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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 (strong words minus weak words) fell slightly to +75 in April, indicating continued steady economic growth.

Words related to wage pressure have risen slightly over the last six months, indicating a modest but still very manageable impact.

## BEIGE BOOK SUGGESTS CONTINUED MODEST ECONOMIC GROWTH

The latest edition of the Federal Reserve's (Fed) Beige Book, released Wednesday, May 31, 2017, 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 of the eight Federal Open Market Committee (FOMC) meetings. We believe the Beige Book is best interpreted by measuring how the key words change over time. The qualitative inputs for the May 2017 Beige Book were collected in April 2017 through May 22, 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 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 advancing, it suggests that the economy is improving.

In May 2017, the barometer declined slightly to +75, after a +77 reading in April and a +53 reading in March. The barometer has generally been climbing since October 2016, but the increase has been marked by a decline in words associated with negative sentiment rather than an increase in words associated with positive

### 1 BEIGE BOOK BAROMETER SUGGESTS STEADY U.S. ECONOMIC GROWTH

- Number of Times "Strong" (and Variations of This Word) Is Mentioned Minus Number of Times "Weak" (and Variations) Is Mentioned



Source: LPL Research, Federal Reserve 06/05/17

## HOW THEY WORK

### BEIGE BOOK AND BEIGE BOOK BAROMETER

The **Beige Book** compiles qualitative observations made by community bankers and business owners about economic (labor market, prices, wages, housing, nonresidential construction, tourism, manufacturing) and banking (loan demand, loan quality, lending conditions) conditions in each of the 12 Fed districts (Boston, New York, Philadelphia, Kansas City, 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 June 13–14, 2017.

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sentiment [Figure 2]. In fact, over that period, strong words have barely advanced, climbing from 85 to 90, but weak words have declined sharply, from 44 all the way down to 15, the second-lowest total of the expansion. The pattern may signal that while barriers to economic growth have decreased, positive growth drivers have not yet kicked into gear. With the impact of oil weakness and dollar strength in early 2016 well behind us and anticipation of potential pro-growth policy from the federal government following the U.S. elections in November, Main Street is clearly perceiving there is less to worry about. At the same time, policy uncertainty may be keeping a decline in barriers to growth from translating to a full willingness to take on the kind of economic risks required to create new opportunities.

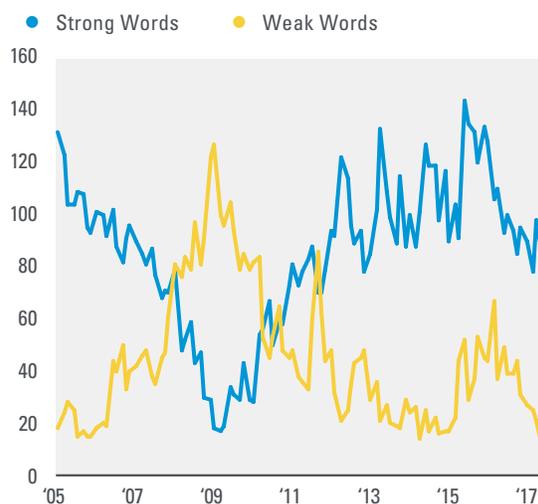
## WATCHING WAGES & INFLATION

As noted in our *Outlook 2017: Gauging Market Milestones* publication, our view is that the Fed will raise rates one to two more times in 2017. Expectations for a rate hike at the June meeting remain high, which, if it takes place, would be the third hike in five meetings over an approximately six-month span.

Market participants continue to monitor inflation and wages closely, as they gauge not just when, but how far and how fast the Fed may raise rates this year and beyond. Each Beige Book provides an economy-wide assessment of wages and prices. On wages, the May 2017 Beige Book observes, “Most firms across the Districts noted little change to the recent trend of modest to moderate wage growth, although many firms reported offering higher wages to attract workers where shortages were most severe.” In discussing price pressures, the May 2017 Beige Book highlights: “On balance, pricing pressures were little changed from the prior report, with most Districts reporting modest increases.”

We monitor wage and price pressures via our Inflation Barometer, which is a simple count of the number of times wage/inflation words (“wage,”

### 2 DECLINE IN WEAK WORDS DRIVING BEIGE BOOK BAROMETER IMPROVEMENT

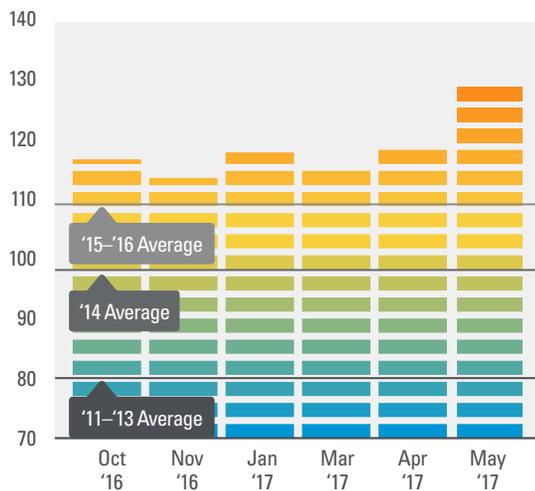


Source: LPL Research, Federal Reserve 06/05/17

“skilled,” “shortage,” “widespread,” and “rising”) appear in the Beige Book. Despite a measured tone in the Beige Books overview, we saw a marked increase in the appearance of words related to wage pressure [Figure 3]. In May 2017, these words appeared 130 times, higher than any Beige Book since December 2015, and may be signaling

### 3 RISE IN WAGE AND PRICE PRESSURES EVIDENT IN OUR INFLATION BAROMETER

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



Source: LPL Research, Federal Reserve 06/05/17

a modest increase in wage pressure that is not yet appearing directly in the economic data.

By comparison, in 2016, these wage/inflation words appeared, on average, just 110 times per Beige Book. These words appeared, on average, 109 times per Beige Book in 2015. In all of 2014—when deflation, not inflation, was a concern—those words appeared an average of just 98 times. The increase in the number of inflation words signals that some wage pressure has started to become a modest but manageable concern.

## CONCLUSION

The May 2017 Beige Book Barometer continues to indicate a potential increase in economic activity over the second half of the year. But at this point it does appear that a decrease in negative sentiment may need to get some help from an increase in positive sentiment for growth to accelerate. Nevertheless, there are clear signs that the economy has steadied, and it may be healthy for Main Street’s positive view of the economy to remain tempered while we await greater clarity on potentially pro-growth policy developments. ■

#### IMPORTANT DISCLOSURES

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The fast price swings in commodities and currencies will result in significant volatility in an investor’s holdings.

Because of its narrow focus, specialty sector investing, such as healthcare, financials, or energy, will be subject to greater volatility than investing more broadly across many sectors and companies.

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