

# THE TOP 10 ECONOMIC INDICATORS: WHAT TO WATCH AND WHY

Economists, analysts, and even individual investors want to keep a pulse on the economy. But no one wants to wade through the massive volume of economic statistics that are put out by various entities, both governmental and private. An understanding of the top 10 economic indicators can help you narrow your focus.

Economic reports and indicators are those often-voluminous statistics put out by government agencies, non-profit organizations and even private companies. They provide measurements for evaluating the health of our economy, the latest business cycles and how consumers are spending and generally faring. Various economic indicators are released daily, weekly, monthly and/or quarterly.

While it is important to keep a pulse on the economy, few analysts or economists wade through all of these massive volumes of data.

Which reports are worth it—and why?

Here's a primer on 10 of the most common and vital economic indicators. Even if you don't follow these reports yourself, it is helpful to know where the "experts" are drawing their opinions from. If you do peruse these reports, remember that data can change rapidly, and that broad trends are not judged by one isolated economic data point. The box on page 16 provides Web site addresses for the top 10 data sources.

## 1) Real GDP (Gross Domestic Product)

### ***What is it?***

The real GDP is the market value of all goods and services produced in a nation during a specific time period. Real GDP measures a society's wealth by indicating how fast profits may grow and the expected return on capital. It is labeled "real" because each year's data is adjusted to account for changes in year-to-year prices. The real GDP is a comprehensive way to gauge the health and well-being of an economy.

### ***Why is it important?***

The Federal Reserve uses data such as the real GDP and other related economic indicators to adjust its monetary policy.

### ***Where does the data come from?***

The U.S. Department of Commerce's Bureau of Economic Analysis releases the data quarterly, including any revisions, within the last week to 10 days of each month following the end of the quarter. Data are spelled out as being "advance estimates," "preliminary estimates," and "final" numbers. Each data release includes an explanation of why the GDP increased or decreased from the previous quarter (quarterly data are also annualized).

## 2) M2 (Money Supply)

### ***What is it?***

M2 money supply represents the aggregate total of all money a country has in circulation. It takes into account all physical currency such as bills and coins; demand deposit savings and checking accounts; traveler's checks; assets

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in retail money market accounts and small money market mutual funds, (i.e., less than \$100,000); individual time deposits and savings deposits, such as certificates of deposits; in addition to some repurchase agreements and Eurodollar holdings.

It does not include institutional money fund assets, large denominated (more than \$100,000) time deposits, or any special reserves banks are required to maintain.

#### ***Why is it important?***

The Federal Reserve uses this data to assess current economic and financial conditions, and to help alter its monetary policy, which includes raising and lowering interest rates. The Fed's actions are aimed at bolstering or reducing the money supply.

Economists and others also use M2 data to predict cyclical economic recessions and recoveries and expected changes in stock prices—not to mention expected changes in the Fed's monetary policy.

Some economists believe that M2's relevancy has waned over the past 20 years. For many years this monetary measurement had closely paralleled the growth or contraction of the U.S. economy and overall changes in prices. But over the past two decades, a bevy of changes—such as the introduction of new depository products, the movement of consumer funds from bank deposits to investment accounts and the internationalization of the economy—has caused the money supply data to fall out of sync with other economic indicators.

Nevertheless, the Fed and some economists and analysts pay attention to the longer-term trends in growth or reduction of the money supply, particularly the six-month figures. And the Fed retains its power to increase the money supply by lowering interest rates as a way to counter a sluggish economy, and to reduce the money supply by raising interest rates if the economy gets overheated.

#### ***Where does the data come from?***

The Board of Governors of the Federal Reserve System releases the data both weekly (on Thursdays) and monthly, during either the second or third week of the month. Monthly data goes back to January 1959; weekly information has been available since January 1975.

### **3) Consumer Price Index (CPI)**

#### ***What is it?***

The CPI measures changes in the prices paid for goods and services by urban consumers for the specified month. The CPI is essentially a measure of individuals' cost of living changes and provides a gauge of the inflation rate related to purchasing those goods and services.

The CPI does not include every item an individual may buy, but instead takes a sampling of several hundred goods and services across 200 item categories. Data is collected through phone calls and personal visits in 87 urban areas across the country.

The CPI does not include income, Social Security taxes, or investments in stocks, bonds or life insurance. But it does include all sales taxes associated with the purchases of those goods and services.

#### ***Why is it important?***

This statistic is the best indicator of inflation that we have to rely on. It is particularly closely scrutinized by financial economists now since it shows inflation to be at a 16-year low. Changes in inflation can spur the Fed to take action to change its monetary policy.

#### ***Where does the data come from?***

The U.S. Department of Labor's Bureau of Labor Statistics releases the national CPI—an average of all areas sampled, monthly, during the second or third week after the end of the measured month. CPIs for three specific metropolitan areas are also published monthly, while CPIs for other specific metropolitan regions are published every other month.

Data releases include details about very specific products.

### **4) Producer Price Index (PPI)**

#### ***What is it?***

The PPI is a group of indexes that measures the changes in the selling price of goods and services received by U.S. producers over a period of time. Think of it as the business-side equivalent to the CPI that measures changes in prices paid by consumers: The PPI captures price movements at the wholesale level, before price changes have bubbled up to the retail level.

The PPI tracks price changes in virtually all goods-producing sectors, including agriculture, forestry, fisheries, mining and manufacturing. The PPI also tracks price changes for a growing portion of the non-goods-producing sectors of the economy as new PPIs are introduced. Prices from 25,000 establishments are tracked monthly.

This report measures prices for goods at three stages of production: finished goods, intermediate goods and crude goods.

This was called the Wholesale Price Index from 1902 until 1978.

#### ***Why is it important?***

This index is timely because it is the first inflation measure available in the month. In addition, by watching crude prices, which are first in the chain of production trends, one can sometimes spot inflation in the pipeline, before it shows up in the CPI.

#### ***Where does the data come from?***

The U.S. Department of Labor's Bureau of Labor Statistics releases the data monthly, during the second full week of the month following the reporting month.

### **5) Consumer Confidence Survey**

#### ***What is it?***

A gauge of the public's confidence about the health of the U.S. economy that reflects the public's optimism/

pessimism and the nation's mood.

Five questions are asked of a random sampling of 5,000 individuals, of whom about 3,500 respond. The survey asks their thoughts and feelings about business conditions, the labor market, consumer spending and economic growth, and their financial and employment expectations six months into the future. Each question can be assigned three opinions: positive, negative and neutral.

#### ***Why is it important?***

This statistic is a leading indicator of consumer spending—consumers are more inclined to spend money when they are feeling confident about their financial and employment prospects.

#### ***Where does the data come from?***

The Conference Board's Consumer Research Center releases the data monthly on the last Tuesday of each month.

### **6) Current Employment Statistics (CES)**

#### ***What is it?***

CES provides comprehensive data on national employment, unemployment and wages and earnings data across all non-agriculture industries, including all civilian government workers. Information is disseminated in many different ways—for example, employment/unemployment rates among men and women, varied ethnic groups and teens.

Employment data is based on a survey of 300,000 establishments across 600 industries, which account for approximately one-third of all payroll employees. Industries include retail trade, manufacturing and construction. CES provides details on numbers of hours worked and earnings of all surveyed across the nation.

The "employed" are defined as all full- and part-time workers and temporary and intermittent employees who received pay for the cited period. It includes those on paid vacation or sick leave, and excludes

business proprietors, self-employed, unpaid family members and volunteers.

#### ***Why is it important?***

This is the earliest indicator of economic trends released each month. Employment rates indicate the well-being of the economy and labor force. Changes in wages point to earnings trends and related labor costs. Economists focus on the monthly change in total non-farm payrolls and in which sectors jobs were gained or lost.

Interesting trends can also be derived from the payroll data, such as the average number of hours per week worked and the average hourly earnings. This data gives an indication of how tight the labor market is—tight labor markets can translate into wage inflation.

#### ***Where does the data come from?***

The U.S. Department of Labor's Bureau of Labor Statistics releases the data monthly, usually on the first Friday following the reference month, but always within the first 10 days after month-end.

### **7) Retail Trade Sales and Food Services Sales**

#### ***What is it?***

This data tracks monthly U.S. retail and food service sales, details changes from previous periods, and identifies in which sectors sales increased and/or decreased.

The data is based on a random sampling of 5,000 retail and food service firms. Figures are broken out to both include and exclude sales of automobiles. Sales are weighted and benchmarked to represent the nation's three million retail and food services firms.

#### ***Why is it important?***

The numbers measure consumers' personal consumption across retail industries and track growth or deceleration of personal consumption spending, which makes up approximately two-thirds of the annual U.S.

GDP. Analysts use the data to help track consumer spending trends and forecast the direction and magnitude of future spending. Automobile sales are separated from the data because of their volatility, which can sometimes obscure the underlying pattern of spending.

#### ***Where does it come from?***

The U.S. Department of Commerce's U.S. Census Bureau releases the data monthly, during the second week of each month.

### **8) Housing Starts (Formally Known as "New Residential Construction")**

#### ***What is it?***

An approximation of the number of housing units on which some construction was performed during the month. Data is provided for single-family homes and multiple unit buildings. The data indicates how many homes were issued building permits, how many housing construction projects were initiated and how many home construction projects were completed.

#### ***Why is it important?***

Housing starts are highly sensitive to changes in mortgage rates, which are affected by changes in interest rates. Although this indicator is highly volatile, it represents about 4% of annual GDP, and can signal changes in the economy and the effects of current financial conditions. Analysts and economists know to watch for longer-term trends in housing starts.

#### ***Where does the data come from?***

The U.S. Department of Commerce's U.S. Census Bureau releases the data monthly, within two to three weeks after the end of the reporting month.

### **9) Manufacturing and Trade Inventories and Sales**

#### ***What is it?***

This data represents the combined value of trade sales and shipments

## WEB ADDRESSES FOR DATA SOURCES

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| <p>1) Real GDP (Gross Domestic Product)<br/>U.S. Department of Commerce's Bureau of Economic Analysis<br/><a href="http://www.bea.gov">www.bea.gov</a></p> <p>2) M2 (Money Supply)<br/>Board of Governors of the Federal Reserve System<br/><a href="http://www.federalreserve.gov/releases/h6">www.federalreserve.gov/releases/h6</a></p> <p>3) Consumer Price Index (CPI)<br/>U.S. Department of Labor, Bureau of Labor Statistics<br/><a href="http://www.bls.gov/cpi/home.htm">www.bls.gov/cpi/home.htm</a></p> <p>4) Producer Price Index (PPI)<br/>U.S. Department of Labor, Bureau of Labor Statistics<br/><a href="http://www.bls.gov/ppi/home.htm">www.bls.gov/ppi/home.htm</a></p> <p>5) Consumer Confidence Survey<br/>The Conference Board, Consumer Research Center<br/><a href="http://www.consumerresearchcenter.org">www.consumerresearchcenter.org</a></p> | <p>6) Current Employment Statistics (CES)<br/>U.S. Department of Labor, Bureau of Labor Statistics<br/><a href="http://www.bls.gov/ces/home.htm">www.bls.gov/ces/home.htm</a></p> <p>7) Retail Trade Sales and Food Services Sales<br/>U.S. Department of Commerce, U.S. Census Bureau<br/><a href="http://www.census.gov/cgi-bin/briefroom/BriefRm">www.census.gov/cgi-bin/briefroom/BriefRm</a></p> <p>8) Housing Starts (Formally Known as "New Residential Construction")<br/>U.S. Department of Commerce, U.S. Census Bureau<br/><a href="http://www.census.gov/cgi-bin/briefroom/BriefRm">www.census.gov/cgi-bin/briefroom/BriefRm</a></p> <p>9) Manufacturing and Trade Inventories and Sales<br/>U.S. Department of Commerce, U.S. Census Bureau<br/><a href="http://www.census.gov/cgi-bin/briefroom/BriefRm">www.census.gov/cgi-bin/briefroom/BriefRm</a></p> <p>10) S&amp;P 500 Stock Index (the S&amp;P 500)<br/>Standard &amp; Poor's Corp.<br/><a href="http://www.spglobal.com">www.spglobal.com</a></p> |
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by manufacturers in a specific month, as well as the combined values of inventories in the whole-sale and retail business sectors and manufacturing. The current and most recent past month's inventory/sales ratios are also provided. Information is provided across 17,000 manufacturing, retail and wholesale companies within 160 industries.

**Why is it important?**

This data set is the primary source of information on the state of business inventories and business sales. Inventory rates often provide clues about the growth or contraction of the economy. A growth in business inventories may mean sales are slow and the economy's rate of growth is also slowing. If sales are slowing, businesses may be forced to cut production of goods, and that can eventually translate into inventory reductions.

**Where does the data come from?**

The U.S. Department of

Commerce's U.S. Census Bureau releases the data monthly, approximately six weeks after the end of the subject month.

**10) S&P 500 Stock Index (the S&P 500)****What is it?**

The Standard & Poor's 500 is a market-value-weighted index of 500 publicly owned stocks that are combined into one equity basket. This basket of stocks has become the industry standard and benchmark for the overall performance of the U.S. equity markets.

The S&P Index Committee chooses the indexed stocks based upon market size, liquidity and industry group representation. Component companies are periodically replaced. Companies are most often removed because of a merger with another company, financial operating failure or restructuring. Prospective companies are placed in an index "replacement pool" and vacancies are filled from that pool.

**Why is it important?**

The index is designed to measure changes in the stock prices of component companies. It is used as a measure of the nation's stock of capital, as well as a gauge of future business and consumer confidence levels. Growth of the S&P 500 index can translate into growth of business investment. It can also be a clue to higher future consumer spending. A declining S&P 500 index can signal a tightening of belts for both businesses and consumers.

Economists tend to look for long-term trends rather than short-term fluctuations in the S&P 500 index. The S&P 500's 10-year total return, for example, has become a common indicator of longer-term trends.

**Where does the data come from?**

Standard & Poor's is solely responsible for compilation of the S&P 500 index. However, real-time information on the index is available daily from financial news organizations and publications, as well as from Standard & Poor's. ♦