

Going into the second half of 2011 – Sunshine before the storm!

Going into the second half of 2011 we are seeing some signs of improvement in the regional manufacturing activity, and in the overall economy. This recovery from the first half pull back was indeed expected and recent statistics demonstrate some of that taking place. However, we need to remain cautious as the improved economic performance is likely to last only in the second half of 2011, and not necessarily spill over into 2012. The probability of a recession developing in the first half of 2012 remains around 40-50%.

We argued in the June report that the GDP growth in the second quarter will weaken and be between 0.8 – 1.3%, unfortunately, our expectations materialized. However, the GDP statistics that were released last week are not entirely negative news. There was a clear positive sign in those numbers – the pickup in the non-residential investment spending. In fact, for the first time in this expansion, the GDP growth was driven not by some destabilizing government policies or unsupported consumer spending, but by the investment component. This is a fundamental change and if prevails, may turn around the fate of the labor market. In fact, the July labor market report may reflect some of that already. We expect the economic data to start showing improvements in the short term. The growth rate of the US economy, and with it the economic performance of the Buffalo region will improve over the next few months, but this is not likely to be a permanent recovery. The fundamental factors remain soft, and the projection into 2012 is indeed scary. The likelihood of a recession developing at the end of the first quarter of 2012 is rising and approaching 50%. This is a very uncomfortable level for investment, and may deter the growth in investment we observed in the second quarter.

In October of 2010 we argued that the new wave of monetary expansion will cause stagflationary effects in 2011, and unfortunately this also materialized. The US monetary expansion appears to be to a significant degree driven by the fiscal situation of the Federal government. The upcoming further monetary expansion will only further inflate commodity prices and destabilize the economy. The development of this world wide recession with higher commodity prices will likely impact growth and inflation in 2012 and possibly into 2013 – 2014.

The Buffalo-Niagara regional seasonally adjusted PMI posted an 8.1 point increase in July. This is a healthy performance. However, despite this gain, the index failed to recover to the March – April levels. The Production indicator jumped by nearly 10 points, as 37.5% of our survey responders reported higher production levels, while only 31.3% reported reduced production activity.

The seasonally adjusted New Orders index jumped by 15 points. 43.7% of responders reported higher new orders activity, that is 8% higher than in the previous month. Lower new orders were reported by 31.3%, nearly 20% lower than the 50% response we saw in June.

The Employment index produced the highest level since February. The indicator increased to 51.2 as only 18.7% of survey responders indicated lower employment levels. The survey results failed to show any robust employment gains, but did support a stable employment situation, with 56.3% of responders reporting the same level of employment.

Commodity prices continue to remain a concern. 56.2% of our survey responders indicated higher commodity prices, that is up from the 50% response rate in June. The seasonally adjusted Commodity Price index edged higher and reached 75.

This was indeed a somewhat optimistic way to start the second half of the year, and this optimism is likely to continue for the next couple of months and possibly throughout the rest of the year. But 2012 needs to be more seriously evaluated as clouds appear to form into a storm.

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