



September 4, 2000

## WILL THE U.S. LANDING BE SOFT OR HARD?

### Key Points

- The U.S. Conference Board's Leading Economic Index (LEI) is currently flashing a warning signal. Is a recession looming or is this a repeat of 1994-95?
- Using the same methodology as the Conference Board, we generated separate composite leading indexes for the old and the new economy.
- When the LEI is split in two this way, the signal is less alarming. Our old-economy LEI signals a gradual deceleration in growth but no contraction. Our new-economy LEI has also peaked but signals a modest downshift in growth.
- This is consistent with a slowing of growth in the overall economy. It does not herald a recession.

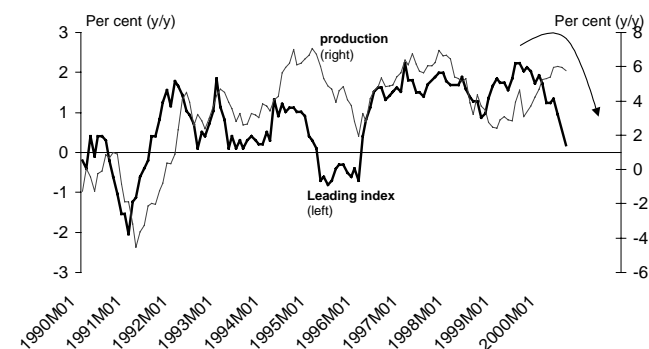
### Grinding to a halt or simply downshifting?

The Conference Board reports that its index of U.S. leading indicators fell in July for the third straight month, a sign that higher borrowing costs will restrain growth in coming months. Coming on top of the latest string of economic data releases, this reading will give further comfort to Fed policy makers.

In the past, however, three consecutive monthly declines in the Leading Economic Index (LEI) has been a signal of recession. Is this what's in store? Let's find out.

### (1) U.S. Recession Looming?

U.S. industrial production Vs U.S. composite leading index



Source: NBF Research

### What is the LEI?

The Leading Economic Index is a composite of 10 indicators designed to predict changes in economic activity. The 10 component series all have varying lead times for cyclical tops and bottoms.<sup>1</sup>

### How clairvoyant is it?

Historically, the LEI has peaked and bottomed earlier than the underlying economy and is therefore an

<sup>1</sup> The Conference Board's LEI, originally developed by the U.S. Bureau of Economic Analysis, consists of: average workweek, weekly jobless claims, new orders for consumer goods, vendor performance, manufacturers' new orders, building permits, stock prices, money supply, the yield curve, and consumer expectations. This mix of leading indicators was determined to represent the various sectors of the economy.

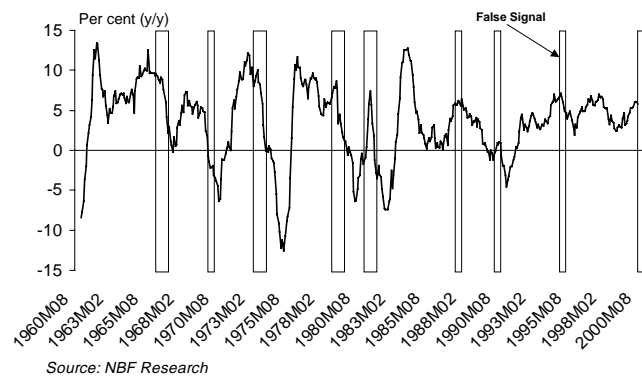
important forecasting tool. As a rule of thumb, turning points in the economy are signalled by three consecutive months of LEI movement against the previous trend.

Chart 2 shows industrial production growth and the peak signals provided by the LEI (boxes). As the chart shows, the forecasting record of the LEI is fairly good. On average it has turned down 10 months ahead of economic tops, though with high variability, and it has provided few false signals.

However, three consecutive monthly LEI declines were recorded prior to the 1994-95 soft landing. Does the current LEI warning – a drop of 0.1% in July after similar declines in the previous two months – signal a looming recession, or a repeat of the 1994-95 episode?

**(2) A Reliable Crystal Ball?**

U.S. industrial production growth (line) & LEI peak signals (boxes)

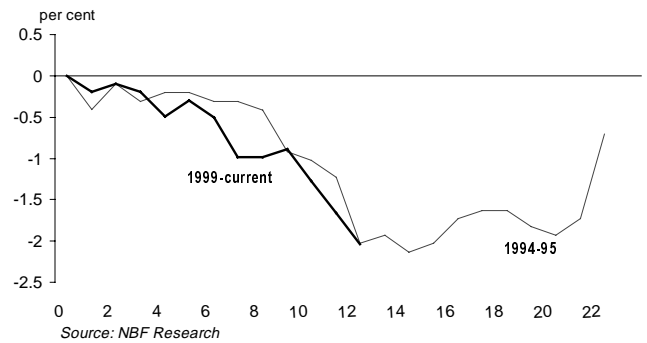


**A lot like 1994-95**

A repeat of 1994-95 seems the most plausible outcome. Chart 3 shows the path followed by the LEI in the tightening movements of 1994-95 and of 1999 to date. The resemblance is striking.

**(3) A Lot Like 1994**

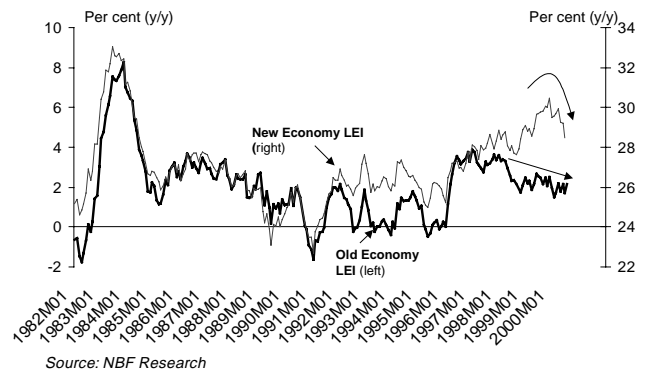
Changes in the U.S. leading index (from start of the tightening cycle)



Pushing the analysis a little further, we split the LEI in two, to reflect the major structural changes now under way in the U.S. economy and the key role played by the new economy. Using the same methodology as the Conference Board, we generated separate composite leading indexes for the old and the new economy.

**(4) An Important Nuance**

NBF U.S. composite leading indexes: Old and New economy LEI



The results are presented in chart 4. From this angle, the LEI signal looks less alarming. Our old-economy LEI signals a gradual deceleration in growth but no contraction. Our new-economy LEI has also peaked but signals a modest downshift in growth. Taken together, these signals are consistent with a slowing of growth in the overall economy. They do not herald a recession.

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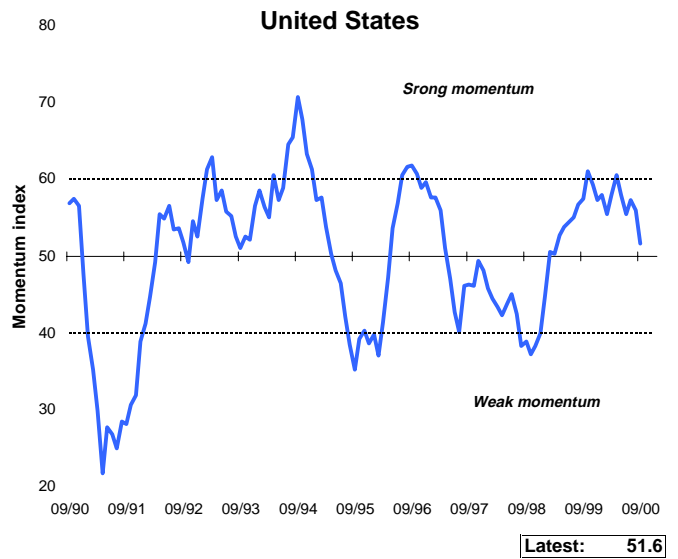
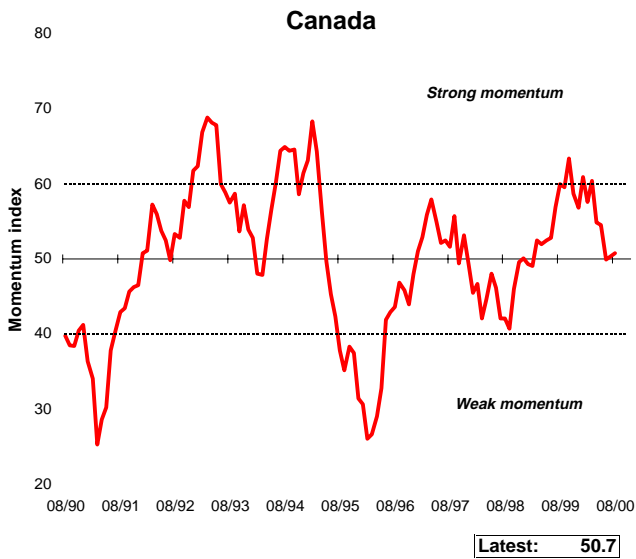
**NBF Economic Scoreboard**

Canada	
	Bullish ← Neutral → Bearish
<b>Market Movers:</b>	
Employment	●
GDP	●
Consumer Prices	●
Retail Sales	●
Housing Starts	●
Industrial Prices	●
International Trade	●
Manufacturing Activity	●
<b>Overall Reading</b>	✓

United States	
	Bullish ← Neutral → Bearish
<b>Market Movers:</b>	
Employment	●
Employment Cost Index	●
Retail Sales	●
NAPM	●
GDP	●
Consumer Prices	●
Industrial Production	●
International Trade	●
Producer Prices	●
Durable Goods' Orders	●
<b>Overall Reading</b>	✓

The **Economic Scoreboard** is used to measure cyclical risk for the bond market. For each market mover, we calculate the monthly deviation from short-term trend (where positive deviations are bearish and negative deviations are bullish). The indicators are then summed-up using equal weights to generate the **overall reading** of cyclical momentum.

**Economic Momentum**



**Economic momentum** is the 12-month cumulative sum of our scoreboard's overall reading. When deviations exceed 10%, momentum is considered to be very strong/weak.

## ECONOMIC CALENDAR : CANADA & UNITED STATES

### The Week Ahead (September 4 – September 8)

#### US Indicators

Date	Time	Release	Month	Previous	<i>Estimate</i>	
					Consensus	NBF
06-Sep	08:30	Productivity	2000Q2 (revised)	5.3%	5.5%	5.5%

#### Canadian Indicators

Date	Time	Release	Month	Previous	<i>Estimate</i>	
					Consensus	NBF
05-Sep	08:30	Building permits	July	7.2%	0.2%	2.0%
06-Sep	08:30	Help-wanted index	August	171	171	172
08-Sep	07:00	Employment	August	-17.3 K	+19 K	+24 K
	07:00	Unemployment rate	August	6.8%	6.7%	6.7%
08-Sep	08:30	Capacity utilization rate	2000Q2	87.6%	88.0%	88.2%

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