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BUSINESS CONDITIONS MONTHLY

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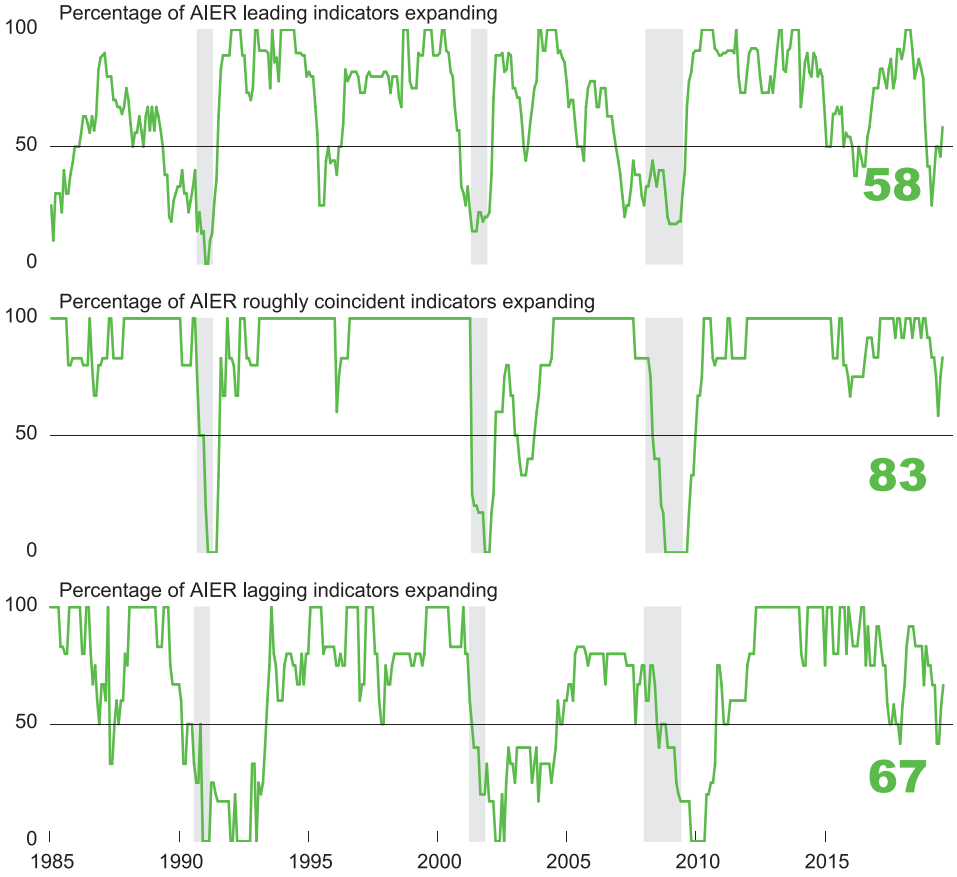
AIER's leading indicators index rose in August, moving slightly above neutral; consumers remain key.

AIER's Business Cycle Conditions Leading Indicators index posted a gain in August, rising to 58 following a dip below neutral in July. The Roughly Coincident Indicators index rose to 83 while the Lagging Indicators moved up to 67 (see chart). Across-the-board improvements for the three indexes are positive signs given the uneven performance of the underlying economy, but risks remain elevated.

Consumers remain critical to the outlook. Most of the changes in the Leading Indicators Index were related to consumers or the labor market. The broad range of economic data related to the consumer and labor market are mixed (consistent with the Leading Indicators Index fluctuating around the neutral 50 level), suggesting the economy remains vulnerable.

Incoherent, illogical, politically-motivated government policies are the biggest threats to economic stability and continued expansion. The outlook remains somewhat tilted to the positive, but careful monitoring of potentially destabilizing policy is warranted.

Chart 1. Indicators at a glance



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

Consumer and labor-market-related indicators drove changes to the Leading Indicators Index, highlighting their importance to the outlook.

Leading Indicators rebound in August but remain close to neutral

The Leading Indicators index rose to 58 last month following a below-neutral 46 in July. Over the last six months, the Leading Indicators Index has an average of 44.5, with three readings below neutral (including a low of 25 for March), two exactly neutral, and just one above neutral. Over the prior six months, the average was 65.3 with just two coming in below neutral. While the Leading Indicators Index has weakened on average, it has shown some improvement since hitting the low in March. Still, the latest reading of 58 is close enough to neutral to justify concern.

The index had five changes in August among the 12 leading indicators with three related to consumers or the labor market. The changes were mostly offsetting with a slight net on the positive side. Initial claims for unemployment insurance improved from a neutral trend to a favorable trend. This suggests the labor market remains healthy. However, the August employment report (which came out after the indicators were updated) was also mixed, with private-sector jobs growth slowing significantly but average hourly earnings posting solid growth, the length of the average workweek increasing, the unemployment rate holding steady near a multi decade low, and the participation rate rising.

Another consumer-related leading indicator, real new orders for consumer goods, jumped from a negative trend to a positive trend suggesting retailers have some confidence in the outlook for consumer spending. However, consumer sentiment (The University of Michigan Index of Consumer Expectations) fell from a positive trend to a negative trend, offsetting the improvement in consumer-goods orders.

Heavy-truck unit sales moved back to a positive trend after just one month in a neutral trend. As discussed last month, sales have been on a solid rising trend since hitting a multi decade low during the Great Recession. However, the path upward has not been straight. The trend in sales turned negative twice during the climb from the recession low, first in 2012, then again in 2016. The possibility that the transition to a neutral trend last month may have been just a pause in the upward trend appears credible.

Debit balances in customer margin accounts moved to a positive trend just one month after moving to a neutral trend. Though the debit-balances indicator had been in an uptrend from mid-2016 through early 2018, hitting a record high in January 2018, it has been trending flat or downward for most of the past 18 months.

Overall, 7 of the 12 leading indicators maintained a positive trend in August, with the remaining 5 trending lower.

The Roughly Coincident Indicators had one change in August as consumer confidence in the present situation moved from neutral to positive (a stark contrast to the weakening of the University of Michigan leading indicator). That change pushed the overall index from 75 to 83 in August. The strong labor market has been a main reason for continued high levels of consumer confidence in the present situation. If the labor market should weaken, confidence may quickly follow.

AIER's Lagging Indicators index posted its second straight gain, rising to 67 in August from 58 in July and readings of 42 in June and May. Only one indicator changed direction in August as the core CPI indicator moved to a neutral trend from a negative trend. Overall, three indicators are trending higher, one is trending lower, and two are neutral.

The Leading Indicators index improved in August but remains near the neutral 50 level, reflecting the uneven performance of the economy. With consumer spending accounting for about 70 percent of nominal gross domestic product, as goes the consumer, so goes the economy. Monitoring consumer fundamentals (jobs, income, wealth, and sentiment) is advisable. Overall, the results of the business cycle indexes suggest a slightly positive but cautious outlook.

Private-sector jobs growth has slowed, raising the question: is hiring slowing because of difficulty finding qualified employees or because employers are becoming more cautious in an environment of incoherent, illogical, politically-motivated government policies and escalating trade wars?

Mixed signals from the August jobs report

U.S. nonfarm payrolls added 130,000 jobs in August, putting the three-month average at 156,000, well below the 199,000 average since 2011. Despite the slow-down in jobs growth, hourly earnings rose, the length of the workweek increased, the unemployment rate held steady and the participation rate rose.

Private payrolls added just 96,000 in August resulting in a three-month average of 129,000. Over the past year, the monthly gain for private payrolls is 165,000. Since 2011, the 12-month average gain has ranged between roughly 150,000 and 250,000, putting the last 12 months in the lower part of the range. Job creation has clearly slowed over the past 7 months. A critical question therefore is: has hiring slowed because of difficulty finding qualified employees or because employers are becoming more cautious in an environment of incoherent, illogical, politically-motivated government policies and escalating trade wars?

On the positive side, the unemployment rate held steady at 3.7 percent for the third month in a row and the participation rate rose in August to 63.2 percent. The unemployment rate is just 0.1 percentage points above the 3.6 percent cycle low from April and May 2019 and the second-lowest since 1969.

Average hourly earnings rose 0.4 percent in August, resulting in a 12-month gain of 3.2 percent; it has been above 3 percent for 11 months. The average length of the workweek increased by 0.1 hours to 34.4 hours in August.

Combining payrolls with hourly earnings and hours worked, the index of aggregate weekly payrolls rose 0.7 percent in August and is up 4.5 percent from a year ago. This aggregate measure has posted relatively steady year-over-year gains in the 3.5 to 5.5 percent range since 2011.

Will slowing jobs growth further damage consumer sentiment?

The August results from the University of Michigan Surveys of Consumers show overall consumer sentiment fell sharply from the final July result. Consumer sentiment fell to 89.8 in August, down from 98.4 in July. The result is the second-lowest result since 2016. The two sub-indexes were both lower in August. The current-economic-conditions index fell to 105.3 from 110.7 in July while consumer expectations, one of the AIER leading indicators (see above) — plunged to 79.9 in August versus 90.5 in July.

A number of key points came out of the survey: monetary and trade policies have heightened consumer uncertainty—but not pessimism—about their future financial prospects; consumers strongly reacted to the proposed September increase in tariffs on Chinese imports; consumers' reaction from the first cut in interest rates in a decade was to increase apprehensions about a possible recession; consumers concluded that they may need to reduce spending in anticipation of a potential recession; it is likely that consumers will reduce their pace of spending while keeping the economy out of recession at least through mid 2020.

Retail sales have been relatively strong recently

Retail sales and food-services spending rose 0.7 percent in July following a 0.3 percent gain in June. Excluding the volatile auto and energy categories, core retail sales and food services were up 0.9 percent in July after a gain of 0.6 percent in June. Both categories have risen for five consecutive months. Over the past year (through July), total retail sales and food services were up 3.4 percent while core retail sales and food services have increased 4.2 percent. Strength in July was widespread, with gains in 10 retail-spending categories, while 3 categories posted declines. Continued gains in retail sales and consumer spending overall are likely heavily dependent on continued strength in the labor market and confidence that government policies will not cause a recession.

The personal-consumption-expenditures price index continues to rise at a slow pace by historical comparison.

Consumer price increases remain modest

The personal-consumption-expenditures price index rose at a 1.4 percent pace for the 12 months through July. For core consumer prices, which exclude volatile food and energy components, the index rose 1.6 percent. Over the past 20 years, the annualized rate of increase in the core personal-consumption price index is 1.7 percent. Core consumer-price increases have stabilized at just under 2 percent and appear unlikely to accelerate dramatically in the quarters ahead.

Price increases are not widespread. The areas showing the most significant, persistent increases are: owners' equivalent rent (a fictitious number representing what home owners would pay themselves to rent their home), some areas within health care, education, restaurants, some areas of insurance, and some areas of household services. Most goods prices continue to fall, especially technology goods.

Money-supply growth has accelerated recently

M2 money supply for the three months through July is up 8.0 percent versus a 6-month growth rate of 5.8 percent and a 12-month growth rate of 4.8 percent. The three-year annualized growth rate is 4.9 percent while the five-year growth rate is 5.4 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 0.3 percent in July, resulting in a 12-month rise of 4.9 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 6.4 percent increase over the past year followed by consumer loans, up 5.3 percent. Residential real estate loans posted the slowest growth at just 2.4 percent. Excessive credit growth can be a significant problem during economic expansions; however, the current pace of expansion appears modest.

Bond yields have plunged in 2019

While a long economic expansion, tight labor market, and massive federal budget deficits could be expected to produce rising bond yields, the combination of persistently modest price increases, extremely accommodative central bank policies around the world, and elevated uncertainty due to incoherent, illogical, politically-motivated government policies have resulted in a plunge in Treasury bond yields throughout 2019. After rising above 3.2 percent in late 2018, the yield on the 10-year Treasury bond has fallen to around 1.5 percent in recent weeks. Bond yields are likely to remain extremely low as long as price increases remain moderate and uncertainty over domestic and global economic growth remain elevated.

CAPITAL MARKET PERFORMANCE

(Percent change)

	August 2019	Latest 3M	Latest 12M	Calendar Year 2018	2017	2016	Annualized 3-year	5-year	10-year
Equity Markets									
S&P 1500	-2.1	6.1	-0.3	-6.8	18.8	10.7	10.1	7.7	11.2
S&P 500 - total return	-1.6	6.9	2.9	-4.4	21.8	12.0	12.7	10.1	13.5
S&P 500 - price only	-1.8	6.3	0.9	-6.2	19.4	9.5	10.5	7.9	11.1
S&P 400	-4.4	3.9	-8.0	-12.5	14.5	18.7	6.3	5.5	11.1
Russell 2000	-5.1	2.0	-14.1	-12.2	13.1	19.5	6.4	4.9	10.1
Dow Jones Global Large-Cap Index	-2.5	3.8	-1.9	-10.4	42.9	-10.0	12.7	3.5	6.2
Dow Jones Global Large-Cap ex-U.S. Index	-3.4	0.7	-5.2	-15.7	41.0	-10.7	8.2	-1.2	1.9
STOXX Europe 600 Index	-1.6	2.8	-0.7	-13.2	7.7	-1.2	3.4	2.1	4.9
Bond Markets									
iShares 20-plus Year Treasury Bond ETF	10.8	11.7	21.7	-4.2	6.5	-1.2	1.7	4.3	4.3
IiShares AAA - A Corporate Bond Fund	3.1	5.1	9.2	-5.2	2.9	1.7	0.9	1.3	NA
Commodity Markets									
Gold	7.1	17.6	27.1	-1.7	12.6	9.0	5.4	3.5	4.9
Silver	11.6	27.0	25.5	-8.3	3.8	17.5	-0.6	-1.1	2.4
CRB all commodities	-4.0	-6.9	-5.9	-5.4	2.2	12.9	-1.3	-4.4	0.3

CONSUMER FINANCE RATES

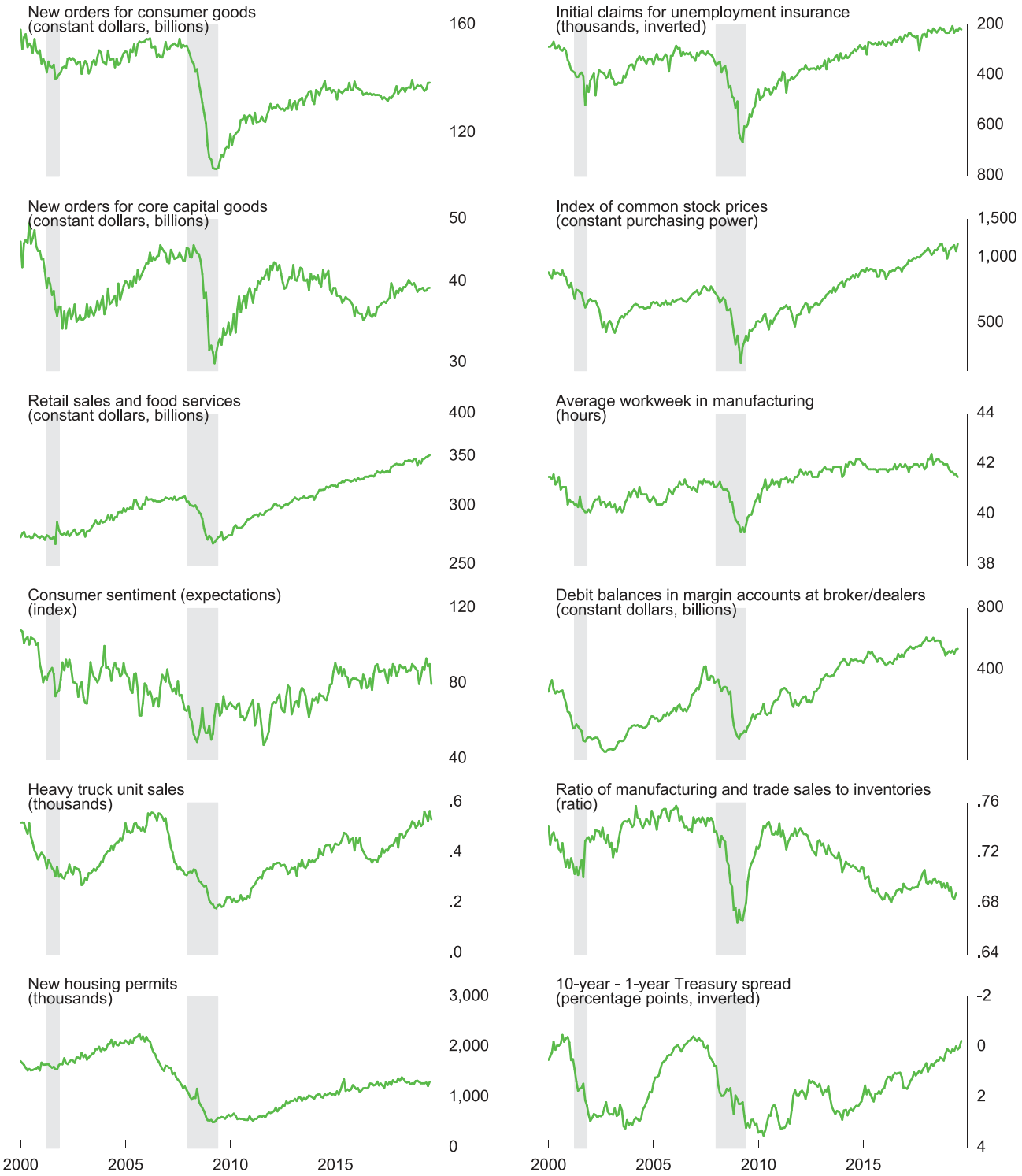
(Percent)

	August 2019	Latest 3M	Latest 12M	Average for Year 2018	2017	2016	Average over Period 3-year	5-year	10-year
30-yr. fixed mortgage	3.6	3.7	4.3	4.5	3.7	3.9	4.2	4.0	4.1
15-yr. fixed mortgage	3.1	3.2	3.7	4.0	2.9	3.1	3.5	3.3	3.4
5-yr. adjustable mortgage	3.4	3.4	3.8	3.8	2.9	2.9	3.5	3.3	3.3
48-month new car loan	NA	5.4	5.3	5.0	4.3	4.2	4.8	4.6	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.

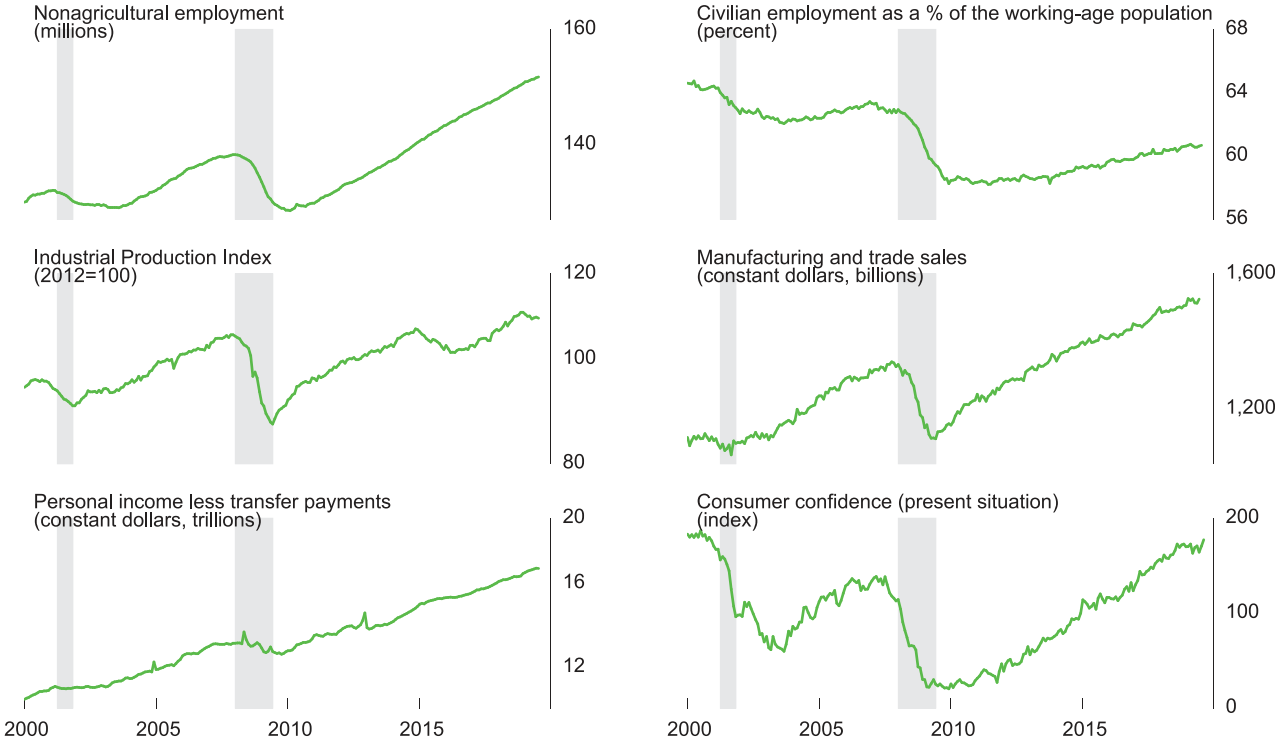
LEADING INDICATORS (2000-2019)



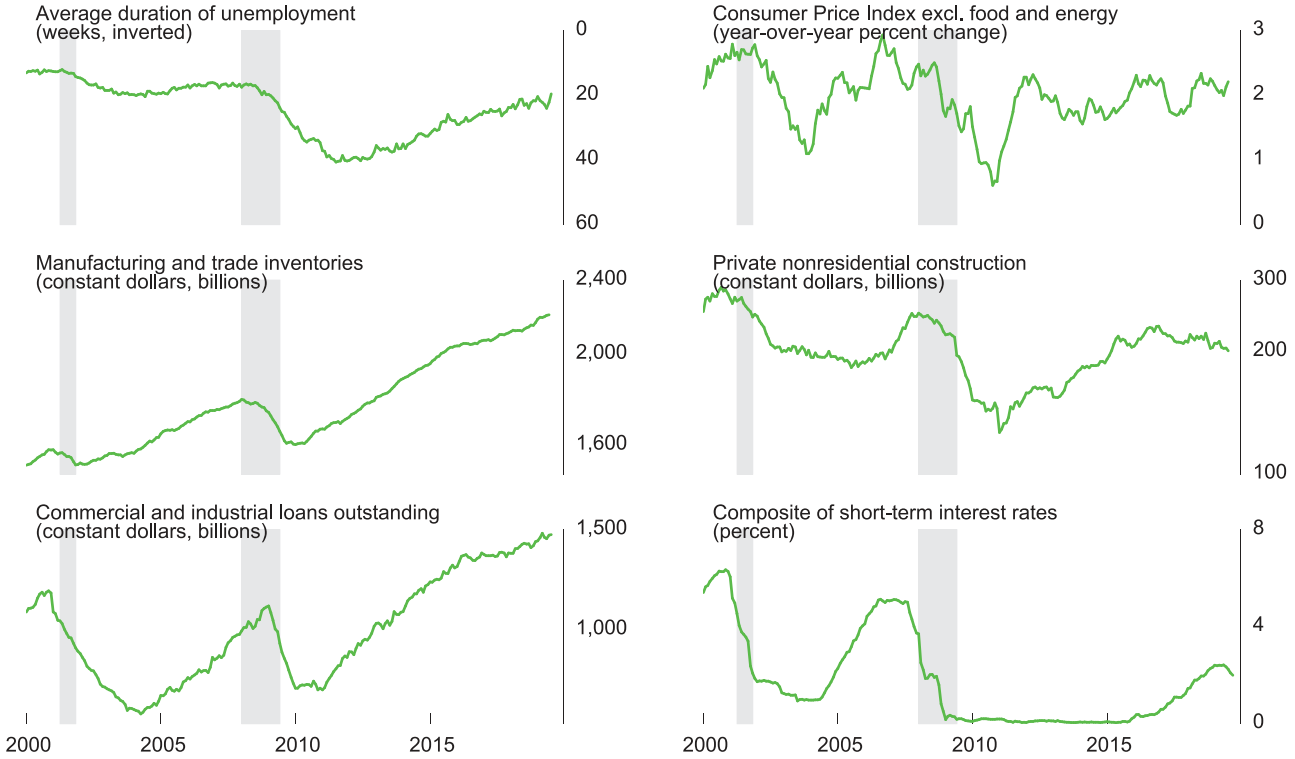
Sources for Appendix: Bureau of Economic Analysis, Bureau of Labor Statistics, Department of Labor, Federal Reserve, New York Stock Exchange, Standard & Poor's, The Conference Board, University of Michigan, U.S. Census Bureau (Thomson Reuters Datastream).

Note: Shaded areas denote recessions.

ROUGHLY COINCIDENT INDICATORS (2000-2019)



LAGGING INDICATORS (2000-2019)



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

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Research
Robert Hughes Senior Research Fellow

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

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