

U.S. indicators: less than meets the eye

by Leif Johnson

What index of U.S. economic activity has risen steadily for the past year despite the headlong plunge of the real economy in the opposite direction?

Which index constantly changes its composition so that it can prove its conclusions regardless of the conditions of the economy?

And which one grew by 3.9 percent in January, despite a collapse of capital spending, rising unemployment, and washed-out exports?

It is the Index of Leading Economic Indicators, constructed and managed by a nest of Mont Pelerinites in the Bureau of Economic Analysis (BEA) at the Department of Commerce.

The Mont Pelerinites have produced a burst of euphoria, including the *Wall Street Journal's* announcement that the indicators' rise is "Confirming That Recession Is Over" and Commerce Secretary Malcolm Baldrige's statement that, "There has never been a gain in the leading index this large without an economic recovery." The President himself succumbed, exulting that the indicators "flashed a bright green light for recovery."

The index in question consists of 10 "indicators" or components which are then weighted and multiplied by a "trend factor." The components of the index have undergone drastic changes, particularly over the past eight years, so that today's index bears little resemblance to the one existing in 1975. Each time there is a major overhaul of the index, precipitated by a failure to predict recession or recovery, the Bureau of Economic Analysis recalculates the entire index back to its 1948 inception date.

The 1975 revision, for example, eliminated or significantly changed 7 of the 10 indicators, making the indices incompatible and forcing a revision of the entire index historically. The revisions made in 1979 and again at the end of 1982 have yielded the same result, a complete revision of all previous figures.

Alterations

For example, in December 1982 the BEA realized that the "sensitive crude material" indicator, which included crude petroleum and natural gas, would not have produced a posi-

tive number because those prices were declining. Since it is expected that such crude materials prices increase during a recovery, those prices were eliminated, and lumber, a semi-manufactured product, not previously included, was added to this indicator.

The thesis of "recovery" is thus made *a priori*, and the index is altered to prove that conclusion.

Some manipulations of the leading index have been so gross that even the press has raised its eyebrows. Earlier this year the BEA decided to throw out the index of business failures, while keeping the index of new business formations. *Business Week* and the *Wall Street Journal* felt compelled to take notice, since last spring's business failures were 48 percent ahead of those in 1981. In the first six weeks of 1983, business failures are running another 41 percent higher than in the same period of 1982, but fortunately for the leading index's "recovery thesis," business failures are not among the measured indices.

Index components

The first two indicators concern labor: average work week of production workers in manufacturing and average weekly initial unemployment claims. They do not include actual employment.

Together, these two components accounted for a quarter of the 3.6 percent December-January rise in the index. The larger factor was the lengthened work week from 38.9 hours in December to 39.7 hours in January.

It is assumed that the greater the work week increase, the stronger the recovery. Why is this necessarily so? Perhaps, as appears to be the case, employers are granting remaining employees overtime to fill increased orders, but refusing to take on new workers—hardly a sign of recovery or confidence in one.

The statistic of a nearly one-hour increase in the work week is itself suspect. Except in times of national emergency, such a large month-to-month fluctuation is unlikely. It is much more probable that this is a statistical fluke, similar to that which produced the reported large drop in unemployment in January.

The average new unemployment claims indicator bears the same sort of problem. It could indicate a reduction in unemployment or a reduction in unemployment claims eligibility. Currently less than half the unemployed Americans are eligible for compensation, and that percentage drops as workers take "any job they can get."

The largest segment of the index deals with output, orders, delivery time, building permits, and new business formation. Here we have indices that are bona fide, although subject to large problems of interpretation, problems the BEA implicitly settles in favor of the recovery thesis.

The large increase in new manufacturing orders, a legitimate index in itself, cannot be measured separately from inventory buildup and sales—as it is in the index. Thus, in the January Index figure, new orders add .61 percent to the

total 3.6 percent rise, but inventory change is stated as "not available," so there is no immediate way to judge whether the new orders are reflected in sales or are going into inventory. But from available auto production and sales figures through the first three weeks of February, we see that a very large inventory accumulation is occurring in that industry, which represents a substantial portion of the new orders index, and whose saleability is in doubt (see *EIR*, March 8).

The next indicator is amusing. Measuring the length of freight delivery time to companies, it assumes that the longer the delay, the stronger the economy. Disregarded is the fact that, because of trucking deregulation, delivery time has been lengthened by the bankruptcy of hundreds of freight carriers. Strikes, storms, extended winter cold, and railway abandonments or accidents will also make this indicator rise.

The indicator estimating contracts and orders for plant and equipment is indeed a useful measure of economic activity. This was the only measure that fell in January's index, declining by 0.26 percent. But there was a huge real decline from \$13.82 billion in December orders to \$11.75 billion in January. How could this 15.0 percent plummet have only a -0.26 percent impact on the overall index while a 2.1 percent increase in the work week produced a 0.76 percent increase in the index?

The reason, according to Mr. Tamm of the BEA, is that all indicators are weighted for seven different factors among which are "economic significance," "timing," "conformity to business cycles," "smoothness," "currency," and "other statistical properties." Each indicator is "scored" using whole and fractional points and calculated to the thousandth place.

After this alchemy is complete, the resultant percentage values are added and then multiplied by a "trend factor," which increases the final index figure.

The index also includes the Standard & Poor's 500 stocks and money supply (M-2) among its indicators. But while all other price or output indicators are legitimately deflated to 1972 dollars, stock prices are listed in current dollar values. What would the magic S&P number look like in 1972 dollars and what would that do to the value of the index?

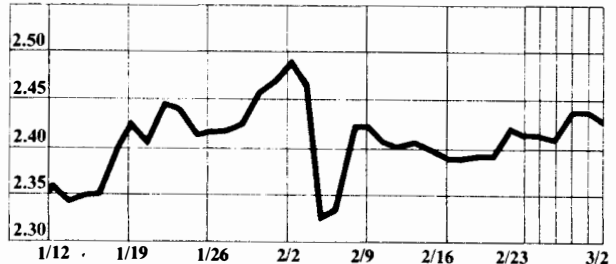
Under procedures for the index, a sizeable increase in the money supply (M-2) would create a recovery. One-quarter (0.86 percent) of the January index jump came from a 2.2 percent increase in the money supply, an increase that was produced by revising the December M-2 figure downward from \$853.4 billion to \$836.8 billion. Had that figure not been revised, the increase in M-2 would have been 0.3 percent.

The last indicator, building permits issued, showed a very healthy jump in the basic data, resulting in a big 0.44 percent contribution to the index. Building permits are issued for all new construction from \$2 billion power plants to \$2,000 swimming pools, and in most major cities, for any alterations made where doors or walls are to be moved. Thus this index, reflecting construction activity whose cost range is very large, cannot legitimately be used without some cost factor being included.

Currency Rates

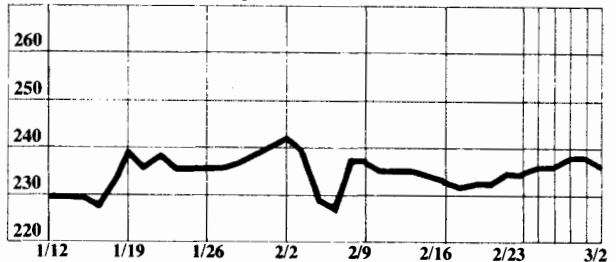
The dollar in deutschemarks

New York late afternoon fixing



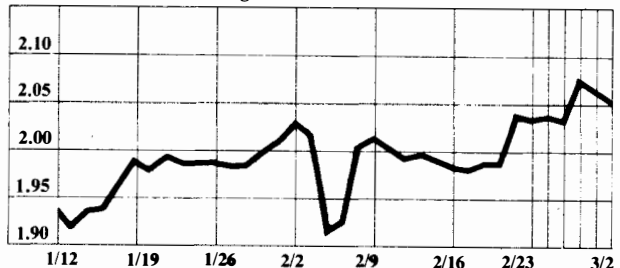
The dollar in yen

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing

