Chart of the Month | October 2024

Uncharted Territory: Understanding This Economic Cycle

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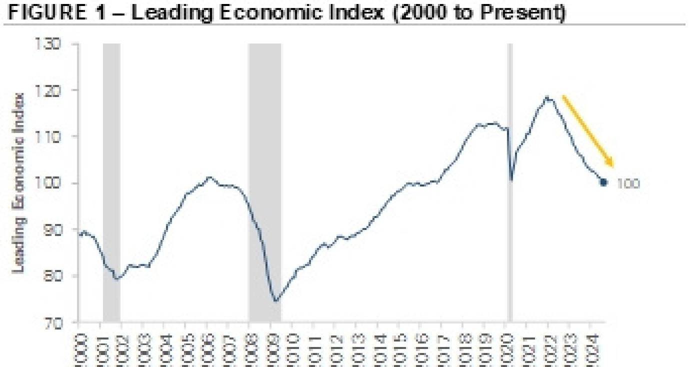
The economy is in uncharted territory. Figure 1 graphs the Leading Economic Index (LEI), which tracks ten data points that tend to change before the overall economy does. Economists monitor the LEI because it includes data that can provide insight into future economic activity, such as unemployment claims, building permits, and manufacturing hours worked. A rising LEI signals improving economic conditions, while a declining LEI suggests worsening conditions. In early 2020, the LEI declined as the pandemic led to economic shutdowns. Following a brief recession, the index rebounded later in 2020 and into 2021, driven by government stimulus, the reopening of the economy, and low interest rates. The LEI peaked in November 2021, but it has declined steadily over the past few years and is now the lowest since 2016.

Figure 2 graphs the number of consecutive monthly decreases in the LEI, with gray shading marking past U.S. recessions. Historically, when the LEI declines for several consecutive months, the economy is often entering or is already in a recession. For example, in 1979, the LEI declined for eight consecutive months leading up to the recession. The number of consecutive monthly declines ranged from three months ahead of the 1981 recession to four in 1990 and six in 2001. The longest streak of declines before a recession started was ten months in 2007. The latest data shows the LEI has declined for 30 consecutive months, which surpasses all prior levels. This trend is concerning because it is generally associated with recessions.

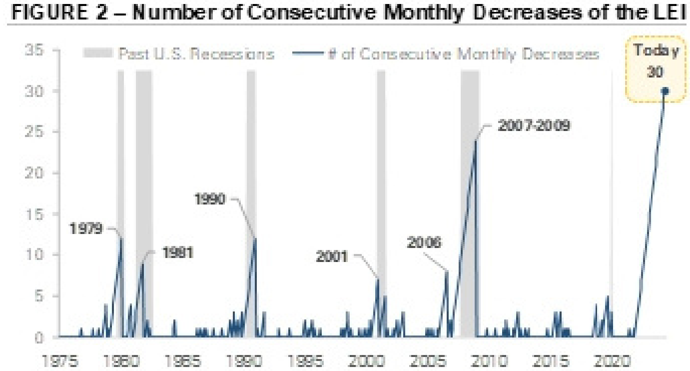
The steady decline of the LEI suggests that economic growth should be slowing more than it is, highlighting that today's economic cycle is unlike anything we've seen before. The disconnect may be explained by several demographic and fiscal changes brought on by the pandemic. Domestic migration surged, requiring investment in new neighborhoods, roads, and schools. The Federal Reserve cut interest rates to near zero, enabling businesses and individuals to lock in low-cost debt. The government issued stimulus checks and passed multiple spending bills to invest in infrastructure and incentivize domestic manufacturing. The pandemic exposed weaknesses in global supply chains, prompting companies to reinvest in U.S.-based production. The LEI's recent trend doesn't mean the economy is broken, just that it's different. It's unclear how long these changes will last, but the two charts below are a reminder of just how much the economy changed during the pandemic.

FIGURE 1 – Leading Economic Index (2000 to Present)



Source: U.S. Conference, NBER. Data from 1/1/2000 to 8/31/2024.

FIGURE 2 – Number of Consecutive Monthly Decreases of the LEI



Source: U.S. Conference Board, NBER. Data from 1/1/1975 to 8/31/2024.

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