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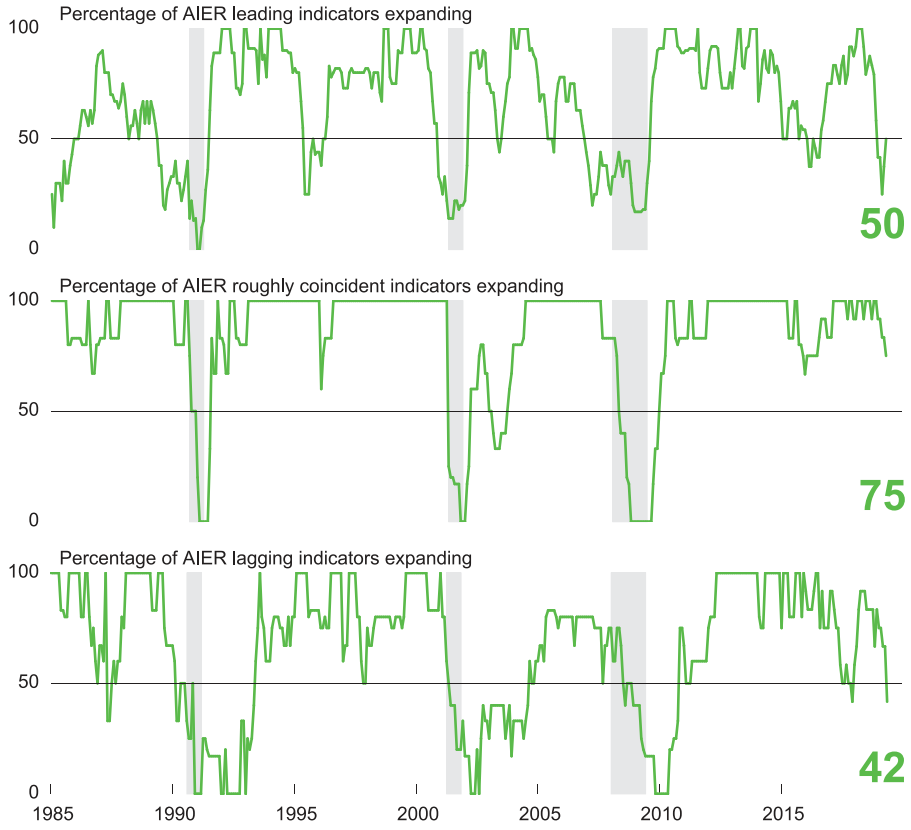
AIER's Leading Indicators index returned to neutral in May; outlook remains uncertain.

AIER's Leading Indicators index rose 12 points to a neutral reading of 50 in May, up from 38 in April. The Roughly Coincident Indicators index and the Lagging Indicators index both fell, to 75 and 42, respectively (see chart). May is the second consecutive month of improvement for the leaders index. The back-to-back improvements and neutral 50 reading reduce some of the concern regarding the outlook. However, mixed economic reports and a high degree of uncertainty regarding trade policy suggest caution remains warranted.

The current expansion is on the verge of becoming the longest in U.S. history. Given the longevity, it is not surprising the unemployment rate has reached a multi-decade low. A bit more surprising is the very slow pace of increase in consumer prices. Furthermore, there are few signs of excessive credit expansion (except for credit to the federal government) and money-supply growth remains moderate. Rising asset prices combined with modest debt growth are putting balance sheets for most sectors in reasonably good positions. Despite mixed data on economic activity, there are still many positives supporting the current economy. Unfortunately, policy is not one of them.

Chart 1. Indicators at a glance



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

The AIER Leading Indicators index posted a neutral 50 reading in May, but high levels of uncertainty regarding tariffs and trade policy are clouding the outlook for the economy.

Leading indicators turn neutral in May

The AIER Leading Indicators index rose to 50 in May. The improvement extends the important reversal in momentum seen last month. The return to neutral ends a run of four months at levels historically associated with impending recession. While the outlook for the economy remains highly uncertain, the performance of the leading indicators over the last two months is a welcome relief.

Among the 12 leading indicators that make up the Leading Indicators index, 4 are trending higher, 4 are neutral, and 4 are trending lower. Four indicators changed direction in May, with 3 improving and 1 worsening. Three of the indicators that changed were related to consumers. Real new orders for consumer goods moved back to a neutral trend in May just one month after turning positive. Real retail sales improved to neutral in May after showing a downtrend in April. Consumer expectations as surveyed by the University of Michigan jumped from a downtrend in April to a positive trend in May. On balance, the consumer indicators are slightly favorable.

Real stock prices was the fourth indicator to change in May, improving from a neutral reading in April to a positive trend in May. Nominal stock prices have posted sharp gains in early June, after posting declines for most of May. The S&P 500 remains about 3 percent below the peak of late April.

The Roughly Coincident Indicators index fell 8 points to 75 in May from 83 in April. Industrial production dropped to a downtrend from an uptrend in the prior month while consumer confidence in the present situation rose from a negative trend to a neutral reading. On balance, four roughly coincident indictors remained in uptrends while one was neutral and one was in a downtrend.

The Lagging Indicators index fell 25 points in May to a reading of 42. Among the six lagging indicators, just two were trending higher while three were trending lower and one was neutral. Duration of unemployment dropped to a downtrend from a positive trend in the prior month while short-term interest rates moved from a favorable trend to a neutral trend.

May is the second consecutive month of improvement for the leading index since hitting a low of 25 in March. The back-to-back improvements and neutral 50 reading are reducing some of the concern regarding the performance of the leaders index over the past several months. However, continued mixed results from economic reports and a high degree of uncertainty regarding trade policy and the impact of rising tariffs are clouding the outlook for the economy and suggest a high degree of caution remains warranted.

The current expansion is approaching the record for duration. The current record is 120 months, from April 1991 (trough month) through April 2001 (peak month). The current expansion began in July 2009 (the trough month was June 2009), so the current expansion will tie the record in June 2019 and break the record in July 2019 if the expansion continues, which is highly probable at this point.

The Consumer Price Index is rising at a slow pace by historical comparison, with increases concentrated in a few key areas

Consumer price increases remain moderate

Despite a near-record duration for the current expansion, increases in consumer prices remain moderate. The Consumer Price Index posted a 2.0 percent increase for the 12 months through April. The volatile food and energy categories had gains of 1.8 and 1.7 percent respectively while the core consumer price index, which excludes food and energy, increased 2.1 percent. These increases are a bit faster

than the 5-year annualized gains of 1.5 percent for the consumer price index, 1.3 percent for food, and –2.5 percent for energy. The 5-year rate for the core consumer price index was 2.0 percent. The core consumer price index has been in the 1 to 2 percent range for most of the past 25 years, well below the double-digit gains of the early 1980s.

Key areas accounting for much of the persistent increases include owners' equivalent rent, tobacco, medical care, education, and, more recently, motor vehicle insurance. Owners' equivalent rent accounts for about 24 percent of the consumer price index and has posted a five-year annualized increase of 3.2 percent. A unique attribute of owners' equivalent rent is that there is no actual transaction. The number represents what a homeowner theoretically would pay to rent their home to themselves. An argument can be made that including a category with such a significant weight yet no real underlying transaction inaccurately boosts the final index. If food, energy, and shelter were excluded from the Consumer Price Index, the 12-month gain would be just 1.1 percent, exactly in line with the five-year annualized pace of increase.

Among the other significant contributors, tobacco prices are up 4.6 percent for the year and 4.3 percent annually over the last five years; medical care is up 2.3 percent for the year and 2.7 percent over five years; education has risen 3.3 percent over the past year and 2.9 percent annually over five years; and motor vehicle insurance is up 1.4 percent for the year but 5.7 percent annually over the last five years.

On the opposite end of the spectrum, the Consumer Price Index for all goods except for food and energy goods is down 0.2 percent for the past year and down 0.4 percent annually over the last five years. Overall, consumer prices have been increasing at a moderate pace. Food and energy continue to be volatile, but within the core consumer price index, goods prices are generally falling while services, particularly housing, education, and medical services, are rising.

Money-supply growth has decelerated

M2 money supply for the three months through April is up 2.1 percent versus a 6-month growth rate of 3.8 percent and a 12-month growth rate of 3.9 percent. The three-year annualized growth rate is 4.6 percent while the five-year growth rate 5.2 percent. The three-year and five-year growth rates were in the 8–10 percent range in the mid-1980s.

Commercial bank lending has been restrained

Commercial banking institutions in the U.S. increased total loans and credit outstanding by 1.3 percent in April, resulting in a 12-month rise of 4.7 percent. That is less than half the pace of credit growth over the two years prior to the last recession. Commercial and industrial loans led the way with a 7.6 percent increase over the past year while residential real estate loan growth came in at just 1.4 percent. Excessive credit growth can be a significant problem during economic expansions; however, the current pace of expansion appears modest.

Survey of senior loan officers suggests caution by bankers

The latest survey of senior loan officers at commercial banks suggests a degree of caution. The survey indicates that on average, bankers are tightening lending standards for commercial real estate loans amid weakening demand. However, bankers are generally holding standards steady or easing standards slightly for other categories including commercial and industrial loans, residential real estate, and consumer loans except for credit cards. In all categories, bankers are reporting somewhat diminished demand for new credit.

Household and corporate balance sheets are generally healthy…

Household net worth hit a new record high in the first quarter, reaching $108.6 trillion, an increase of 4.5 percent versus the fourth quarter of 2018. Household liabilities were essentially flat while assets rose 3.9 percent. Liabilities as a percentage of assets fell to 12.9 from 13.4 percent at the end of 2018, well below the 40-year average of 14.6 percent. In aggregate, household balance sheets appear solid.

The nonfinancial corporate sector saw a similar improvement. Total assets rose by 2.2 percent while total liabilities rose just 0.8 percent. The liabilities-to-assets ratio fell to 43.6 percent in the first quarter from 44.2 percent. Both are below the 40-year average of 44.7 percent and well below the peak of 50.4 percent from the early 1990s. Despite some concern about corporate leveraging, aggregate balance sheets for the nonfinancial corporate sector are not at extremes. There does appear to have been some restructuring of corporate balance sheets over the last several years. On balance, the nonfinancial corporate sector has increased debt while reducing equity outstanding. This may be a reasonable shift given the low cost of debt financing. The risk is that when interest rates rise, debt-service costs will rise for debt that needs to be rolled over.

…but federal-government debt continues to explode

The federal government continues to run massive deficits. For the first 7 months of the government's fiscal year (October through April), the deficit totaled $531 billion versus $385 billion last year, a 38 percent jump. For the 12-month period through April 2019, the federal government ran a $924 billion deficit versus a $707 billion for the 12 months though April 2018, a 31 percent jump.

Total public debt outstanding as of the end of 2018 was 105.3 percent of gross domestic product. As of the end of 2007, just 11 years ago, total federal public debt as a share of gross domestic product was just 62.9 percent. According to the Treasury Department, total debt outstanding as of May 31, 2019, was $22 trillion. The latest projections by the Congressional Budget Office show deficits are expected to continue to run around 4 percent of gross domestic product over the next 10 years, adding significantly to total debt outstanding and increasing interest expense.

CAPITAL MARKET PERFORMANCE

(Percent change)

	May 2019	Latest 3M	Latest 12M	Calendar Year 2018	2017	2016	Annualized 3-year	5-year	10-year
Equity Markets									
S&P 1500	-6.7	-1.7	0.7	-6.8	18.8	10.7	9.3	7.3	11.7
S&P 500 - total return	-6.4	-0.7	3.8	-4.4	21.8	12.0	11.7	9.7	14.0
S&P 500 - price only	-6.6	-1.2	1.7	-6.2	19.4	9.5	9.5	7.4	11.6
S&P 400	-8.1	-5.2	-7.0	-12.5	14.5	18.7	6.6	5.6	12.1
Russell 2000	-7.9	-7.0	-10.3	-12.2	13.1	19.5	8.3	5.3	11.3
Dow Jones Global Large-Cap Index	-6.2	-2.0	-2.7	-10.4	42.9	-10.0	11.3	3.3	6.9
Dow Jones Global Large-Cap ex-U.S. Index	-5.7	-3.1	-7.8	-15.7	41.0	-10.7	7.9	-1.1	3.0
STOXX Europe 600 Index	-5.7	-1.0	-3.7	-13.2	7.7	-1.2	2.0	1.4	5.9
Bond Markets									
iShares 20-plus Year Treasury Bond ETF	6.6	9.8	8.8	-4.2	6.5	-1.2	0.4	2.9	3.4
IiShares AAA - A Corporate Bond Fund	1.4	3.1	3.8	-5.2	2.9	1.7	0.1	0.5	NA
Commodity Markets									
Gold	1.3	-1.2	-0.3	-1.7	12.6	9.0	2.3	0.9	3.1
Silver	-3.4	-8.4	-12.5	-8.3	3.8	17.5	-3.4	-5.3	-0.7
CRB all commodities	-1.5	0.8	-6.8	-5.4	2.2	12.9	0.3	-3.5	1.5

CONSUMER FINANCE RATES

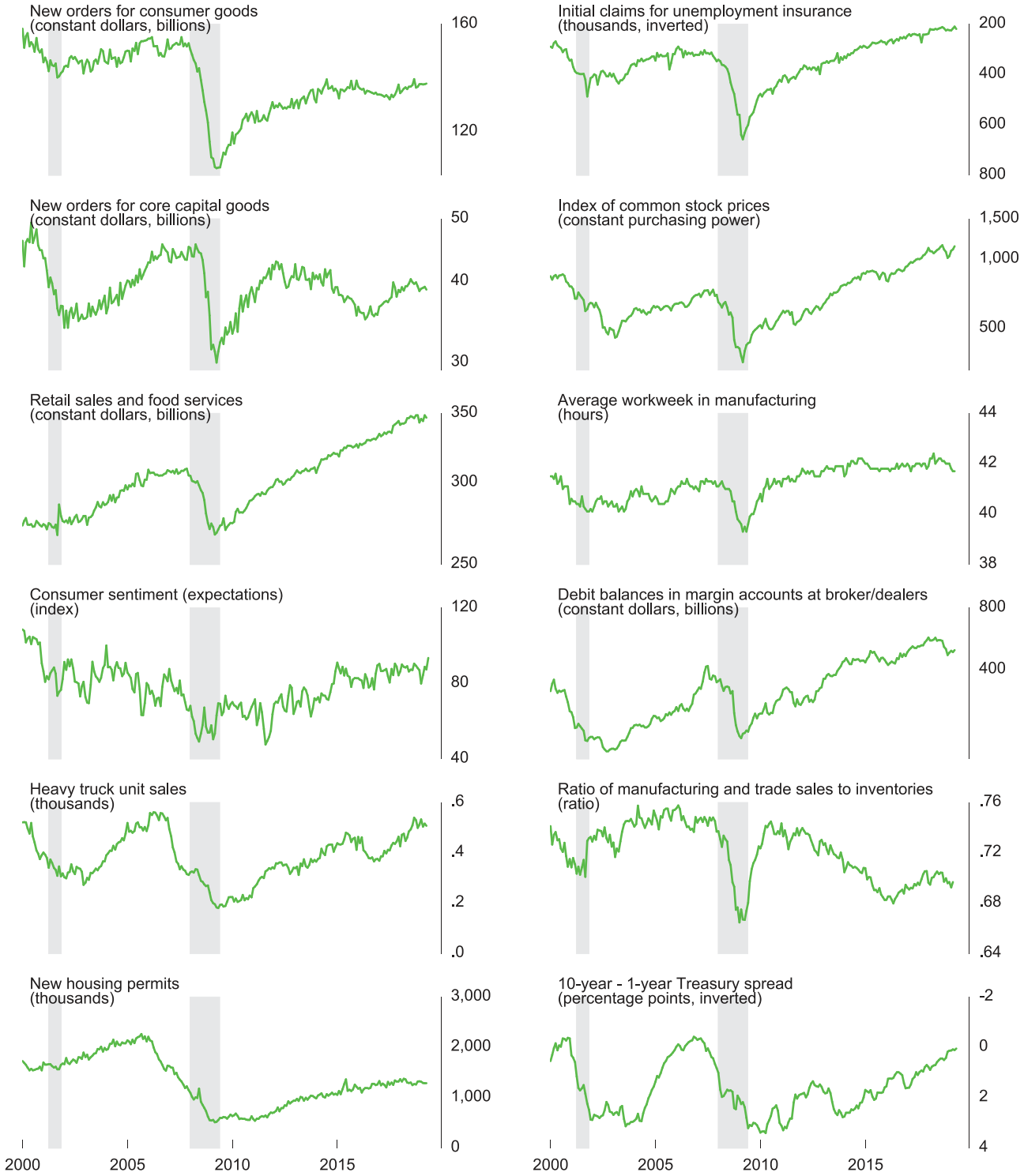
(Percent)

	May 2019	Latest 3M	Latest 12M	Average for Year 2018	2017	2016	Average over Period 3-year	5-year	10-year
30-yr. fixed mortgage	4.1	4.2	4.5	4.5	3.7	3.9	4.1	4.0	4.2
15-yr. fixed mortgage	3.5	3.6	4.0	4.0	2.9	3.1	3.5	3.3	3.5
5-yr. adjustable mortgage	3.7	3.7	3.9	3.8	2.9	2.9	3.4	3.2	3.3
48-month new car loan	NA	5.5	5.2	5.0	4.3	4.2	4.8	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: Barrons, Commodity Research Bureau, Dow Jones, Frank Russell, iShares, Standard & Poor's, STOXX Europe 600, Refinitiv.

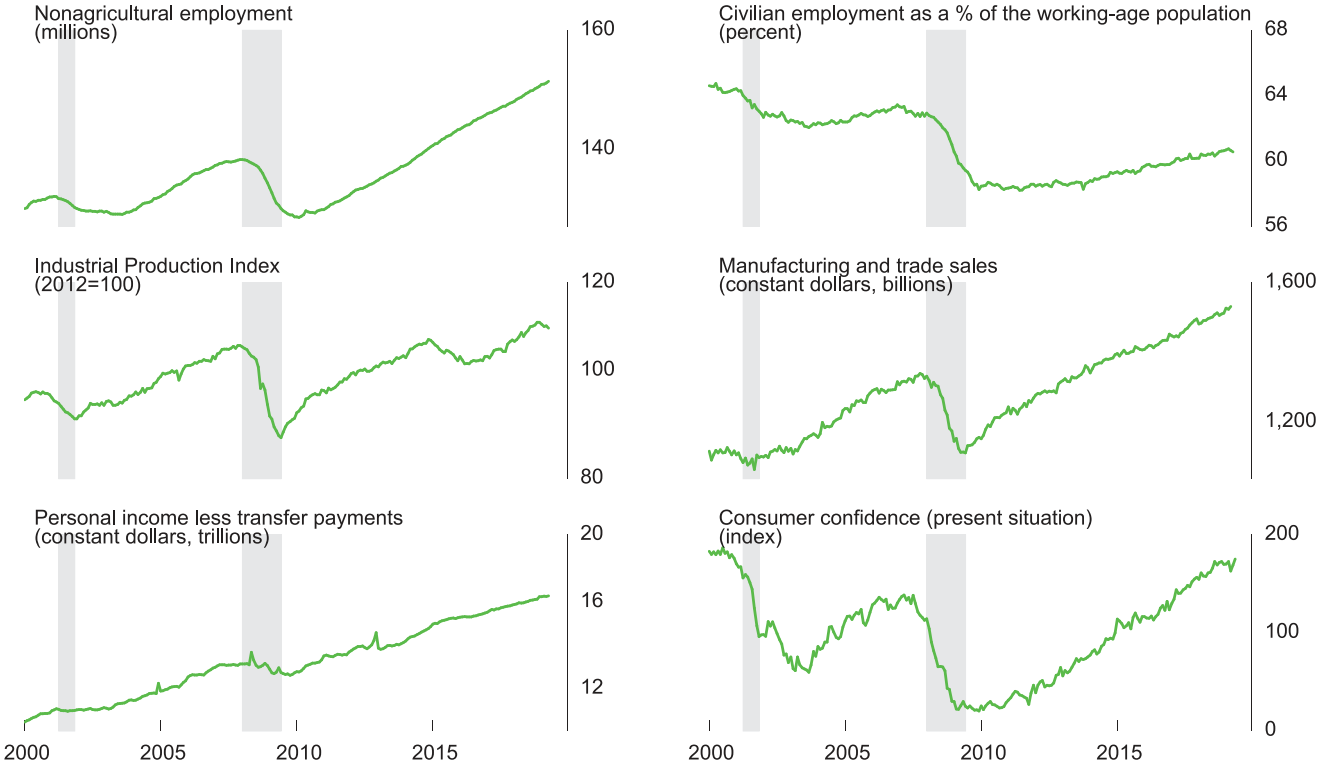
LEADING INDICATORS (2000-2019)



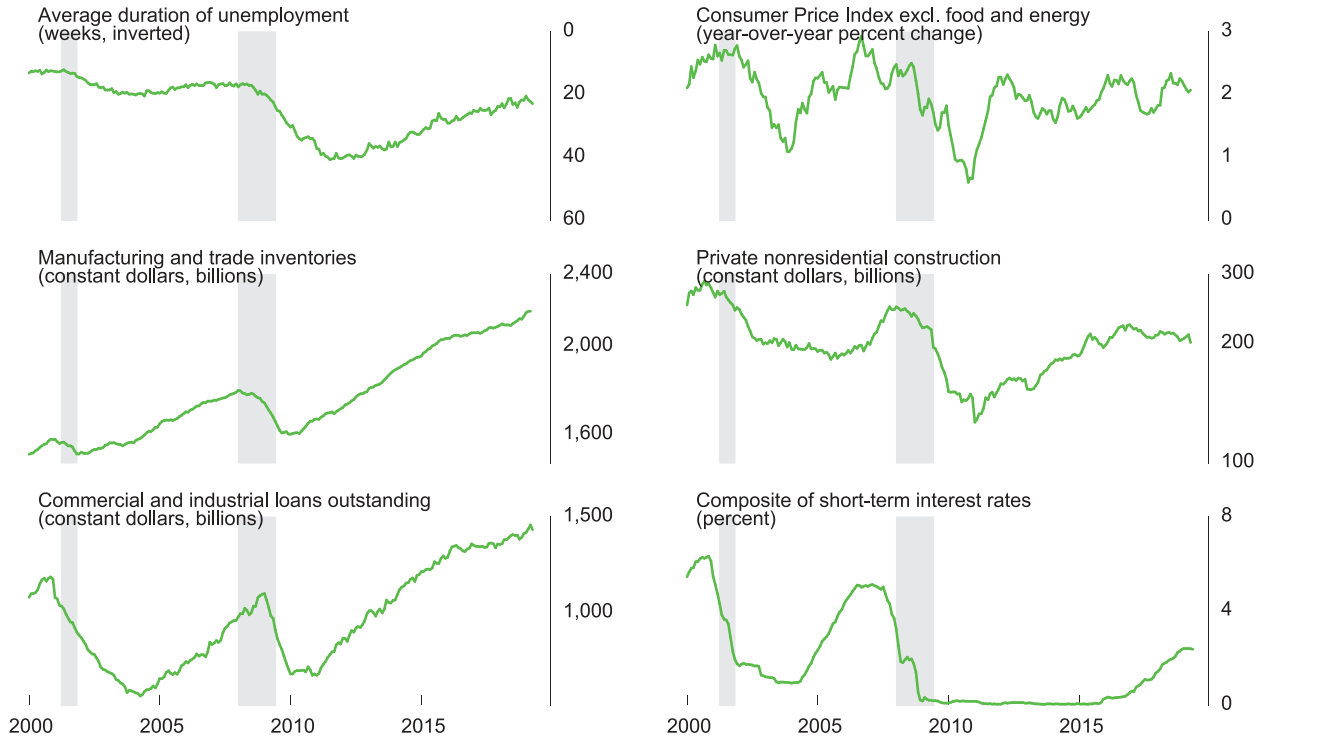
Sources for Appendix: Bureau of Economic Analysis, Bureau of Labor Statistics, Department of Labor, Federal Reserve, New York Stock Exchange, Standard & Poor's, The Conference Board, University of Michigan, U.S. Census Bureau (Thomson Reuters Datastream).

Note: Shaded areas denote recessions.

ROUGHLY COINCIDENT INDICATORS (2000-2019)



LAGGING INDICATORS (2000-2019)



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