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Economics Group

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Thank You, Yield Spread, For Another Gain in LEI

The Leading Economic Index added 0.2 percent in January consistent with our slow growth outlook. The top driver was the yield spread—the difference between 10-year Treasury yield and the Fed Funds rate.

After 4+ Years, Can We Still Call it Unconventional?

The Leading Economic Index added another 0.2 percent in January signaling the slow growth expansion will continue. Having said that, the top contributor to the increase in January is more a reflection of stimulative monetary policy than a self-sustaining expansion. The yield spread added 0.19 points to the overall index and is essentially a function of the Federal Reserve's determination to keep its target lending rate at historic lows while continuing to engage in "unconventional" asset purchases. It bears noting that quantitative easing began with $600 billion in agency mortgage backed security purchases in December 2008. That program was extended in March 2009. Fed Chairman Ben Bernanke laid out the plans for what would come to be known as "QE2" at the Jackson Hole meeting of global heads of central banks in the Summer of 2010, though that program was not official Fed policy until November of that year. Operation Twist followed in 2011 in an attempt to bring down longer-term rates before the Fed committed to unlimited asset purchases in September 2012 with additional funding for that program approved in December 2012. What this means for the LEI is that this accommodative monetary policy has allowed the yield spread to be a key driver of "growth" on an uninterrupted basis for more than four years.

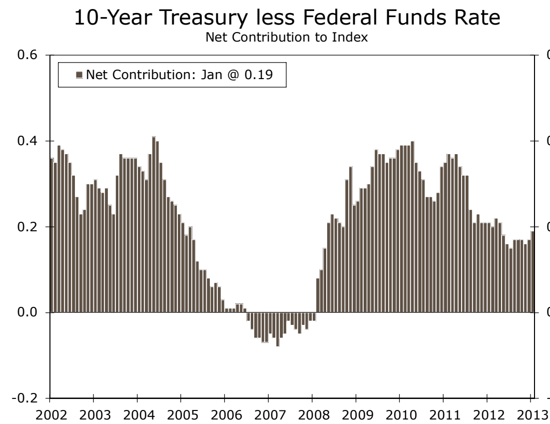
Stock Market Gains and Construction Recovery Help

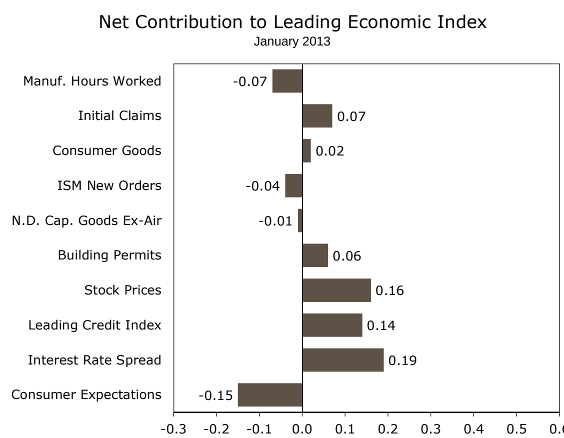
That is not to say that there are no prospects for growth outside of stimulative monetary policy. Indeed, stock prices jumped in January and those gains resulted in the second largest overall contribution to the LEI. The ongoing healing in residential construction was visible in the boost to the index from a January increase in building permits.

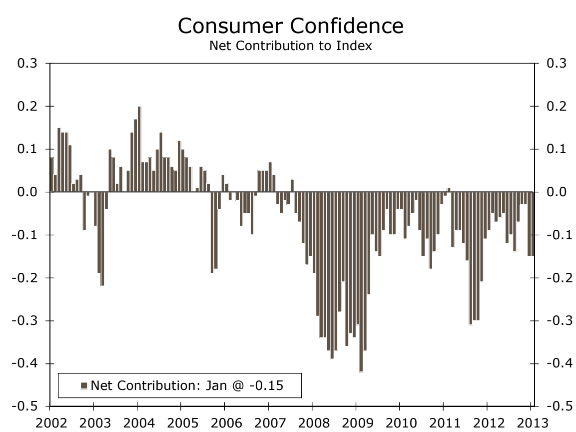
We have been warning repeatedly about a weak start to the year for the factory sector and that argument has been bolstered by indications of weakness in this report as well. Manufacturing hours worked, ISM new orders and core capital goods orders were all net drags on the leading index. In a separate report this morning, the Philadelphia Fed reported deteriorating conditions in the factory sector in February dashing any hope for near-term relief for these components.

The largest net drag was from consumer confidence. In stark contrast to the previous observation about the steady contribution from the yield spread, the utter lack of confidence among consumers has been a drag on the leading index for every month but one for more than five years.

While we find greater value in the forward-looking indexes in this report, the coincident index and the lagging index each added 0.4 percent, keeping the coincident-to-lagging ratio about the same.







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