

April 23 2018

BEIGE BOOK: WINDOW ON MAIN STREET

John Lynch *Chief Investment Strategist, LPL Financial*
Shawn Doty, *Senior Analyst, LPL Financial*

KEY TAKEAWAYS

Based on our analysis, the Beige Book continues to deliver a positive view of the U.S. economy.

The Beige Book Barometer fell to +55 in April, but remains within its recent range.

Price and wage pressures remained moderate, but trade concerns were evident.

BEIGE BOOK SUGGESTS CONTINUED MODERATE ECONOMIC GROWTH

The latest edition of the Federal Reserve’s (Fed) Beige Book, released Wednesday, April 18, 2018, sustained a positive view of the U.S. economy. The Beige Book is a qualitative assessment of the domestic economy and each of the 12 Fed districts individually. The report is prepared eight times per year, ahead of each Federal Open Market Committee (FOMC) meeting—the next of which is set to take place May 1–2, 2018. We believe the Beige Book is best interpreted by measuring how key words change over time. The qualitative inputs for the April 2018 Beige Book were collected in the weeks prior to April 9, 2018.

SENTIMENT SNAPSHOT

At LPL Research, we created our proprietary Beige Book Barometer (BBB) [Figure 1] to evaluate the sentiment behind the Beige Book collage of data. The BBB measures the number of times the word “strong” or its variants appear in the Beige Book less the number of times the word “weak” or its variants appear. When the BBB is declining, it suggests that the economy is deteriorating; when it’s advancing, it suggests that the economy is improving.

1 BEIGE BOOK BAROMETER CONTINUES TO SUGGEST MODERATE GROWTH

- Number of Times “Strong” (and Variants) Is Mentioned Minus Number of Times “Weak” (and Variants) Is Mentioned



Source: LPL Research, Federal Reserve 04/23/18

HOW THEY WORK

BEIGE BOOK AND BEIGE BOOK BAROMETER

The **Beige Book** compiles qualitative observations made by community bankers and business owners about economic (housing, labor market, manufacturing, nonresidential construction, prices, tourism, wages) and banking (lending conditions, loan demand, loan quality) conditions in each of the the 12 Fed districts (Boston, Kansas City, New York, Philadelphia, etc.). This local color that makes up each Beige Book is compiled by 1 of the 12 regional Fed districts on a rotating basis—the report is much more “Main Street” than “Wall Street” focused. It provides an excellent window into economic activity around the nation using plain, everyday language. The report is prepared eight times per year, ahead of each of the eight Federal Open Market Committee (FOMC) meetings. The next FOMC meeting is May 1–2, 2018.

The **Beige Book Barometer** is a diffusion index that measures the number of times the word “strong” or its variations appear in the Beige Book less the number of times the word “weak” or its variations appear. When the Beige Book Barometer is declining, it suggests that the economy is deteriorating; when the Beige Book Barometer is rising, it suggests that the economy is improving.

The barometer fell to +55 in April, down from its March reading of +68, but still within its recent range. A reading at this level remains in line with our expectation of continued steady growth for the U.S. economy. The number of weak words increased by just 1 (from 17 in March to 18 in April), remaining near expansion lows. A decrease in strong words was the major driver behind this month’s weaker reading [Figure 2]. Historically, a solid base of strong words has been sufficient to indicate steady expansion as long as weak words are low, with a spike in strong words often indicating acceleration after a period of weakness.

TRADE CONCERNS RISING

Taxes, a popular topic in recent months, had fewer mentions in April. The word “tax,” which was mentioned 20 times last month, was cited just 6 times in the latest release. However, the word “trade” was mentioned 14 times, versus 11 in March. The word “tariff,” which wasn’t stated at all in the March Beige Book, was referred to 39 times in the latest release—a sign that the topic is on the minds of Main Street. Trade concerns were just starting to ramp up during the collection period for the March beige book (which ended February 26), but most of the headlines about new proposed tariffs happened in March, as did the implementation of steel and aluminum tariffs. (The April Beige Book was the first to capture Main Street’s view on tariffs.) Several districts also pointed out increased steel and aluminum prices, though much of the commentary on tariffs was related to concerns and uncertainty, rather than actual impact. The St. Louis District noted that “some steel and aluminum manufacturers announced plans to reopen facilities and call back workers.”

WATCHING WAGES & INFLATION

Market participants continue to monitor inflation and wages closely, as they gauge not just when, but how far and how fast the Fed might raise rates

2 A DECLINE IN STRONG WORDS PUSHED BAROMETER SLIGHTLY LOWER IN APRIL



Source: LPL Research, Federal Reserve 04/23/18

in 2018 and beyond. Each Beige Book provides an economy-wide assessment of wages and prices.

On wages, the April 2018 Beige Book observes:

Businesses were responding to labor shortages in a variety of ways, from raising pay to enhancing training to increasing their use of overtime and/or automation, among other strategies. Upward wage pressures persisted but generally did not escalate; most Districts reported wage growth as only modest.

On price pressures, it observes:

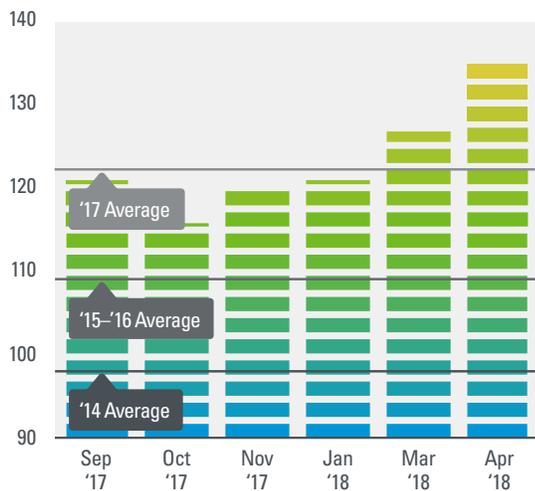
Prices increased across all Districts, generally at a moderate pace. There were widespread reports that steel prices rose, sometimes dramatically, due to the new tariff. Prices for building materials continued to rise briskly, especially for lumber, drywall, and concrete. Transportation costs

also generally rose, with contacts citing higher fuel prices and shortages of truck drivers as the primary causes. There were scattered reports of companies successfully passing through price increases to customers in manufacturing, information technology, transportation, and construction. Businesses generally anticipate further price increases in the months ahead, particularly for steel and building materials.

We monitor wage and price pressures via our Inflation Barometer, which is a simple count of the number of times wage/inflation words (“wage,” “skilled,” “shortage,” “widespread,” and “rising”) appear in the Beige Book. Consistent with the moderate price growth noted in the Beige Book’s overview, words related to inflation climbed modestly in April to +135, from +127 in March. This is the highest reading since July 2017, and above the 2017 average of +122 [Figure 3]. The current level also remains meaningfully above the 2015–2016 average, signaling that we are seeing some wage pressure but that the impact on price levels remains modest.

3 WAGE PRESSURE EVIDENT, BUT INFLATION REMAINS CONTAINED

- Number of Times Wage/Inflation Words Are Mentioned in Beige Books



CONCLUSION

The April 2018 Beige Book Barometer continues to point toward economic growth, in line with LPL Research’s expectation that the U.S. economy may produce gross domestic product growth of up to 3% in 2018.* The count of weak words remains near expansion lows, though the number of strong words did move lower in April. Main Street showed signs of uneasiness about trade and tariffs, a topic we will continue to watch. We may need positive sentiment to rise if we are to see acceleration beyond the barometer’s current level, but the overall positive tone in the context of a low level of negative words reflects continued optimism on Main Street. ■

*LPL Research projects real gross domestic product (GDP) growth of around 3% in 2018. This is in line with historical mid-cycle growth of the last 50 years. Economic growth is affected by changes to inputs such as business and consumer spending, housing, net exports, capital investments, and government spending.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results.

Any economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing involves risk including loss of principal.

DEFINITIONS

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

This research material has been prepared by LPL Financial LLC.

To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL Financial LLC is not an affiliate of and makes no representation with respect to such entity.

Not FDIC or NCUA/NCUSIF Insured | No Bank or Credit Union Guarantee | May Lose Value | Not Guaranteed by Any Government Agency | Not a Bank/Credit Union Deposit

RES 48205 0418 | For Client Use | Tracking #1-722815 (Exp. 04/19)