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Economics is a dismal science (at least to forecasters)

Washington, March 28 (Bloomberg) -- The following table shows economists' second-quarter 2002 forecasts as surveyed by Bloomberg News from March 18 to March 27. All figures are as of the end of the quarter except for GDP, which is expressed at a quarterly annualized rate.

	2Q GDP	Unemp. Rate	CPI YOY	Fed Funds	2-Yr Note	10-Yr Note
Number of replies	50	48	47	45	41	46
Median	**3.0%**	**5.7%**	**1.3%**	**2.00%**	**3.70%**	**5.40%**
Average (mean)	2.9%	5.7%	1.3%	1.93%	3.74%	5.38%
High forecast	4.5%	6.2%	2.8%	2.50%	4.80%	5.65%
Low forecast	0.5%	5.4%	0.5%	1.75%	3.10%	4.90%

On balance, using the median estimates, forecasters were clearly reacting to the pleasant surprises of Q42001 and the rebound during Q12002. Note the implicit degree of monetary tightening forecast for Q2 2002 embedded in a Fed Funds median forecast of 2.00%.

This morning's data provides a metric on the degree of disappointment with earlier optimism as to the sustainability of economic growth in the early phases of recovery. In our opinion, much of that optimism came from a focus on "simple monetary" models that stress either rates or monetary aggregate growth rates. Since then monetary aggregates have receded. The Bloomberg survey data that records what the survey panel thought as of March 28th seemed to place great faith on the combination of very easy monetary conditions combined with both tax cuts and government fiscal expansion supported by the inventory replenishment cycle. While some survey respondents were dubious (low forecasts of 0.5% GDP growth in Q2), the median forecast was 3.0%.

Today's data reaffirms the weakness in advance retail sales that had been noted earlier by retail survey data and the weaker consumer confidence number published by the University of Michigan. Similarly, business inventories continued to decline showing no evidence that 'replenishment' is suddenly about to occur. Capacity utilization numbers for May showed no change from the prior month suggesting that business investment spending will continue to be delayed. The waning of consumer demand has to delay business spending that would expand capacity. Visibility is not good at the level of the firm, or, alternatively, managers sense that sales are not picking up and are conserving cash flow until underlying conditions justify both increased inventories and increases in capital equipment purchases.

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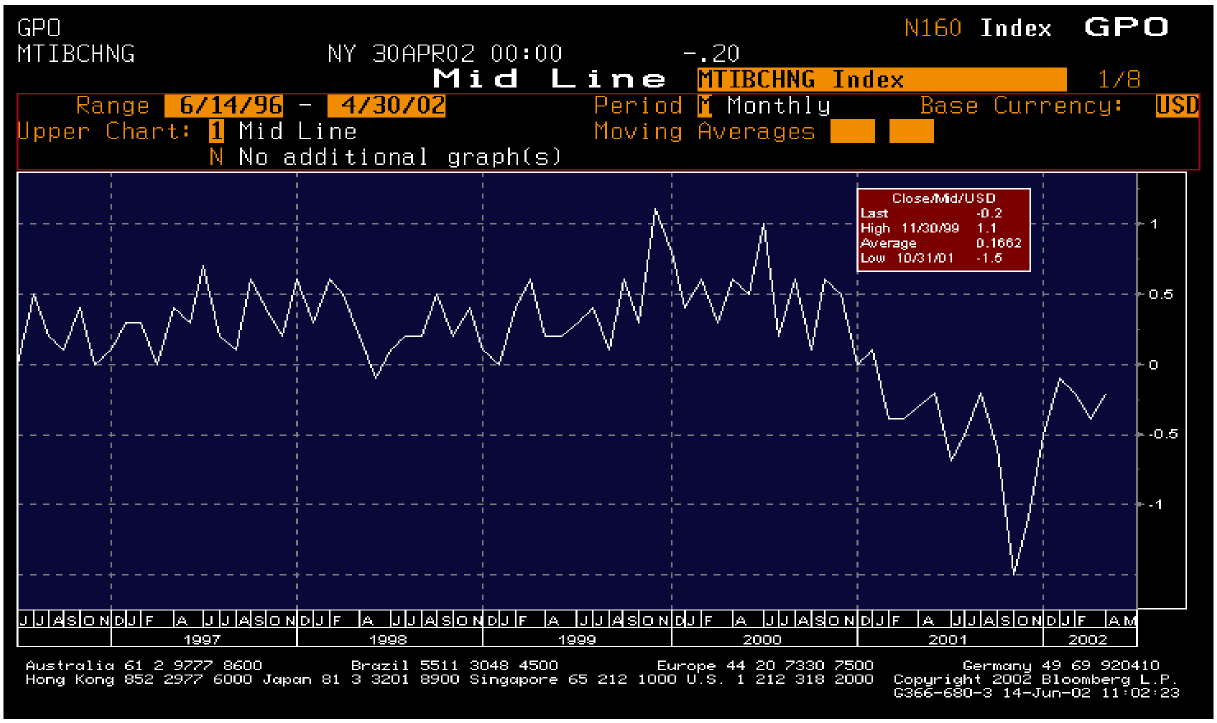
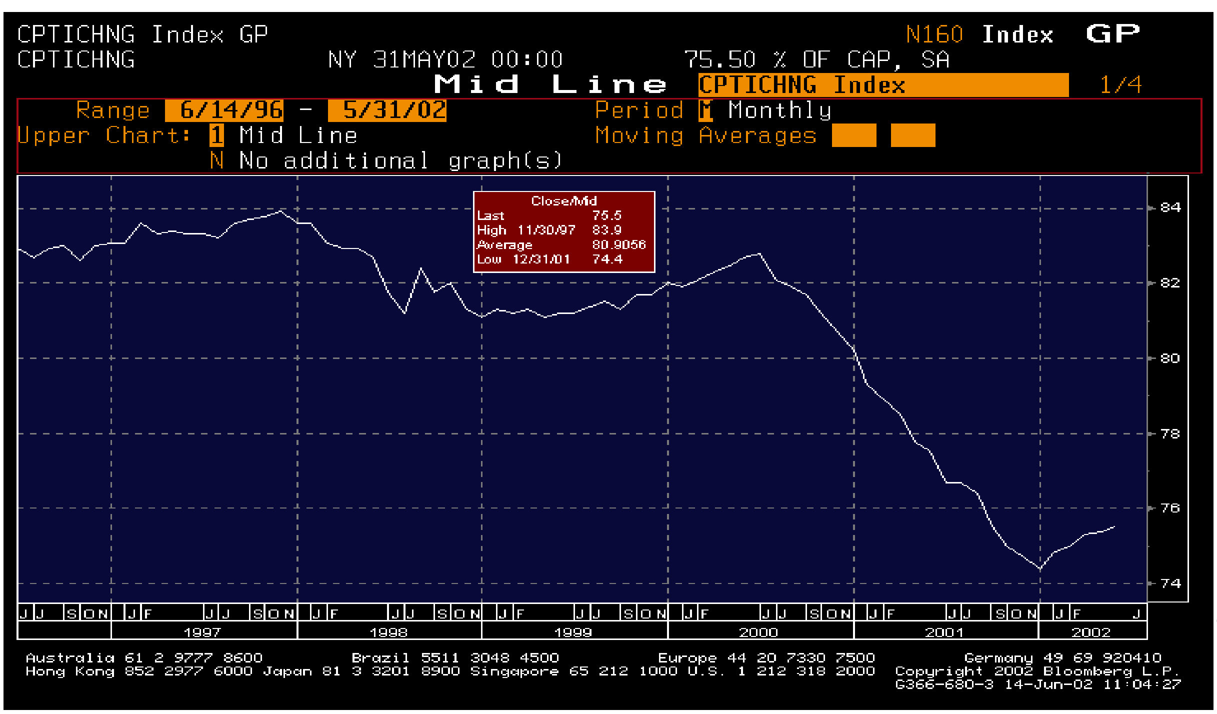
April Business Inventory Changes



Capacity Utilization



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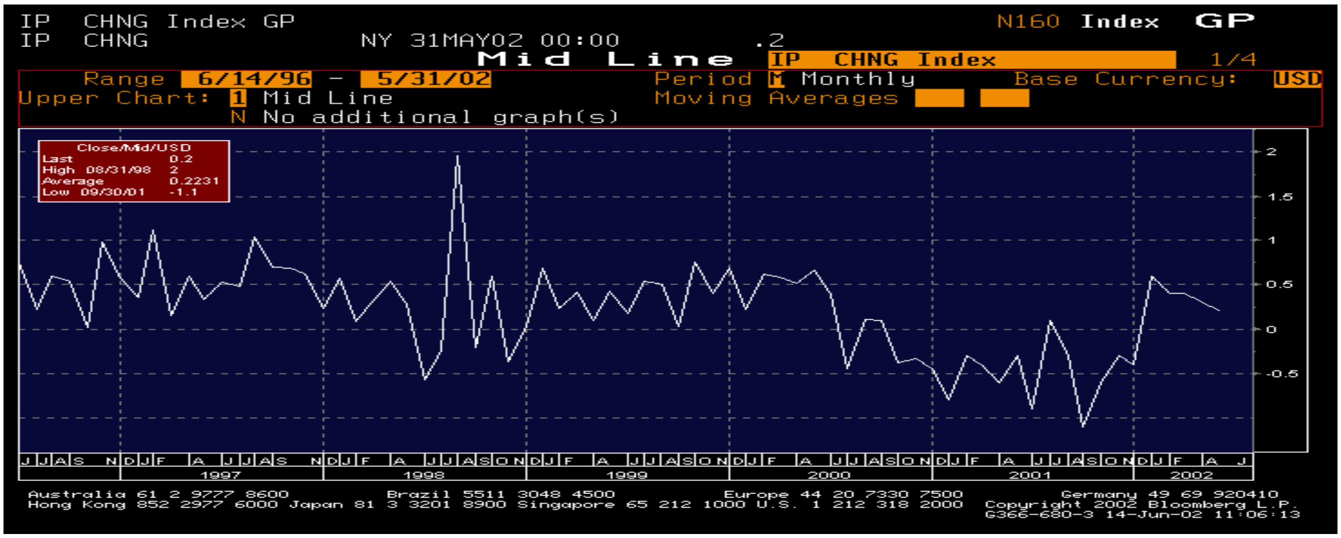
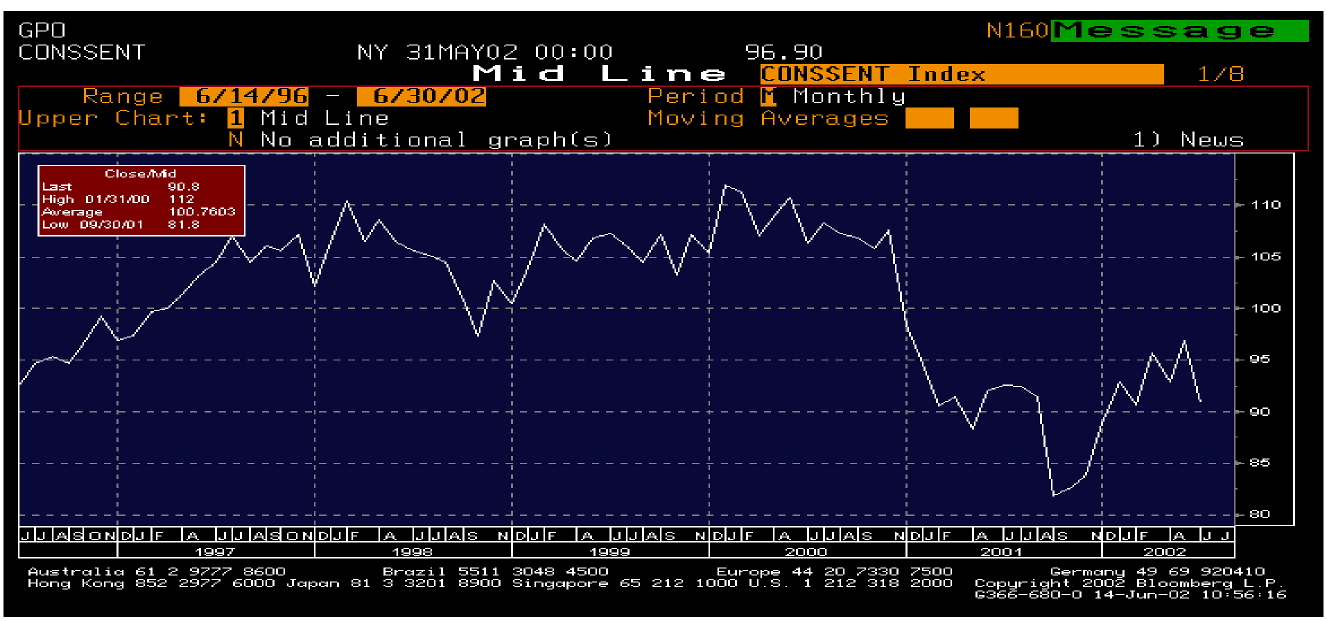
Capacity Utilization



Capacity Utilization is not rising rapidly because Industrial Production changes, while positive, are not increasing sufficiently fast to use up the installed and newly installed capacity. That acts to retard the resumption of investment spending as well as the growth of new jobs. Consumer sentiment indicators are also

University of Michigan Consumer Confidence



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pointing to moderation, undoubtedly reflecting the slow pick up in new jobs. Both the current conditions and expectations measures were off sharply in the preliminary survey.

Conclusion:

The apparent deterioration or at the least the failure to show significant improvements must suggest that recovery will be 'stretched." This leads to some forecasts of GDP growth in the neighborhood of 2%. That in itself would not be a failure, but it gives 'market timers' something to think about as valuations are being corrected: will growth accelerate in 2H2002 and FH2003. The dual negatives, geopolitical uncertainty and economic uncertainty, seem consistent with increased risk-taking. Contrarians will no doubt cheer the mounting wall of worry as the NASDAQ tries to find a bottom.