Sharp upturn in business activity amid stronger client demand

Key findings

Output and new order growth regain momentum

Fastest increase in cost burdens on record

Slowest rise in employment since July 2020

Data were collected 12-26 January 2021.

January PMI™ data signalled a sharper expansion in business activity across the U.S. service sector. Excluding November’s recent high, the latest upturn was the fastest since March 2015, amid a stronger rise in new business. Foreign client demand also picked up, as new export orders returned to growth. Despite a notable improvement in business confidence, the rate of job creation eased as pressure on capacity dwindled and concerns regarding the short-term outlook remained.

Meanwhile, cost burdens soared once again, with the rate of input price inflation the fastest since the survey began in 2009. Firms largely passed on higher costs to clients through a marked rise in charges.

The seasonally adjusted final IHS Markit US Services PMI Business Activity Index registered 58.3 in January, up from 54.8 in December and higher than the earlier released ‘flash’ estimate of 57.5. The rate of growth was the second-sharpest in almost six years, with firms linking the upturn to stronger client demand and an increase in new business.

January data indicated a strong rise in new orders. Excluding November’s recent high, the pace of expansion was the fastest since February 2019 as sales growth regained momentum. The increase was often attributed to greater demand from new and existing clients.

At the same time, foreign customer demand picked up, as new business from abroad returned to expansion. Although only marginal, the rate of growth was the fastest for three months.

Service providers registered another marked increase in input prices at the start of 2021. The rise in cost burdens was the sharpest since data collection began, and the rate of increase has now accelerated for three successive months. Higher input prices were reportedly linked to greater fuel, transportation and supplier costs, especially for PPE.

In line with strong client demand and a spike in input prices, service providers recorded a steep increase in selling prices during January. The rate of charge inflation was the second-quickest on record, only slower than the peak seen in November 2020.

Despite a faster rise in new business, a number of firms reported sufficient capacity to process incoming new work in January. As a result, companies increased workforce numbers only marginally, and at the slowest pace since July 2020.

Reflecting less pressure on capacity, backlogs of work rose fractionally during January. The increase in outstanding business was the softest in the current seven-month sequence of expansion.

Finally, service providers signalled a stronger and robust degree of confidence in the outlook for output over the coming year in January. Optimism was the second-highest since May 2015, with firms linking positive sentiment to hopes of a successful vaccine roll-out and an end to the pandemic during 2021. Many companies also noted that they expect client demand to pick up further once restrictions are lifted.
The IHS Markit Composite PMI Output Index* posted 58.7 in January, up from 55.3 in December, to signal the quickest rise in private sector business activity since March 2015. Sharper rises in manufacturing and service sector activity supported overall growth.

New business growth also accelerated, largely driven by a robust increase in client demand at manufacturing firms. The rate of expansion in private sector new orders was the second-fastest since September 2018. At the same time, firms signalled a renewed rise in new export orders.

Deteriorating vendor performance and supplier prices hikes led to the steepest rise in cost burdens since data collection began in October 2009. As a result, private sector output charges increased significantly at the start of 2021.

Business confidence improved in January, amid stronger output expectations at service providers. Manufacturers were slightly less upbeat, but still anticipate higher output in one year’s time.

Finally, a softer rise in employment at service providers offset a quicker increase in job creation at manufacturers, as pressure on service sector capacity waned.

*Composite PMI indices are weighted averages of comparable manufacturing and services PMI indices. Weights reflect the relative size of the manufacturing and service sectors according to official GDP data. The U.S. Composite Output Index is a weighted average of the U.S. Manufacturing Output Index and the U.S. Services Business Activity Index.

Commenting on the latest survey results, Chris Williamson, Chief Business Economist at IHS Markit, said:

“A strong start to the year for manufacturing was accompanied by a marked upturn in the service sector, driving business activity growth to the fastest rate for almost six years during January. The improving data set the scene for a strong first quarter, and a rise in business expectations for the year ahead bodes well for the recovery to gain traction as the year proceeds. Companies have become increasingly upbeat amid news of vaccine roll-outs and hopes of further stimulus.

“The downside is that prices have risen sharply. Rising costs have fed through to higher prices charged for goods and services, which rose in January at a rate not seen since at least 2009. Inflation therefore looks likely to be pushed higher in the near-term. However, some of these price pressures reflect short-term supply constraints, which should ease in coming months as the recovery builds and more capacity comes online.”
Methodology

The IHS Markit U.S. Services PMI™ is compiled by IHS Markit from responses to questionnaires sent to a panel of around 400 service sector companies. The sectors covered include consumer (excluding retail), transport, information, communication, finance, insurance, real estate and business services. The panel is stratified by detailed sector and company workforce size, based on contributions to GDP.

Survey responses are collected in the second half of each month and indicate the direction of change compared to the previous month. A diffusion index is calculated for each survey variable. The index is the sum of the percentage of ‘higher’ responses and half the percentage of ‘unchanged’ responses. The indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease. The indices are then seasonally adjusted.

The headline figure is the Services Business Activity Index. This is a diffusion index calculated from a question that asks for changes in the volume of business activity compared with one month previously. The Services Business Activity Index is comparable to the Manufacturing Output Index. It may be referred to as the ‘Services PMI’ but is not comparable with the headline manufacturing PMI figure.

The Composite Output Index is a weighted average of the Manufacturing Output Index and the Services Business Activity Index. The weights reflect the relative size of the manufacturing and service sectors according to official GDP data. The Composite Output Index may be referred to as the ‘Composite PMI’ but is not comparable with the headline manufacturing PMI figure.

Underlying survey data are not revised after publication, but seasonal adjustment factors may be revised from time to time as appropriate which will affect the seasonally adjusted data series.

For further information on the PMI survey methodology, please contact economics@ihsmarkit.com.

Flash vs. final data

Flash services data were calculated from 85% of final responses. Flash composite data were calculated from 85% of final responses.

Since October 2009 the average difference between final and flash Services Business Activity Index values is 0.1 (0.4 in absolute terms). Since October 2009 the average difference between final and flash Composite Output Index values is 0.1 (0.4 in absolute terms).

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For further information on the PMI survey methodology, please contact economics@ihsmarkit.com.