TrendMacrolytics

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On the Road to Recovery?

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It strikes us as good news of a sort that the recent bevy of data has been mixed enough to at least offer hope that the worst of the economy's slide might be over. Just as a shift in sentiment away from the doomsday scenario of earlier this fall largely explains the improved market tone of the past several weeks, the marginal change in outlook is apparently showing up as a modicum of firming in various statistical representations of the economy's behavior. Of course, that's not a bad thing in itself. To the extent that economic conditions might be less severe than first feared, moderation of the extreme levels of risk aversion which had gripped the markets should also be sustained. That implies that in the absence of additional exogenous political/security shocks (i.e., another terrorist attack), equities are unlikely to retest their September lows.

Nevertheless, it would be a leap to suggest, as a growing body of opinion is now doing, that these still-tentative indicators point to a growing likelihood of early recovery. We would caution, in fact, that the data is by no means clear cut that hard-hit sectors of the economy can even be said to be bottoming at this point. Indeed, about the most that can confidently be said based on the information currently available is that the rate of decline appears to be slowing.

Yesterday's NAPM manufacturing survey, for example, showed the overall purchasing managers' index rising nearly 5 points to 44.5 in November. But the below-50 reading still documents the 16th consecutive month of contraction for manufacturing, and represents an improvement only set against the post-attack period of economic trauma recorded in October. By contrast, the PMI stood at 47.9 in August and 47 in September. Similarly, the large jump in the new orders component of the index, which rose more than 10 points to 48.8, combined with a slowing in the rate of inventory liquidation, could be read in isolation as foreshadowing an end to the "inventory correction." But both the new orders and inventory components were stronger in September than in yesterday's survey for November. The bounce off depressed October levels, in other words, doesn't yet signal an improvement in underlying trends.

Today's *New York Times* report portraying **Fed** officials as adopting a cautious perspective on the economy's immediate prospects suggests at least that the central bank is taking a less sanguine view than are many private analysts. Nowhere in the *Times* piece, though, is there even a hint that Fed officials recognize the nature of the monetary deflation that still confronts them. It offers a characterization of the central bankers analogous to physicians keenly focused on the symptoms of a malady while having no understanding of its cause. "The main force inhibiting a strong comeback, Fed officials say, is the perception among businesses that the rates of return available to them from investing in new equipment remain too low given the uncertainty about demand for their products, the overall health of the economy and the risks associated with the campaign against terrorism," write **Richard Stevenson** and **Louis Uchitelle**. What that formulation fails to encompass is the risk premium that deflation of the unit of account imposes on expected returns to capital, placing the economic viability of marginal investment projects in serious doubt. As long as our monetary authorities remain blind to this basic reality, chances for an early return to economic vitality likewise appear highly dubious.

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