

Special Commentary — October 12, 2023

## The Spirits are Spooked

### Summary

- Although the Animal Spirits Index (ASI) remained positive in September, it fell to 0.1 from 0.69 in August. This is the largest change in the ASI since March 2020.
- All five components were subtractive in September.
- The dramatic slip reflects the cracks that are beginning to emerge in the economy.

Economist(s)

#### **Azhar Iqbal**

Econometrician | Wells Fargo Economics  
Azhar.Iqbal@wellsfargo.com | 212-214-2029

#### **Delaney Conner**

Economic Analyst | Wells Fargo Economics  
Delaney.Conner@wellsfargo.com | 704-374-2150

#### **Nicole Cervi**

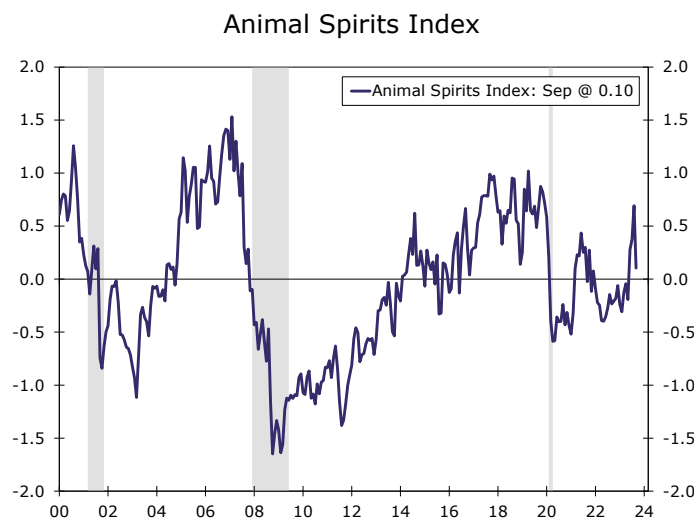
Economist | Wells Fargo Economics  
Nicole.Cervi@wellsfargo.com | 704-410-3059

## The Spirits Are Down for Spooky Season

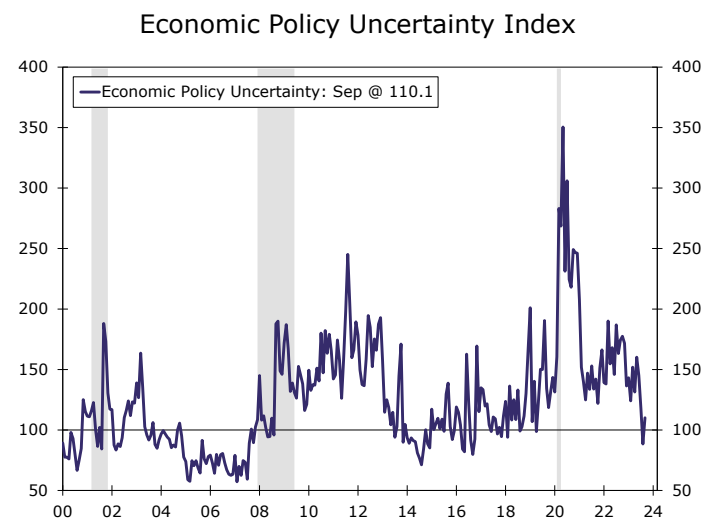
The Animal Spirits Index (ASI) fell sharply to 0.1 in September from 0.69 in August. Previous reports detail the index methodology, but on a basic level, an index value above zero indicates optimism and a value below zero suggests pessimism.<sup>1</sup> September's slip is the largest change seen in the ASI since March 2020.

The ASI consists of five indicators: the S&P 500 Index, the Conference Board's Consumer Confidence Index, the yield curve (the spread between the 10-year and three-month Treasury yields), the VIX Index and the Economic Policy Uncertainty Index. The policy uncertainty and VIX indices inversely affect the ASI. In other words, a rise in uncertainty or volatility decreases the index, while a fall increases the index, all else equal.

All five components were subtractive in September. Financial markets were down on the month. The eminent risk of a government shutdown at the start of the fiscal year as well as ongoing debates about the path of Fed policy contributed to the downswing. The S&P 500 Index dipped by about 220 points in September, while the VIX Index increased almost four points. In the bond market, the yield spread narrowed to -94 bps in September from -113 bps in August. However, the still-deep inversion continued to weigh on the ASI.



Source: Wells Fargo Economics



Source: Baker, Bloom & Davis and Wells Fargo Economics

Consumers were also pessimistic in September. The Consumer Confidence Index fell 5% over the month to 103, a noteworthy downfall from July's high of 114. Meanwhile, the Economic Policy Uncertainty Index jumped over 20 points to 110. In August, the policy index reached its lowest level since 2016. The spike over the month emphasizes the intense policy-related stress the potential government shutdown brought. While Congress was able to temporarily avert the shutdown, the ousting of Kevin McCarthy as Speaker of the House could also lead to increased policy uncertainty.

There are some cracks in the economy beginning to appear, and the downtick in September's ASI seems to reflect that. While core inflationary pressures continue to ease, households are being placed under increasing amounts of stress as interest rates continue to rise and growth in real disposable income has faltered. As rising real interest rates exert headwinds on the economy, we look for real GDP growth to turn negative next year and for the jobless rate to climb somewhat. The pullback is likely to weigh on the animal spirits throughout the end of this year and into next year, creating scope for the ASI to return to the negative.

## Endnote

1 - Please see [The Roar of the Animal Spirits: A New Index](#) and [Finding Neverland: What Drives Animal Spirits?](#) (January 2018). ([Return](#))

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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 Seery	Economist	704-410-0369	Shannon.Seery@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	704-410-1437	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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