Economic Indicator — August 19, 2024

Mis-Leading Index? LEI Breaks Through Pandemic-Era Low

Summary

The outlook for a soft landing is still in play, and the Leading Economic Index continues to signal otherwise. The LEI declined 0.6% in July, bringing the streak to 29 consecutive months without a gain. At 100.4, the index has now fallen below the prior cycle's low reached in April 2020.

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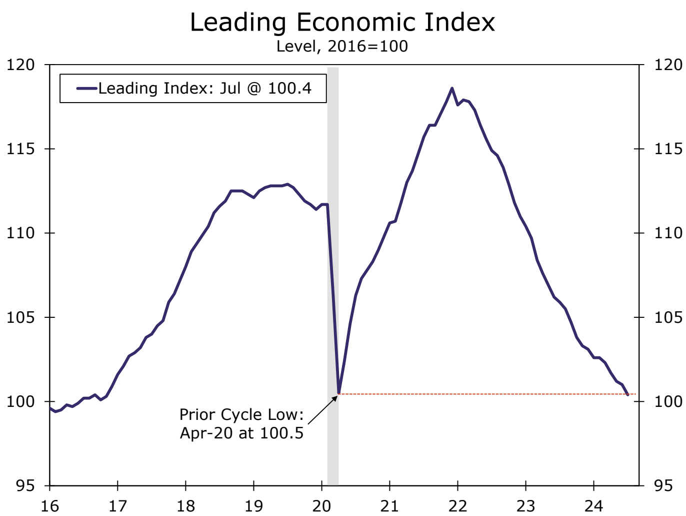
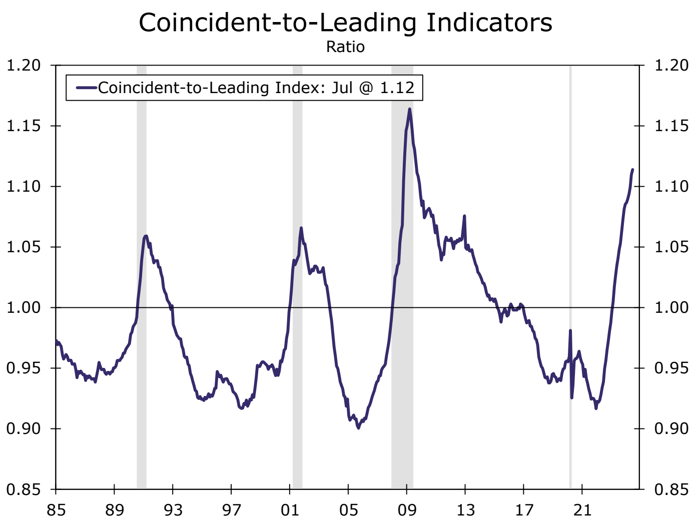


Source: The Conference Board and Wells Fargo Economics

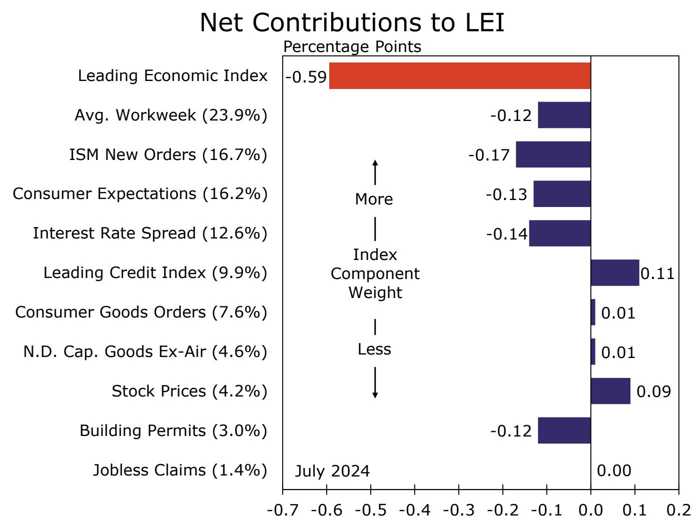
Long Way Down

The Leading Economic Index (LEI) declined 0.6% in July, bringing the streak to 29 consecutive months that the index has gone without an increase. The decline brings the index level to 100.4, declining below the prior cycle low previously reached in April 2020 (chart). The index level is now at its lowest point since 2016.

The Coincident Index came in flat on the month at 112.5. The index, a gauge of how the economy is currently performing, has been consistently increasing on trend since it began recovering from the 2020 recession. The recent positive trend for the Coincident Index in tandem with the persistently pessimistic trend in the LEI has led the Coincident-to-Leading Index ratio to increase exponentially. Ratio values greater than one signal that the outlook for the economy is comparatively worse than current economic performance, and vice versa. The ratio sits at 1.12 in July, signaling that the outlook for the economy is significantly more negative than the present situation (chart). This is the highest the ratio has been since 2009 in the trough of the Great Financial Crisis. The ratio usually peaks at the end of a cycle prior to a rebound in economic growth, a signal that the economy could be poised for decent growth in the quarters ahead.



Source: The Conference Board and Wells Fargo Economics



Source: The Conference Board and Wells Fargo Economics

Digging into the components of the LEI, most components contributed negatively to the monthly decline (chart). The largest drags were the usual suspects: the ISM new orders subindex subtracted 0.17 percentage points, consumer expectations subtracted 0.13 percentage points and the interest rate spread subtracted 0.14 percentage points. Building permits surprised to the downside in July, falling 4% to a 1,396K pace. The negative outturn was enough to take off 0.12 percentage points from the LEI. Recent labor market weakness from the July jobs report did not leave the LEI unscathed, as average weekly hours worked in the manufacturing industry also subtracted 0.12 percentage points.

There were only two components that contributed positively in July, with the Leading Credit Index leading the charge and adding 0.11 percentage points. The S&P 500 also modestly contributed 0.09 percentage points, offsetting some of the weakness in the other components. Any sort of sustained rebound in the LEI will require the consistent, significantly negative contributors of the ISM new orders index, consumer expectations and the yield curve to turn higher, an outcome that may still be a ways off given recent uncertainty around the timing and degree of monetary policy easing this year and next. Despite the indicator's trend decline and recession risks that remain elevated, the long downdraft in the LEI overstate recent weakness in the economy.

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