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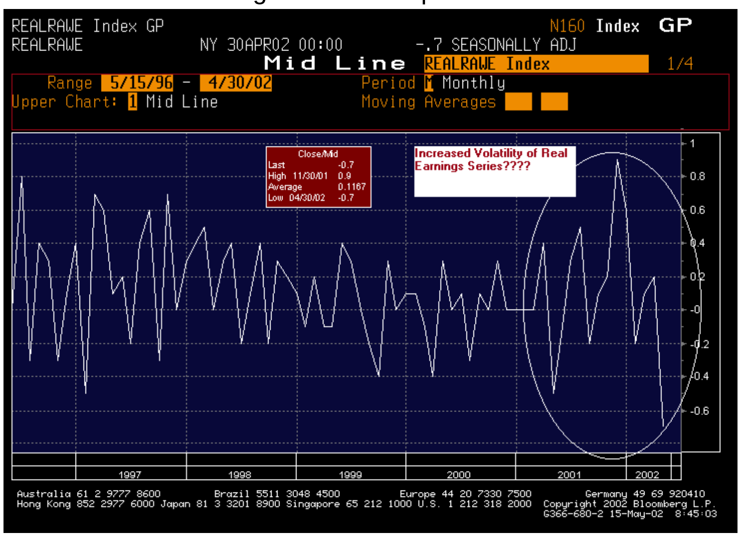
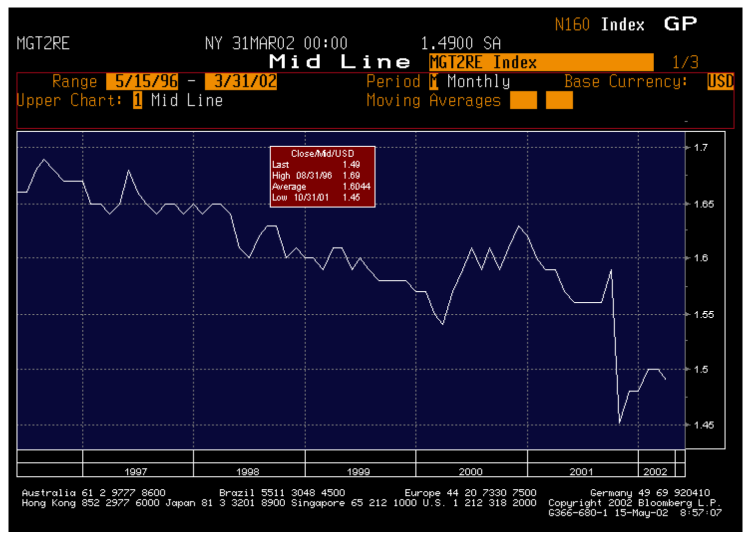
Quick Pics on the Recovery

Real earnings took a sharp decline of 0.6% last month continuing the pattern of increased volatility that has occurred since last year when the economy nosedived. It is unclear how to interpret the most recent data although we know that nominal wage growth has slowed quite sharply. We will want to come back to these data because the sustainability of high levels of consumer demand will ultimately revolve around the behavior of sustainable real income, particularly now that the impact of tax rebates, income tax refunds and lower tax rates is now in place.





Inventories continued to decline in March, but these data seem to point to inventory/sales ratios that still may be falling. Remember, this is a six week old picture. In fact, the retail sales numbers we have been seeing together with the absence of a sharp pickup in employment suggest that sales out of inventories are continuing, pushing down inventory sales ratios even further. **The ‘bad news’ is that stability in inventory behavior has not yet occurred, but the good news is that continued sales must force more production fairly soon.**

Inventory liquidation was the driver for GDP growth in Q1 and there will be less force from inventory reductions in Q2. That may suggest that Q3 will see a more normalized relationship between production and sales, leading to a more balanced growth picture in 2H 2002. We are not yet in full recovery, but the economy is making progress. Some of that is showing, if only slightly, in corporate profits that are now recovering. We should anticipate a greater rate of corporate profits recovery as we move into the 2H of 2002.

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