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BEIGE BOOK: WINDOW ON MAIN STREET

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KEY TAKEAWAYS

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

The Beige Book Barometer rose to +62, consistent with the average of +64 for 2017.

Weather-related words declined in January, while references to tax reform rose.

BEIGE BOOK SUGGESTS CONTINUED MODERATE ECONOMIC GROWTH

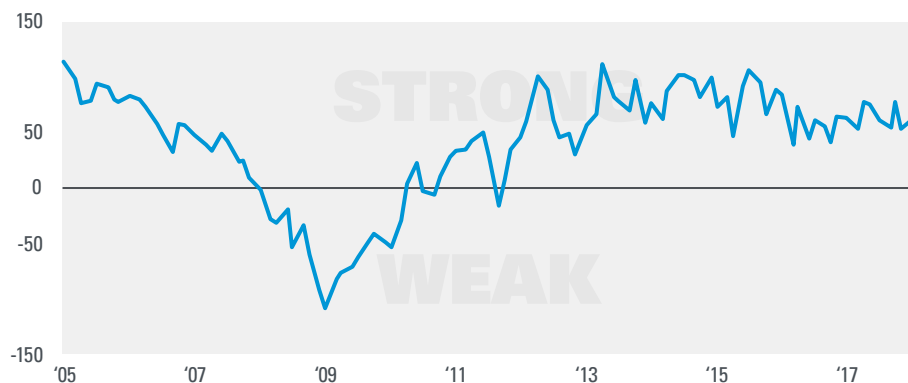
The latest edition of the Federal Reserve’s (Fed) Beige Book, released Wednesday, January 17, 2018, continued to deliver a positive view of the U.S. economy. The Beige Book is a qualitative assessment of the domestic economy and each of the 12 Fed districts individually. The report is prepared eight times per year, ahead of each Federal Open Market Committee (FOMC) meeting—the next of which is set to take place from January 31 to February 1, 2018. We believe that the Beige Book is best interpreted by measuring how key words change over time. The qualitative inputs for the January 2018 Beige Book were collected in the weeks prior to January 8, 2017.

SENTIMENT SNAPSHOT

We created our proprietary Beige Book Barometer (BBB) [Figure 1] to evaluate the sentiment behind the entire Beige Book collage of data. The BBB is a diffusion index measuring 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 01/22/18

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 January 31—February 1, 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.

In January 2018, the barometer climbed from a November reading of +53 to +62, close to the +64 average for all of 2017. This movement brings the barometer back to the middle of the range it has held since 2012. The number of weak words declined, nearly hitting a low for the expansion, which drove most of the improvement [Figure 2]; meanwhile, strong words remain well off the peak hit in the middle of 2015. 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 off of a period of weakness.

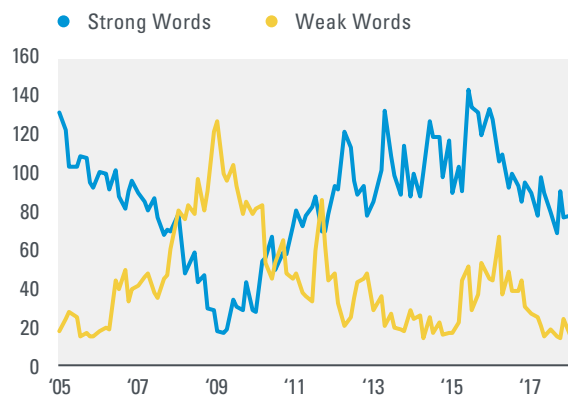
HURRICANE IMPACT DECLINING, TAX REFORM GETTING ATTENTION

The United States felt the devastating impact of Hurricane Harvey in late August, and Hurricane Irma in early September, marking the first time two Category 4 or stronger magnitude hurricanes have made landfall within the country in the same year. The hurricanes remain an important story, as regional recovery and rebuilding provides a small boost to the economy, but the attention given to the economic impact has slowly declined. The words “hurricane” or “weather” appeared in the Beige Book 65 times in October, 37 times in November, and 15 times in the most recent version. Meanwhile taxes, which usually go unmentioned, appeared 4 times in the November Beige Book and 23 times in the most recent edition, as Main Street tries to gauge the impact of the new tax law.

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

2 WEAK WORDS REMAIN NEAR CYCLE LOW



Source: LPL Research, Federal Reserve 01/22/18

On wages, the January 2018 Beige Book observes:

Most Districts cited on-going labor market tightness and challenges finding qualified workers across skills and sectors, which, in some instances, was described as constraining growth. Several Districts noted elevated demand for manufacturing and construction labor. Most Districts said that wages increased at a modest pace.

On price pressures, it observes:

Most Districts reported modest to moderate price growth since the last report...Reports of pricing pressures were mixed across the country although several Districts noted increases in manufacturing, construction, or transportation input costs. Firms in some

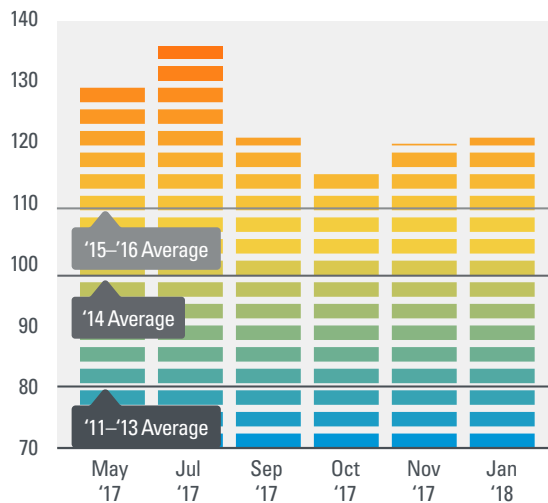
Districts noted an ability to increase selling prices. Retailers in some Districts reported modest price increases and there were reports of rising home prices across most of the country. Agriculture and energy commodity prices were mixed.

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 January to +121, nearly matching the 2017 average of +122 [Figure 3]. The count of wage/inflation words has held at this level following a brief spike to +136 in July. The current level remains meaningfully above the 2015–2016 average, signaling that we are seeing some wage pressure but that the impact on price levels remains modest.

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WAGE PRESSURE EVIDENT, BUT INFLATION REMAINS CONTAINED

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



Source: LPL Research, Federal Reserve 01/22/18

CONCLUSION

The level of the January 2018 Beige Book Barometer has been historically associated with continued economic expansion. The count of weak words came in near expansion lows, while positive words held steady. The attention given to Hurricanes Harvey and Irma has declined, although the hurricanes remain significant events for the impacted regions, while Main Street exhibited an overall positive response to the new tax law. 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. ■

IMPORTANT DISCLOSURES

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