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ECONOMIC TALKING POINTS

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Maybe….Just Maybe the Economic Contraction is Beginning to Slow?

With the volatile year-end holiday weeks over, we return to a pattern that more accurately reflects the underlying conditions in the economy. Initial jobless claims for the week ending January 10th bounced back to the trend we have seen since the start of November. New applications jumped to 524,000, an increase of 54,000 from the previous week, bringing the four-week moving average to 518,500.

There are two observations to make here. First, it appears first time applications for unemployment benefits have reached a plateau. We can only hope it won't get worse. The number of weekly filings has averaged 527,000 since November 1st, and we are still roughly in that range. The second observation concerns the total number of unemployed Americans collecting unemployment insurance. It fell by 115,000 to 4.49 million in the latest week (January 3rd), which happens to be the same as the latest four-week moving average. Taking a longer perspective, since November 1st this number has averaged 4.27 million. Yes, that's less than the latest week reported, but again within reasonable range.

One conclusion we could make from the latest jobless claims report is that while the economy is in severe recession, perhaps the rate of decline is no longer accelerating. We say this not just because of the claims data. There are also some curious statistics we picked up in December Producer Prices report and from the regional Federal Reserve Bank surveys.

PPI

The headline number showed wholesale prices fell by 1.9% last month, which caused the year over year change in the PPI to drop 0.9%. That's the first decline in 7 years. However, when you exclude food and energy, prices actually ticked up in December by

0.2% after an increase of 0.1% in November. For the year, core PPI, actually surged by 4.3%, more than twice as fast as 2007 and 2006 and the largest year end increase since 1988! (By the way, that's one strong piece of evidence that we are not headed for a bout of chronic deflation.)

There is one other interesting statistic in this report worth mentioning. Of all the components in the PPI release, one excellent leading indicator of turning points in the business cycle is the change in prices for "core crude goods." We're talking about shifts in the supply and demand for industrial raw material at the very earliest stage of production, ex food and energy. It's an extremely sensitive, if volatile statistic. In December, the price of core crude goods fell 2.2%, after declining 20.4% in November and 17% in October. December's was in fact the smallest decline since July! Again, its way too premature to say the end of recession is in sight. But these are the kinds of stats we will need to monitor in the months ahead for clues that perhaps, just perhaps, we are approaching a turning point.

The NY and Philly Feds

Also released today were two Federal Reserve Bank surveys. The New York Fed's Empire index, which looks at manufacturing activity in the state, contracted again this month, though not as much as in previous months. The January index stood at -22.2, its best showing in four months. (The index fell to -27.9 in December, 24.9 in November, and – 24.3 in October.)

The other report was the Philadelphia Fed's Business Outlook Survey, where the headline number came in at a minus 24.3 for January. Interestingly, this too was the smallest contraction since September. (Minuses 36.1 in December, 39.8 for November and 38.7 in October.)

The Philly Fed report contains another noteworthy point. In the survey, which covers manufacturers in the eastern Pennsylvania, southern New Jersey and Delaware, businesses leaders polled were more upbeat on the six month economic outlook than they were a month ago. The 6-month expectations index shot up to a positive 7.4 in January, after a minus 10.4 the previous month. Their outlook index for new orders shot up to a positive 11.4, from minus 4.1 in December.

We suspect this optimism reflects greater confidence that the upcoming Administration will shortly begin implementing its trillion-dollar stimulus program to revive economic growth. We agree with this optimism --- but with one important caveat. The stimulus program will certainly adrenalize the economy. But until bank balance sheets are restored to health and confidence and trust returns to the private capital markets, the beneficial impact of the fiscal package will remain muted, or worse, bring a only a brief respite from recession.

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