Economic Indicator — April 18, 2024

Old Habits Die Hard: The LEI Returns to the Red in March

Summary

After increasing for the first time in nearly two years in February, the Leading Economic Index slipped back into the red and declined 0.3% in March. Despite the monthly decline, the index broke above the threshold that is historically consistent with recession.

Economist(s)

Tim Quinlan
Senior Economist | Wells Fargo Economics
Tim.Quinlan@wellsfargo.com | 704-410-3283

Nicole Cervi
Economist | Wells Fargo Economics
Nicole.Cervi@wellsfargo.com | 704-410-3059

Monthly Decline, But Recession Light Went Out

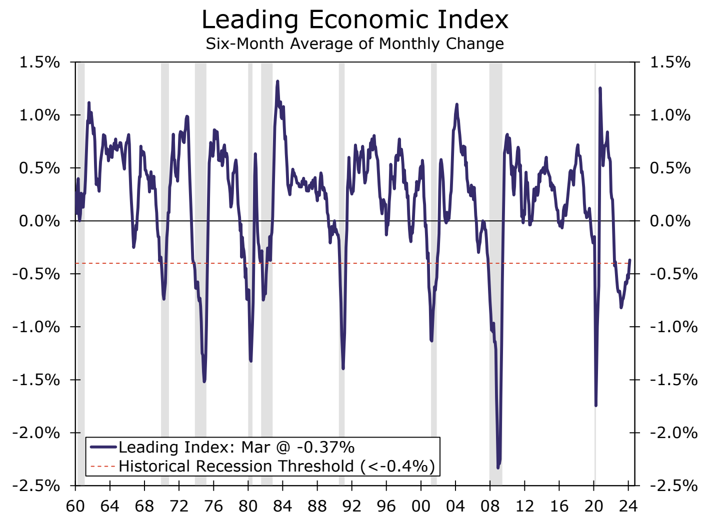
After increasing for the first time in nearly two years in February, the Leading Economic Index (LEI) slipped back into the red and declined 0.3% in March. The teetering is illustrative of rising uncertainty on the path of the U.S. economy in the coming year. Employment growth is solid, yet inflation has proven persistent and is supportive of a "higher-for-longer" interest rate environment. So while capital expenditures and residential construction had shown some signs of life in the opening innings of 2024, a sustained rebound in these interest-rate sensitive spaces may be a little ways away.

Despite the monthly decline in the LEI, the index is no longer signaling a recession. As shown in the nearby chart, whenever the six-month average growth rate of the LEI has fallen below -0.4%, a recession has occurred before the growth rate resurfaced. The index's increase in February and relatively smaller monthly declines over the past few months helped lift it above the recession threshold for the first time since July 2022, without a recession ensuing. The move corroborates the ISM manufacturing index breaking into expansionary territory for the first time in 16 months in March. While other recession bellwethers like the inverted yield curve are still flashing red, the LEI's improvement suggests the economy's underlying strength remains intact even if the pace of expansion is set to moderate in the coming months.

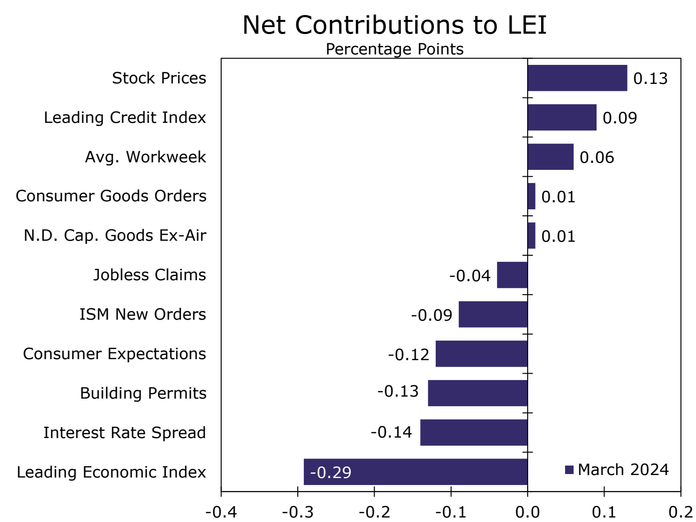
Digging into this report's monthly moves (chart), stock prices continued to lead the charge and the LEI by 0.13 percentage points (pp) in March. The positive contribution marks the fifth straight month of gains, but the tide may be turning. Weaker than expected earnings during the first quarter and rising Treasury yields have led the S&P 500 lower over the past few weeks. While markets have seen some recent softness, credit conditions remain accommodative. The Leading Credit Index added 0.09 pp to the LEI in March.

Beyond the financial sector, economic conditions look mixed. Average weekly hours worked by production workers in the manufacturing industry have inched up over the past few months, leading to a 0.06pp contribution. Manufacturers have edged up their capacity utilization as new orders have awakened in recent months. The new orders component of the ISM manufacturing index broke into expansionary territory in March, yet it remains below its long-term average and thus continues to weigh on the LEI (-0.09pp). Elsewhere, residential building permits (-0.13pp) pulled back last month as home builders have grown less optimistic about prospective demand amid the recent climb in mortgage rates back above 7%.

Overall, the mixed signals from the LEI's components point to activity in interest-rate sensitive sectors wavering in anticipation of lower borrowing costs this year. Yet the path of Fed easing is increasingly uncertain. Until we have more clarity on the timing and magnitude of rate cuts, the LEI may remain volatile.



Source: The Conference Board and Wells Fargo Economics



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Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Patrick Barley	Economic Analyst	704-410-1232	Patrick.Barley@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey George	Economic Analyst	704-410-2911	Aubrey.B.George@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Coren Burton	Administrative Assistant	704-410-6010	Coren.Burton@wellsfargo.com

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