October 18, 2012

Economics Group

Tim Quinlan, Economist
tim.quinlan@wellsfargo.com • (704) 374-4407

LEI & Philly Fed Both Surge: A Faster Pace of Growth?

The Leading Economic Index posted its largest monthly gain since February, and the Philadelphia Fed Survey returned to expansion territory for the first time since April. Is the economy poised for a growth spurt?

Residential Construction Boosts the LEI

The 0.6 percent monthly gain in the Leading Economic Index (LEI) bested consensus expectations for a more modest gain of just 0.2 percent. The best explanation we can offer for the miss is that most forecasters did not update their projection after yesterday's release of key residential construction data. That report showed that building permits posted the largest monthly spike (up 11.6 percent on the month) since the expiration of the homebuyer tax credit back in 2010. Building permits is one of the 10 input components of the LEI, and in the month of September, it was the primary driver of growth. In fact, this component alone exerted more of a boost than the second and third largest components combined.

The next largest contributors to growth in the LEI were both reflections of positive financial conditions. With stock prices generally up in September and the Fed's renewed efforts to keep the cost of consumer financing low, both the stock prices component as well as the credit index were the next largest positive contributors.

The gains in the LEI were strong enough to offset drags from the ISM new orders component, which remained soft in September, and jobless claims, which trended higher.

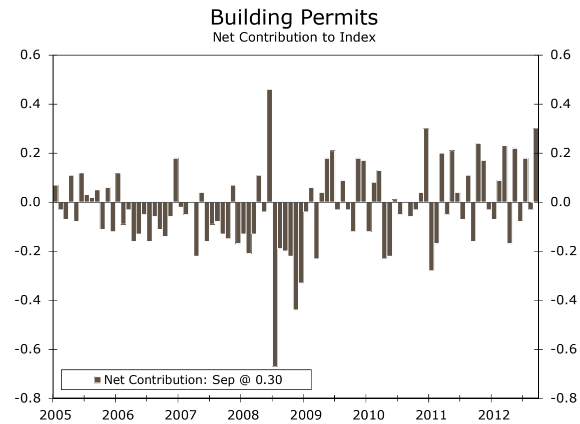
Bruised and Battered, Couldn't Tell What I Felt

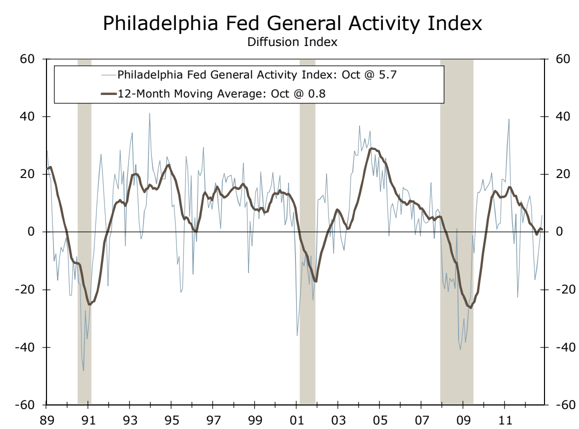
The Philadelphia Fed Index is prized for its long track record as a yardstick for factory sentiment. In the five months between May and September, this indicator offered an early warning signal that manufacturing activity was slowing. It turned out to be no "false-alarm" either, as non-defense capital goods orders ex-aircraft turned firmly negative in subsequent months. In that context, today's improvement in the Philly Fed index should come as a welcome departure from the more cautious tone. Unfortunately, the details of the report do not offer the comfort you might expect to find given the stronger headline reading.

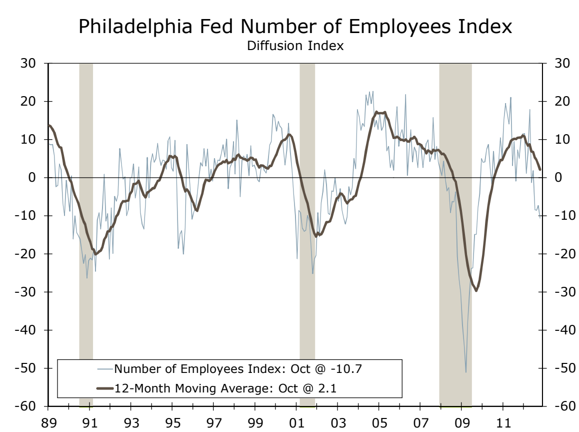
The prices paid component jumped to 19.0 from 8.0, but the prices received measure only improved to 5.4 from -0.2 in the prior month. This is not a good sign for corporate profits if businesses are not able to pass on higher prices. The labor market indicators were not good either, with the number of employees component falling further into contraction territory and the average workweek getting cut even shorter.

Bottom-line: Does This Change the Outlook?

There is some good news here. The improvement in the housing market in general and in residential construction specifically is a clear bright spot. Unfortunately, a lethargic recovery in the labor market and shakiness in orders and industrial production tell us to expect continued slow growth in the final quarter of the year.







Source: The Conference Board, Federal Reserve Bank of Philadelphia and Wells Fargo Securities, LLC

Wells Fargo Securities, LLC Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 715-8437 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 374-7034	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 383-5635	mark.vitner@wellsfargo.com
Jay Bryson, Ph.D.	Global Economist	(704) 383-3518	jay.bryson@wellsfargo.com
Eugenio Aleman, Ph.D.	Senior Economist	(704) 715-0314	eugenio.j.aleman@wellsfargo.com
Sam Bullard	Senior Economist	(704) 383-7372	sam.bullard@wellsfargo.com
Anika Khan	Senior Economist	(704) 715-0575	anika.khan@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 383-6805	azhar.iqbal@wellsfargo.com
Tim Quinlan	Economist	(704) 374-4407	tim.quinlan@wellsfargo.com
Michael A. Brown	Economist	(704) 715-0569	michael.a.brown@wellsfargo.com
Sarah Watt	Economic Analyst	(704) 374-7142	sarah.watt@wellsfargo.com
Kaylyn Swankoski	Economic Analyst	(704) 715-0526	kaylyn.swankoski@wellsfargo.com
Sara Silverman	Economic Analyst	(704) 715-7395	sara.silverman@wellsfargo.com
Zachary Griffiths	Economic Analyst	(704) 715-1030	zachary.griffiths@wellsfargo.com
Peg Gavin	Executive Assistant	(704) 383-9613	peg.gavin@wellsfargo.com
Cyndi Flowe	Administrative Assistant	(704) 715-3985	cyndi.h.flowe@wellsfargo.com