WELLS FARGO

Economic Indicator — May 19, 2022

Leading Index Signals Slowing in April

Summary

While on the surface, the 0.3% dip in the Leading Index may send alarm bells ringing, April's decrease was partly affected by benign factors such as base effects leading to a negative contribution in jobless claims. More worrisome factors dragging on the index are ISM new orders and building permits. The economy is still growing (the Coincident Index added 0.4%), but trouble spots do exist.

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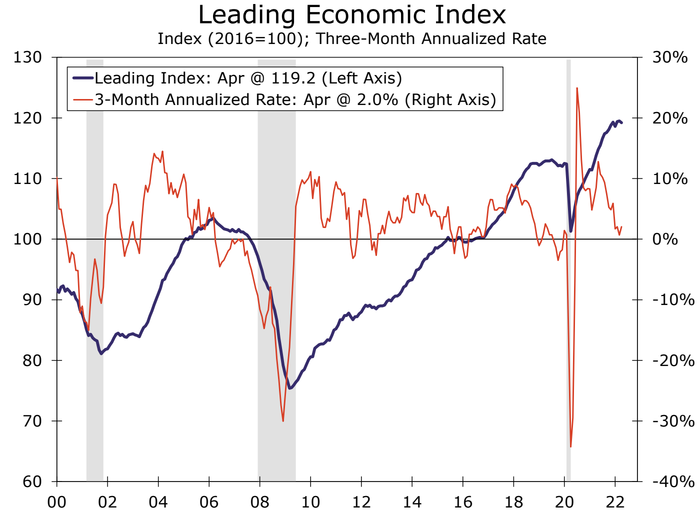
Growth Begins to Moderate

The Leading Economic Index (LEI) declined 0.3% in April, and points to slowing in 2022 after a run up in 2021 pushed the index to a series high. In 2021, the index jumped 7.7% over the year through last December, but at 119.2 in April, the LEI has given back some of those gains and is now at its lowest since November 2021. The three-month annualized pace has moderated to 2.0% in April, which is much slower than the almost 6% seen in December and pales in comparison to the double-digit rates seen in the summer of 2021.

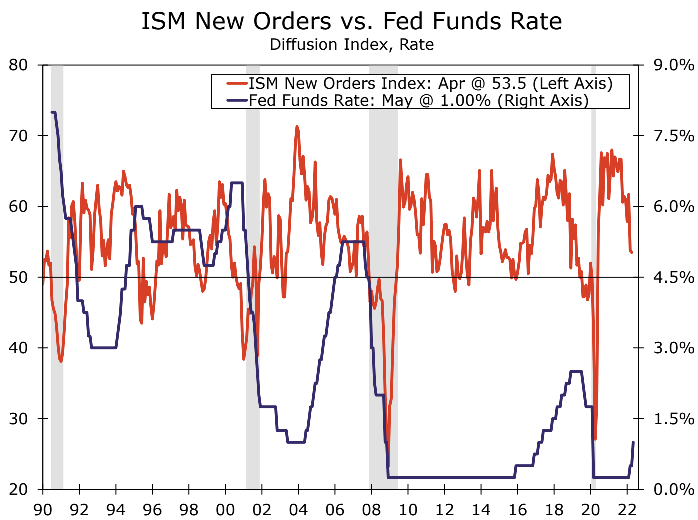
In recent months, it has been somewhat of a battle between the best and the worst of indicators as the interest rate spread and consumer expectations have taken center stage. Over the past three months, the interest rate spread has averaged a positive contribution of 0.26 percentage points (pp), while consumer expectations have dragged the headline index down an average of 0.22pp between February to April. As we have noted previously, the interest rate spread measures the 10-year Treasury bond yield minus the fed funds rate and has been boosted by the rapid climb in the 10-year yield since early March. Consumer expectations reflect the blow to consumer sentiment in the past few months. In its preliminary reading, Michigan's Consumer Sentiment Index dropped to a new decade low at 59.1.



Source: The Conference Board and Wells Fargo Economics

Pullback in Demand Amid Rising Rates

The broad-based decline in the LEI was also due to some weakness in ISM new orders and building permits. The ISM new orders index contributed -0.05pp as it fell for the second consecutive month in April. Building permits took away another 0.10pp as they dropped 3.2% in April from the month prior. The tenth of a percentage point was the largest negative contribution from building permits since September 2021 when the Delta variant lead to uncertainty in the housing market. Softness in both of these indicators likely arises from the influence of borrowing rates influencing demand atop the already expensive material and labor costs, which have been weighing on production of goods and deterring construction for quite some time. Mortgage rates have remained well-above 5% and have put a speed bump in front of a housing market that has surged full-steam ahead since the beginning of the pandemic era. The FOMC has already raised rates 75 bps since March and with more tightening on the way it would not be surprising to see further slowdown in these indices in the near term. Companies and households are going to have to adjust to more expensive borrowing costs after a period of prolonged cheap debt during the pandemic.

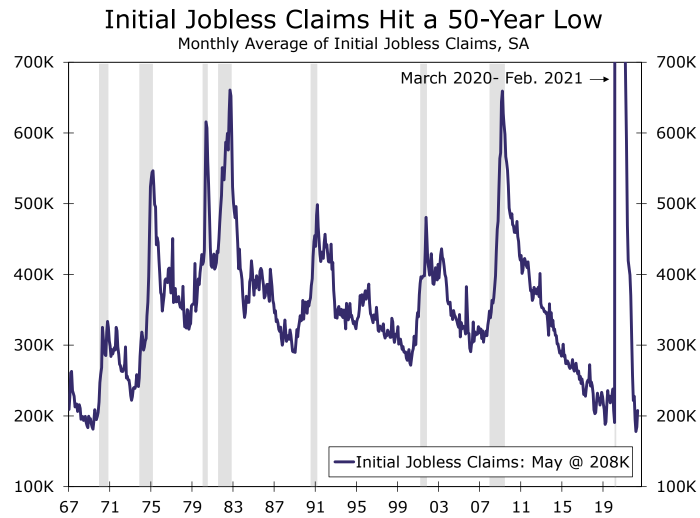


Source: Institute for Supply Management, Federal Reserve Board and Wells Fargo Economics

Jobless Claims a Head Fake, Labor Market Remains Extremely Tight

Initial jobless claims weighed on the LEI in April, but shouldn't be mistaken for a sign of a slowdown in the labor force. The average of jobless claims in March was an astounding 178K, which marks the lowest in the series in over 50 years. Although jobless claims rose in April, it was only to 184.4K, which marks the fifth lowest monthly print recorded. Similar to January, when initial jobless claims also negatively contributed to headline LEI, April's -0.08pp contribution from jobless claims had more to do with base effects that are extremely hard to compete with than any cause for concern.

For all the racket it has made recently, the S&P 500 did not add or subtract from headline LEI in April as the monthly average almost perfectly mirrored that of March to the decimal, staying at 4,391.3 points. Through mid-month in May, the monthly average of the index is down around 7.7% from April, without a sharp rebound, May LEI will be negatively affected. Another roughly neutral contribution came from consumer goods which technically added to the overall index but only a scant 0.01pp. In the near term, we suspect consumer goods will be at somewhat of a crossroads when it comes to demand pressures. Inflation looks to weigh on real disposable income, but up to this point consumers have kept spending even in the face of high inflation, corroborated most recently by the 0.9% increase in retail sales in April as well as notable upward revisions to March data.



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

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