Business activity growth accelerates to seven-month high in February

KEY FINDINGS

Output increases at sharp rate

New business expansion also picks up pace

Faster rises in employment and backlogs highlight strain on capacity

Business activity across the U.S. service sector continued to improve in February, with the rate of expansion quickening to the fastest since July 2018. The rise in output was supported by a sharp increase in new business and a return to growth in new export orders. Moreover, foreign demand rose at the strongest rate since last May. Subsequently, pressure was placed on capacity and led to the fastest rise in outstanding business for nine months. In expectation of further new order growth and in an effort to clear backlogs, the pace of job creation reached a five-month high and was strong overall. That said, service providers were less upbeat towards the year-ahead outlook for business activity.

The seasonally adjusted final IHS Markit U.S. Services Business Activity Index registered 56.0 in February, up from 54.2 in January and broadly in line with the earlier released ‘flash’ figure of 56.2. The rise in business activity was the quickest since last July and above the long-run series trend. Panellists reported that greater client demand and favourable economic conditions were key driving factors behind the upturn.

At the same time, service providers registered a faster increase in new business in February. More robust client demand and the opening of new facilities were commonly mentioned as contributing factors to the latest rise. The expansion was the strongest since last October and historically sharp. Firms also reported a return to growth in new export orders following a two-month sequence of decline. Furthermore, the pace of increase was the fastest for nine months and well above the series average.

In line with a stronger rise in new business, firms were required to take on more staff in February amid strains on capacity. The rate of job creation was the quickest for five months and accelerated significantly from that seen in January. At the same time, backlogs of work increased for the second successive month and to the greatest extent since May 2018.

Meanwhile, inflationary pressures picked up in February, with service providers registering faster rises in both input prices and output charges. The strong increase in cost burdens was largely linked to higher raw material and fuel prices, tariffs and higher interest rates. The rate of input cost inflation accelerated from January’s 22-month low and was the quickest since last November. Firms reportedly sought to pass greater cost burdens on to clients through increased output prices. The rate of charge inflation quickened for the second month running as more favourable demand conditions allowed companies to raise prices.

Service sector firms remained optimistic in February. The degree of confidence was, however, weaker than that seen in January and historically subdued. Although service providers commented on the strength of client demand, others highlighted concerns around the sustainability of new business growth.
Commenting on the PMI data, Chris Williamson, Chief Business Economist at IHS Markit said:

“The US PMI surveys tell a tale of two economies in February, with any slowdown story confined to the goods-producing sector. While manufacturing struggled, with the surveys consistent with a near-stalling of factory output and order books, the service sector remained encouragingly resilient, enjoying its strongest burst of activity for seven months.

With the size of the vast service sector overshadowing the manufacturing sector, the two surveys suggest the overall pace of economic growth accelerated in February. Having correctly indicated that the economy grew at a slower but still solid pace in the fourth quarter (our model from the survey indicated 2.5% growth against an initial official estimate of 2.6%), the data for the first two months of 2019 point to a similar 2.6% annualised rate of expansion.

In addition to signalling stronger economic growth, the surveys suggest hiring also remained encouragingly solid in February with a 250,000 non-farm payroll rise indicated, albeit predominantly driven by the service sector.

The worry is that the manufacturing slowdown will spill over to the service sector, damping economic growth in coming months. Companies themselves certainly appear to have become more circumspect, with business optimism cooling in February amid worries over the impact of tariffs, trade wars, higher prices and rising interest rates.”