AIER.ORG

AIER American Institute for Economic Research

BUSINESS CONDITIONS MONTHLY

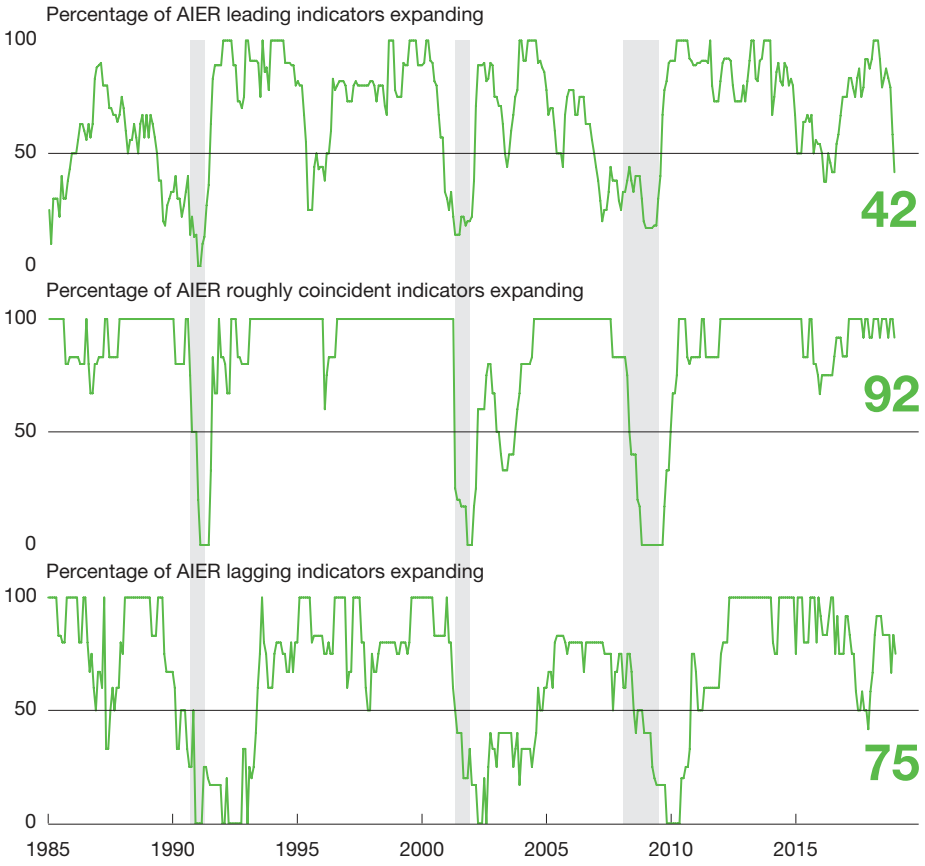
February 2019 Vol. 6 Issue 2

AIER's Leading Indicators index fell again in January, dropping below 50 for the first time since August 2016; government shutdown limits economic data.

AIER's Business Cycle Conditions Leading Indicators index fell 16 points to 42 in January. The result was the first reading below 50 since August 2016. The Roughly Coincident Indicators index fell to 92 while the Lagging Indicators index dropped to 75 (see chart). The string of four declines pushing the Leading Indicators index below 50 is a cautionary sign. However, a single month below 50 does not suggest a recession is imminent. More data is needed to conclude that a recession is the most likely path for the economy.

The government shutdown has resulted in delays in publishing many economic data series. Those delays make gauging current economic conditions more difficult. However, data from private sources suggest the economy is still relatively healthy despite some signs of weakness. Limited economic data and some signs of weakening in data that are available, combined with a high degree of uncertainty in trade policy and global economic conditions, warrant a more cautious view, but continued expansion remains the most likely path.

Chart 1. Indicators at a glance



Notes: Shaded areas denote recessions. A score above 50 indicates expansion. **Source**: AIER.

Weakness in the AIER Leading Indicators index is broadening, resulting in the first reading below the neutral 50 level since August 2016

Leading indicators drop below neutral in January

Note: The recent government shutdown included the Department of Commerce, the source of some of the AIER business cycle indicators. For the January update, 9 of the 24 indicators have been delayed. The remaining 15 indicators were updated on schedule. Caution should be exercised when interpreting the results of the indicators.

The AIER Leading Indicators index fell to 42 in January. The decline was the fourth in a row and pushed the index below 50 for the first time since August 2016. The index last fell below 50 in March 2016 and remained at or below 50 for six months from March through August. The performance of the indicators was consistent with a broad economic slowdown, but no recession developed. More data will be needed to determine whether a recession is the most likely path for the economy. For now, the broadening weakness justifies an elevated degree of caution, but the outlook is for continued expansion in the economy.

Among the 12 leading indicators, only 6 were updated for the most recent month. The remaining six indicators did not have updated data, so they continued with the same trends as last month. Overall, 4 of the 12 leading indicators maintained a positive trend in January, with 6 trending lower and 2 indicators neutral. Among the six with updated information, four weakened from the prior month. Initial claims for unemployment insurance, the University of Michigan index of consumer expectations, and real stock prices all moved from a neutral trend to a declining trend in January. Real new orders for consumer goods went from a positive trend to a neutral trend. The 10-year–1-year Treasury yield spread held in a favorable trend while the average workweek in manufacturing remained in a downtrend.

The roughly coincident indicators fell to 92 in January. The Roughly Coincident Indicators index has oscillated between 92 and 100 since March 2017, hitting 92 in 6 of those months and scoring perfect 100s in 17. Four of the six indicators had updated data for the month with three of those maintaining their trend from the prior month. The Conference Board Consumer Confidence Present Situation Index weakened to a neutral trend in January. In total, five indicators had positive trends, one had a neutral trend, and none were in a downward trend.

AIER's Lagging Indicators index also declined in the latest month, falling to a reading of 75 in January from 83 in December. Among the six lagging indicators, five had updated data available. Among those five, three indicators changed trend with two weakening and one improving. In total, four indicators are trending higher, one is trending lower, and one is neutral. That compares to four trending higher, two trending neutral, and none trending lower in December.

Overall, the three AIER business cycle–indicator indexes weakened in January though, because of the government shutdown, about a third of the indicators were not updated. Vigilance is warranted given the signs of broadening weakness and the high level of uncertainty regarding trade policy and global economic conditions.

Surveys of purchasing managers indicate that business conditions remain positive but that some concerns are developing.

Purchasing managers' surveys suggest continued economic expansion

Surveys of purchasing managers from the Institute for Supply Management suggest support for continued economic expansion but also highlight a range of concerns, from ongoing uncertainty over trade policy and tariffs to lingering effects from the government shutdown. On balance, the results are positive but suggest a more challenging business environment in 2019.

The manufacturing Purchasing Managers' Index composite index registered a 56.6 percent reading in January, up 2.3 points from 54.3 in December. January is the 29th month in a row above the neutral 50 level and the 117th above the 42.9 percent threshold consistent with expansion in the overall economy. Among the key components, the New Orders Index rebounded to 58.2 from 51.3 in December, a rise of 6.9 points, while the backlog of unfilled orders remained close to a neutral reading of 50.0, coming in at 50.3 versus 50.0 in the prior month. The production index was at 60.5 percent in January, up from 54.1 in December, and the employment index fell to 55.5 percent in January, down from 56.0 in December. Customer inventories in January are still considered too low, with the index rising to 42.8 from 41.7 in the prior month.

The Institute for Supply Management's nonmanufacturing index fell to a reading of 56.7 from 57.6 in December. The January result is the 108th consecutive reading above 50.

Among the key components of the nonmanufacturing survey, the business-activity index was 59.7 in January, down from 59.9 in December, while the nonmanufacturing new-orders index came in at 57.7, down from 62.7 in December, and the employment index increased to 57.8 in January, versus 56.3 in December.

Small-business optimism remains near record levels with the poor quality of available labor being the most pressing concern.

Small-business survey suggests strong momentum

The small-business-optimism index from the National Federation of Independent Business eased back to 104.4 in December, just 4.4 points below the all-time high of 108.8 in August 2018. The latest result extends a run of 25 consecutive months above 100, a very high figure by historical comparison. The single-most-important problem among small businesses remains the poor quality of the available labor force, particularly in the context of an already-tight labor market and the record-high percentage of firms with open jobs.

The general outlook remained positive as the percentage of respondents believing now is a good time to expand came in at 24, down from 29 in November. The net percentage of respondents expecting better economic conditions ("better" minus "worse") came in at 16, down from 22 in November but still quite high compared to negative numbers from 2016. A net 23 percent expect higher sales over the coming months while a net 4 percent reported higher sales for the most recent three months versus the prior three months.

The percentage of firms planning to increase employment rose to 23 percent from 22 percent in November. A record 39 percent of firms report having openings they are not able to fill. At the same time, the percentage of firms reporting few or no qualified applicants for job openings was 54 percent, nearing the record-high 55 percent in June and August. That combination in the labor market of healthy demand and weak supply has a net 35 percent of firms saying they have already increased compensation over the past three months while 24 percent intend to increase worker pay over the coming months.

The labor-market dynamics have made quality of labor the most important issue for small businesses. Among the 10 issues listed in the survey, quality of labor ranks first at 23 percent, just below the record high of 25 percent. Government regulation and red tape was second with 14 percent while taxes and availability or cost of insurance tied for third with 13 percent. At the bottom of the list was inflation with just 1 percent and financing and interest rates with 3 percent. Inflation has been at the bottom of the list for several years, reflecting the slow pace of price increases over the current cycle.

Capital expenditures by small businesses also remains solid, with 61 percent of such businesses having made capital expenditures during the past six months. That is below the typical percentage in the upper 60s during the late 1990s but well above the mid-40s percentages during the last recession. Twenty-five percent of firms have plans for capital expenditures over the next three to six months, down from 29 percent last month.

Measures of consumer attitudes pulled back, especially regarding future expectations, but views of the present remain strong.

Consumer attitudes become less optimistic

The Consumer Confidence Survey from The Conference Board and the Survey of Consumer Sentiment from the University of Michigan both show consumer attitudes pulled back in January relative to December but remain at historically favorable levels overall. The Consumer Confidence Index fell to 120.2 in the latest reading, down from 126.6 in December, while the University of Michigan Consumer Sentiment Index dropped to 91.2 from 98.3.

Of the two major components within the Conference Board Index, the present-situation index decreased from 169.9 to 169.6 while the expectations index fell to 87.3 from 97.7 last month.

The two sub-indexes for the Michigan survey had somewhat weaker performances in January. The current-economic-conditions index dropped to 108.8 from 116.1 in December. The second sub-index — that of consumer expectations, one of the AIER leading indicators — fell 7.1 points, or 8.2 percent, for the month, coming in at 79.9 versus 87.0 in December.

Despite the declines in the survey indexes, the levels of the indexes remain relatively high by historical comparison but do reflect rising concerns regarding the outlook for the economy.

The labor market remains very strong, providing a solid foundation for continued expansion.

January employment report shows strong gains

U.S. nonfarm payrolls added 304,000 jobs in January, boosting the three-month average gain to 241,000. Since the beginning of 2011, private payrolls have added an average of 200,000 per month, helping drive the unemployment rate down to 4.0 percent and helping boost wage growth to 3.2 percent.

Within the 304,000 gain in jobs, goods-producing industries added 72,000 employees in January, well above the average gain of 55,000 over the past year. Durable-goods manufacturing and construction led with additions of 20,000 and 52,000 jobs, respectively. For private service-producing industries, which typically account for the lion's share of job creation, payrolls added 224,000 workers, led by a 74,000 increase in leisure and hospitality. Health care and social-assistance industries added 45,000 jobs while professional and business services added 30,000 in January. Retail added 21,000 workers after a drop of 12,000 in the prior month. The public sector added 8,000 employees.

CAPITAL MARKET PERFORMANCE

(Percent change)

	January 2019	Latest 3M	Latest 12M	Calendar Year 2018	2017	2016	Annualized 3-year	5-year	10-year
Equity Markets									
S&P 1500	8.1	-0.3	-4.3	-6.8	18.8	10.7	11.8	8.5	12.8
S&P 500 - total return	8.0	0.3	-2.3	-4.4	21.8	12.0	14.0	11.0	15.0
S&P 500 - price only	7.9	-0.3	-4.2	-6.2	19.4	9.5	11.7	8.7	12.6
S&P 400	10.4	0.6	-6.1	-12.5	14.5	18.7	11.7	6.9	13.9
Russell 2000	11.2	-0.8	-4.8	-12.2	13.1	19.5	13.1	5.8	13.0
Dow Jones Global Large-Cap Index	7.3	1.2	-9.1	-10.4	42.9	-10.0	9.5	4.7	8.5
Dow Jones Global Large-Cap ex. U.S. Index	7.2	3.3	-14.4	-15.7	41.0	-10.7	6.9	0.6	5.2
STOXX Europe 600 Index	6.2	-0.8	-9.3	-13.2	7.7	-1.2	1.6	2.1	6.5
Bond Markets									
iShares 20+ year Treasury bond	0.4	7.4	-0.6	-4.2	6.5	-1.2	-1.4	2.4	1.6
iShares AAA-A Corporate bond	2.4	3.3	-1.8	-5.2	2.9	1.7	0.2	0.3	N/A
Commodity Markets									
Gold	3.2	8.8	-1.4	-1.7	12.6	9.0	5.8	1.3	3.7
Silver	3.9	12.1	-6.7	-8.3	3.8	17.5	4.5	-3.6	2.5
CRB all commodities	0.9	-0.7	-6.9	-5.4	2.2	12.9	2.5	-2.1	2.6

CONSUMER FINANCE RATES

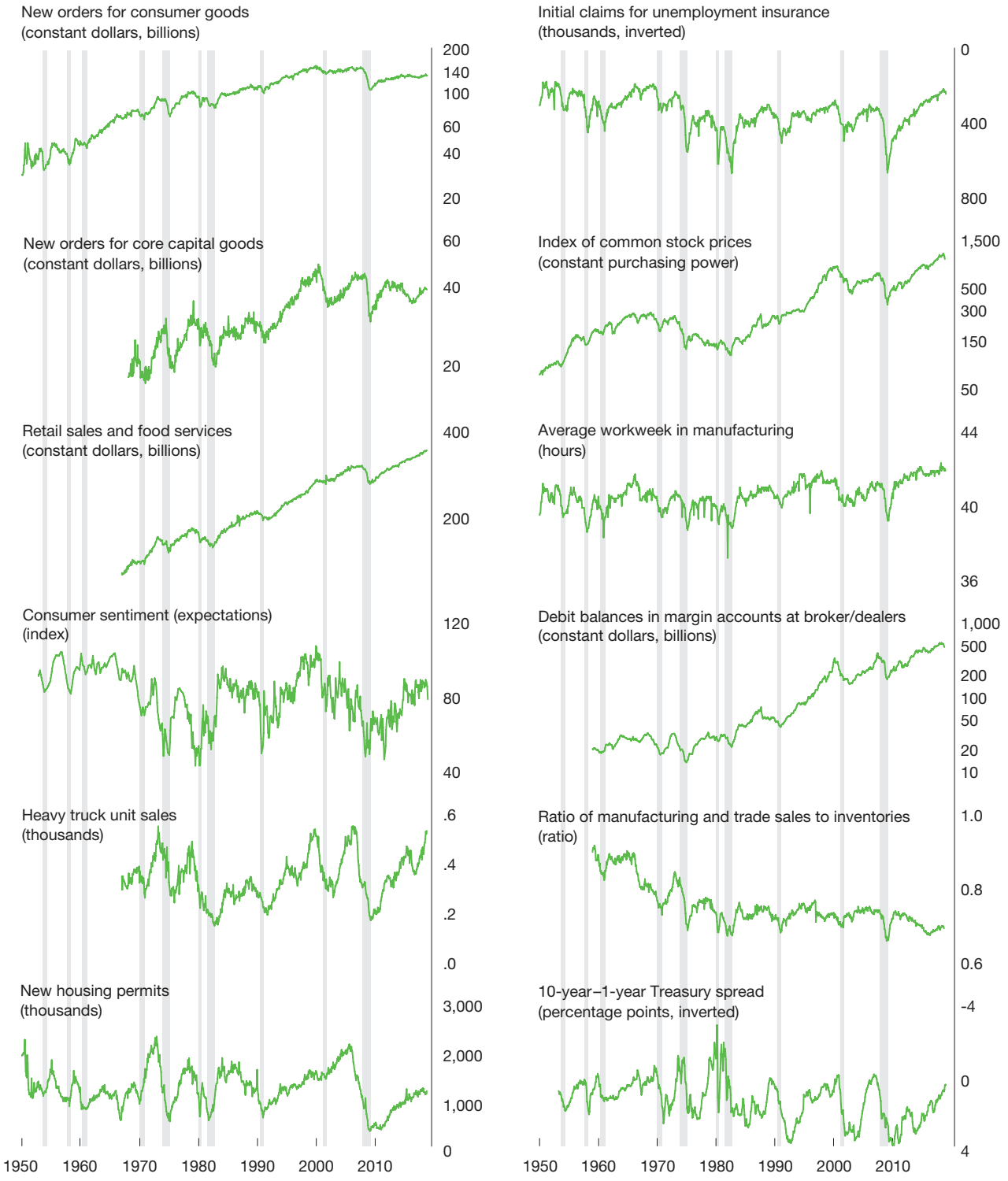
(Percent)

	January 2019	Latest 3M	Latest 12M	Average for Year 2018	2017	2016	Average over Period 3-year	5-year	10-year
30-yr. fixed mortgage	4.5	4.7	4.6	4.5	3.7	3.9	4.1	4.0	4.2
15-yr. fixed mortgage	3.9	4.1	4.0	4.0	2.9	3.1	3.4	3.3	3.5
5-yr. adjustable mortgage	3.9	4.0	3.9	3.8	2.9	2.9	3.3	3.2	3.3
48-month new car loan	NA	5.3	5.0	5.0	4.3	4.2	4.7	4.5	5.0

Note: New-car loan rates are quarterly data. Values shown are for latest quarter.
Calculations for annualized returns have changed to use daily data instead of monthly averages.

Sources for tables on this page: Bankrate, Barron's, Commodity Research Bureau, Dow Jones, Federal Reserve, Frank Russell, iShares, Standard & Poor's, STOXX Europe 600, Thomson Reuters.

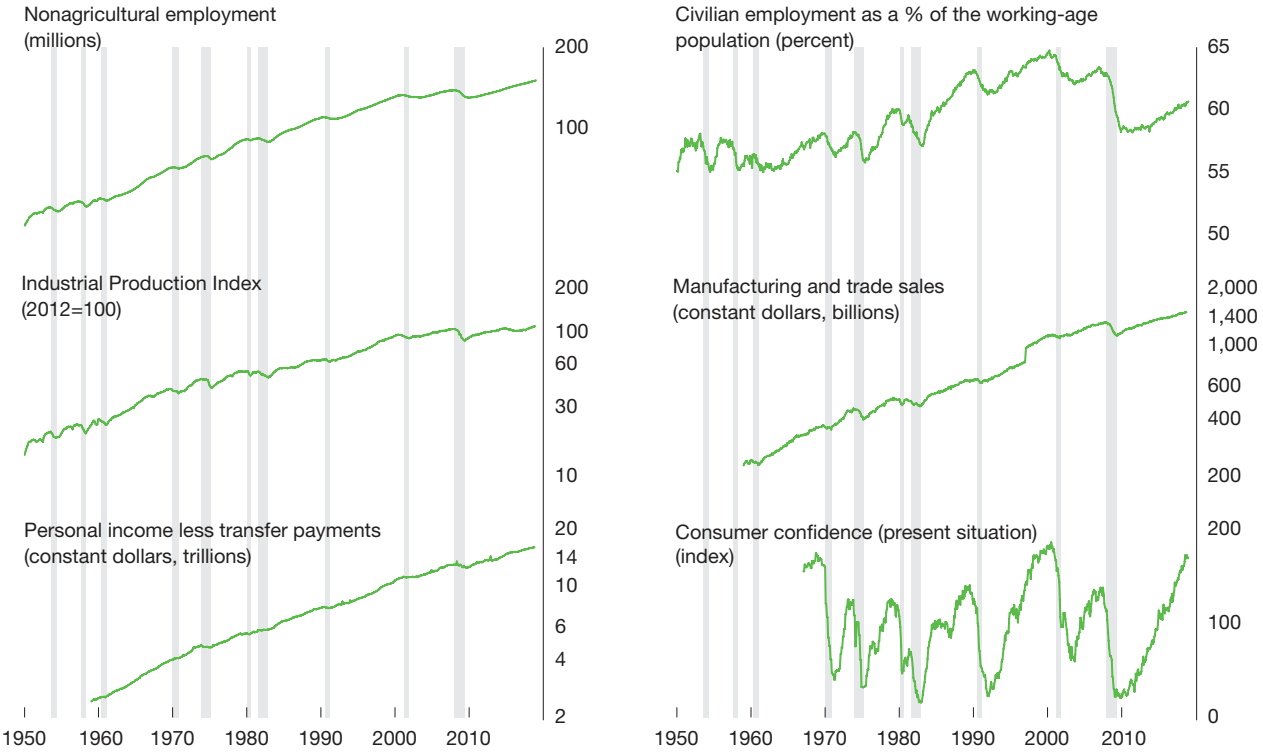
LEADING INDICATORS (1950–2018)



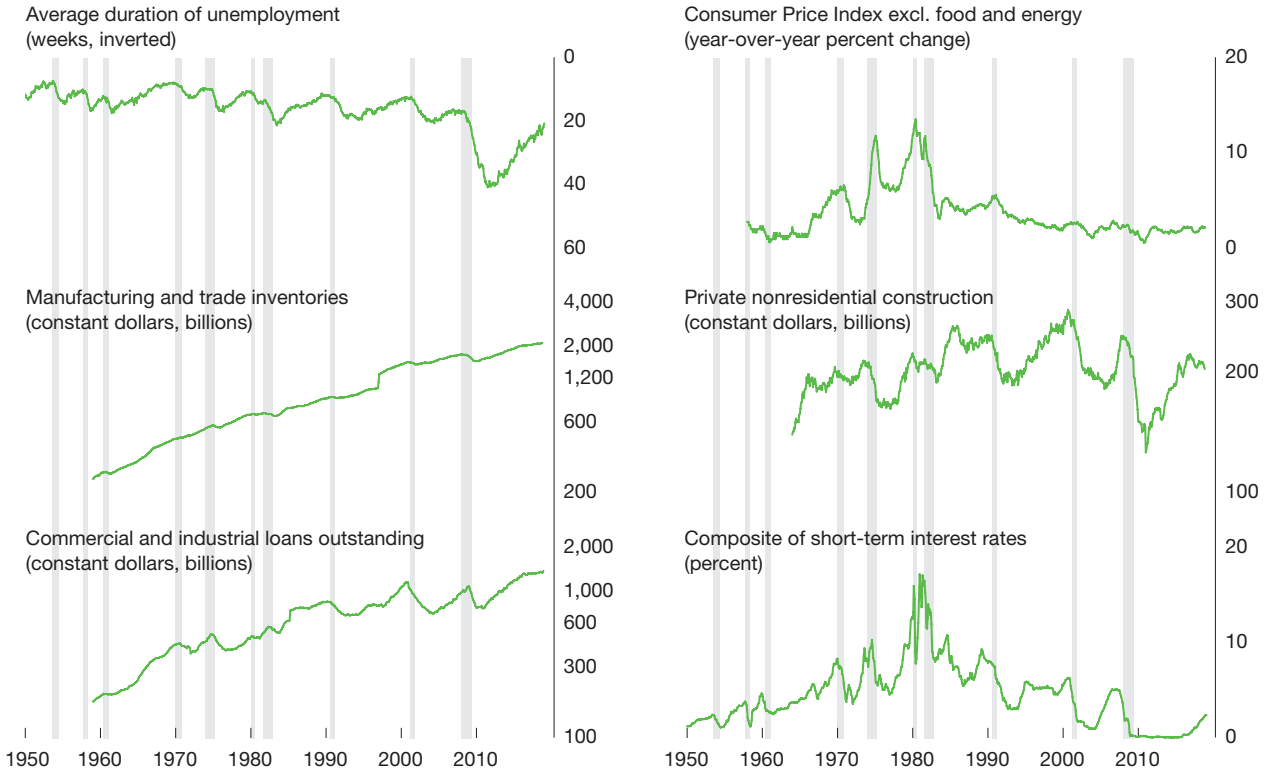
Sources for Appendix: Bureau of Economic Analysis, Bureau of Labor Statistics, Department of Labor, Federal Reserve, New York Stock Exchange, Standard & Poor's, The Conference Board, University of Michigan, U.S. Census Bureau (Thomson Reuters Datastream).

Note: Shaded areas denote recessions.

ROUGHLY COINCIDENT INDICATORS (1950–2018)



LAGGING INDICATORS (1950–2018)



AIER American Institute for Economic Research
250 Division Street
Great Barrington, MA 01230

Our Mission

Founded in 1933, the American Institute for Economic Research is a national nonprofit organization that educates Americans on the value of personal freedom, free enterprise, property rights, limited government, and sound money.

Our Impact

More than 80 years of AIER research demonstrates that these core principles are essential for the advancement of peace and for the economic prosperity of our nation and its citizens. We provide valuable resources and information to help people make sound economic and financial decisions.

Donate Today

Help AIER promote freedom, free enterprise, and sound money while teaching the benefits of limited government.

Visit www.aier.org
Call 1.888.528.1216

ISSN 2376-0516 (print)
ISSN 2376-0524 (online)

BUSINESS CONDITIONS MONTHLY

Research
Robert Hughes Senior Research Fellow
Rachel Shabani Graphic Designer

To contact AIER by mail, write to
American Institute for Economic Research
PO Box 1000
Great Barrington, MA 01230

Twitter
twitter.com/aier

LinkedIn
linkedin.com/company/american-institute-for-economic-research

For more information or to donate, visit: **www.aier.org**