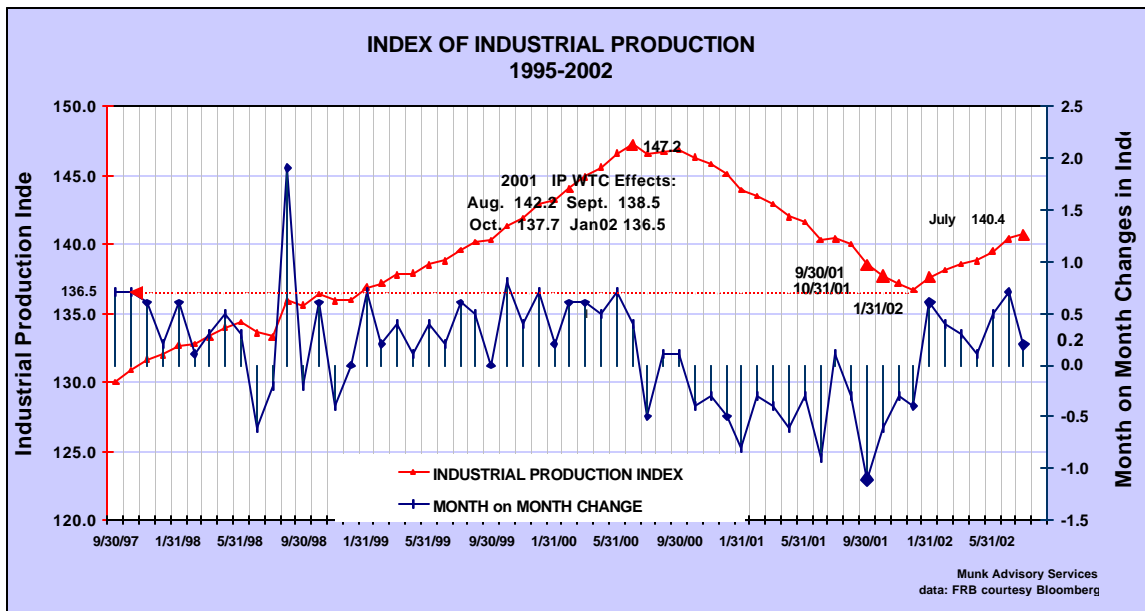
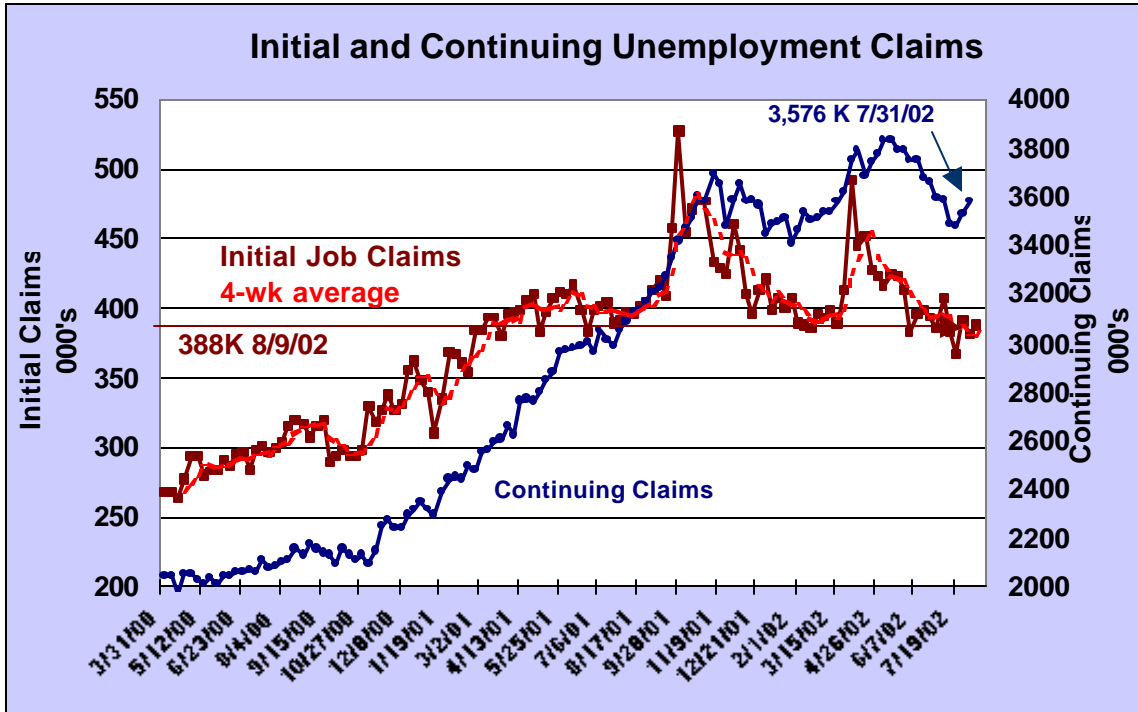




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Crunch Time: Consumption will depend on Job Growth

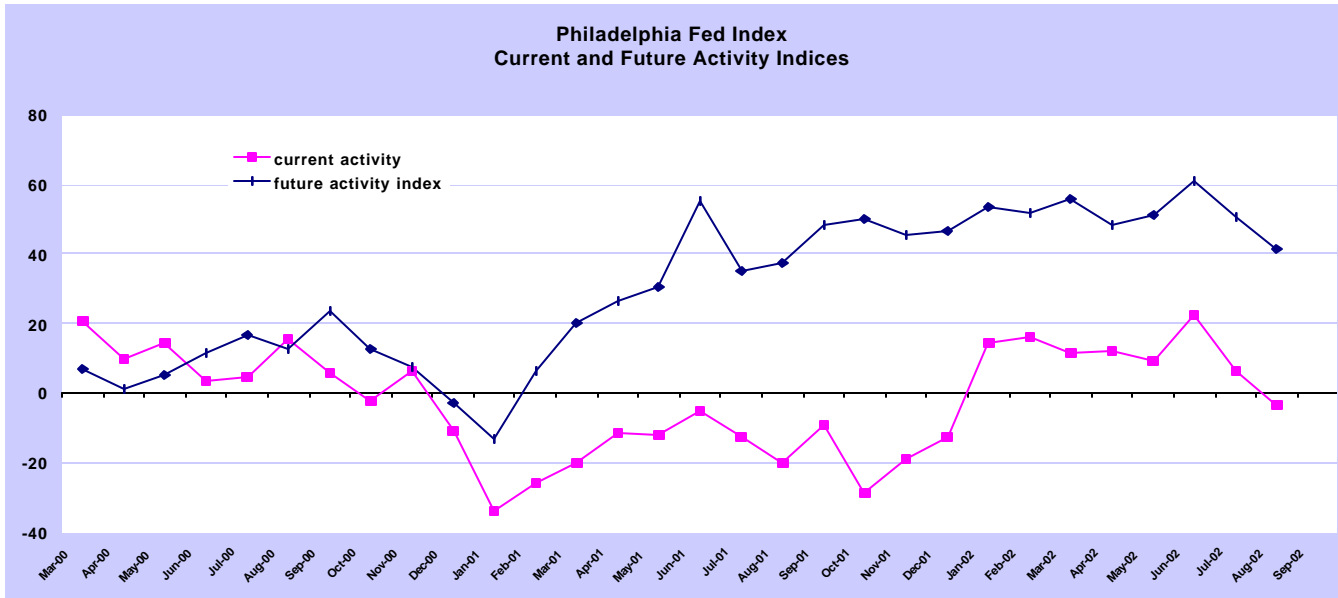


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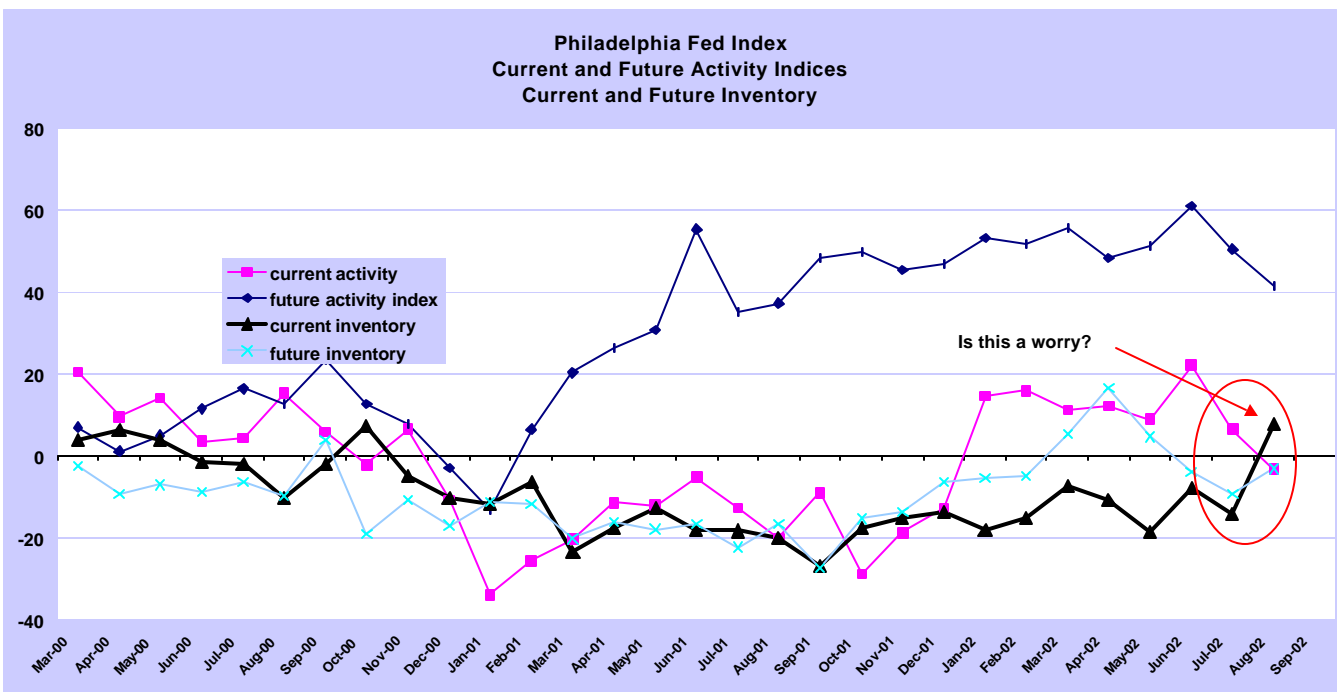
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Philadelphia Fed Activity Indices frequently point the direction for other economic indicators, and one key variable that the Fed will be watching is Industrial Production. Currently, its rate of expansion has



basically 'stalled out.' In the chart above, notice that current activity is rising at a slower rate, but the forward activity is seen as contracting!

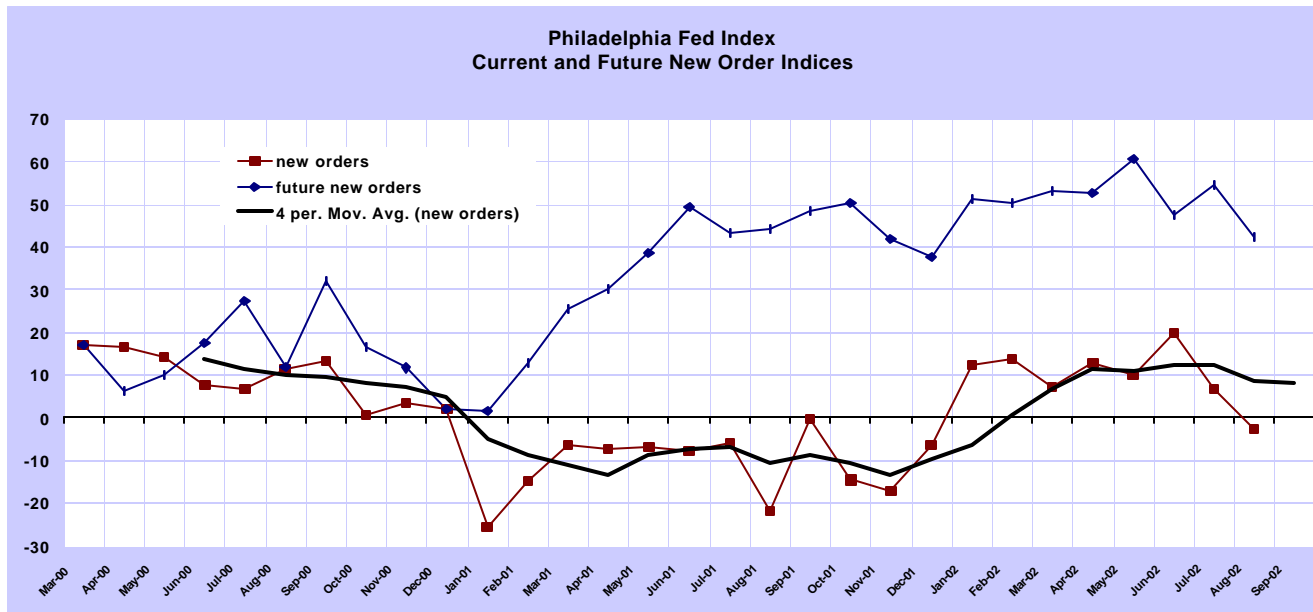
The explanation may lie in the behavior of current and future orders. What might be a worry? An inventory build that is the result of a rapid and unexpected slowing of sales. Some analysts have





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pointed to the behavior of current inventory...that it is climbing. This could be just a natural rebuilding



of diminished inventory after the steep reductions in QI, but it also could accompany a sudden reduction in demand. The Current Activity index decreased its rate of growth one month prior and that might indeed signify that this inventory build was 'involuntary'. The absolute decline in New Orders shown above is definitely worrisome, even though businesses expect future orders to expand. Is this a realistic hope? It certainly suggests some optimism is still left after a series of setbacks, but taken in context, we wonder if some of the survey data doesn't just reveal the sort of inconsistency between plans and realization.

If the Phil Fed Surveys were good predictive instruments for some of the 'harder data' that often trigger market reactions (e.g. the ISM), there are hints of problems ahead in this recovery. In the graph below (which is admittedly 'noisy', businessmen think there are margin problems ahead. (Compare the current and future price data that seems to indicate a divergence with current prices rising faster than future prices). The current new orders have shown substantial weakness but surprisingly, particularly on a 4 week moving average basis, but business remains more optimistic on future orders. As to the future average workweek, what seemed to be a stall in the rate of growth suddenly rolled over.

The key to consumption is job growth and job growth is keyed on business plans for future production and expectations on margins and demand. If the Philly Fed survey is accurate, August and September may see further slowing. Certainly, that corresponds with the diminished capital expenditure plans going forward.

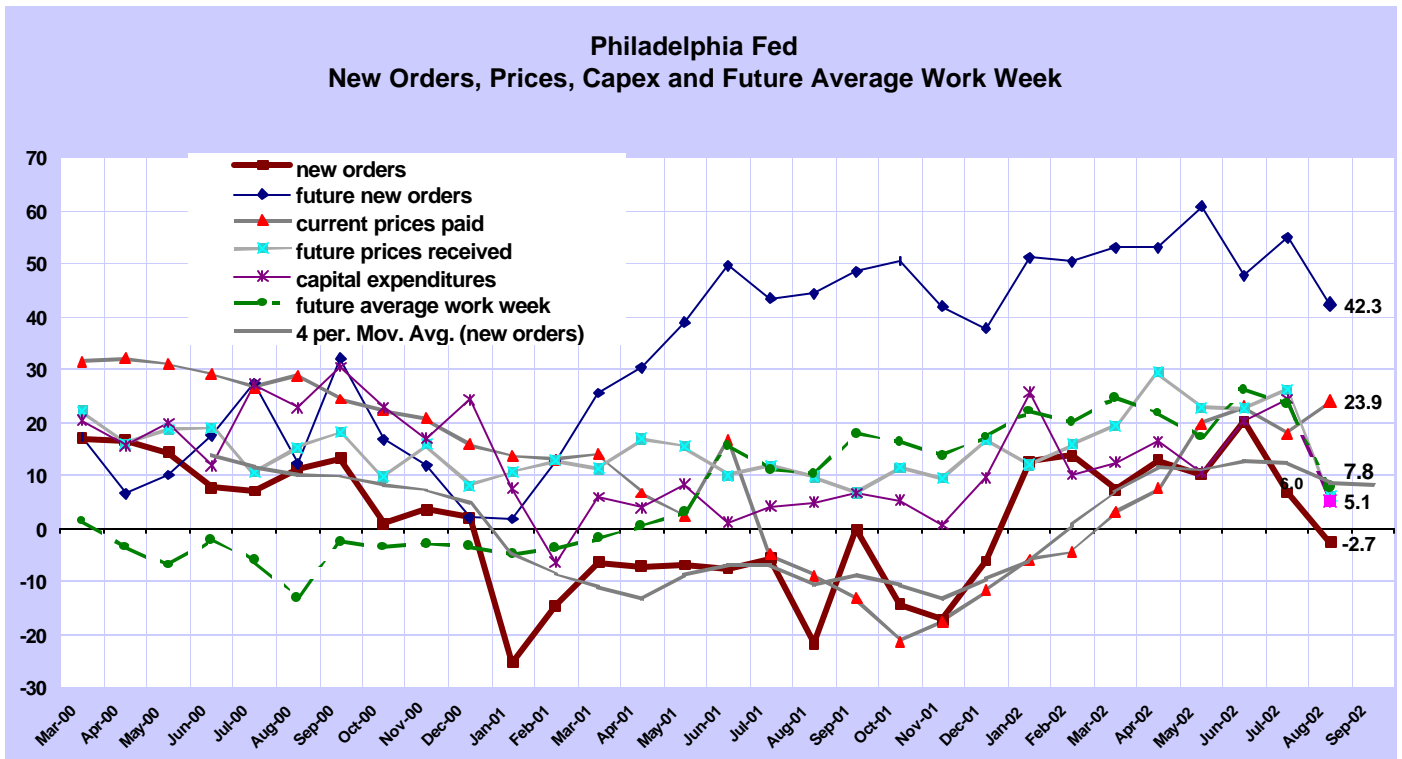
Taken together with the Industrial Production numbers released today, the Philly Fed Survey has sent a warning signal that the slowing growth in the economy could portend a true 'stall' just ahead. We



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should get some further confirmation or negation with the next ISM and next Employment Report.

Ultimately, consumer demand will depend upon a continued income growth and a slowing of production, accumulation of inventory and reduced capital expenditure plans make this a prime concern.



Tomorrow, the data on the CPI, Real Earnings, Housing Starts and Building Permits and finally the University of Michigan Consumer Confidence Survey will appear. It would be a surprise to see a reversal in the recent trends that show a significant slowing in economic growth. If these data confirm that slowing, the Fed may be back on the case rather soon. Negative momentum is difficult to fight and the Fed will not want to see further “headwinds” develop.