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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 continued its recent move higher, rising to +68 in March.

Weather and tax reform were popular topics, and trade started to show up as well.

BEIGE BOOK SUGGESTS CONTINUED MODERATE ECONOMIC GROWTH

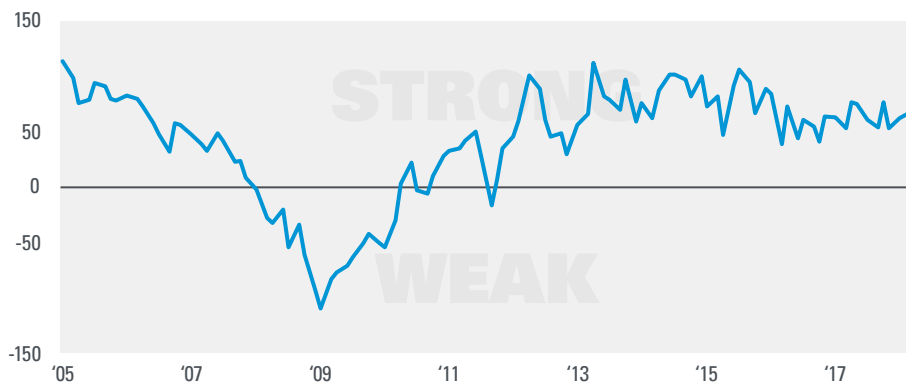
The Federal Reserve (Fed) was in the news last week, as markets digested the March 20–21 Federal Open Market Committee (FOMC) meeting statement. The outcomes of the meeting were broadly in line with market expectations, with the Fed hiking interest rates by 0.25%, and upgrading its economic forecasts as the impact of tax reform was included for the first time. The law had not yet passed when the Fed released its previous forecasts on December 13, 2017. The Fed’s forecast of the future path of interest rates (commonly known as dot plots) showed an expectation of three rate hikes in 2018 (in line with LPL Research’s view), and another three to four in 2019, which was higher than the Fed’s previous expectation of two. But the latest FOMC meeting statement wasn’t the only noteworthy release; the Fed also published its latest Beige Book on March 7, which continued to deliver a positive view of the U.S. economy.

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

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 03/07/18

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 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.

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.

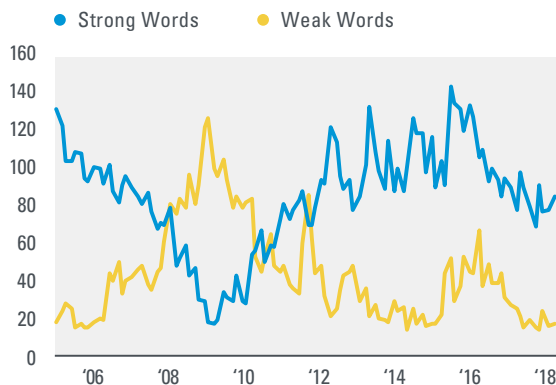
The barometer continued its steady climb in March 2018, moving from a January reading of +62 to +68—in line with our view of continued steady growth for the U.S. economy. The number of weak words increased by just 1 (from 16 in January to 17 in March), remaining near expansion lows. However, an increase in strong words was able to push the overall barometer higher [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 off a period of weakness.

WEATHER, TAX REFORM, AND TRADE

Weather continued to be a popular topic in the March Beige Book, but the focus shifted from 2017’s hurricanes to colder than normal weather in early 2018. The areas hardest hit by the hurricanes continued to mention the impacts of the storms including a weaker orange crop in Florida and tightness in the construction labor market related to rebuilding. Colder than usual weather was a leading theme though, and was mentioned as a headwind for retail, construction, and leisure industries in some regions.

Taxes maintained their relevance as well, appearing 20 times in the most recent edition, as Main Street continues to gauge the impact of the new tax law. In addition, even though most of the data was collected before the recent tariff announcements, the potential for trade disruptions was mentioned. Several districts brought up steel specifically, with the Cleveland Fed indicating, “Steel producers reported raising selling prices because of a decline in market share for foreign steel and expectations about potential outcomes of pending trade cases.”

2 STRONG WORDS PUSHED BAROMETER HIGHER IN MARCH



Source: LPL Research, Federal Reserve 03/07/18

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

On wages, the March 2018 Beige Book observes:

In many Districts, wage growth picked up to a moderate pace. Most Districts saw employers raise wages and expand benefit packages in response to tight labor market conditions. Contacts in a few Districts conveyed reports of modest increases in compensation following passage of the Tax Cuts and Jobs Act.

On price pressures, it observes:

Prices increased in all Districts, and most reports noted moderate inflation. Four Districts saw a marked increase in steel prices, due in part to a decline in foreign competition. Price growth for building

materials such as lumber picked up, stemming from an uptick in construction activity. Several Districts reported moderate increases in broad transportation costs, caused primarily by higher fuel costs that boosted freight rates. Home and commercial lease prices rose across most of the country.

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 March to +127, from +121 in January, putting the latest reading just above the 2017 average of +122 [Figure 3]. 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.

CONCLUSION

The March 2018 Beige Book Barometer continues to point toward economic growth, which is in line with LPL Research’s expectation that the U.S. economy could potentially produce gross domestic product growth of up to 3% in 2018.* The count of weak words remains near expansion lows, while positive words moved higher, potentially showing the beginnings of a period of acceleration. Main Street continues to exhibit an overall positive response to the new tax law, and also showed signs that it’s starting to react to recent trade developments, even though this Beige Book’s collection period was before the most recent tariff announcements were made. 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. ■

3 WAGE PRESSURE EVIDENT, BUT INFLATION REMAINS CONTAINED



*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

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Investing involves risk including loss of principal.

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.

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