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ECONOMIC TALKING POINTS

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July 1, 2009

Lots of Mixed Economic Reports --- But ISM Tells the Real Story

A slew of economic reports were released this morning but when you add them all up, they don't appear to provide much clarity. The numbers show an economy zigzagging in every direction.

Some reflect a further deterioration in business conditions:

- Construction spending was down 0.9% in May;
- MBA's mortgage applications index to buy or refinance homes fell 19% in the latest week;
- ADP noted that 473,000 jobs were lost in the private sector last month, worse than expected;

But others suggest an improvement in the economic landscape:

- June ISM index for manufacturing rose to 44.8, from 42.8 in May;
- Pending homes sales increased 0.1% and was up 6.7% for the year, according to the National Association of Realtors.
- Outplacement firm Challenger Gray & Christmas said the number of layoffs announced by U.S. companies fell to a 15-month low of 74,393 in June. That was the fifth monthly drop in announcements in a row.

Such conflicting data can be frustrating for anyone trying to decipher it all. However, keep in mind such cross currents in the economic stats are quite typical when an economy is in the midst of switching tracks from recession to recovery. As you might imagine, during a serious recession indicators will uniformly point to weakness --- and when an economy is expanding, the data consistently shows strength. It is precisely when the business cycle reaches an inflection point that we get a combination of both positive and negative news, which of course can be exasperating because it generates uncertainty and confusion.

So what do you do in such circumstances?

Focus on the indicators that have a track record of cutting through the chaff and are known for being ahead of the economy. The ISM manufacturing report is one that falls into this category and thus deserves greater study. What this series tells us is encouraging because it reinforces the view that the recession is virtually over. The headline PMI number rose to 44.8 in June, signaling that manufacturing activity in the U.S. shrank at the slowest pace in 10 months in June. More importantly, once the PMI exceeds 41.2%, it generally indicates an expansion is underway in the overall economy. Good news because this is the second consecutive month the PMI rose above that critical 41.2% level.

There's more positive news in this release. For the first time in nearly a year, manufacturers are revving up output. The ISM manufacturing production index leaped to 52.5 from 46 in May. This is the first month the production index has moved above 50%, after nine months of contraction. This is significant. Once this index moves above 50.4%, it often lifts the all-important Federal Reserve industrial production measure, which has been falling since the start of the recession. Once the Fed's industrial production reverses course and turns up, it solidifies the argument the 2008 – 2009 recession is history.

By the way, one leading indicator in the ISM release that is rarely mentioned but worth noting is the supplier deliveries index. During periods of economic weakness when demand is soft, orders manufacturers receive from customers get filled fairly quickly. Delivery times are faster simply because manufacturers are not especially busy. However, once economic conditions improve and the volume of orders pick up, customers end up waiting longer to receive the goods they ordered. Well, it looks like waiting times increased materially last month. The June supplier deliveries index has crossed above the 50 milestone for the first time in eight months, to 50.6, which means manufacturers are getting busy and delivery times are slowing.

Auto sales

Another important data point to be released later today is auto sales and we expect the numbers to show an upward surprise. June could be the best month of the year with sales exceeding a 10 million-unit rate. If so, it would be another encouraging sign that consumers believe the recession is fading and that sets the stage for greater spending. As we have said before, pent up demand to replace existing vehicles has been building the past two years. Replacement sales alone would lift purchases to a 12 million-unit rate, but that level won't be reached until 2010, when the economic recovery is well underway.