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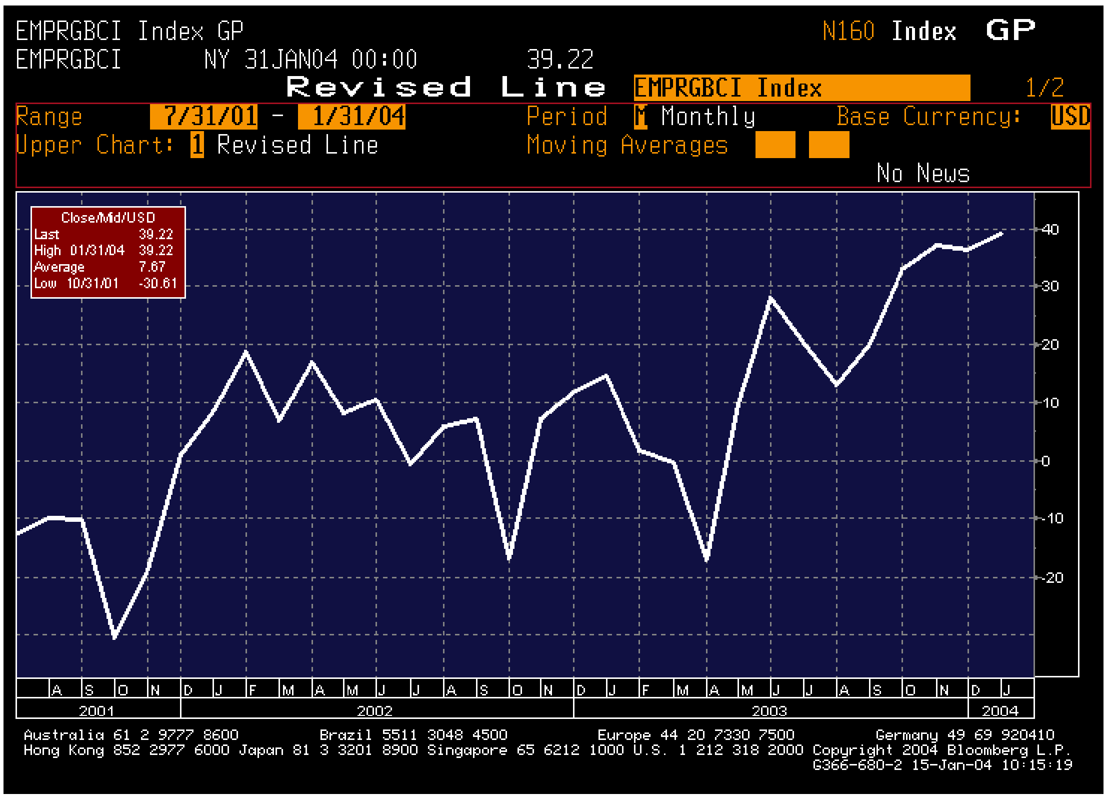
Data Review 01-15 -04

The theme that dominates the data flow ---as it has for the past few months----is the rotation of the sources of growth from households to business. While this shift is clear, it has some important differences from previous "shifts." For one, while the manufacturing side of the economy continues to expand, the employment situation still does not show the accustomed growth pattern. Second, the trend toward a more resolute control of inventories by business is visible in the newly released Fed of New York Business Conditions Survey. General Business conditions in the NY survey rose to a **record high of 39.2.**



That's the good news. The bad news is that employment conditions, work week and inventories do not show the kind of growth that the economy will need as the rate of growth of consumption slows and production and business investment trends expand. Ultimately, there must be household income growth to support the approximate 70% of GDP that comes from consumption. Businessmen in NY, like their counterparts throughout the country, are gaining optimism. That's a prerequisite for business investment and it augurs a much better profit performance going forward. Corporate cash flows grow, business buys more productive equipment and improves its enterprise software, hardware and networking capabilities to support it. That translates to better profits along the corporate food chain. What is not expanding simultaneously, however, is job growth, at least among the surveyed firms. Nor have inventories grown a pace with production. This is a story perfect for corporate profits but does not give support to fast rising household incomes…particularly

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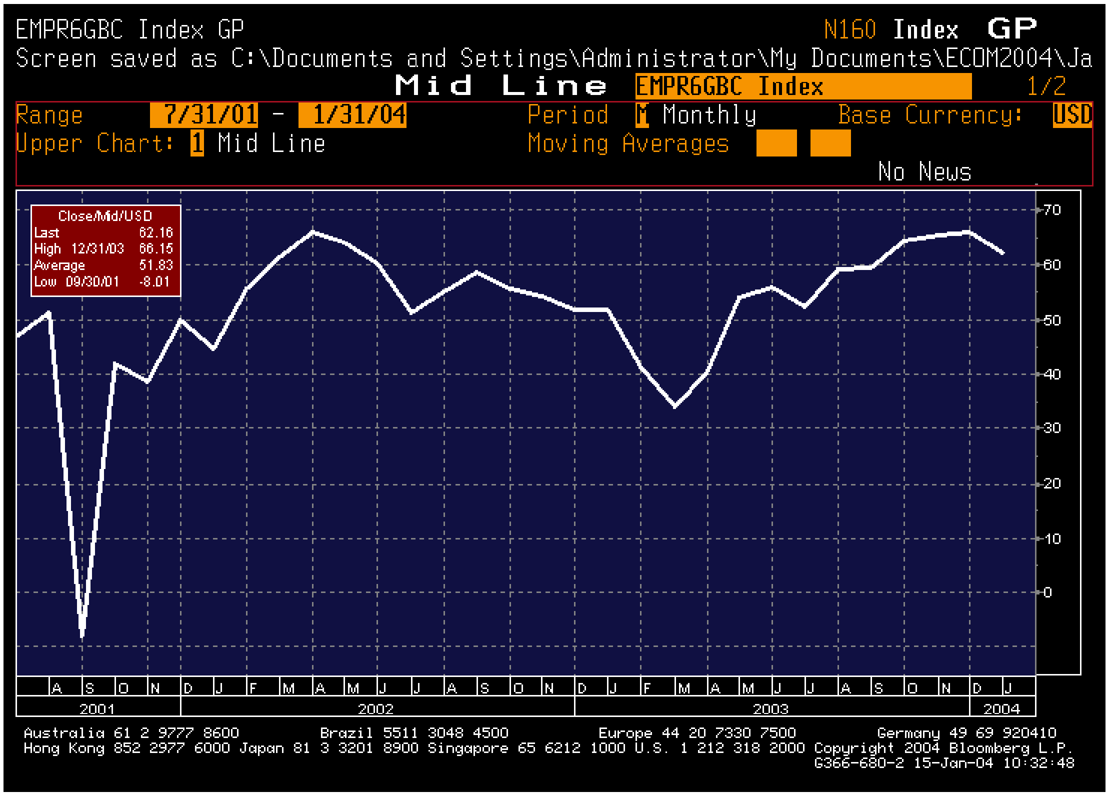
those that depend on wage income.



Future Business Conditions

The NY survey continues with the expansion pattern noted in the "current" environment, but it also exhibits some slowing of growth for the future, and that may be the reason for a more constricted forward inventory and employment situation.

Retail Sales data and the Initial Claims data, however, portray a quite robust QIV performance that is at least reducing the rate of job loss. The advance retail sales data is dominated by a strikingly good performance in autos and a much less impressive record on the "soft" consumer goods side. Overall sales expanded 0.5% and the ytd sales performances have forced analysts to elevate the QIV GDP estimates significantly above the earlier-consensus 4%. The current Bloomberg survey on QIV GDP is 4.2%, but a survey done today would probably print at 4.5% or higher. Some of this spending must be showing up in a less emphatic effort by firms to reduce their overall job-cutting and this is reflected in a substantially better performance on the initial claims front, particularly the 4 week average. The 4 week average fell to 348,000, a three-year low. What bothers us is the lack of forward optimism expressed in the inventory and forward employment sentiment of the business sector. Since it is well known that the economy's job growth generally derives from new business formation and the growth of younger firms, the picture that is being created from current data may be overly pessimistic. The Labor Deportment is about ready to announce benchmark revisions and it is quite possible that labor data that arrives over the next few weeks will show a much-improved trend in job growth.

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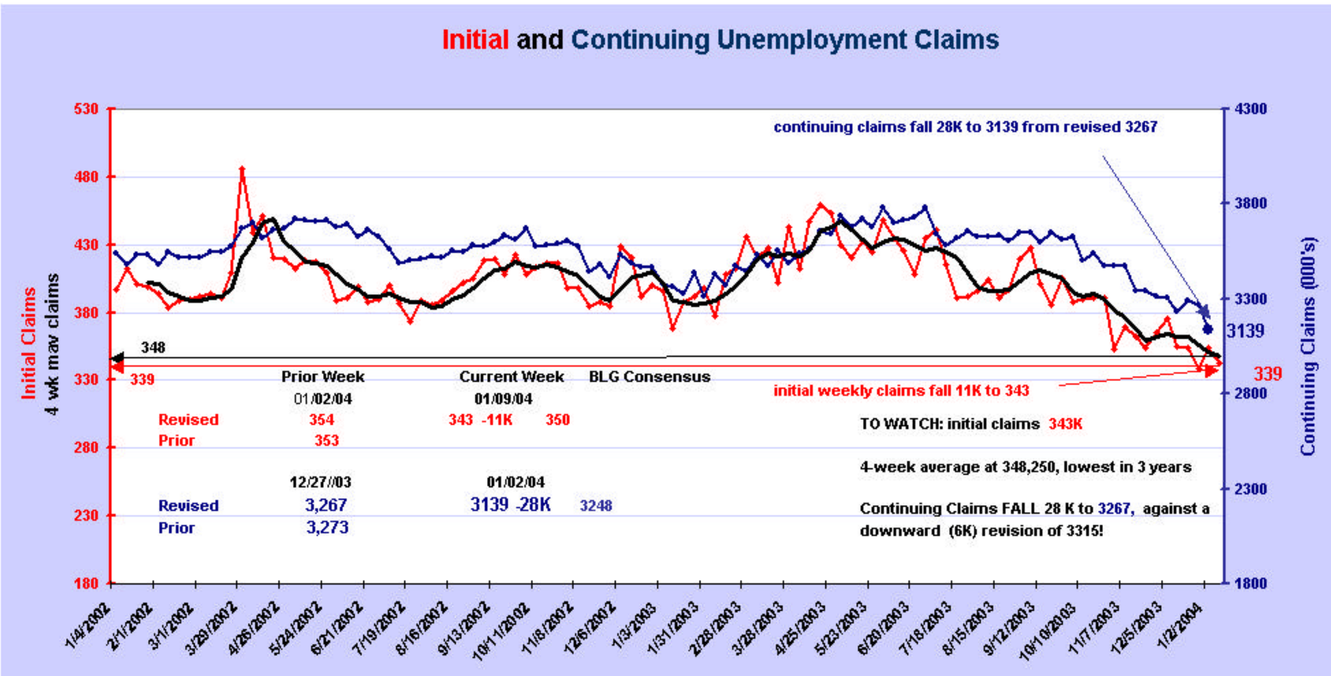
The other source of consumer income growth **could** come from a faster rise in nominal wages. Using nominal wages as a proxy for household income growth might be surprising were we living in the old world of 3% inflation. But that is not the case today. In fact, we are in a benign or 'threateningly benign' environment in which most price index data show a continued deceleration.



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