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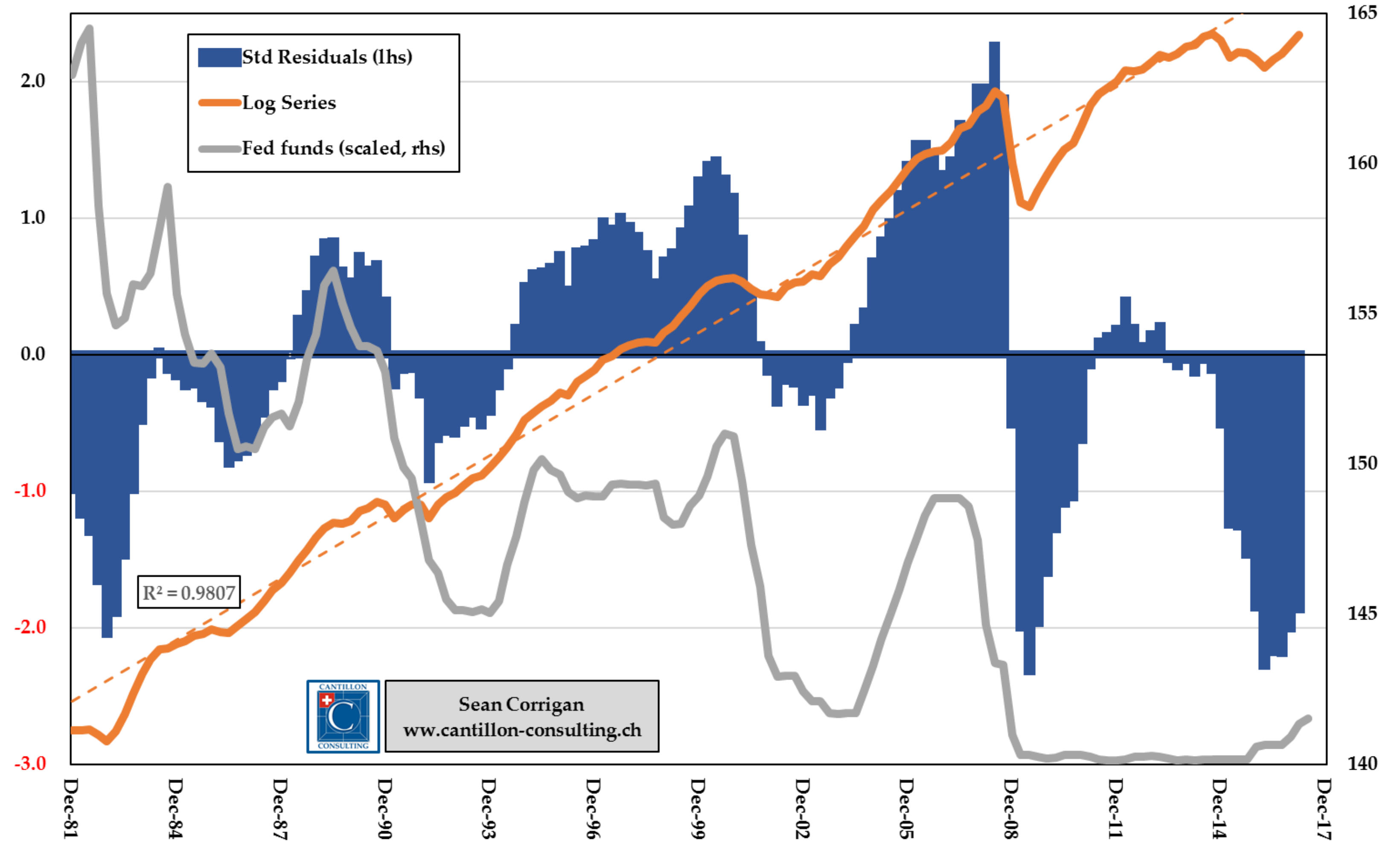
Forecasting the Fed: patterns, predictions & the PMI

There are those who cite the later Hayek (among others) to argue that the Fed should run a policy which aims at keeping Nominal GDP stable - or at least growing at a constant pace, depending on who it is to whom you are actually talking.

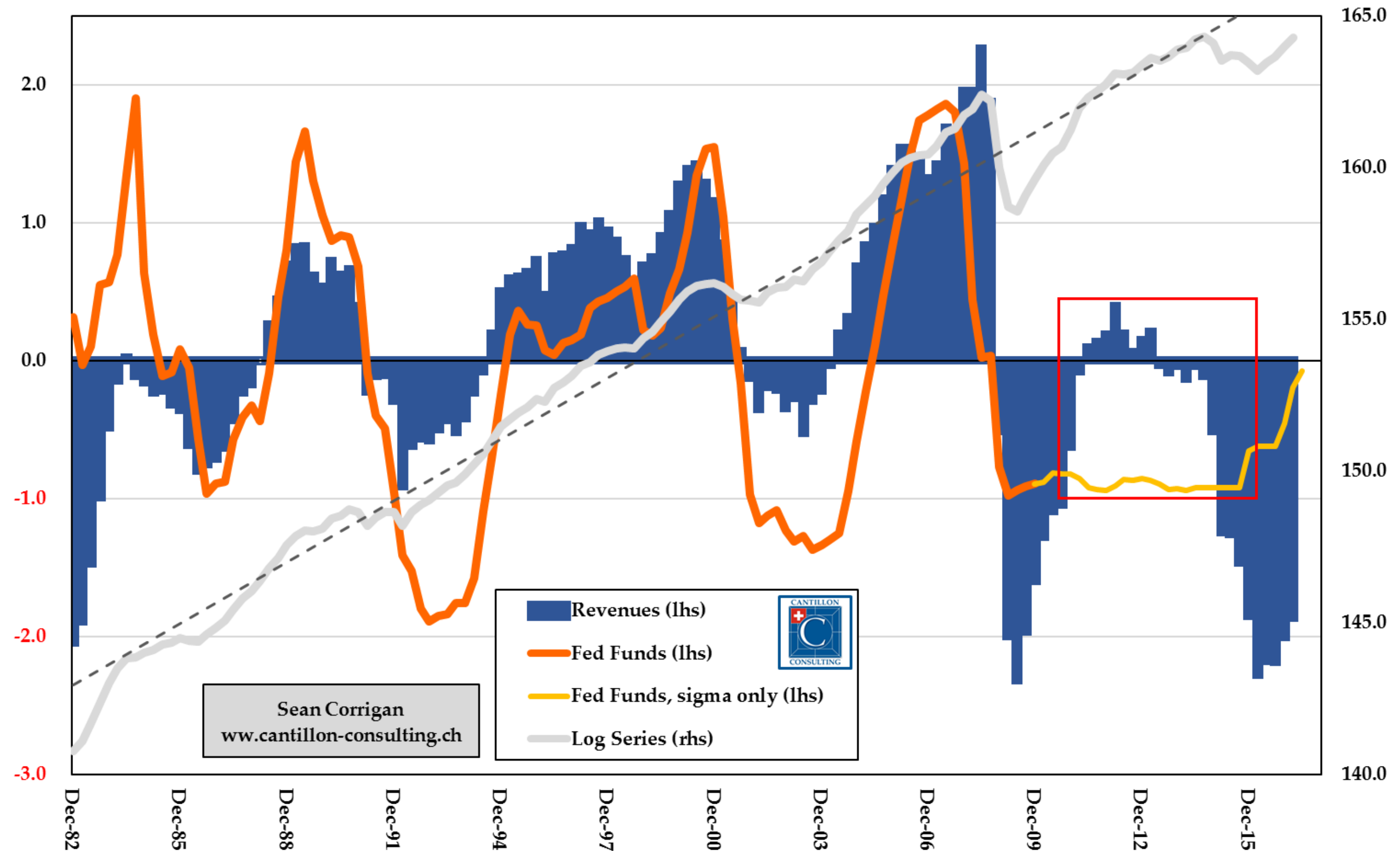
As the associated chart shows – and unwittingly or not - it has been doing pretty much exactly that latter for much of the past 35 years – at least if one abstracts from the inexorable, underlying downward bias of interest rates, as the version of this we present overleaf attempts to do.



Now we can see that only during the ‘zero-bound’ episode has a prolonged move *independent* of fluctuations in real-economy cash flow been seen (in the period delineated by the red box), though, as a glance back at our preceding visualization reveals, this occurred only because of the interplay of the steep negative slope of said underlying trend with an unchanged *observed* policy rate.

[NB: In ‘zero-bound’ territory, post-2008, we have scaled using the 82-08 sigma but NOT that trend’s slope]

Other work we have done has led us to the rule of thumb that nominal growth in this subset of overall outlays of greater than 6% tends to elicit rate hikes from the Fed.

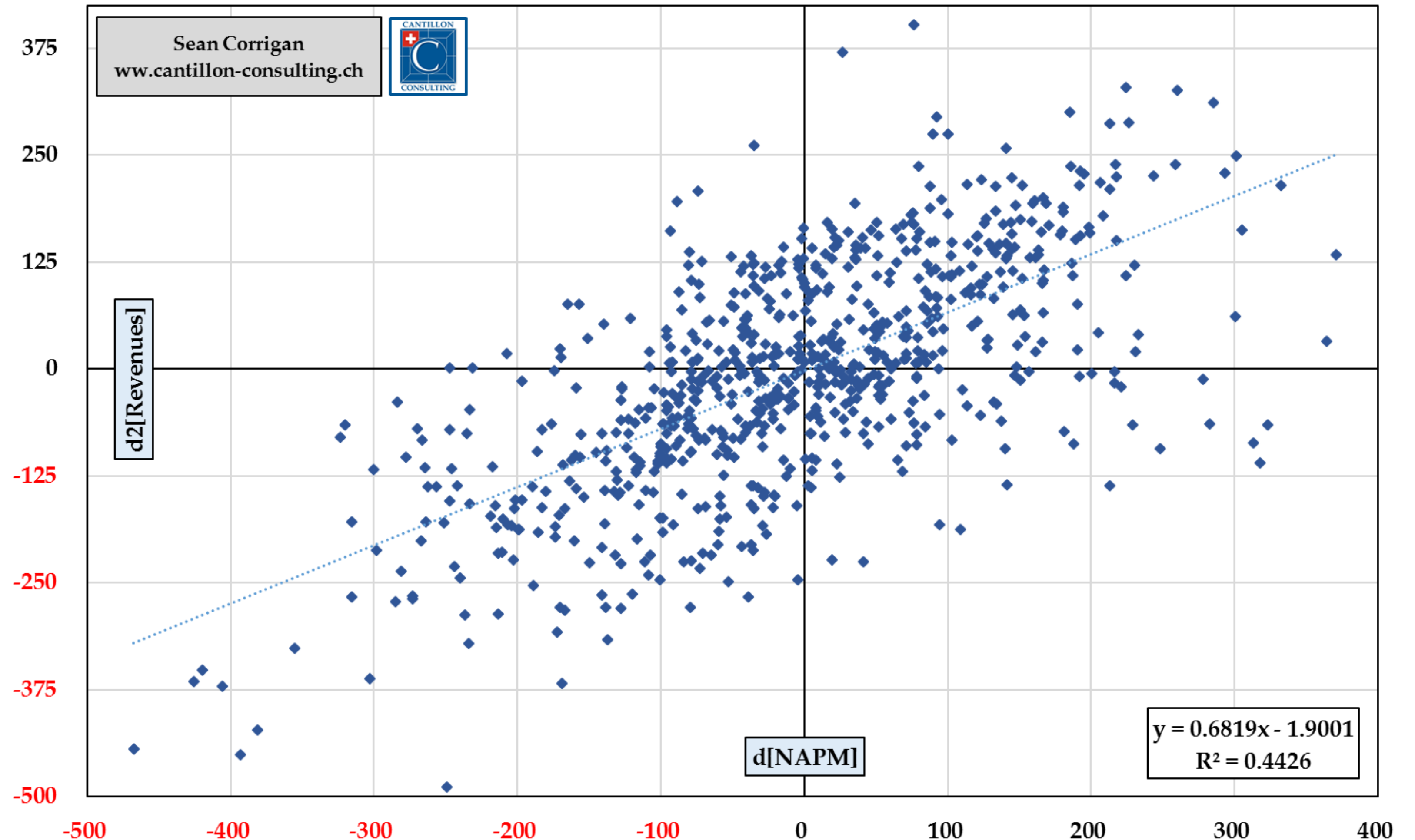


After a strong rebound from the shale-induced trough which was set in the first quarter of last year, we *had* been running comfortably in excess of that 6% threshold.

The evidence of the past two months is that – again partly due to the effect of the intervening fall in energy prices on this *nominal* measure – we may have temporarily dipped back below it.

However, as demonstrated here, arithmetical improvements in the PMI survey correlate well with *accelerations* in this key measure of revenue growth

NAPM YOY v 2nd difference Revenues, rolling normalization, 1952-2017: *Source - ISM, Census*



Thus we might take heart from the fact that, excluding the rebounds from the last two, full-blown recessions, those PMI readings remain strong, if a touch off the local maximum set in the spring.

The working hypothesis, then, is that turnover should not long continue to stagnate.

NAPM Index, 3mma normalized: *Source - ISM*

2.0
1.0
0.0
-1.0
-2.0
-3.0
-4.0

Dec-83 Dec-86 Dec-89 Dec-92 Dec-95 Dec-98 Dec-01 Dec-04 Dec-07 Dec-10 Dec-13 Dec-16

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Reassuringly, the link from expressions of positive PM sentiment to more cash jingling its way into the businessman-responder's till – i.e., to quicker revenue growth – also tends to extend to increases in *profitability* before too long. On past form, therefore, a further measure of improvement here is also to be expected.

Please address any questions to info[at]cantillon-consulting.ch

Those wishing to engage the author's services and to ensure a steady flow of such insights are cordially invited do likewise.

Further details can be had at the web address listed at the foot of this page.

US Manufacturing After-tax Profits NAPM t-4, divergence: *Source - Census QFR*

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