

Economic Indicator — June 17, 2021

## LEI Points to Continued Expansion Despite Supply Chain Constraints

### Summary

The Leading Economic Index (LEI) rose another 1.3% in May after reaching its first post-COVID high in the prior month. The strength was broad-based, with seven out of 10 components positively contributing on the month, led by a 0.89 contribution from initial jobless claims. The Leading Index could be even stronger were it not for continued supply constraints.

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### Parts and Labor are Both in Short Supply

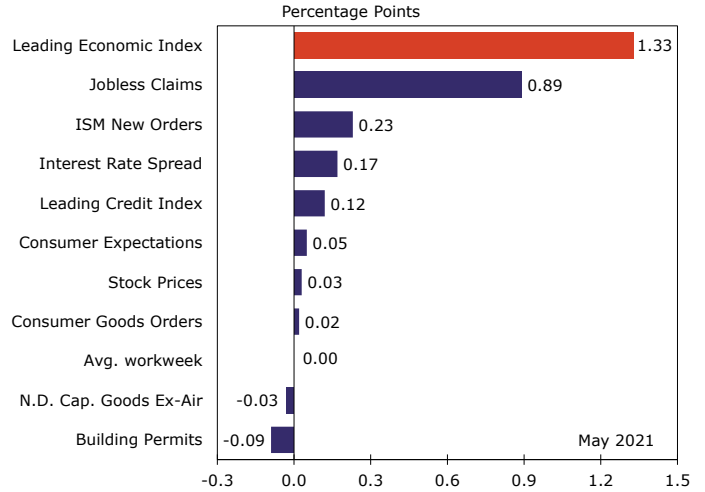
The Leading Economic Index continued to advance in May, rising 1.3% to 114.5. Similar to April's gain, the index's strength was broad-based with seven out of 10 components advancing on the month. The demand outlook remains promising, with ISM new orders and consumer expectations continuing to improve. The interest rate spread and the leading credit index also positively contributed on the month. Financing conditions have been rather favorable over the past year and should remain so, as credit quality continues to improve with the ongoing expansion.

In keeping with the theme of the past few months, May's increase could have been stronger had it not been for supply constraints holding up activity. Manufacturing hours worked, consumer and capital goods were all flat or marginally negative on the month. Producers are having trouble getting their hands on the parts and labor necessary to increase production. While these headwinds should fade over the course of the year as supply chains adjust and more workers are able and willing to return to work, we would not be surprised to see these supply chain and labor constraints still holding back the LEI next month.

### A Decline in Joblessness Advances the Economic Outlook

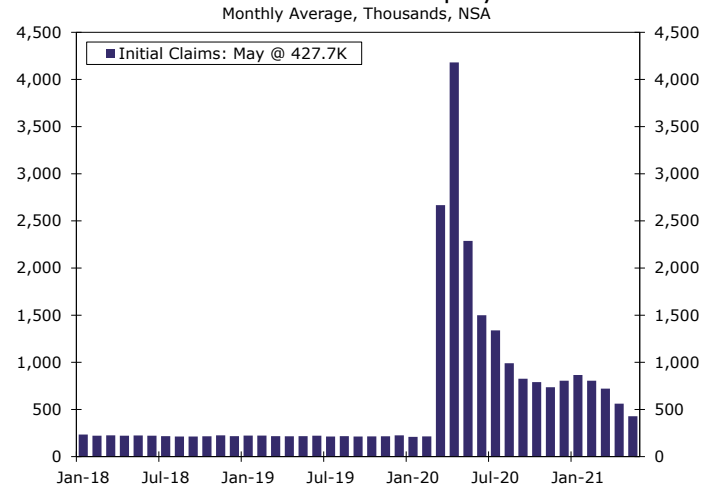
Once again, initial jobless claims provided the largest positive contribution on the month. As the economy has continued to reopen, workers have found themselves on more sure footing as job openings rise and layoffs fall. While both initial and continuing claims remain elevated relative to their pre-pandemic averages, they should recede in the coming months as the labor market recovery continues. Moreover, workers' incentive to claim benefits is starting to fall as expanded unemployment benefits expire. While the federal top-up to normal state benefits as well as the extended coverage for gig workers and the long term unemployed will not expire until September, 25 states have elected to end all or some of these benefits early. The cessation of benefits is intended to bring more workers back into the labor market, as companies struggle to staff up to meet the wave of demand enveloping most sectors of the economy. These moves could affect initial claims for regular state benefits—the series included in the LEI—at the margin, given that workers will have less incentive to file initial claims, but the larger effect is likely to be seen in continuing, PEUC and PUA claims. Layoffs, unsurprisingly, are likely to be the primary determinant of jobless claims' contribution going forward. According to the April JOLTS survey, layoffs are at their lowest level since at least 2002, and should remain low due to employers' inability to find new workers.

### Net Contributions to LEI



Source: The Conference Board and Wells Fargo Securities

### Initial Claims for Unemployment

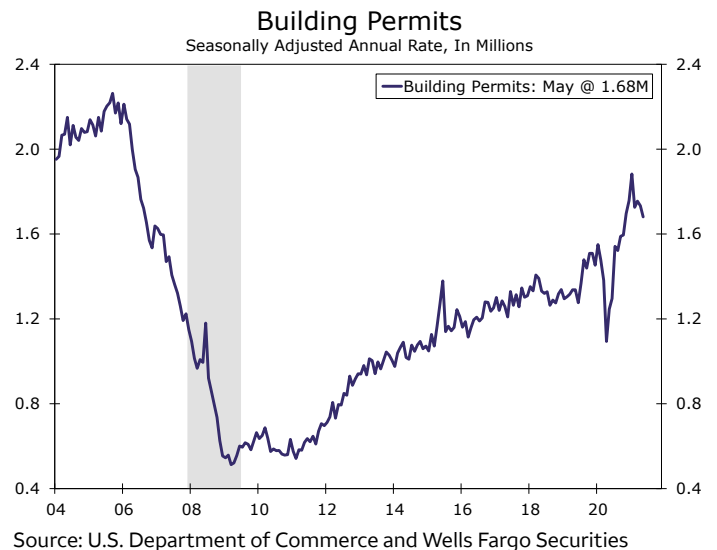


Source: U.S. Department of Labor and Wells Fargo Securities

## Material Shortages Forcing Home Builders to Hold Back

Building permits provided the largest negative contribution on the month. Much like the industrial sector, home builders have had to contend with an array of supply shortages that have boosted building costs. Even when builders are able to source the necessary supplies, it has become increasingly difficult to find the various tradesmen necessary to move forward with projects. While home building has rebounded over the past year, these headwinds have prevented many builders from keeping pace with surging demand, putting upward pressure on home prices.

Going forward, we expect home building to remain above its pre-pandemic trend. A lackluster recovery following the housing crisis and delays resulting from last year's shutdowns have left the country several millions homes short of demand, particularly at the starter-home level, according to report from Freddie Mac. Moreover, there is some evidence that certain supply constraints are easing, most notably lumber. While still elevated, lumber prices have fallen roughly 40% from their peak in May. Further price declines for this critical input along with an improving labor supply should help home building stabilize in the months to come.



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