

## The U.S. Economy Will Grow Slowly and Not Sink Into a Recession, The Conference Board Reports

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Varied economic indicators produced by The Conference Board are now pointing to slow growth ahead in the U.S., but not a recession, according to an analysis released today by The Conference Board, the global research and business membership organization.

'The challenge for both the Federal Reserve Board and the U.S. economy is that this period of sub-par growth is likely to have little impact on inflation and short-term interest rates,' says Gail D. Fosler, Executive Vice President and Chief Economist of The Conference Board. Her analysis appears in StraightTalk, a newsletter designed exclusively for members of The Conference Board's global business network. 'Rather than coming down, they are likely to remain high for an extended period or even go up.'

Over the past three months, The Conference Board index of leading economic indicators has turned down relative to its level six months ago for the first time in this expansion.

'While this signal is not particularly alarming, since the downturn is still rather modest, it does suggest that the economic cycle is more mature than is generally presumed,' says Fosler. 'Although such downturns do occur, they usually happen toward the end of the economic cycle.' The current downturn is still in the range of the 1995 slowdown rather than the sharper declines before the 1990 and 2001 recessions.

The rate of change in the leading index is as important as its level. The LEI may dip into negative territory, but the decline is likely to be modest or brief. The key element is not only the level of the index, but the magnitude and duration of its decline. According to both of these indicators, the LEI is now signaling a downturn - not a recession.

### **THE FED IS IN A PICKLE**

The Federal Reserve Board is currently operating with little leeway. The current topline Consumer Price Index is rising above a 4 percent annual rate, which is the highest inflation rate in over 15 years. Core CPI is running at about 2.5 percent, which is on a par with the rate that preceded the 2001 recession, and appears to be moving up to the 3 percent inflation rates of the mid-1990s.

'Despite the financial market's enthusiasm for the Fed's restraint in August, it is hard to believe that the Fed will not have to continue to raise the Fed funds rate in the face of these inflation pressures,' says Fosler. 'Before the Fed can actually cut rates, an event or shock of a sufficient magnitude to reverse the currently entrenched optimism in commodity markets will have to occur.'

The next several months bear watching. Earlier, the Fed's tightening had little or no impact and it appeared that the U.S. economy might be reaccelerating after the shock from Hurricane Katrina in the fourth quarter. The deceleration in the economy is clearer now that consumer and investment spending and the housing and employment sectors are beginning to weaken. Over the past two years, the financial indicators in the LEI have taken the U.S. economy toward lower ground and the nonfinancial indicators are now following suit.

### **CAPITAL GOODS MARKETS ARE WEAKENING**

One of the biggest disconnects in the U.S. economy has been between the rapid growth in the capital goods and manufacturing sectors and the systemic weakness of the consumer sector. The consumer goods sector, which was propped up by low interest rates during 2000-2002, never faced the traditional recession challenge. Outside of housing investment, the consumer sector never recovered either. While consumer spending has remained in the 3-4 percent range, the major benefactor has been consumer-related imports. Domestic consumer goods orders on average have not grown at all over the past four years.

The capital goods sector has been the other overwhelming economic driver during this cycle. The acceleration in nondefense capital goods orders during this cycle dwarfs past investment booms - even those of the tech 'bubble' of the late 1990s. The year-to-year growth in capital goods orders peaked at about 30 percent late last year. This growth is the result of what has been, until very recently, rapid growth in domestic infrastructure, housing, technology, and capital goods investment, as well as a boom in investment in other parts of the world - especially emerging markets - which is reflected in the rapid growth in export orders. Exports of capital goods have been rising at a 13 percent annual rate over the past year.

But recently, the capital goods sector appears to be slowing. Besides the slowdown in capital investment in the second quarter Gross Domestic Product, there has been a sharp drop in capital goods orders overall.

Despite a bounce back in August from July's dip, the slowdown over the last several months in the Institute of Supply Management export orders index, which is generally a good leading indicator of export orders, is a matter of even greater concern. The decline in the short-term trend of this index suggests that external global demand for capital goods may be slowing. Vendor performance, as measured by the percentage of companies reporting slower deliveries, is still relatively high (above 50 percent).

## **WHERE WILL PROFITS GO?**

Corporate profitability, which is an important long-lead indicator of the business cycle, is making stunning gains. When corporate profits are high, investment usually grows rapidly and businesses spend more freely on travel, marketing, and other general administrative expenses. Hiring rises and, equally important, so does liquidity.

'What is clear is that companies have been spending their cash flow freely through investments and stock buybacks and increased dividends,' adds Fosler. 'Companies still appear relatively liquid, but the financing gap is now in territory that bears vigilance.'

*Source: StraightTalk, The Conference Board*

## **ABOUT THE CONFERENCE BOARD**

Not-for-profit and non-partisan, The Conference Board is one of the world's leading research and business membership organizations. It produces the widely-watched Consumer Confidence Index, Help-Wanted Advertising Index, and Leading Economic Indicators for the U.S. and eight other major nations. The Conference Board is also noted for its economic forecasts and CEO surveys, and for its studies on global productivity, corporate governance, business ethics, corporate citizenship, workplace diversity and mature workers. Its conference and council programs attract more than 18,000 senior executives each year. [www.conference-board.org](http://www.conference-board.org).

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