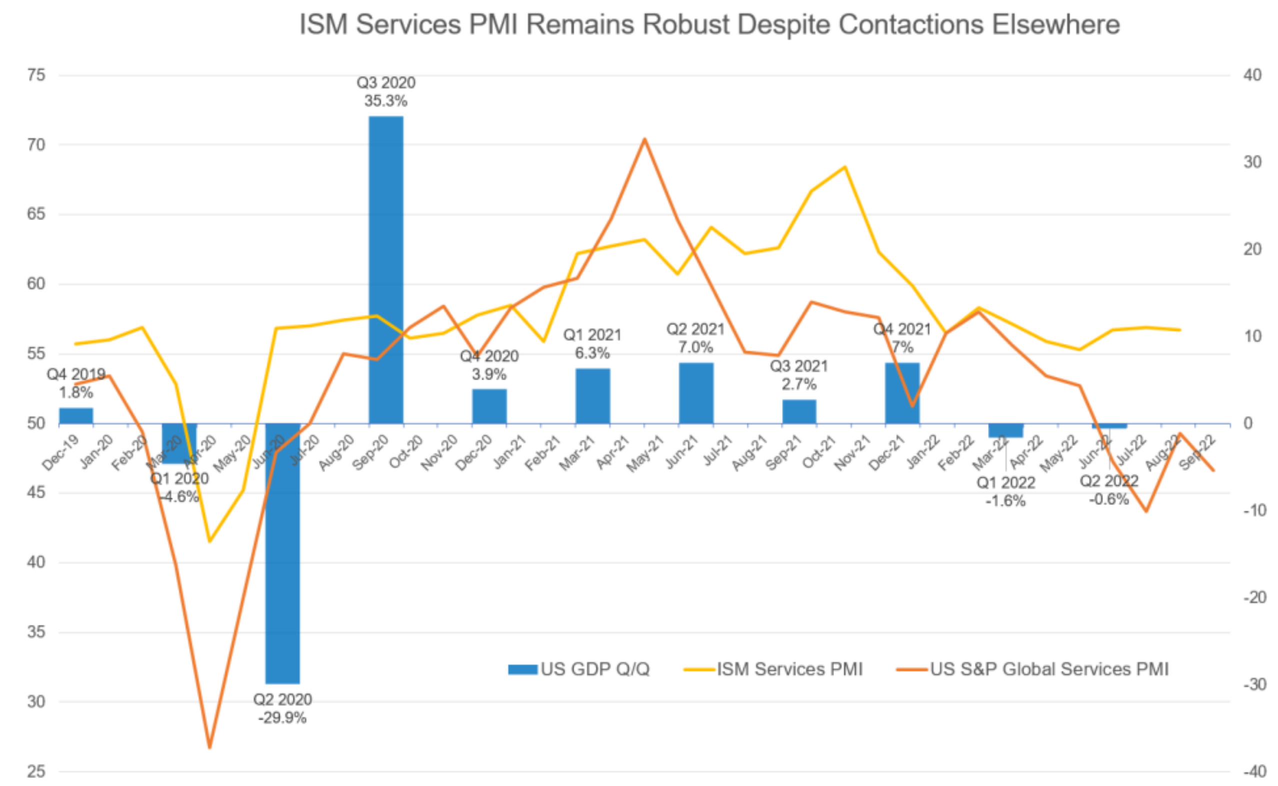
The ISM Services PMI and S&P Global services PMI have diverged notably since June 2022 - and understanding the reasons for this divergence is important to gauge the implications for US economic activity.

This analysis highlights three key grounds for divergence:

a. The ISM PMI is likely to be resilient because it has a wider range of industries, of which some have benefited from higher commodity prices
b. The ISM may have a bias towards larger firms that are more insulated from cost pressures
c. The S&P Global index is a business activity (output) index alone vs ISM's weighted approach

The ISM PMI has been steady in positive territory over the past six months, implying robust growth above the 50-breakeven threshold since the initial 2020 Covid shock. The September reading saw a minor 0.2-point moderation to 59.1. S&P Global's services PMI has been in contractionary territory below 50 since July, weakening further in today's October flash to 46.6.

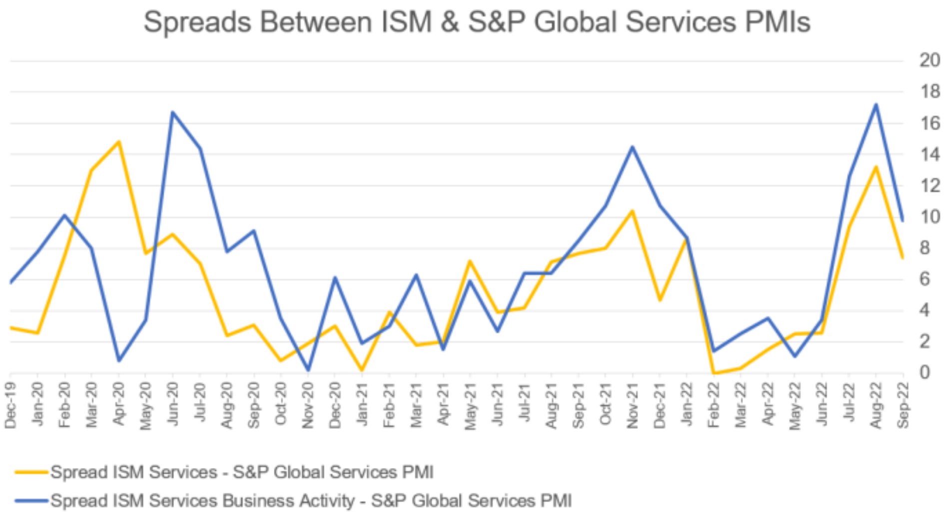
The two indicators comprise substantial differences in survey methodology. As such, the fall in the S&P Global indicator does not imply a similar decline in the ISM print.



Source: MNI / ISM / S&P Global / Bloomberg

Headline PMI: The ISM Services print is a composite figure based on equal weighting of four indices (Business Activity, New Orders, Employment and Supplier Deliveries). This gives an impression of the health of the overall sector. The S&P Global PMI is a business activity index alone and as such simply a measure of overall service sector output, omitting the weighting of subindexes such as employment. The S&P Global Services Business Activity Index is the direct equivalent of the Manufacturing Output Index, based on the survey question "Is the level of business activity at your company higher, the same or lower than one month ago?".

When comparing the ISM business activity index directly with the S&P Global index, the divergence between the two indicators is even more apparent (9.8 points in September) highlighting the need for further investigation.



Source: MNI / ISM / S&P Global / Bloomberg

Industry coverage: The ISM Services PMI was previously known as the Non-manufacturing ISM PMI. As such, the survey comprises any activity other than manufacturing: agriculture, mining, utilities, construction services, wholesale/retail trade and public administration. This is significantly broader than the S&P index, which incorporates solely the private US services industry.

The ISM's inclusion of areas such as public sector activities provides a more holistic measure of growth, yet compared to the S&P survey, may mask the extent of economic downturn driven by private sector decline.

Whilst the S&P index is likely to indicate a more direct implication of shifts in consumer spending on services and consumer confidence levels, the ISM index will be affected by the health of certain industries such as agriculture, extractive sectors and public administration. Higher food and energy commodity prices suggest boosted confidence and activity in those respective sectors, and the S&P Agriculture and Energy equity subindices have easily outperformed the broader market in 2022.

Company size: Both reports express that they ensure that small, medium and large businesses are weighted and represented appropriately. Anecdotal evidence suggests that the ISM index is more weighted towards large companies. [By the way, since the ISM has members who reply to these indices as opposed to a representative survey, surely it suggests that larger companies would be overrepresented?] A greater share of large corporations could mean the ISM index is less affected by economic shocks such as the spike in energy prices.

The NFIB Small Business Optimism index currently remains around initial pandemic levels and below the long-run average. The general implication is that larger firms will likely be in a more financially stable position to weather high inflation and will have a greater buffer regarding weak growth conditions.

Survey panel: The ISM survey looks at a panel of around 800, whilst S&P Global has a panel of 400. As the ISM does not publish the response rate, these are not distinctly comparable and data quality cannot easily be commented on. Both indexes stress having balanced geographical representation, The individuals surveyed at each firm also vary. The ISM solely queries purchasing managers, who are largely focused on stock inflows and production levels, whilst the broader interviewing process by S&P Global includes responses from finance / c-level roles. One potential upshot from ISM's interviewee profile is that the recent relaxation in global supply chain bottlenecks may be having an outsized beneficial effect to the broader index. As supply chain improvements are in part the consequence of falling new orders this positive effect has a troubled origin.

	ISM Services	**S&P Global Services**
Headline PMI	Composite based on equal weighting of individual indices (Business Activity, New Orders, Employment and Supplier Deliveries)	Business activity index (overall output)
Industry Coverage	Any activity other than manufacturing: includes agriculture, mining, utilities, construction services, wholesale/retail trade and public administration	Only private US services industry
Survey Panel Size	Around 800 (response rate unknown)	Around 400 (response rate 85%)
Company Size	Varied sizes, including largest US companies	Varied sizes
Surveyed Individual	Supply Managers	Varied