"Bernard Baumohl brilliantly, clearly, and yes, entertainingly, describes what every investor and business partner should know about economic indicators. This is an extraordinary and insightful work"

—Robert Hormats, Vice-Chairman, Goldman Sachs (International)

Retail Sales

Employment

China's Industrial Production

GDP

The Secrets of ECONOMIC INDICATORS

Hidden Clues to Future Economic Trends and Investment Opportunities

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"This is the most up-to-date guide to economic indicators and their importance to financial markets in print. The coverage of less-reported indicators, especially those from nongovernment sources, is hard to find elsewhere. The inclusion of the actual published tables helps the newer student of the markets find the data in the public release. For anyone trying to follow the economic data, this should be next to your computer so that you can understand and find the data on the Internet."
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"Economic statistics, employment data, Federal Reserve surveys. Think they are boring? Think again! They can drive markets into a frenzy, causing billions of dollars to be made or lost in an instant. Bernie Baumohl brilliantly, clearly, and, yes, entertainingly describes what every investor and business manager should know about economic indicators: which ones move markets, how to interpret them, and how to use them to spot and capitalize on future economic trends. The Secrets of Economic Indicators *is an extraordinary and insightful work—an enormously important contribution to the body of financial literature. Read it and then keep it on your desk. Consult it the next time you are deluged with a flurry of economic statistics. Your understanding certainly will be enhanced, and your portfolio will likely be as well."*
—Robert Hormats, Vice Chairman, Goldman Sachs (International)

"Bernie Baumohl has accomplished something of real value in The Secrets of Economic Indicators*. He has successfully demystified the world of financial and economic news that bombards us in our daily lives. Both professional investors and casual observers of the world of finance and economics will be grateful for what he has done. The constant stream of heretofore bewildering news from the world of business and finance can now be easily understood. Every businessperson or investor should keep a copy of Baumohl's book close at hand as he or she catches up on the business, stock market, and economic events of the day. It is great, at long last, to have someone who has eliminated what may have been so perplexing to so many and to have done so with such remarkable clarity."*
—Hugh Johnson, Chairman and Chief Investment Officer of Johnson Illington Advisors

"If you want to make money investing, this is an essential trend-tracking tool that will help get you to the bank. This book is the real deal. Bernard Baumohl miraculously breathes life into deadly economic indicators and boring statistics . . . he knows what he's talking about, and his expertise proves it."
—Gerald Celente, Director, The Trends Research Institute

"Baumohl has a gift for taking a complicated subject and allowing it to read like a fast-moving novel. My confidence in reading and understanding economic indicators as portrayed in this book made me realize the possibilities this information holds for improving my personal net worth as well as navigating my business toward higher profits. I recommend this book if you care about your future finances."
—Morris E. Lasky, CEO, Lodging Unlimited, Inc.; Manager and consultant for $6 billion in hotel assets; Chairman, Lodging Conference; Chairman, International Hotel Conference

"I find Baumohl's writing fascinating. In addition to the famous indicators, he includes many that I hadn't heard of. I really appreciate that he tells you exactly where to find each indicator on the Web. Just about anyone who's serious about understanding which way the economy is headed will want to read this book. It could be a classic."
—Harry Domash, Columnist for MSN Money and Publisher, Winning Investing Newsletter

"I think this is an excellent book. It's well written, accessible to a variety of readers, deals with an interesting and important subject, and covers the topic well. It deserves to get a lot of notice and use."
—D. Quinn Mills, Alfred J. Weatherhead, Jr., Professor of Business Administration, Harvard Business School

THE SECRETS OF ECONOMIC

Hidden Clues to Future Economic Trends and Investment Opportunities

INDICATORS

SECOND EDITION

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SECOND EDITION

BERNARD BAUMOHL

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To my mother, Eva Baumohl, a Holocaust survivor; and in memory of my father, Naftali Baumohl

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About the Author

Bernard Baumohl is managing director of The Economic Outlook Group and oversees its forecasts of economic trends and risks. He also conducts seminars on how to find and utilize economic indicators so that corporate leaders and investors can stay ahead of the business curve. Baumohl was an award-winning *TIME Magazine* economics reporter for two decades and covered the domestic and international economy from *TIME*'s New York and Washington bureaus. As an economist for European American Bank, he monitored and developed forecasts of U.S. economic activity. He also served as an analyst with the Council on Foreign Relations. A frequent guest on television and radio, he has lectured on economics at New York University, Duke University, and the New York Institute of Finance. A recipient of the John Hancock Award for Excellence in Financial Journalism, Baumohl has a master's degree in international affairs and economics from Columbia University.

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What's New in the Second Edition?

From the beginning, I wanted to write a different sort of book on the economy and its ties to the financial markets. My approach was to focus on economic indicators—specifically, those key indicators that can, if read correctly, provide timely insights on where the economy is headed—and how that information can influence the value of stocks, bonds, and currencies. However, a book on economic indicators runs the risk of being antiquated unless it is periodically updated to reflect the changing universe of these market-sensitive measures. For instance, new economic indicators have been introduced since the first edition was published, and some of them show promise as useful forecasting tools. Other measures have undergone significant methodological refinements so that they can more accurately anticipate the economy's direction.

Aside from updating the collection of economic indicators, economists and investors have also had to confront several new and far-reaching issues on the workings of the U.S. and international economy. For example, there has been much discussion recently about whether the yield curve is still a reliable predictor of business cycles, or whether inflation measures adequately take into account not just changes in the price of goods and services, but also improvements in their quality.

For all these reasons, I felt the time was right for a second edition that would not only revise the list of the most important economic indicators, but would also explain their significance in a way that makes the analysis more relevant.

So what is new in this book?

In the first chapter, changes were made in the ranking of the most influential indicators. Such revisions became necessary following the introduction of new measures of economic activity, and also because of the modifications made to the way several existing indicators were computed.

I also decided to address the question I get most frequently from clients: Which economic indicators are best known for being ahead of the business curve? In response, I added a chart that lists the top ten "leading economic indicators." This list is based not just on my research, but also on the valued opinions I received from other economists. However, the chart given here, unlike the others you'll see, does not formally rank the leading indicators, because there is no agreement as to which consistently serves as "the best" crystal ball.

By far, most of the changes take place in Chapter 3. Among the most noteworthy is the addition of three measures: the *ADP National Employment Report*, the *Federal Open*

Market Committee (FOMC) *Statement*, and the release of *Treasury International Capital* (TIC) flows. The federal government has also redesigned a number of existing indicators, and that required new charts and descriptions for this book.

Chapter 4 deals with the most important international economic indicators. To keep the list current, India's GDP and inflation were added. Although this country is often referred to as the "other" giant of Asia, many experts believe India will overtake China in population and even GDP later this century.

For Chapters 5 and 6, all U.S. and foreign Internet addresses were checked to see if they were working so that you won't get that annoying "Does not exist" message. Finally, a new type of list was inserted at the end of Chapter 5—one that consists of useful "unconventional" economic indicators. These are less well-known monthly or weekly measures that gauge business activity within a specific business sector, such as the volume of railroad freight traffic, movie box office receipts, and hotel bookings—all of which help corroborate what the broader economic indicators tells us about the current and future strength of the economy.

Bernard Baumohl
March 2007
Princeton Junction, New Jersey

PREFACE

"You want to write a book about *what*? *Economic indicators*? How did you come up with this death wish?"

That was the first response I got after telling a colleague at *TIME* what I was up to. She, too, was a financial journalist, so I expected some sage advice and support. We continued our conversation over lunch. "Did I hear you correctly?" she asked, still incredulous. "We *are* talking about your writing a book on economic statistics, right?" Yes, I nodded, and then went on to explain why this idea had been percolating in my mind for months. I knew it was a tough topic to write about, but I was ready to take it on. She listened patiently to my reasoning and then let loose a barrage of suggestions.

"First, let's get real here. To make this work, a book on economic indicators has to be sexy. Edgy. Really funny. Get in some lurid details about consumer prices. Tell some lascivious tales about industrial production and capacity utilization. Toss in lots of jokes on durable-goods orders. Then there's the humor that just springs at you when writing about foreign trade and nonfarm productivity. And . . . hey, shouldn't you be taking notes on all this?"

The appetite I came to the restaurant with was suddenly gone. Not because she was poking fun at the idea. Just the opposite. Beneath all that sarcasm was a genuine message that I knew had to be taken seriously. The subject of economic indicators can be lethally boring because of its impenetrable jargon and reliance on tedious statistics. I realized from that brutal lunch encounter that my biggest challenge in writing this book was not simply to identify and describe the world's most influential economic indicators, but to make the whole subject approachable and even—dare I say it—interesting. My purpose from the start was to reach out to those who had little or no experience navigating the maze of key economic statistics and to dispel the notion that you need an economics degree, an MBA, or a CPA to understand what these indicators tell us about the economy and how we can use them to make better investment and business decisions.

The broader question, of course, is why do this book at all? Why should anyone outside the economics profession even care about economic indicators? Why is it important for the average person to know how many new homes are under construction, whether factories produced more or fewer goods in the latest month, or whether executives charged with buying raw material for their companies are increasing their orders or cutting back? Why bother with any of this stuff? Why not let the experts sort out the mishmash of economic numbers and tell us what it means?

Indeed, most Americans have little desire to follow such esoteric measures. They are content to rely on the insights of their investment advisers or hear television pundits muse endlessly about the economy and the financial markets. Other than that, few show interest in probing any further. However, that attitude changed abruptly in 2000 with the bursting of the stock market bubble and the collapse of the dot-com sector. Investors were sickened and then angered by the resulting loss of trillions of dollars in personal wealth. It made no difference whether the money was in one's personal savings, a 401(k), or a pension. No investment escaped unscathed. The decimation was universal, and for Americans, it became a painful and sobering reminder of just how much one's financial well-being was staked to the risky business of stocks and bonds.

Perhaps the most troubling revelation to come out of this awful experience was how utterly dependent ordinary investors had allowed themselves to become on so-called "experts" for virtually all investment advice. It turned out that these very "experts"—veteran portfolio managers and longtime professional market watchers—failed miserably in their responsibility to help protect the assets and curb the losses of their investing clients. Worse still, investors became justifiably furious when they realized they were also being lied to by some of the companies they had invested in and even by the brokerage firms with whom they had entrusted their hard-earned money.

The result was predictable. Disillusioned by the ineffectual advice of their brokers, the seemingly endless revelations of corporate fraud, and the biased research reports put out by some well-known Wall Street firms, a growing number of Americans have since decided to venture into the investment world by themselves, trusting their own instincts rather than someone else's. These investors are emboldened by the fact that they can now access a huge assortment of information resources from home and work. They can even access them while traveling. There is, today, an unprecedented abundance of economic and financial news and analysis instantly available to anyone, anytime. This includes virtually 24/7 radio and television coverage of business news and, of course, hundreds of useful Web sites that offer valuable data as well as varied perspectives on the outlook for the financial markets and the economy.

How do the economic indicators fit into all this? Why should investors—or business executives, entrepreneurs, and ordinary workers—pay particular attention to these reports? Because they are the vital barometers that tell us what the economy is up to and, more importantly, in what direction it is likely to go in the future. These indicators describe the economic backdrop that will ultimately affect corporate earnings, interest rates, and inflation. They can also influence the future cost of financing a car or house, the security of our jobs, and our overall standard of living. Even business leaders are under pressure to monitor economic indicators more closely. Knowledge of economic conditions in the U.S. enables CEOs to make decisions with greater confidence about whether to buy more equipment, increase inventories, hire workers, or raise fresh capital. In addition, for firms competing in the global marketplace, international economic indicators are of particular importance, because they allow executives to assess business opportunities abroad.

But how do you begin to evaluate these economic reports? There is such a bewildering variety of economic statistics in the public domain that following them all can be harmful to your health. New sets of economic numbers come out every day, week, month, and quarter, and they often tell conflicting stories about what's going on in the U.S. In addition, stocks, bonds, and currencies react differently to economic indicators. Some economic news can cause tremors in the financial markets, while other news produces no reaction at all. Many indicators have no forecasting value whatsoever, yet others have established an impressive track record of being able to predict how the economy will behave during the next 12 months.

Moreover, different indicators originate from different sources. The U.S. government pumps out loads of economic data through agencies such as the Commerce Department's Bureau of Economic Analysis and the Federal Reserve Board. However, numerous private groups also release market-moving indicators. One of the best known is The Conference Board for its Consumer Confidence and Leading Economic Indicators series. In addition, the National Association of Realtors reports monthly data on existing home sales, and Challenger, Gray and Christmas, the outplacement firm, tallies the number of announced corporate layoffs each month. Note that these sources just gauge U.S. economic activity. When you look at the assortment of economic indicators released by other countries, the quantity of information available becomes mind-numbing.

Clearly there is too much economic information out there, and not all of it is useful. So what do you focus on? How does an investor, a CEO, or even an economist decide which of the many gauges of business activity are worth tracking? Which indicators pack the greatest wallop in the financial markets? Which ones are known for doing the best job of predicting where the economy is heading? These are the key questions I try to answer in this book.

The book is organized in a way that I believe makes the most sense for you. Chapter 1, "The Lock-Up," begins with the drama that typically surrounds the release of a sensitive economic indicator. After the embargo is lifted and the economic report flashes across computer screens around the world, reaction to the latest news by global money markets can affect the financial well-being of every American.

One cannot successfully write a book on economic indicators without at least gently introducing a few basic economic terms. In Chapter 2, "A Beginner's Guide: Understanding the Lingo," I try to define as painlessly as possible those key phrases and concepts that are essential to know when reading about economic indicators.

The essence of the book begins with Chapter 3, "The Most Influential U.S. Economic Indicators." Here, all the major U.S. economic indicators are evaluated, and each one is discussed in a format designed to answer these vital questions:

- Why is this indicator important to know?
- How is it computed? (Sure, not everyone will want to get into the nitty-gritty details of how economic indicators are put together. Nevertheless, by understanding the

underlying methodology of how they are calculated, one is better able to appreciate the usefulness of these indicators, as well as their shortcomings.)

- What does the economic indicator have to say about the future? The purpose of this question is twofold. First you are shown how to interpret the official report and its accompanying tables. Particular emphasis is placed on the most interesting and useful data points in the economic release. Second, guidance is given on how to locate valuable clues in the tables that may offer you a heads-up on how the economy might perform in the months ahead. To make this task easier, copies of actual releases are included with most indicators covered in this book. Virtually all the economic releases mentioned are available on the Internet for free. You can read them on their respective Web sites or download the releases as PDF files. (Note that Internet addresses for the economic indicators are included in this book.)
- How might bonds, stocks, and the dollar react to the latest economic reports? The financial markets often respond differently to economic data. Much depends on the specific indicator released, how timely it is, whether investors are surprised by the news, and what else is going on in the economy at the time.

Chapter 4, "International Economic Indicators: Why Are They So Important?," examines the most influential foreign economic indicators. Because the U.S. economy and its financial markets are closely integrated with the rest of the world, one can no longer afford to ignore measures of economic activity in other countries. If the economies of other nations are growing, they'll buy more from U.S. producers. On the other hand, poor growth abroad bodes ill for many large U.S. companies and their employees. In addition, American investors interested in buying foreign stocks and bonds for their own portfolios should track foreign economic indicators to identify those countries and regions in the world that might offer the most attractive returns.

Chapter 5, "Best Web Sites for U.S. Economic Indicators," is evidence of how much times have changed. Not too long ago, anyone interested in obtaining a set of current and historical economic statistics had to purchase them from a private number-crunching firm. The more stats you wanted, the more costly it was. Today, nearly all this data can be accessed instantly on the Internet for free! The democratization of economic statistics gives everyone, from the experienced professional to the weekend investor, the opportunity to download, read, and analyze economic information. In this chapter, I've assembled what I think are among the best and most authoritative Web sites for economic data. Again, all are free, though some may ask users to register.

Chapter 6, "Best Web Sites for International Economic Indicators," is a compilation of Web sites that enables you to quickly locate foreign economic data that might otherwise be tough to find. However, there's one important caveat to keep in mind: No country collects and disseminates as much high-quality economic information as the U.S. Its breadth and integrity make it the gold standard in the world. Although there is a vast amount of international economic data on the Web, one has to approach such sources with caution. There are issues concerning language (many are not in English), comprehensiveness, accuracy, and timeliness. In this chapter, I've listed sites on the Internet that in my judgment are the best and most trustworthy for international economic data—and that are available in English! Once again, every site listed is free (at least at the time of this writing).

Finally, let me close by saying that this book was fun to write, largely because I learned a great deal in the process. It is not meant to be a textbook or some intellectual treatise on the economy. My purpose throughout is to help give you a better understanding of how to look at economic indicators, why they can be so influential, what they might tell us about the future, and how people can best utilize all that information. If I have accomplished this in some way, than it was worth all the swearing and temper tantrums I went through every time my computer crashed in the course of this endeavor.

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ACKNOWLEDGMENTS

One gratification that comes with completing a book is that I now get a chance to thank those whom I relied on for advice, contacts, and support along the way. To be sure, there are many people to thank—so many, in fact, that mentioning all their names would greatly lengthen this book. Still, there are some that deserve special mention because they were so giving of their time and their counsel.

I must begin by breaking with tradition. It is customary in these pages to reserve thanking your family until the end. However, that order makes little sense to me in this case. My family deserves top billing here, because I relied on their support the most these last two years. From day one I expropriated a room in our home and turned it into an impassable maze of documents, newspapers, and boxes. Indeed, we can no longer recall the color of the carpet underneath. Moreover, during the last two years, when I was writing or traveling, the burden of overseeing family and household matters fell largely on my wife, Debbie. She was the one who got our three girls off to school every morning, prepared their lunches, helped with their homework, chauffeured them to playdates, met with teachers, accompanied them to doctor checkups, got them ready for bed, paid the bills, and so much more. Without a doubt, this book would not have been possible without her support and love. Nor will I ever forget how my daughters, Ashley, Rachel, and Nicole, tried to help me in the first days by printing "Do not disturb" signs and taping them outside my door. From beginning to end, my family provided the best home environment for me to carry out this project, and for that I will always be grateful.

I am also indebted to Carolina Buia (writer and television journalist) and Marc Lieberman (NYU economics professor). Both listened to my ideas, read the initial treatment of the book, and opened some very important doors to the publishing world. I also benefited greatly from the experience and wisdom of others, including Adam Cohen (the *New York Times*), Jordan Goodman (personal finance author), Dan Kadlec (*TIME*), Jeffrey Liebenson (KMZ Rosenman), Larry Moran (Bureau of Economic Analysis, Commerce Department), Michael Panzner (HSBC Securities), David Skidmore (Federal Reserve Board), Sue Hensley and Gary Steinberg (Department of Labor), Sam Slater (Fidelity International), Chris Williamson (NTC Economics), Joel Prakken and Ben Herzon (Macroeconomic Advisers, LLC), and Douglas Offer (ADP, Inc.).

There are two people I'd like to name who were not involved in the preparation of this book, but were nevertheless enormously important to me because I learned so much from them about economic journalism. They are Bill Saporito, *TIME*'s exceptionally gifted business editor, and the late George Church (*TIME* and the *Wall Street Journal*), who was a brilliant writer on all topics, but none more so than on economics. I view both their work as the benchmark in excellent writing and editing.

Finally, one of the luckiest things to have happened to me was to work with Jim Boyd, my editor at Prentice Hall. Writing a book the first time can be a daunting experience, but Jim made the process so much easier with his intelligent guidance and sense of humor. It was a real privilege working with him. I also want to thank Michael Thurston, project editor at Pearson Education, who supervised the production of this rather complicated book.

Let me make one last note. Though I made every effort to make sure this book is accurate, I alone am responsible for any follies that might have slipped through.

Chapter 1

The Lock-Up

Shortly after dawn on most weekday mornings, a strange ritual takes place in Washington, D.C. Two dozen select men and women leave their homes, grab their newspapers, and rush off to spend part of the day under virtual house arrest. Yes, house arrest—as in incarceration. Precisely where they go to be confined can vary day to day. It could be in a dilapidated government building one morning and a high-tech office complex the next. Regardless of the location, what occurs in all these places is always the same. They enter a strict, prison-like setting where contact with the outside world is cut off.

One Friday morning, this same group climbs a long set of steps to the side entrance of a sleek, white-stone building on 3rd Avenue and C Street in the heart of the nation's capital. Armed guards greet them at the entrance for a security check; from this point on, everyone has to wear their ID tags at all times. The visitors proceed across a lobby and down a quiet, narrow corridor, eventually stopping in front of a locked, heavy wooden door. A government official awaits them and quickly opens the door to reveal a drab, windowless, L-shaped room 40 feet long and some 10 feet across. It is empty except for two dozen plain-looking orange and chrome chairs, each resting alongside a row of narrow cubicle-like desks. A digital clock high on the wall breaks time down to seconds. It is 7:30:15 a.m., and already 12 people have found their way into the "lock-up" room. More are expected within the next 15 minutes. All who enter dutifully sign their names on a special sheet.

Despite its austere appearance, there is an atmosphere of calm in the room, at least for now. Some visitors talk excitedly about the previous night's televised basketball game. Others are either chatting on cell phones or checking their BlackBerrys for messages. A few keep to themselves by catching up on the morning paper or downing a quick muffin and coffee. Everyone in the room, however, makes a point of always knowing the time, with some people eyeing the digital clock so frequently that their actions may be mistaken for nervous tics.

As the time approaches 8 a.m., there is a palpable change in mood. Gone now are the sounds of light conversation; these sounds are replaced by the din of laptops firing up. Everyone appears to be focused on what is about to occur.

At 7:55 a.m. sharp, a government official walks in and picks up a wall phone to call the Naval Observatory, home to the Vice President of the United States. It is also the location of the ultra-accurate atomic clock. She listens intently for a few seconds and then abruptly hangs up without saying a word. The individual then inserts a key into a lock on the wall, which allows her to adjust the digital clock to the precise second. With the correct time now set, the official then turns around to make a terse announcement.

"Please turn off all cell phones and other communication devices, and disconnect laptops from your telephone lines."

To make sure everyone complies, the official walks across the room and eyes each desk. Meanwhile, a second federal employee arrives, carrying copies of a highly sensitive government report. Each one is placed facedown on an empty desk.

Then it begins.

At precisely 8 a.m., the door to the lock-up room clicks shut. From this point on, all those inside are out of touch with the rest of the world. No one is permitted to leave. No calls or messages can come into or go out of the room. Security is tight. A guard stands by outside, ready to use force if anyone attempts to sneak out.

What secret is the government protecting? Is the CIA about to begin a classified briefing on intelligence activities? Are Congressional investigators huddling to hear the newest terrorist threat? No. All these precautions are taken for one reason. The government is about to release numbers. Statistics. More precisely, economic statistics. The visitors in the room are business reporters representing news organizations from around the world, and this morning they're working out of the Department of Labor's secure pressroom.

Why such tight secrecy? Because in the next few seconds, these journalists will be the first to lay their eyes on one of the country's most sensitive economic measures—the monthly report on employment conditions. It can shed fresh light on whether the U.S. economy is growing or facing a slowdown. Did the number of Americans who have jobs rise or fall in the latest month? Have hourly wages gone up, or did they drop? Did people work more hours or fewer? These statistics might not seem particularly earthshaking to most Americans, but they can and do whip the global stock, bond, and currency markets into a frenzy. For individual investors and professional money managers, the information in the jobs report can mean the difference between having a winning or losing portfolio. It also explains the need for the security measures. Individuals getting such hot figures ahead of time can make a quick bundle of money, because they know something about which no one else in the financial markets is yet aware of. To prevent such abuses, the government guards these and dozens of other key economic indicators as tightly as a military base. It also implements a carefully controlled procedure to disseminate sensitive economic news.

8:00:00 The instant the door is shut, reporters dive in to grab the latest release on employment conditions, which up to now has been facedown. They have just 30 minutes to read, digest, and write their stories on how the job market changed during the previous month. Most of the journalists arrived that morning with the expectation that the employment release would carry dismal economic news, with the number of people without jobs rising—a troubling sign the economy was weakening. At least that was the opinion of most professional forecasters whom these reporters had consulted just days earlier.

But on this particular morning, the employment report stuns everyone. Those in the lock-up room read with amazement that companies actually hired workers in far greater numbers than anyone expected. Moreover, other figures in the report appear to corroborate signs that the economy is doing quite well. Wages are rising, and factory overtime is increasing. Far from slowing, the latest evidence indicates the economy is actually picking up steam. It is astounding news of which the rest of the world is yet unaware.

As the digital clock continues its silent countdown, reporters working on the story suddenly face some urgent questions. What's really happening in the economy? Why were so many "experts" caught off guard? What does this mean for future inflation and interest rates? How might the stock, bond, and currency markets react to the news?

Though the latest jobs report was unexpected, these journalists are not completely unprepared. As is their routine, a day or two earlier they showered private economists with questions that covered a variety of hypothetical employment scenarios. What does it mean if the job market worsens? What if it actually improves? Now the reporters are frantically searching through their interview notes to help them file their stories.

8:28:00 A Labor Department worker in the lock-up room notifies television reporters that they can now leave under escort to prepare for their live 8:30 broadcast of the jobs report.

For the remaining journalists in the room, there is just a brief warning: "Two minutes left!" By now, most have pieced together their initial versions of the story—the headline, the opening sentences, key numbers, and the implications for the economy. All that's left are some last-minute fact-checking and a word tweak here and there.

8:29:00 "One minute. You can open your telephone lines—*BUT DO NOT TRANSMIT*!"

The level of tension is not just high in the lock-up room. At that moment, money managers and traders in New York, Chicago, Tokyo, Hong Kong, London, Paris, and Frankfurt are riveted to their computer screens, anxiously waiting for the release of the crucial jobs report. It's a stomach-churning time for them, because investment decisions that involve hundreds of billions of dollars will be made the instant the latest employment news flashes across their monitors. Why such worldwide interest in how jobs fare in America? For one thing, many foreign investors own U.S. stocks and bonds, and their values can rise or fall based on what the job report says. Second, the international economy is now so tightly interconnected that a weak or strong jobs report in the U.S. can directly impact business activity in other countries. If joblessness in America climbs, consumers will likely purchase fewer cars from Germany, wine from France, and clothing from Indonesia. In contrast, a jump in employment means households will have more income to spend on imports, and this can stimulate foreign economies.

8:29:30 “Thirty seconds!” The fingers of reporters hover over their computers’ Send button, ready to dispatch the latest employment news to the world. On-air reporters are also prepared to deliver the news live.

8:29:50 An official counts the final seconds out loud:

“Ten . . . nine . . . eight . . . seven . . . six . . . five . . . four . . . three . . . two . . . one!”

8:30:00 “Transmit!” Reporters simultaneously hit the Send button on their keyboards. In seconds, electronic news carriers, including Bloomberg, AP, Reuters, and Japan’s Kyodo News, release their stories. Television and cable news stations, such as CNBC, Bloomberg TV, CNN, and MSNBC, broadcast the report live. A second or two later, computer screens around the globe carry the first surprising words: “Jobs unexpectedly rose the previous month, with the unemployment rate falling instead of rising!”

For journalists in the lock-up room, the stress-filled half-hour grind is over, and they are now free to leave. But the work has just begun for those in the investment community.

At the Chicago Board of Trade (CBOT), where U.S. Treasury bonds and notes are traded, news of the strong job growth sparks pandemonium. Bond traders were so sure they would see a deterioration in the job market that many had bet millions on such an outcome. These traders bought bonds for clients prior to the government’s release on unemployment and expected to earn a quick bundle of money based on the following strategy: If the number of people employed fell, it would drag down consumer spending. That, in turn, would slow the economy, reduce inflation pressures, and cause bond prices to turn up and interest rates to fall, thereby guaranteeing traders an easy profit.

The strategy was sound, but they bet on the wrong horse. Instead of laying off workers, companies were substantially adding to their workforce. The economy was not slowing, but demonstrating remarkable strength, and those bond traders who hoped to make a fast buck for their customers now face losing lots of money. With more people getting jobs, household income increases, and that leads to greater spending and borrowing. The presence of a more robust economy heightens concerns about future inflation and rising interest rates. The result: Bond prices begin tumbling and interest rates start climbing. In order to cut their losses, hundreds of floor traders at the CBOT are now screaming, jumping up and down, flailing hand signals in a desperate attempt to rid themselves of bonds whose values are fast eroding.

Stock investors are also dazed by the news and jump into action. A drop in unemployment is bullish for the economy. More consumer spending translates into higher business sales and fatter corporate profits, which can lift share prices. However, because the New York Stock Exchange, the world’s largest marketplace for equities, doesn’t start trading on the floor for another hour (9:30 a.m.), money managers rush to buy stock index futures on the Chicago Mercantile Exchange (CME), where S&P 500 and NASDAQ contracts are traded electronically virtually 24 hours a day, five days a week. Action here occurs at lightning speed, with orders being executed in just three tenths of a second—faster than the blink of an eye. The enthusiasm of traders in the premarket hours is a harbinger of things to come. By noon that day, stocks across the board reach their highest prices in months.

At the same time, the New York Mercantile Exchange explodes into action. Commodity specialists in the cavernous trading room are also caught off guard by the jobs report and are now gesturing wildly and barking out orders to buy oil and gasoline contracts on the expectation that a resilient economy will drive up demand for fuel in the future. After all, as business activity accelerates, factories operate longer hours and use more electricity. Business and leisure travel should pick up as well. Airlines will use greater amounts of fuel. The positive jobs report will encourage more shopping and weekend getaway trips, resulting in greater gasoline consumption. Thus, moments after the Labor Department releases the news on jobs, the futures prices of gasoline, heating oil, and other types of fuel shoot up.

Meanwhile, in currency markets across Asia and Europe, news of the rebound in U.S. jobs makes the dollar a more attractive currency to own. Foreign investors are always keen on placing their money wherever they can earn a better payoff in the global marketplace. This morning, with U.S. interest rates and stocks both heading higher, owning American securities makes the most sense. Foreigners proceed to load up on U.S. equities and bonds, causing the dollar to climb in value against other currencies.

Back in Washington, hours earlier an emissary from the Labor Department delivered an advance copy of the employment release in a sealed package to the president's top economic adviser. White House officials now huddle to discuss ways to spin the positive jobs report for political gain. How should the president comment on it? Does the employment news require a change in public policy? How can it be used to support the administration's economic plan? What impact might it have on the federal budget?

Unquestionably the single most important institution to evaluate the crucial employment report is the Federal Reserve. Economists there also see the release before it goes public. They begin to scrutinize the data to detect any stress or imbalance in the labor market that could destabilize the economy. Fed experts ponder whether the unemployment rate is falling so fast that it will drive wages higher and fire up inflation pressures. As they pore over the jobs statistics, a secret but informal discussion commences inside the Fed on whether a change in interest rate policy is needed.

It has been a hectic morning for investors, policymakers, and reporters. But what about the vast majority of Americans? How did they respond to the turn of events in the employment report? Did they drop everything at 8:30 a.m. and rush off with paper and pen to the nearest television or radio to take notes on how the economy changed the month before? Not likely. In sharp contrast to all the frenetic activity in world financial markets, most households were preoccupied with carrying out the routines of daily life—getting ready for work, sending kids off to school, or doing some early shopping before the crowds show up at the supermarkets. Let's face it—the data released on jobs is just too remote and abstract to be of much interest to them. However, that doesn't mean the employment news will not affect them; everyone in the country will in some manner be touched by what transpired in the financial markets after the jobs report went public. It makes no difference whether one is a business owner, a retiree, a housewife, an employee, a homeowner, or a renter. All will eventually feel the fallout from the news that came from the Labor Department's pressroom that morning. That fallout will produce a mixture of both favorable and unfavorable developments.

What might the benefits be? Clearly, rising employment is positive for the economy. The more American workers earn, the more they have to spend on goods and services. As long as there's no danger of the economy expanding so fast that it threatens higher inflation, everyone gains from rising employment. Furthermore, the government spends less on unemployment benefits, which eases the strain on the federal budget. Now for the bad news. You'll recall that when the government released its surprisingly strong jobs report, it spooked bond traders into selling Treasury securities, which quickly drove up interest rates. With the cost of credit going up, banks and other lenders have little choice but to raise their rates on home mortgages and car loans. Even homeowners holding variable-rate mortgages now have to dig deeper into their pockets to make higher monthly payments. There's more bad news. Remember how commodity investors at the New York Mercantile Exchange reacted by bidding up the price of oil and other kinds of fuel? That will shortly spill into the retail sector, which means drivers will end up paying extra for gas, and homeowners will shell out more for heating oil. Plane travel becomes more expensive too as airlines boost fares to offset the higher cost of aviation fuel.

Now let's return to positive consequences. In foreign exchange markets, the dollar's value jumped in response to the jobs news. A stronger U.S. currency is good for American consumers because it lowers the price of imports such as foreign-made cars, home electronics, and perfumes. That, in turn, puts pressure on U.S. firms to keep their own prices down, all of which helps contain U.S. inflation. Americans traveling overseas also can purchase more with each dollar. However, here's the flip side to a muscular greenback: If your job depends on selling products in foreign markets, you could be in trouble. A strong dollar makes U.S.-made goods more expensive in other countries, and foreign buyers might want to look elsewhere for better deals.

U.S. Economic Indicators

It may be hard to believe all this action and reaction can be triggered by just a single statistic. If you multiply that by more than 50 economic indicators that are released every week, month, or quarter, you begin to understand why the stock, bond, and currency markets are in a perpetual state of motion. Among the other influential economic indicators that can rattle financial markets are consumer prices, industrial production, retail sales, and new-home construction. It is precisely because these indicators can so easily sway the value of investments that the government takes extraordinary steps to control the flow of sensitive economic information.

That wasn't always the case. Thirty years ago, barely any guidelines applied to the release of economic reports. A lock-up room was a term reserved for prisons, not pressrooms. The lack of strict ground rules on the publication of these influential statistics created the perfect climate for abuse. Politicians tried to control the release of economic news to score points with voters. When President Nixon heard that the Commerce Department was about to go public with an upbeat figure on housing starts, he pressed the agency to time the release for maximum political effect. On those occasions when economic figures turned out to be a liability, Nixon sought to hold up the report until such time he believed its release would get little notice.

Even Wall Street firms realized that big money could be made off the economic numbers given the lax supervision of their release. Some brokerages went so far as to dish out large amounts of money to reporters who were willing to leak economic news to the firm's traders before writing about it. Anyone who got an advance peek at the economic statistics stood to gain millions in a matter of minutes by knowing which stocks and bonds to trade. Eventually this blatant manipulation of the economic indicators led a furious Senator William Proxmire to schedule Congressional hearings in the 1970s on how these reports are released. Later that decade, the government set up a strict calendar that included rigid rules on how economic data would be distributed. Today, nearly every major economic indicator is released under tight lock-up conditions, which has enhanced the integrity of how the public gets such sensitive information. Trading based on inside information of economic indicators is now virtually unheard of.

This still leaves us with the most important task of all, though. How do you decipher what all these indicators actually tell us about the economy? After all, at least four key economic indicators are released on a weekly basis, 43 every month, and nine each quarter. Do we really need so many measures? Absolutely. The U.S. is the largest and most complex economy in the world. No single indicator can provide a complete picture of what the economy is up to. Nor is there a simple combination of measures that provide a connect-the-dots path to the future. At best, each indicator can give you a snapshot of what conditions are like within a specific sector of the economy at a particular point in time (see Table 1A). Ideally, when you piece together all these snapshots, they should provide a clearer picture of how the economy is faring and offer clues on where it is heading.

Yet even if you took the time to absorb every bit of economic information and monitored each squiggle in the indicators, don't expect to uncover a crystal-ball formula that can single-handedly forecast what consumer spending, inflation, and interest rates will do in the months ahead. That's because there are some important caveats when dealing with economic indicators. First, they often fail to paint a consistent picture of the economy. Different indicators can simultaneously flash conflicting signals on business conditions. One can show the economy improving, while another may point to a clear deterioration. For example, the government might report a drop in the unemployment rate, normally a bullish sign for the economy. However, a different employment survey might show a day

Table 1A: How Economic Indicators Track the U.S. Economy

The federal government and private groups release dozens of economic reports on a weekly, monthly, or quarterly basis. Each is a barometer that measures activity in a particular segment of the U.S. economy. By following these indicators, one can get the latest reading on the economy's health and valuable clues on where it is heading.

Real GDP and its Components *	Key Indicators
Consumption (71%) Goods (31%) Services (40%)	Retail sales Consumer installment credit Personal income and spending Employment report New claims for unemployment insurance Consumer confidence and sentiment surveys MBA - mortgage refinancings ADP National Employment Report ABC/Money consumer comfort index Real earnings Auto sales Chain store sales
Business Fixed Investments (17%) Nonresidential (12%)	Industrial production Capacity utilization Orders for durable goods ISM surveys Federal Reserve Bank regional surveys Factory orders Manufacturers' shipments, inventories, and orders
Residential (5%)	Housing starts New single-family home sales Existing home sales MBA mortgage applications NAHB survey on home building

* Percentages are based on how the economy performed in 2006

Change in business inventories (<1%)

Manufacturing and trade inventories

Government spending (17%)

Construction spending
Federal budget balance report

Net exports (-5%)

International trade
Current account balance
Treasury International Capital (TIC) System

Signs of Price Pressures

Inflation

Consumer price index
Producer price index
Employment cost index
Non-farm productivity
Unit labor costs
Import and export prices
Employer costs for employee compensation
Federal Open Market Committee (FOMC) Statement

or two later that companies are laying off workers in record numbers. You're now presented with two contradictory portraits of labor market conditions, both covering the same time period. Which should you believe?

The confusion doesn't stop there. Another complication, one especially maddening to investors and economists, is that people can behave counterintuitively. Just look at two ostensibly related reports: consumer confidence and consumer spending. The first measures the general mood of potential shoppers: If they are upbeat about the economy, it stands to reason they will spend more. If there is widespread gloom and uncertainty about the future, logic would lead you to believe people will curb their spending and save money instead. However, that's not the way it plays out in the real world. There appears to be little relationship between these two measures. During the mild 2001 recession, consumer confidence kept plummeting throughout the year, reaching levels not seen in decades. Yet these same consumers not only refused to cut back on spending that year, they bought homes and cars at a record pace. Obviously, one cannot determine the outlook for consumer spending just by monitoring the psychological state of American households. The inclination to spend is influenced by many factors, including personal income growth, job security, interest rates, and the buildup in wealth from the value of one's home and the ownership of stocks and bonds.

There is also the quandary that comes with abundance. Everyone—from the professional money manager down to the mom dabbling part time in the markets—can be overwhelmed by the statistical minutia out there. How do you discern which indicators are worth watching and which ones to view with skepticism or even ignore? How does an investor employ economic indicators to help choose which stocks and bonds to buy and sell, and when? Which measures should a business forecaster follow to spot coming economic trends? What key indicators should corporate chiefs rely on to help them decide whether to hire new workers or invest in new equipment?

You can find the answers to these questions in subsequent chapters, but clearly some economic indicators are far more telling than others. Generally, the most influential statistics—those most likely to shake up the stock, bond, and currency markets—possess some of the following attributes:

- **Accuracy:** Certain economic measures are known to be more reliable than others in assessing the economy's health. What determines their accuracy is linked to how the data is compiled. Most economic indicators are based on results of public surveys. Getting a large and representative sample is thus a prerequisite for accuracy. For instance, to measure the change in consumer price inflation, the government's Bureau of Labor Statistics sends out agents and conducts telephone interviews every month to find out how much prices have changed on 80,000 items and services at 23,000 retail outlets around the country. To calculate shifts in consumer confidence, the Conference Board, a business research organization, polls 5,000 households each month.

  Another variable is the proportion of those queried who actually came back with answers. How quickly did they respond? The bigger and faster the response, the better the quality of the data and the smaller the subsequent revisions. If an indicator has a history of suffering large revisions, it generally carries less weight in the financial markets. After all, why should an investor buy stocks or a company hire additional workers when the underlying economic statistic is suspect to begin with? The monthly construction spending report by the Commerce Department is one that gets substantially revised and is thus often ignored by the investment community. In contrast, housing starts figures are rarely revised, which is why this indicator is taken far more seriously.

- **Timeliness of the indicator:** Investors want the most immediate news of the economy that they can get their hands on. The older the data, the more yawns it evokes. The more current it is, the greater the wallop it packs on the markets. Case in point: Investors pay close attention to the employment situation report because it comes out barely a week after the month ends. In contrast, there's far less interest in the Federal Reserve's consumer installment credit report, whose information is two months old by the time it's released.
- **The business cycle stage:** There are moments when the release of certain economic indicators is awaited with great anticipation. Yet those same indicators barely get noticed at other times. Why do these economic measures jump in and out of the limelight? The answer is that much depends on where the U.S. economy stands in the business cycle. (The business cycle is a recurring pattern in the economy consisting first of growth, followed by weakness and recession, and finally by a resumption of growth. We'll take a closer look at the business cycle in the next chapter.) During a recession, when there are lots of unemployed workers and idle manufacturing capacity, inflation is less of a concern. Thus, measures such as the consumer price index, which gauges inflation at the retail level, do not have the same impact on the financial markets that they would if the economy were operating at full speed. During recessionary periods, indicators that grab the headlines are housing starts, auto sales, and the major stock indexes, because they often provide the earliest clues that an economic recovery is imminent. Once business activity is in full swing, inflation measures like the CPI take center stage again, while the other indicators recede a bit into the background.
- **Predictive ability:** A few indicators have a reputation of successfully spotting turning points in the economy well in advance. We mentioned how housing and auto sales as well as the stock indexes have such characteristics. However, other less-known measures are harbingers of a change in business activity. One such indicator is the advance orders for durable goods. Generally, economic gauges known for being ahead of the curve carry more weight with investors.
- **Degree of interest:** Depending on whether you're an investor, an economist, a manufacturer, or a banker, some indicators might be of greater interest to you than others. Business leaders, for instance, might focus on new home sales and existing

home sales figures to see whether Americans are in a shopping mood. By monitoring such statistics, companies selling furniture and appliances can decide whether to expand operations, invest in new inventories, or shut down factories.

Those in the forecasting business want to know what's ahead for the economy and thus concentrate on a set of measures known as "leading indicators." These include initial unemployment claims, building permits, the ISM purchasing managers report, and the yield curve.

Investors in the financial markets also have their favorite indicators; the specific measures they watch depend on what assets are at greatest risk. Those trading stocks focus on indicators that foreshadow changes in consumer and business spending because they can affect future corporate profits and the price of shares (see Table 1B). For bond traders, the looming concern is not company profits, but the outlook for inflation and interest rates. Any evidence suggesting that inflation might accelerate can hurt bonds. (Table 1C shows the economic indicators most sensitive to the bond market.) Players in the currency markets look for economic news that can drive the dollar's value up or down. Signs pointing to a robust U.S. economy, for example, normally lure foreigners to invest in this country, especially if the other major economies show comparatively little growth. That lifts the greenback's value against other currencies. (Table 1D identifies the measures most likely to move the dollar.) Finally, we stated earlier that certain economic indicators have demonstrated over time an ability to spot turning points in the economy well in advance. Any unusual movement up or down in these forward-looking measures should tip off investors and business leaders to an upcoming shift in economic activity. The 10 indicators listed in Table 1E are particularly noteworthy, because history has shown them to be quite successful in sending early signals of a change underway in the economy. However, unlike the other tables, I have chosen not to formally rank the leading indicators, because no single one can act as the perfect crystal ball. The real value here is to see if two or more of these measures are behaving in a collective manner.

Table 1B: Economic Indicators Most Sensitive to Stocks

Rank	Indicator	Page
1	Employment Situation Report	25
2	ISM Report—Manufacturing	156
3	Weekly Claims for Unemployment Insurance	40
4	Consumer Prices	271
5	Producer Prices	273
6	Retail Sales	74
7	Consumer Confidence and Sentiment Surveys	92
8	Personal Income and Spending	63
9	Advance Report on Durable Goods	124
10	GDP	107

Table 1C: Economic Indicators Most Sensitive to Bonds

Rank	Indicator	Page
1	Employment Situation Report	25
2	Consumer Prices	271
3	ISM Report—Manufacturing	156
4	Producer Prices	283
5	Weekly Claims for Unemployment Insurance	40
6	Retail Sales	74
7	Housing Starts	178
8	Personal Income and Spending	63
9	ADP National Employment Report	55
10	GDP	107

Table 1D: Indicators That Most Influence the U.S. Dollar's Value

Rank	Indicator	Page
1	Employment Situation Report	25
2	International Trade	240
3	GDP	107
4	Current Account	254
5	Industrial Production/Capacity Utilization	145
6	ISM Report—Manufacturing	156
7	Retail Sales	74
8	Consumer Prices	271
9	Consumer Confidence and Sentiment Surveys	92
10	Productivity and Costs	303

Table 1E: Indicators That Lead the Rest of the Economy

Indicator	Page
Yield Curve	318
New Orders for Durable Goods	124
Producer Prices (crude goods without food and energy)	283
Personal Income and Spending (purchases of durable goods)	63
Housing Permits	178
Weekly Applications for Mortgages	200
Housing Market Index	196
Weekly Claims for Unemployment Insurance	40
Institute for Supply Management (manufacturing survey)	163
UBS/Gallup Survey of Investor Optimism	104

International Economic Indicators

Up to now, we've dealt only with U.S. economic reports. Now let's look at the growing importance of monitoring international economic indicators. During much of the twentieth century, Americans had only a remote interest in following the economic affairs of other nations. Few saw a need to take them more seriously. The U.S., after all, possessed the largest and most self-sufficient economy in the world and, by and large, had been impervious to the ups and downs of foreign economic cycles. If Germany or France or even the emerging countries of Asia suffered an economic downturn, barely anyone in the U.S. would care or even notice.

That's not the case any longer. Though the U.S. economy still reigns supreme, the international economy has undergone vast structural changes in the last three decades. These changes were brought on by a reduction in trade barriers, the modernization of global financial markets, remarkable advances in telecommunications, the Internet, computer technology, and software. The results have been profound. The world economy now operates in a more tightly integrated fashion.

For the U.S., the implications are huge. Healthy domestic economic performance depends increasingly on how well other nations are doing. Gone forever are the days when this country was immune to financial and political mishaps originating halfway around the world. When OPEC decided to sharply boost oil prices in the mid-to-late 1970s, Americans felt real pain. Indeed, U.S. inflation subsequently exploded, ultimately leading to one of the worst U.S. recessions since the Great Depression. Years later investors took another beating during the Asian financial crisis in 1997 when the Dow plummeted by the largest point loss ever on October 27 because investors were worried that problems in Asia would hurt the U.S. economy and corporate earnings. In addition, who would have imagined that a bond default by Russia in 1998—a country with an economy the size of Illinois and Wisconsin combined—would be considered so grave a threat to world financial markets that the Federal Reserve was under pressure to orchestrate a global rescue plan to calm investors worldwide?

Just how dependent have American companies become on other nations for profits and job creation? The numbers speak for themselves. Nearly half the earnings of S&P 500 firms come from business generated outside the U.S. More than 22 million American workers—nearly two in 10 jobs—are linked to foreign trade. One out of every four dollars generated in the U.S. economy is based on trade. What all this boils down to is that foreign economic indicators should be followed with the same regularity, interest, and scrutiny as the domestic indicators. If foreign economies do well, U.S. firms are in a better position to sell more exports, earn more money, and keep millions of American workers employed. By closely monitoring the international indicators, U.S. companies can seek out new foreign markets or decide whether to expand (or shut down) facilities overseas. American investors can diversify their portfolios more smartly by identifying and purchasing those foreign stocks and bonds that might offer a lucrative return.

Another important reason to monitor the performance of other major economies is that it helps us check the mood of foreign investors. As long as they view the U.S. as a safe and attractive place to invest, capital from abroad will continue to flow into this country, and that is vital to the well-being of the U.S. economy. Foreign investors play an indispensable role in financing U.S. economic growth by lending this country an average of more than $2 billion a day—money that goes into buying stocks, bonds, and other American assets. Why does the U.S. need to borrow such huge sums from other nations? Because consumers and the federal government together spend so much on cars, computers, military hardware, and health care (to name just a few items) that little domestic savings is left over. Yet savings is the lifeblood that keeps an economy healthy. It's used to finance productive investments, such as building efficient factories and funding the research and development of new and better products. Without adequate savings, the U.S. would be incapable of showing healthy long-term growth.

To make up for the shortfall in domestic savings, the U.S. has to lure the surplus savings of other countries. In addition, while all that foreign capital entering the U.S. has kept the economy humming, serious risks come with being so dependent on overseas creditors. America's net foreign debt has skyrocketed in the last decade from $50 billion to a staggering $2.5 trillion—the most of any nation in the world. In the process, foreigners have acquired an unprecedented share of U.S. assets; they own 45% of all U.S. Treasury issues, 40% of American corporate bonds, and more than 15% of all equities. Should the mood of those investors turn sour on the U.S. market—something that can occur if there is poor expectation of investment returns here as compared with other countries—it could spark a sell-off of American stocks and bonds by foreigners.

For all these reasons international economic indicators have lately taken on a more prominent role in the formulation of investment and business strategies. However, as with U.S. economic data, literally hundreds of foreign economic measures are released every month. With so much information being thrown at investors and business executives each day, how do you know which of these statistics are worthy of consideration? There is no one simple answer to this question. American companies and investors have different interests and risk exposures in the global economy.

In this book three factors are considered in determining the most influential international economic indicators. First, after the U.S., which are the largest economies in the world? Second, how liquid are the markets in those countries? That is, how easy is it to buy and sell securities on their exchanges? Third, who are the important trading partners of the U.S.? By trade, we're talking about the exchange of goods (such as the sale of trucks, pharmaceuticals, and computers) and the exchange of services (such as insurance, consulting, transportation, and entertainment). The service sector is especially important because it includes the all-important category of investment flows. Table 1F lists the "must-watch" international economic indicators.

Table 1F: Top International Economic Indicators

Indicator	Page
German Industrial Production	328
German IFO Business Survey	330
German Consumer Price Index	332
Japan Tankan Survey	336
Japan Industrial Production	342
Eurozone/Global Purchasing Managers Index	347
OECD Composite Leading Indicators (CLI)	354
China Industrial Production	357
India GDP and Wholesale Price Index	362
Brazil Industrial Production	368

CHAPTER 2

A Beginner's Guide: Understanding the Lingo

Every field of study has its own jargon, an assortment of words or phrases with which one has to grow familiar to understand the subject. Economic indicators are no different. You will regularly come across certain terms and expressions when dealing with measures of economic performance. No need to worry, though. The language of economic indicators is fairly straightforward if you give it a chance. In many cases their meaning and significance are surprisingly obvious. So let's proceed with some of the most common concepts you'll encounter when reading about these indicators.

ANNUAL RATES

You're cruising down the highway at 65 miles per hour. Whether your destination is actually 65 miles away is not important. What counts is what your speedometer tells you: If you keep up this driving pace for a full hour, you will travel about 65 miles.

The term "miles per hour" is used to measure relative speed. A similar relationship exists with economic indicators. A common way to compare how fast the economy is growing is to measure changes in activity in the form of annual rates. For instance, the government might report that autos were selling at a 14 million vehicle annual rate the previous month. That doesn't mean automakers sold 14 million cars and trucks the month before; it's how many will be sold if last month's pace were maintained for each of the next 12 months. Why do it this way? The reason is experts find it easier to look at performance on a yearly basis.

The methodology used to annualize a figure is simple enough: To turn a monthly level into an annual rate, simply multiply it by 12. If you have two months of data that you want to annualize, multiply it by 6. If it's a quarterly change—which is how the GDP is reported—multiply the three-month change in activity by 4. Thus, whenever you see an economic indicator reported in an annual rate, it is telling you what will happen if that pace were sustained for a full 12 months.

Business Cycle

Like human nature, the economy has its ups and downs. At times the economy can grow robustly, with household income rising, consumers happily spending, and companies hiring and expanding their businesses. However, there also are periods when the economy looks tired, with growth barely perceptible. There is less consumer shopping and little, if any, new business investment is under way. In the most extreme case, the economy actually shrinks, which is what happens in a recession. Over time, however, recessions give way to a fresh round of economic activity. These swings, from good times to awful times and then eventually back to good times again, are roughly what we mean by a business cycle.

Why does the economy have such cycles? Why not have steady, continuous, nonstop growth? After all, that should make everyone happy.

The reason the economy is condemned to undergo business cycles is because it's only natural. An open economy is essentially a reflection of human behavior, with millions of people making decisions every day. What should they buy? How much can they spend? Is it time to invest in stocks? Corporate leaders face different issues. Is it time to hire workers? Rebuild inventories? Buy another company?

Occasionally consumers and businesses make mistakes that can have broader economic consequences. Households might have borrowed so much that they're having difficulty servicing their debt. Banks could see their profits slip as loan defaults rise. Retailers might miscalculate by filling their stockrooms with new goods just when consumers are cutting back on spending. If the mistakes are grave enough and widespread, they can lead to an economic downturn, with people being laid off. Fortunately, the government has several tools at its disposal to revive growth, such as lower interest rates, tax cuts, and greater federal spending.

The business cycle itself has five phases. The first phase is the highest point of output the economy achieves just before it gets into trouble and turns down. After the peak comes phase two, which is the recession itself, a painful process whereby the economy actually shrinks. It saps the wealth and confidence of households and causes all sorts of financial distress for business. Such economic contractions can last six months or as long as several years. The third phase is reached when the economy finally hits bottom, a point known as the recession trough. The fourth phase occurs after the economy stops shrinking and resumes it growth path, or recovery. Finally, when the level of economic activity (or output) pushes past the previous high point, the business cycle marks the fifth and last phase, often called the expansion.

Because a recession is an integral part of the business cycle, it's important to define just what we mean by that term. Many economists and journalists declare a recession when there are two back-to-back quarters of negative GDP growth. Those quarters equal six consecutive months where the economy is shrinking. However, that is a rough, finger-in-the-wind assessment. The real task of determining when a recession begins and ends is left to a select group of academic economists working under the National Bureau of Economic Research (NBER), a nongovernmental and nonpartisan think tank based in Massachusetts. They make the call on whether the economy has turned down or up by evaluating several key economic indicators, such as job growth, personal income, industrial production, as well as the quarterly GDP figures.

According to the NBER, there have been 32 business cycles in the U.S. since 1854, with the average recession lasting 17 months. Since World War II, there have been 10 business cycles, with recessions averaging only 10 months long—which means the economy is now achieving longer periods of growth before getting into trouble. Just why the economy has been experiencing fewer recessions lately is a topic of debate among economists, though most attribute it to improved economic policymaking in Washington, combined with a more versatile business sector.

CONSENSUS SURVEYS

You're all set to go out for a leisurely walk. Weather forecasters have predicted sunny skies and warm temperatures, so you head out in shorts and leave the sweater at home. Ten minutes later a heavy thunderstorm erupts, followed by colder air. You quickly scramble back for a change of clothing, all the while cursing the forecasters. How could they have gotten it so wrong?

Money managers encounter similar experiences, except that instead of weather reports, they tend to rely on surveys that feature forecasts from experts on what an upcoming economic indicator will report. If the actual economic news falls in line with expectations, there is generally little market reaction to the news, because investors already anticipated it. By getting it right, those forecasters demonstrated that they have a good grasp on what the economy is up to. However, had the news about the economy turned out to be radically different from what private experts predicted, money managers would have rushed in to readjust their investment positions. These abrupt moves can potentially shake up the value of stocks, bonds, and currencies. Why such violent market reactions? Any major departure from expectation means that something is going on in the economy for which the experts failed to account. Naturally this creates fresh uncertainty about current and future economic conditions. The bigger the gap between consensus expectations and reality, the larger the backlash in the financial markets.

Who puts out these consensus surveys, and how are they done? Many financial wire service organizations, such as Bloomberg, Dow Jones, Reuters, and Market News International, produce their own consensus surveys by polling economists for their predictions on key upcoming economic indicators. These indicators include consumer prices, producer prices, industrial production, retail sales, capacity utilization, and others. The methodology used is fairly simple: The responses of individual business economists are basically averaged out, and that becomes the consensus forecast.

Moving Average

There's great temptation to jump to a conclusion about the economy's health from just one month's data, but that's not a wise practice. Economic numbers can be faulty, inaccurate, or, at the very least, misleading because of unusual events such as a major labor strike or severe weather conditions. Such situations can diminish the reliability of an economic indicator in the short term, so it's important to use caution when extrapolating information from just a single month's data.

To get a truer sense of the underlying trend in the economy, it's far better to rely on a moving average of economic numbers. Simply put, a moving average is a computation in constant motion, because it always averages data for the most recent fixed number of months. As a result, the average changes with the introduction of each new monthly report. For example, let's say consumer price inflation shot up 1% in the most recent month. Obviously a rise of that magnitude could raise lots of red flags. However, before anyone panics, it's far more prudent to consider inflation's actual trend by looking at its moving average over the past three or six months. To do this, simply add up the inflation changes over the last three or six months and divide by the total number of months you considered. When the next set of inflation figures are released a month later, recalculate the moving average by including the new figure in the equation and discarding the oldest monthly data so that you are always averaging the latest three- or six-month periods. The virtue of moving averages is that they smooth out random fluctuations and make long-term trends clearer. One disadvantage of a moving average is that it's a lagging indicator. Averages are slower to respond when there's a genuine change in the economy's direction.

Nominal Dollars Versus Real Dollars (Also Known as Current Dollars Versus Constant Dollars)

Anything measured in dollars can be looked at in two ways. Nominal dollars (also referred to as current dollars) represents the actual amount of money spent or earned over a period of time. You'll see stories mentioning how American factory workers received total pay hikes of $500 million, or a 5% increase, in the last 12 months. Or perhaps you read that company A reported that income from sales of sweaters climbed to $220 million that year, up from $200 million the year before, or a jump of 10%. These figures are based in nominal dollars.

However, nominal (or current) dollars gives you only part of the story. What's missing is how inflation can distort such numbers. Let's go back to the example of the earnings of factory workers. They might have seen their pay jump by 5% in nominal terms, but before anyone celebrates, someone should ask this question: "What if the price of goods and services (that is, inflation) rose by 4% during that same period?" In that case, the wages of these workers rose by a less-than-impressive 1% in real (or constant) dollars. In other words, the actual increase in purchasing power these workers gained from their pay hike was far smaller than 5%.

Let's now look at company A. It noted that sales revenue jumped by 10%. However, that doesn't necessarily mean it sold 10% more sweaters. In fact, the firm ended up selling the same number of sweaters both years. The only reason it received more money in the second year is because the company raised the price of sweaters by 10%. Thus, the increase in real (constant) dollar sales was actually zero!

Nominal dollars simply reflects the present value of goods and services exchanged in the marketplace. However, real dollars tells you the true value of goods and services produced or sold, because it strips out the effects of inflation. When economists and investors want to compare the economy's performance over different time frames, they generally look at both measures—nominal and real. They note the change in the size of the economy in nominal dollars because that points to what individuals, businesses, and the government actually spent. However, to find out if the economy genuinely expanded by producing more in quantity or volume, economists and investors look at the numbers in real-dollar terms.

Revisions and Benchmarks

Traders and money managers are always hungry for the very latest piece of economic news. The more timely the information, the more influential it is; and the faster investors can get their hands on it, the quicker they can act.

Therein lies the problem. Government agencies and private groups that supply economic data to the public are under tremendous pressure to get it out quickly, and that's not easy. Every week or month, depending on the economic indicator, statisticians follow a rigid schedule to query sources in the field, collect the raw responses, organize the data, readjust for seasonal factors, perhaps recalculate the numbers to adjust for inflation, and then write some introductory comments about the results before finally releasing it to the public. It's a hurried process in which accuracy and completeness at times take a backseat to getting the information out on deadline. For this reason, the first release of many economic indicators contains pieces of data that are far from reliable and thus are considered preliminary.

Of course, to many investors, it makes little difference whether the initial data is reliable. They trade on these numbers anyway, because the figures represent the very latest information they can get on the economy. Later, though, as more information is received and after statisticians have had a chance to review their computations, the preliminary figures undergo one or more revisions. Though investors also see the revisions to earlier data, they generally do not spark much trading because by then the information refers to a time period that has long since passed. Investors usually focus on the future, not the past. Economists, however, take revisions more seriously because the new figures can affect their forecasts of economic activity.

Benchmark changes are different from monthly revisions. The latter are an ongoing effort to make the statistical results more accurate, especially if there was insufficient time to gather all the data. In contrast, benchmark changes occur about once a year or so, when the government introduces new seasonal adjustment factors or decides to undertake a formal change in the methodology itself. Benchmark revisions can affect economic data going back five, 10, or even more years to allow for historical comparisons.

Seasonal Adjustments

Before most economic indicators are released, they are calculated to reflect seasonal adjustments. What are seasonal adjustments? The simplest way to answer this question is with an example. It's no surprise that consumers do a lot more shopping during the November/December holiday period than at other times of the year. In addition, when the Christmas shopping season is over, retail sales often slow in January and February. These seasonal shifts in consumer spending patterns are quite common. They're temporary changes that have nothing to do with the business cycle.

Let's look at another example. In the spring when schools let out, the number of people getting jobs surges as students enter the workforce to earn money over the summer. By mid-August, the process is reversed, and employment drops off as students leave the workforce and return to school. Again, these fluctuations in employment are perfectly normal and do not indicate a fundamental change in the economy's health. Even industrial production tends to fall in July as automakers shut down plants that month to retool their assembly lines for the new model year. No one should conclude this slowdown in industrial output means that the manufacturing sector is in trouble. These are all routine seasonal shifts that take place in the economy.

How do you differentiate changes that are the result of normal seasonal factors from those that represent a more serious problem in the economy? That's where the seasonal adjustment process comes in. Government experts look at economic data going back five to 10 years to identify recurring trends. These trends are changes in economic activity that have nothing to do with the broader business cycle but that can be explained by short-term external factors (such as summers, winters, and major holidays). After observing such patterns, officials come up with a formula that factors out variations in the economic numbers attributable to seasonal changes. This enables private economists and investors to distinguish economic events that should be viewed as normal from those that are out of the ordinary.

Seasonal adjustments, however, are far from perfect. You could have abnormal economic data even after seasonal adjustments are considered, and it still doesn't necessarily signal a turning point in the economy. Blizzards, floods, terrorism, labor strikes, and major bankruptcies are all unpredictable shocks that can have an impact on economic output, but their effects are almost always short-lived. Moreover, these incidents are easy to identify as the cause of any sharp deviation in business activity. By and large, seasonal adjustments are important to analysts because they can help identify true deviations from the normal course of activity in the economy.

Now that we have reviewed some of the most widely used terms that accompany economic indicators, we're ready to move on to the next chapters. What are the world's most influential economic indicators, and how do you get the most out of these statistics? How do you locate them? Interpret them? Most important of all, where can you find the clues that can tip you off to how the economy might perform in the future?

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