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**Article**

## THE U.S., ECONOMY: RECESSION AHEAD? Contra: Economy Rebounding

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## CONTRA: ECONOMY REBOUNDED

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Despite the recent spate of negative economic reports, the bulk of the economic and financial data suggests that the U.S. economy is not in, nor is it about to enter, a recession. Rather, the U.S. economy is in the weak phase of a growth cycle marked by economic growth rates that are below recent rate trends. While the economy can exhibit recession-like characteristics during this phase – excess capacity, declining investment, layoffs, and weak profits, for example – the slowdown lacks the dynamics, severity, and duration of a recession, and is largely self-correcting.

In terms of historical analogies, the industrial sector is immersed in a deep, though brief, adjustment process very much like 1998, while events in the financial sector this year will harken back to 1987. This adjustment process, which began in July 2000, is motivated by a desire to realign demand and supply to restore margins after a period of unsustainable growth. While the swiftness and intensity of the adjustment is instructive as to what might happen in a genuine recession, rising backlogs over the past six months suggest that production is being cut faster than orders, and will soon recover.

U.S. data for January and February appear consistent with The Conference Board's forecast of about 3.4 percent growth for this year. However, the business cycle is well advanced, and the favorable inflationary conditions that have permitted the Fed to cut interest rates are not likely to prevail in the future.

Until very recently, the United States has enjoyed a near perfect set of macroeconomic conditions

that are, at best, rare. A cyclical recovery in 1996 was prolonged by the effects of the Asian crisis on U.S. inflation and interest rates, and strong productivity provided a degree of inflation control in near boom conditions. Now, and looking ahead, many of these forces are unwinding, placing stress on prices, profits, and U.S. financial markets not seen since the early 1990s. As was the case in 1987 – the last time the Fed moved from an inflation bias to an outright rate cut in an effort to restore confidence – the Fed will find itself again reversing course, as the dominant economic concern returns to inflation.

The U.S. economy continues to improve from month to month. Retail activity in January and February turned in good showings. Led by auto sales that rose from December lows in each successive month, this improvement in consumer spending is fed by the surge in mortgage refinancings that is adding significant liquidity to the consumer sector. Based on January and February performance, consumer spending could advance 4 to 5 percent this quarter.

The Conference Board's Index of Leading Economic Indicators also rebounded in January – although in no way erasing all of the weakness of recent months. While a rebound of this magnitude is not likely to be repeated in February, the trend does suggest that December was the low point for industrial activity, and that a steady improvement can be expected as the spring unfolds.

The U.S. economy strengthened on other fronts as well. Construction spending rose sharply in January, and, given housing and commercial activity, this strength should continue in February. The January durable orders numbers offered hints of a pickup in computer and electronics orders, and the February National Association of Purchasing Managers (NAPM) report posted small improvements across the full spectrum of activity measures. Indeed, vendor performance (the percentage of firms experiencing slower deliveries) and the price index (share of firms paying higher prices) contin-



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ue the strong pattern of recent months and are very much at odds with the weakness in the rest of the NAPM survey.

Overall, the current picture is one of relatively robust demand that is drawing down inventories at significant rates. Given the magnitude of the drop in orders and production in the auto sector alone (e.g. over 25 percent), total production – led by autos – should begin to pick up sharply in March and April. Thus the combination of both demand and production moving in the same direction in the second quarter will, in the second half of the year, add income stimulus to the Fed's interest rate stimulus.