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BUSINESS CONDITIONS MONTHLY

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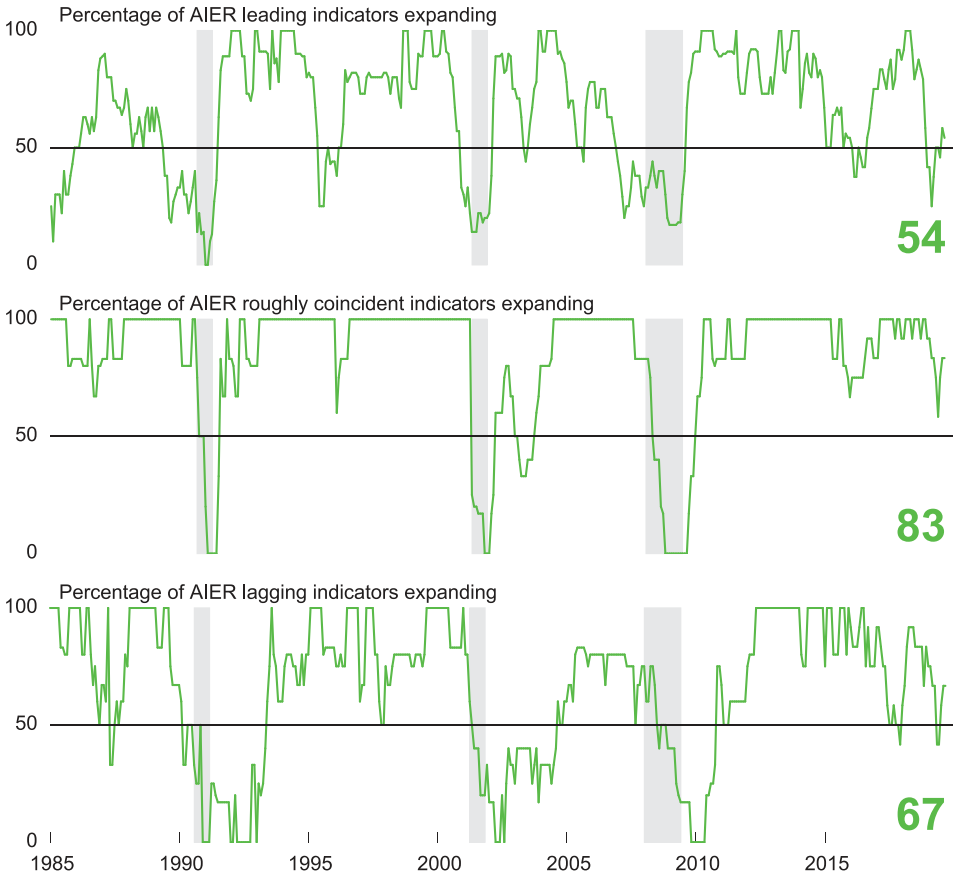
AIER's Leading Indicators index fell in September but remains slightly above neutral. Risks to the economy are rising.

AIER's Business Cycle Conditions Leading Indicators index fell 4 points in September, staying slightly above neutral at 54. The Roughly Coincident Indicators index held at 83 while the Lagging Indicators index remained unchanged at 67 (see chart).

Household net worth hit another record high for the second quarter as assets posted a solid gain while debt growth was modest. The long expansion has pushed unemployment to a multidecade low, supported income growth and boosted home prices. However, nonfinancial corporate debt is rising, a worrying trend given the recent signs of slowing economic growth, elevated risks to the economy from escalating trade wars, and inconsistent, incoherent economic policies.

Recent activity measures for the economy show the manufacturing sector continues to weaken. A survey of manufacturing suggests the downtrend may continue. Residential investment, housing, has been offsetting some of the recent weakness in manufacturing. New-home sales and construction are both getting a tailwind from lower mortgage rates, but a sustained surge is unlikely.

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 continued in September, but the index remains slightly above 50, suggesting continued economic expansion.

Leading indicators declined in September but remain above neutral

The AIER Leading Indicators index fell 4 points to 54 in September. The index has been range bound between 25 and 75 for 10 consecutive months, with three months, including the last two, coming in above 50, five coming in below 50 and two coming in exactly neutral. The average over the period is 46. Fluctuating around the neutral 50 level is consistent with the overall mixed performance of recent economic reports. The general message is continued economic expansion albeit at a slow pace and with a heightened degree of caution.

Overall, 6 of the 12 leading indicators had positive trends in September, with 5 trending lower and 1 indicator was neutral. Positive trends were seen in real retail sales and food services, real new orders for consumer goods, initial claims for unemployment insurance, real stock prices, the 10-year–1-year Treasury yield spread, and housing permits. A neutral result came from debit balances in customers' margin accounts while downtrends occurred in real new orders for core capital goods, total heavy-truck unit sales, the ratio of manufacturing and trade sales to inventory, the University of Michigan index of consumer expectations, and the average workweek in manufacturing.

The changes from the prior month were in total heavy-truck unit sales, moving from a positive trend to a negative trend, offset by housing permits moving from a negative trend to a positive trend. Debit balances in customers' margin accounts moved from a positive trend in the previous month to a neutral trend in the current month.

Overall, the Leading Indicators index remains slightly above 50, indicating continued expansion is likely. However, the recent fluctuation above and below neutral combined with the other mixed economic data and erratic policy suggest a high degree of caution is warranted.

The roughly coincident indicators held at a reading of 83 in September. The Roughly Coincident Indicators index dipped to a low of 58 in June but has stayed above neutral since February 2010. There were no changes among the six individual indicators in September, with five trending higher and one, industrial production, trending lower.

AIER's Lagging Indicators index was also unchanged in the latest month, holding at 67 in September. The index has been above neutral for three consecutive months following a pair of 42 readings in May and June. Among the six lagging indicators, four indicators are trending higher, two are trending lower, and none are neutral.

Consumer balance sheets look healthy with record-high net worth and the lowest liabilities-to-asset ratio since 1984.

Household net worth tops $113 trillion in the second quarter

Household net worth reached $113.5 trillion at the end of the second quarter. Total assets were $129.7 trillion, with financial assets at $90.7 trillion, or 70.0 percent of the total, while nonfinancial assets were $39.0 trillion, or 30.0 percent. Total assets increased 1.6 percent for the quarter and were up 4.7 percent from a year ago.

Household liabilities were $16.2 trillion at the end of the second quarter. Mortgage debt was $10.4 trillion, or about 64.2 percent of the total. Total household liabilities increased 1.1 percent for the quarter and were up 3.2 percent from a year ago.

Within total liabilities, mortgage debt rose 0.7 percent for the quarter while the value of household real estate rose 0.4 percent. Consumer credit totaled $4.1 trillion, or about 25.0 percent of total household liabilities after a 1.4 percent increase for the quarter. From a year ago, consumer credit is up 5.3 percent.

Total household liabilities were 12.5 percent of total household assets, the lowest ratio since 1984. The household debt service ratio, a measure of debt service as a share of disposable personal income, fell to 9.7 percent, an all-time low. The financial obligations ratio, a broader measure that includes debt service plus other financial obligations, fell to 15.0 percent, just above the low of 14.9 percent from 2012.

Personal savings rate was 10.5 percent in the second quarter

Personal savings rate holds above ten percent

The personal savings rate, savings as a percentage of disposable personal income, came in at 10.5 percent in the second quarter as measured by the flow-of-funds report. This measure is broader than the monthly measure from the Bureau of Economic Analysis that is often quoted.

On a three-year moving-average basis (to dampen quarterly volatility), the personal savings rate was 10.0 percent, down slightly from 10.1 percent in the first quarter. The rate has been bouncing around in the 10 to 12 percent range for most of the past nine years. That is a solid improvement over the 6 to 10 percent range for 1999 to 2008 period but well below the 15 to 18 percent range that prevailed for most of the period from 1965 through 1990.

Revised data show liabilities-to-assets ratio near all-time high.

Debt levels rising for Nonfinancial corporate balance sheets

Total liabilities for the nonfinancial corporate sector rose 0.8 percent in the second quarter, below the 2.3 percent gain in total assets. That result pushed the ratio of liabilities to assets down to 62.0 percent from 62.9 percent at the end of the first quarter. However, these newly revised data (including new sources and updated methodology) show a significantly higher debt ratio. The liabilities-to-assets ratio was in the 25 percent to 27 percent range for much of the 1950s. The ratio rose significantly over the next four decades, crossing the 60 percent threshold for the first time in 2000. The ratio retreated to a low of 49.4 percent by 2006 but then resumed an upward trajectory hitting the all-time high of 63.0 in 2018.

Ballooning Federal deficits are driving total government debt to new record high

Government still tops the pack for total debt outstanding

As of the end of the second quarter, total debt outstanding for the U.S. economy was $53 trillion. The largest debt load by sector was the Government with a combined $21.4 trillion or 40 percent of the total. The Federal government share was $18.4 trillion or 34.7 percent versus 24.6 percent at the end of 2009. Over the last 10 years, total Federal debt outstanding has more than doubled and current projections show large and growing budget deficits for the foreseeable future.

Escalating trade wars are taking a toll on U.S. manufacturing

Manufacturing struggles continue

Manufacturing-sector output, which accounts for about 75 percent of total industrial production, rose 0.5 percent in August. Within manufacturing, durable-goods production rose 0.5 percent, matching the gain for nondurable-goods production. From a year ago, durable-goods production is up a very modest 0.7 percent, with categories showing a nearly even mix of gains (6 industries have gains from a year ago) and losses (4 industries have declines from a year ago).

Measured by market segment, consumer-goods production (about 28 percent of total production) rose 0.2 percent in August, with consumer durables down 0.2 percent and consumer nondurables up 0.3 percent. Business equipment (about 10 percent of production) rose 1.0 percent in August and is up 0.4 percent from a year ago. Construction supplies increased 0.9 percent for the month and is up 1.0 percent over the past year. Material production (about 46 percent of output) increased 0.9 percent for the month and is up 0.6 percent from a year ago. The energy component has been a major source of volatility in this category,

particularly following the collapse of energy prices in mid-2014. The non-energy component rose 1.3 percent for the month and is up 3.4 percent from a year ago.

ISM survey suggests more weakness in September

The Institute for Supply Management's manufacturing PMI composite index fell to a reading of 47.8 in September from 49.1 in August. For this index, 50 is neutral, with readings above 50 suggesting expansion and readings below 50 suggesting contraction in manufacturing. Historically, readings above 42.9 have suggested expansion of the overall economy. The September result is the 125th consecutive month above 42.9 but the second month below 50.

Among the key components of the manufacturing index, the production index was 47.3 in September, down from 49.5 in August, suggesting manufacturing output slowed for a second month and the pace of decline accelerated. For September, just three industries in the manufacturing survey reported growth while 11 reported contraction.

The manufacturing new-orders index came in at 47.3, up slightly from 47.2 in August. These were the weakest back-to-back readings since the last recession. Three industries reported growth in new orders in September versus 11 industries with declining new orders. The new-export-orders index, a separate index that measures only orders for export, was 41.0 in September and has been below 50 for 3 consecutive months. The weak result is the lowest since 2009 during the Great Recession and is consistent with slowing global economic activity and deteriorating trade relations.

Housing activity has picked up modestly in recent months thanks to falling mortgage rates, but future gains are likely to be modest

New-home sales getting a tailwind from falling mortgage rates

Sales of new single-family homes jumped 7.1 percent in August to a 713,000 seasonally adjusted annual rate. Sales are up 18.0 percent from a year ago but remain below the peaks of prior expansions. New-home sales have been recovering from a retrenchment during the November 2017 through October 2018 period, and are getting support from a fall in mortgage rates that began in late 2018; however, it is unlikely to be the start of a new sustained surge in housing activity over the coming quarters.

Home construction has a bounce

Housing construction activity picked up in August as starts jumped by 12.3 percent while permits for future construction rose 7.7 percent. Total housing starts rose to a 1.364 million annual rate from a 1.215 million pace in July. The dominant single-family segment, which accounts for about three-fourths of new home construction, rose 4.4 percent for the month to a rate of 919,000 units.

Starts of multifamily structures with five or more units jumped 30.9 percent to 424,000, pushing activity above the robust 300,000 to 400,000 range that multifamily starts have been in for much of the last two economic expansions.

From a year ago, total starts are up 6.6 percent, with single-family starts up 13.7 percent and multifamily starts up 13.8 percent.

For housing permits, total permits rose 7.7 percent to 1.419 million from 1.317 million in July. Total permits are 12.0 percent above the August 2018 level. Single-family permits rose 4.5 percent to 866,000 in July while permits for two- to four-family units were off 2.2 percent and permits for five or more units were up 14.9 percent to 509,000. Permits for single-family structures are up 4.5 percent from a year ago while permits for two- to four-family structures are up 15.8 percent and permits for structures with five or more units are up 27.3 percent over the past year.

CAPITAL MARKET PERFORMANCE

(Percent change)

	September 2019	Latest 3M	Latest 12M	Calendar Year 2018	2017	2016	Annualized 3-year	5-year	10-year
Equity Markets									
S&P 1500	1.8	1.0	1.3	-6.8	18.8	10.7	10.8	8.5	11.0
S&P 500 - total return	1.9	1.7	4.3	-4.4	21.8	12.0	13.4	10.8	13.2
S&P 500 - price only	1.7	1.2	2.2	-6.2	19.4	9.5	11.1	8.6	10.9
S&P 400	2.9	-0.5	-4.2	-12.5	14.5	18.7	7.6	7.1	10.9
Russell 2000	1.9	-2.8	-10.2	-12.2	13.1	19.5	6.8	6.7	9.7
Dow Jones Global Large-Cap Index	2.0	-0.4	-0.5	-10.4	42.9	-10.0	13.4	4.6	6.0
Dow Jones Global Large-Cap ex-U.S. Index	2.5	-2.3	-3.3	-15.7	41.0	-10.7	9.1	0.3	1.8
STOXX Europe 600 Index	3.6	2.2	2.6	-13.2	7.7	-1.2	4.7	2.8	5.0
Bond Markets									
iShares 20-plus Year Treasury Bond ETF	-2.9	7.7	22.0	-4.2	6.5	-1.2	1.3	4.2	3.8
IiShares AAA - A Corporate Bond Fund	-1.1	1.9	8.7	-5.2	2.9	1.7	0.7	1.4	NA
Commodity Markets									
Gold	-3.6	4.4	23.7	-1.7	12.6	9.0	3.7	4.0	3.9
Silver	-6.1	13.4	20.6	-8.3	3.8	17.5	-3.7	0.2	0.5
CRB all commodities	0.1	-5.0	-6.6	-5.4	2.2	12.9	-1.3	-3.9	0.3

CONSUMER FINANCE RATES

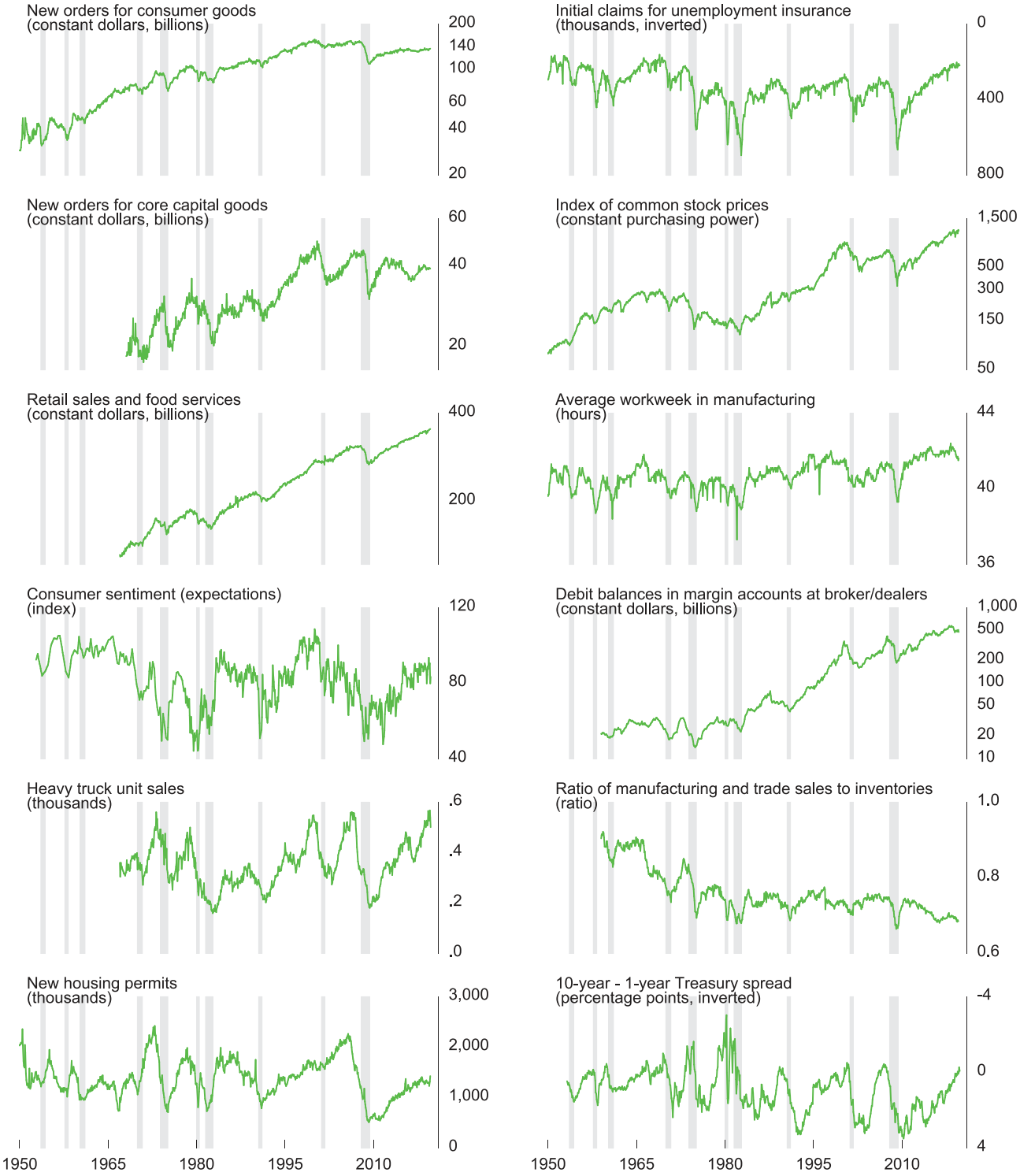
(Percent)

	September 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	NA	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.

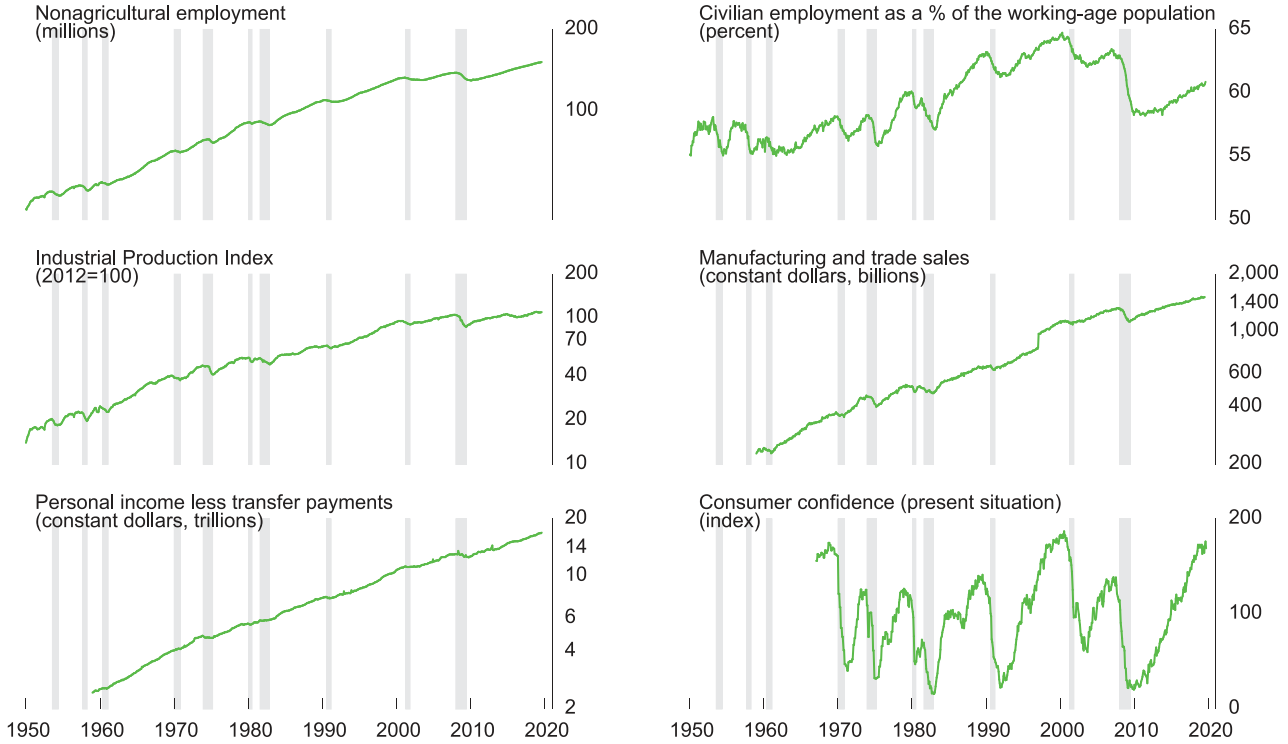
LEADING INDICATORS (1950-2019)



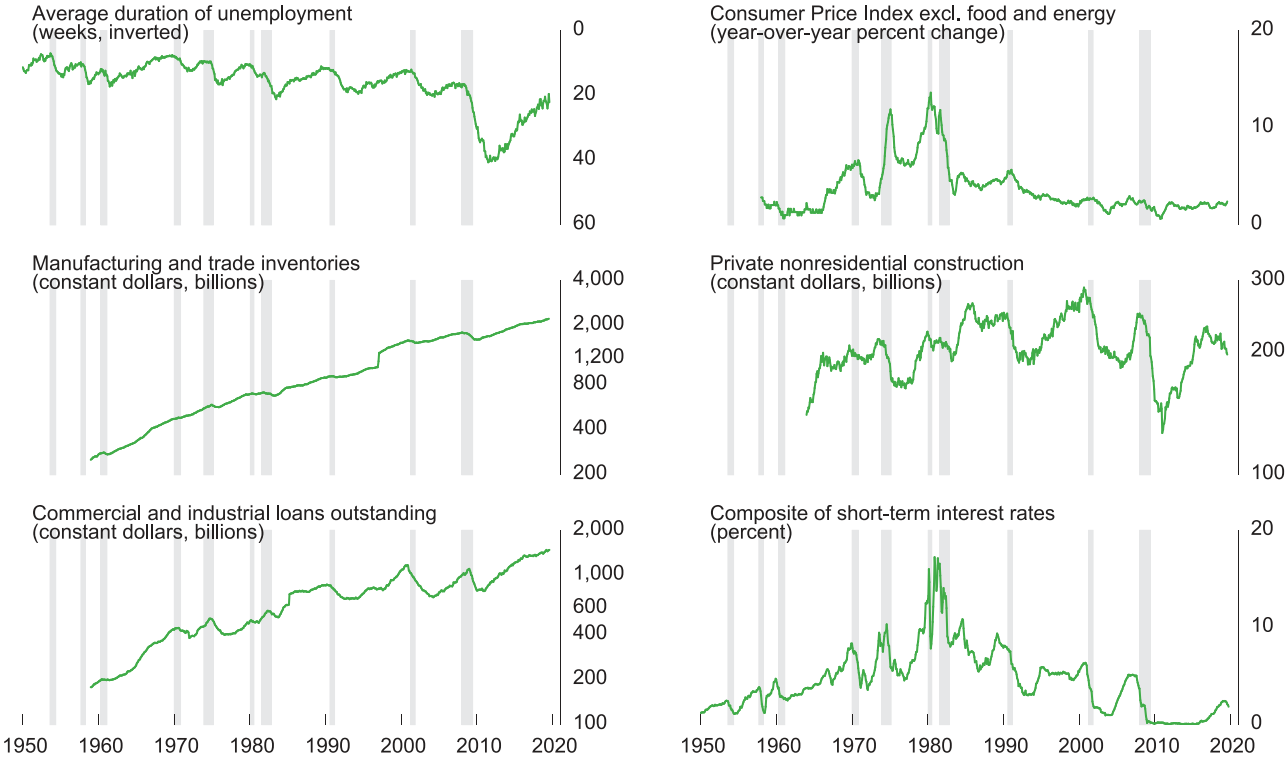
Sources for Appendix: Bureau of Economic Analysis, Bureau of Labor Statistics, Department of Labor, Federal Reserve, New York Stock Exchange, Standard & Poor's, The Conference Board, University of Michigan, U.S. Census Bureau (Thomson Reuters Datastream).

Note: Shaded areas denote recessions.

ROUGHLY COINCIDENT INDICATORS (1950-2019)



LAGGING INDICATORS (1950-2019)



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