



# Economics Group

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## The Animal Spirits Index Bounces Back to Start 2019

*The Animal Spirits Index bounced back in March to 0.83 after ending 2018 at just 0.14, its lowest level of the year. The drop in the policy uncertainty index and recovery in equity prices boosted spirits in March.*

### The Animal Spirits Index: Spotting the Invisible

In our past work, we have introduced an index to quantify Keynes’ “animal spirits.”<sup>1</sup> Our Animal Spirits Index (ASI) is constructed from five variables: (1) the S&P 500 index, (2) the Conference Board’s consumer confidence index, (3) the yield spread, (4) the VIX index and (5) the economic policy uncertainty index. These variables were selected to capture actions of major economic agents, while representing major sectors of the economy, and have the ability to shed light on agents’ expectations about the near-term economic outlook. We utilize a dynamic factor modeling approach in constructing our index.

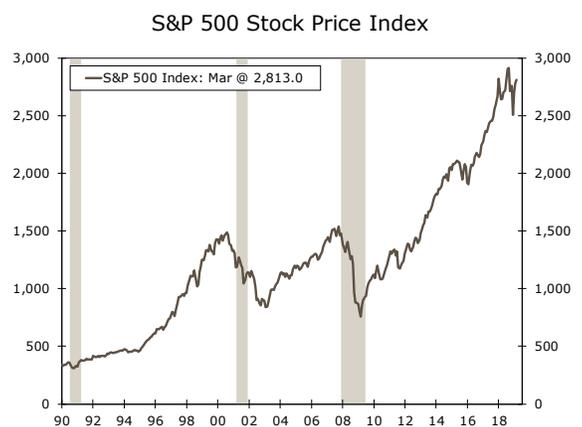
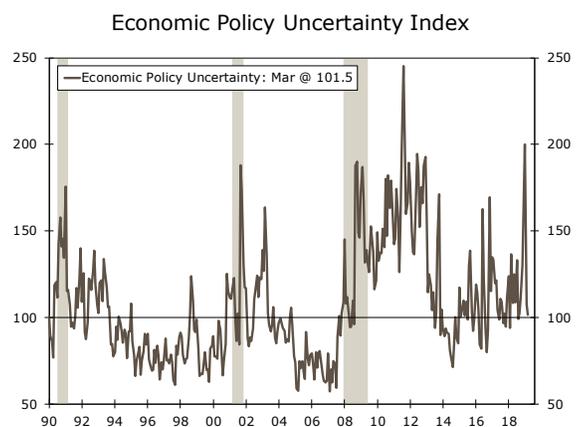
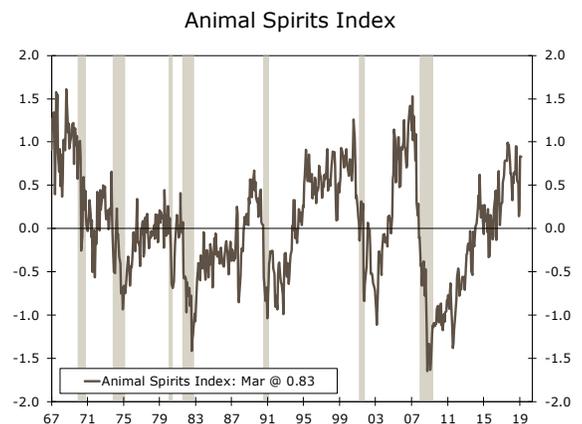
An ASI value above zero indicates positive animal spirits, or optimism, while a value below zero suggests negative animal spirits, or pessimism. Our ASI goes back to January 1967, giving us the opportunity to analyze the index’s behavior during different business cycles and political environments. In analyzing our index, we note key observations that not only set this business cycle apart from prior cycles, but also confirm the severity of the Great Recession and the slow recovery that has followed.

The lowest value of the ASI was during the Great Recession at -1.65, in October 2008. The ASI stayed in negative territory until January 2014, which is consistent with the slow recovery from the Great Recession. However, the index has remained above the zero line for the majority of the time since February 2014, as the economic expansion gained steam and optimism (positive animal spirits) returned.

### What Factors Are Behind the Recent Surge in the ASI?

The ASI rebounded to 0.83 in March after slipping to a two-year low of 0.14 in December. The March ASI increase is mainly due to the easing in policy tensions and equity market recovery. For example, the policy uncertainty index plunged to 101.47 after jumping to 200 in January, which was the highest since September 2011. The S&P 500 index rebounded back above 2,800 in March after a year-end selloff. The VIX also dropped to 15.31 in March from 25.42 in December 2018. Two components of ASI are still under stress. The yield spread went negative for the first time in the post-Recession era and the consumer confidence index dropped in March to 124.1 from 131.4 in February.

Although the yield curve has inverted in March, the ASI shows that economic agents are comfortable with the recent activities in the economic and financial worlds. It seems the economic policy environment along with the equity market recovery have underpinned a bounce back for now. We will continue to update and monitor our ASI and report any significant changes in the index.



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

<sup>1</sup> For additional detail please see, “[The Roar of the Animal Spirits: A New Index](#)” (January 18, 2018) and “[Finding Neverland: What Drives Animal Spirits](#)” (January 31, 2018).

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