Leading Index Suggests Continued U.S. Economic Growth

The LEI rose 0.8% in January, after declining in five of the past seven months. This jump along with our own recession models suggest the near-term probability of recession has reedied but not disappeared.

**Recession or Resuscitation?**

The Leading Economic Index (LEI) jumped 0.8% in January, marking the largest monthly increase in more than two years and bringing the index to an all-time high. Strength in the underlying components was broad-based with nearly every component making a positive contribution to the headline.

The surge in January brought the year-over-year rate up to 0.9%, and revisions to December, which had previously showed a negative year-over-year growth rate for the first time since 2009, now show a 0.09% gain. This should alleviate some concerns of recession, which has typically been preceded by a negative year-over-year growth rate in the index (top chart).

Still the persistent weakness in the Q4 LEI was enough to push one of our short-term recession models up to a 34% probability of recession in the next six months, the highest reading since the Great Recession (middle chart). Though that is elevated relative to the last few years, it is well below our threshold of two quarters above 50% necessary for triggering a recession warning.

Moreover, much of this weakness was driven by a slowdown in the manufacturing sector. The manufacturing sector has a large weight in the LEI, with more than half of the index being derived from manufacturing. We are not in the business of making excuses for data, and the index is certainly suggesting a slowdown in growth, but a decline in the manufacturing sector does not weigh on the broader economy the way it did a generation ago. In the past year for example, manufacturing faltered amid uncertainty surrounding trade policy and slower global growth, and the U.S. economy continued to expand. Such weakness, however, weighed disproportionately on the LEI.

While manufacturing may not be as crucial to the overall economy as it once was, the cyclical nature of the sector means it is more susceptible, which is why we too include manufacturing indicators in our recession models.

The 0.8% surge in the LEI last month brought our model which includes the index recession probability down to roughly 1% (middle chart). However, as we have emphasized in past reports, it is important not to rely on just one sector. Our recession probability models based on forward looking financial indicators, such as the yield curve, still remain elevated. Combining these indicators with our other recession models, we reach a two-quarter ahead recession probability estimate of roughly 18% (bottom chart).

While this is an improvement from Q4, we only have one month of data for Q1. This probability projection assumes we maintain our current position for the next couple of months, which may be difficult if disruptions from the coronavirus emanating out of China spill over into the U.S. factory sector. More broadly, this projection reflects our view that the U.S. economy will continue to expand, but the pace of growth will likely remain around 2%.

Source: The Conference Board, Bloomberg LP and Wells Fargo Securities

---

1 For detail on our recession probability models please see “Recession Talks in the Spotlight: Should We Worry?” February 24, 2016.