

March 4, 2002

Economic Model Update

The positive trends of both our Economic Model and the Index of Leading Economic Indicators have persisted since our January 31st update. Nevertheless, some outside forecasts of economic activity for the balance of this year have recently been ratcheted up, reflecting greater-than-expected strength in manufacturing as reported by the Institute of Supply Management's latest reading. While the jump in the LEI is dramatic, we caution readers that this index is designed to forecast only the *direction* of future economic activity, not the *magnitude* of change. Consumer spending on housing and durable goods, notably motor vehicles, has been an ongoing source of strength during this downturn and consequently may not provide as much stimulus to recovery they have historically. Signs of positive momentum in hand, the economy appears poised for a mild recovery from what will prove to have been only a mild downturn.

Fed Chairman Alan Greenspan's testimony last week to the House Committee on Financial Services which, in part, read as follows, confirms this view:

Indeed, in the past several months, increasing signs have emerged that some of the forces that have been restraining the economy over the past year are starting to diminish and that activity is beginning to firm.

...although household spending should continue to trend up, the potential for significant acceleration in activity in this sector is likely to be more limited than in past cycles.

The central tendency of the forecasts of the members of the Federal Open Market Committee is for real GDP to rise 2-1/2 to 3 percent during 2002. Such a pace for the growth of real output is somewhat below the rates of growth typically seen early in previous expansions. Certain factors, such as the lack of pent-up demand in the consumer sector, significant levels of excess capacity in a number of industries, weakness and financial fragility in some key international trading partners, and persistent caution in financial markets at home, seem likely to restrain the near-term performance of the economy.

