

Economists Expect Spending By Business to Lead Recovery

By JON E. HILSEN RATH
And CONSTANCE MITCHELL FORD

NEW YORK—A modest economic recovery should take firmer root in 2003, led by businesses expected to pour their recuperating profits into investment after two years of cost-cutting.

That is the widely held view among 55 economists who participated in The Wall Street Journal's 2003 economic-forecasting survey. At the same time, they point to a world filled with uncertainties: An extended conflict in Iraq or new rounds of terrorism, they say, could still derail the outlook for even modest growth.

The tepid pace of corporate spending

and hiring has been widely blamed for the economy's slow path to recovery. But with profits now rising—government data show that pretax profits were up 12% in the third quarter in 2002 from a year earlier—the consensus among the 55 forecasters in the Journal survey is that the economy will gradually build momentum throughout the year as companies replenish depleted inventories and invest more heavily in new equipment.

"Businesses are making higher profits and generating more cash and they have to do something with it," says Ian Shepherdson, chief U.S. economist at High Frequency Economics in Valhalla, N.Y.

The average forecast of the economists in the Journal survey calls for real gross domestic product—the value of the nation's output, adjusted for inflation—to grow at an annual rate of 2.7% in the first quarter, 3.2% in the second quarter and 3.7% in the final two quarters of the year. That would be slightly better than 2002 when the economy swung back and forth between strong and weak growth and is believed to have ended the year growing at an annual pace of about 1%. (The government will release an estimate of fourth-quarter GDP later this month). That, in turn, could nudge down the unemployment rate to 5.7% by the end of this year from current levels of about 6%, according to the survey.

When asked to identify what would be the main engine of economic activity in the year 2003, more economists named business investment than any other category: 36 said profits would be up by at least 7% for the year.

Arun Raha, economist with Eaton Corp., an industrial-equipment manufacturer in Cleveland, Ohio, was one of those economists. He notes that corporate profit margins have improved, thanks in part to productivity gains registered from cost-cutting in 2002. He also believes that uncertainties created by last year's accounting scandals have dissipated, making executives more prepared to focus on growth again. Having put off making new investments for two years, many companies are now stuck with aging equipment that needs to be replaced.

"Everything that you need for business investment to pick up is there," says Mr. Raha.

Despite the growing optimism about corporate spending, most economists readily concede that the year ahead is filled with more than the usual number of risks. One is that the weak stock market could continue to weigh on business confidence. (See story, page A4.)

Dual Threats

The most obvious risk is something that economists can't easily punch into their economic models: the dual threats of war and terrorism. The U.S. begins the new year with a confrontation looming in Iraq, with North Korea threatening to restart its nuclear weapons program and with the risk of terrorism lingering just about everywhere. Twenty-six of the 55 economists surveyed said that war and global uncertainties are their primary concerns for 2003.

The mere presence of these uncertainties is already holding back the economy in important ways. The potential for war

Please Turn to Page A2, Column 3

A Boat Goes Missing, And Tiny São Tomé Has No Coast Guard

Nigeria Admits Having Craft But Won't Give It Back; Mixing Oil and Geopolitics

By MICHAEL M. PHILLIPS

CALABAR, Nigeria—On the morning of June 21, 2001, the people of the tiny nation of São Tomé and Príncipe awoke to discover that their Coast Guard was missing.

It wasn't until a year later that they learned that their Coast Guard, a single, 28-foot patrol boat made in Arkansas, was at a Nigerian Navy base here on the Calabar River, 325 miles from home.

Now, 18 months after the boat disappeared, the case has degenerated into a diplomatic standoff rooted in oil and rife with geopolitical maneuvering. They "promised to repair it and send it back," complains São Toméan President



Fradique de Menezes, who adds that he has on several occasions pleaded personally with Nigeria's president for the boat's return. But "nothing has been done," Mr. de Menezes says.

Nigerian President Olusegun Obasanjo's spokesman, Chunji Oseni, says that

Please Turn to Page A5, Column 1

JAN '03

↑ PROFITS

RAY of HOPE

ECONOMIC "ENGINE" WILL SWITCH FROM CONSUMER TO BUSINESS

... OR WILL IT?

E10

we need to see some follow-through. Breadth has improved, although it is not at the level of previous sustained rallies. Meanwhile, corporate bond spreads remain near record high levels.

Bottom Line: It is too early to get a clean read from confirming indicators, but so far financial markets are not flashing the all-clear sign for stocks. The odds of a durable rally will increase if the Fed eases policy at next month's meeting.

Waiting For the Fed

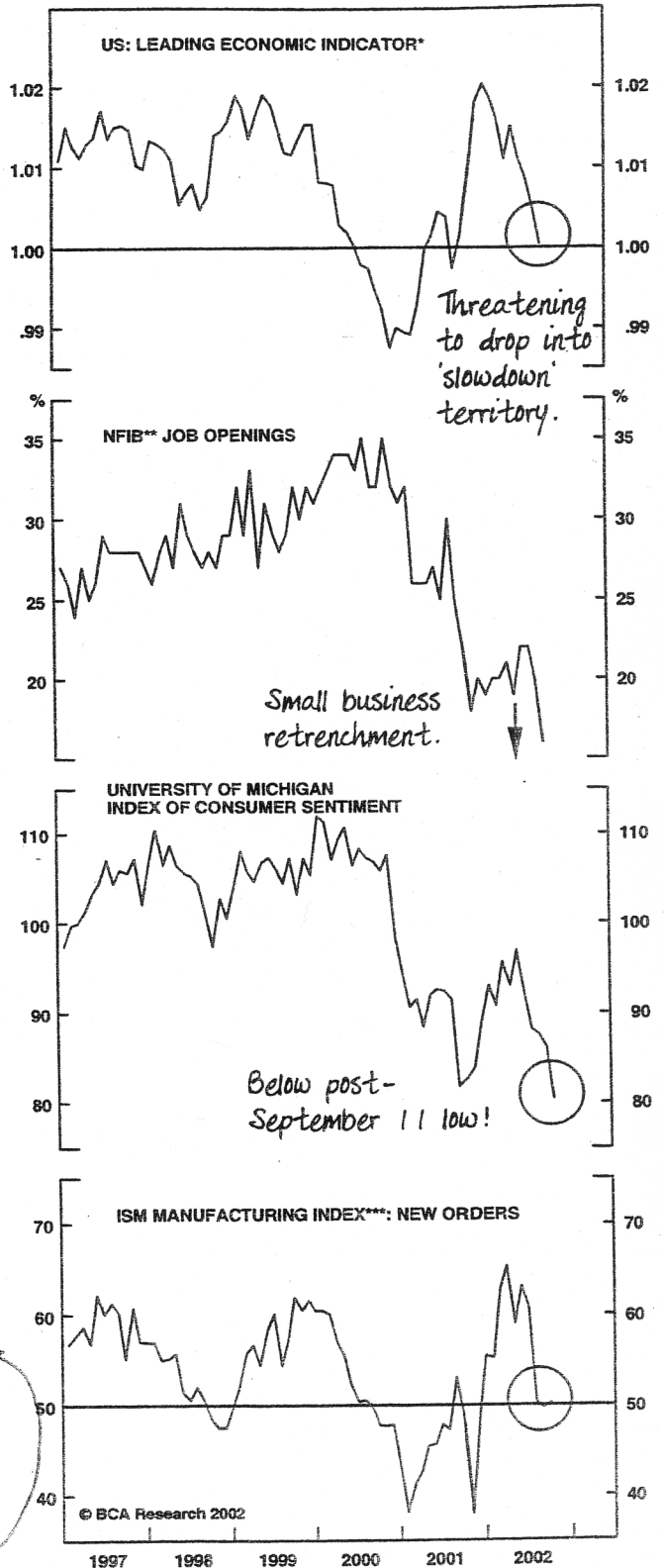
The FOMC is due to meet on November 6, the day after the mid-term Congressional elections. We had been expecting them to ease by 50 basis points in order to protect against the risk of both deflation and a slide back into recession. However, it is possible that the rebound in equity prices will encourage the Fed to remain in a "wait-and-see" mode. Ironically, if that occurred, then the equity rebound may not last very long. The Fed's failure to cut rates in August helped to short-circuit the equity rally that began in late July.

Public statements by the Fed seem to indicate a complacent attitude toward the threat of deflation. Although two FOMC members wanted to ease at the September meeting, the majority believe that policy is already easy enough to support an economic recovery - all that is needed is some patience.

Although the economy has not plunged off a cliff, recent trends suggest that additional stimulus is required. The Conference Board's leading economic indicator is headed below the boom/bust line, the demand for labor is softening, according to the National Federation of Independent Business, and consumer confidence has fallen below the lows reached last year in the wake of the terrorist attacks (Chart I-3). The ISM Manufacturing New Orders index is also sitting on the boom/bust line.

The key issue with regard to the economic outlook continues to be whether corporate sector expenditure will increase before consumer spending and housing activity head lower. At this point, the corporate sector does not show any sign of abandoning its retrenchment mindset.

Chart I-3
Economic Momentum Still Poor



JAN '03 "ADDITIONAL STIMULUS REQUIRED"

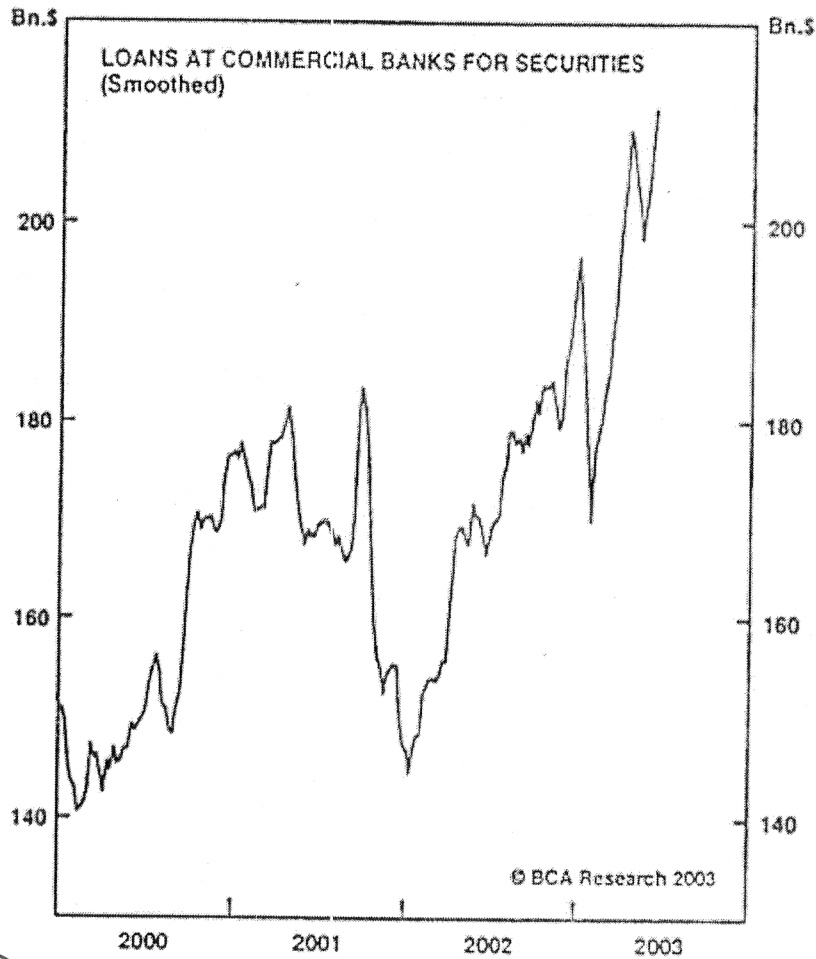
"ECONOMY HEADING BELOW BOOM-BUST LINE"

Handwritten initials and scribbles, including a circled "E11" and a signature.

Jul. '03: POTENT REGULATORY STIMULUS PACKAGE!

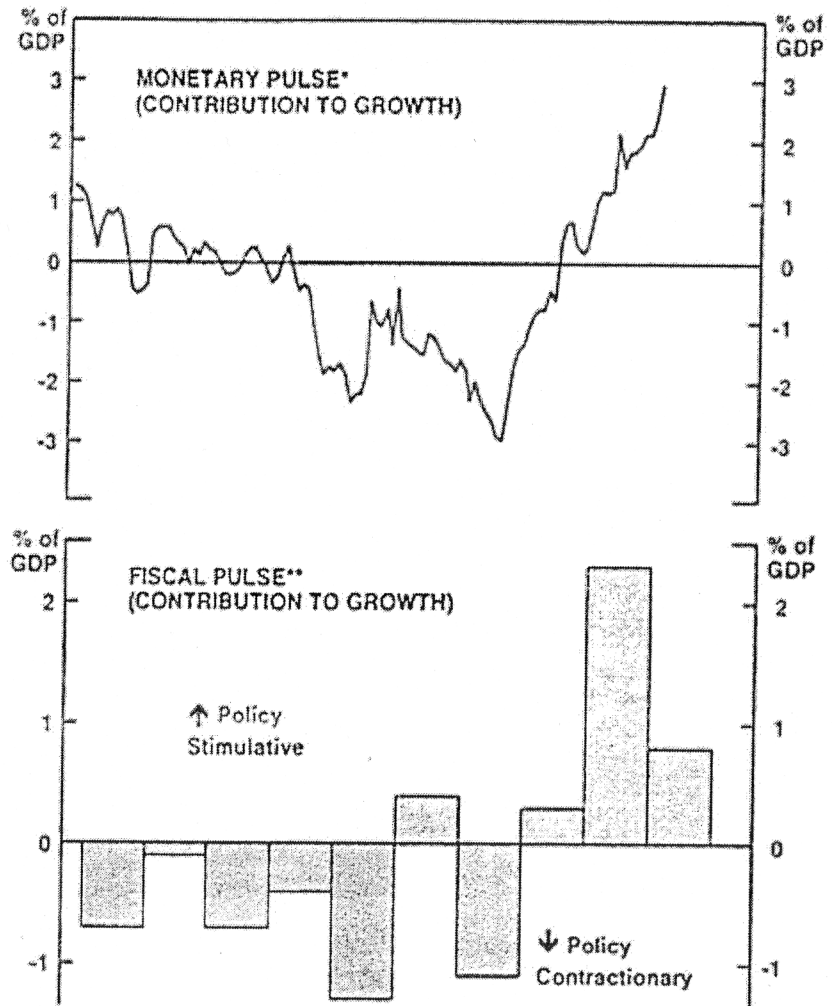
MARGIN LOANS UP

The Fed Could Fuel Speculative Frenzy



MONETARY & FISCAL POLICY

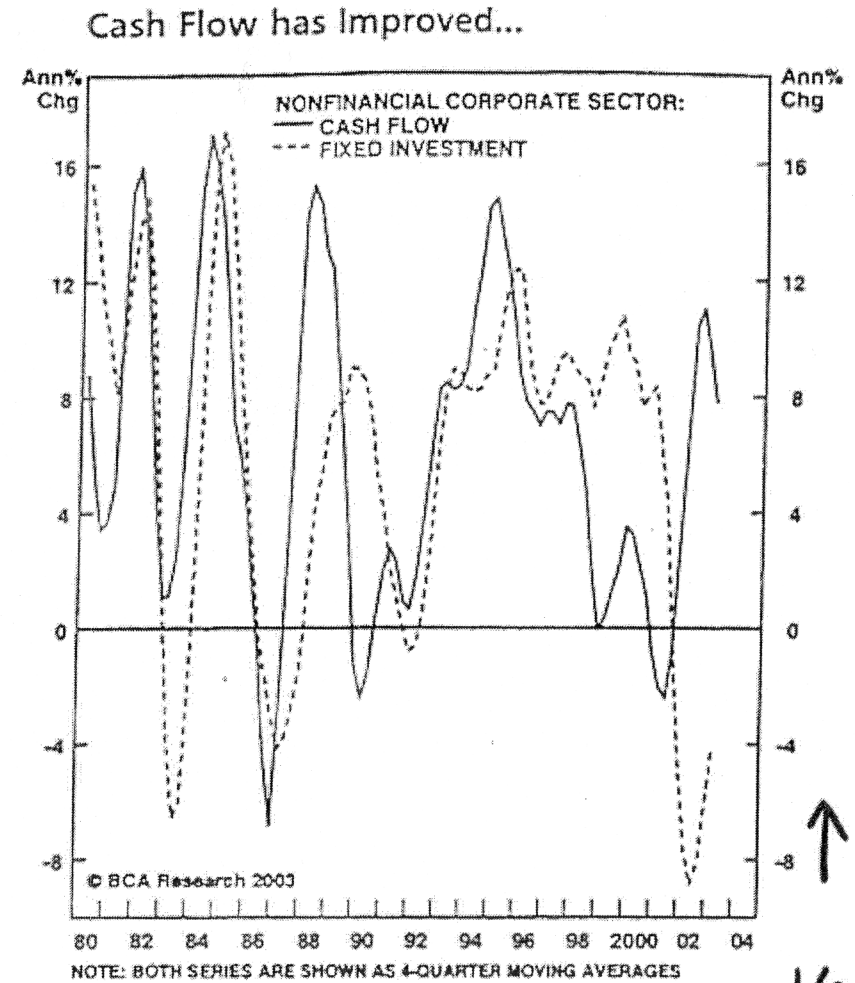
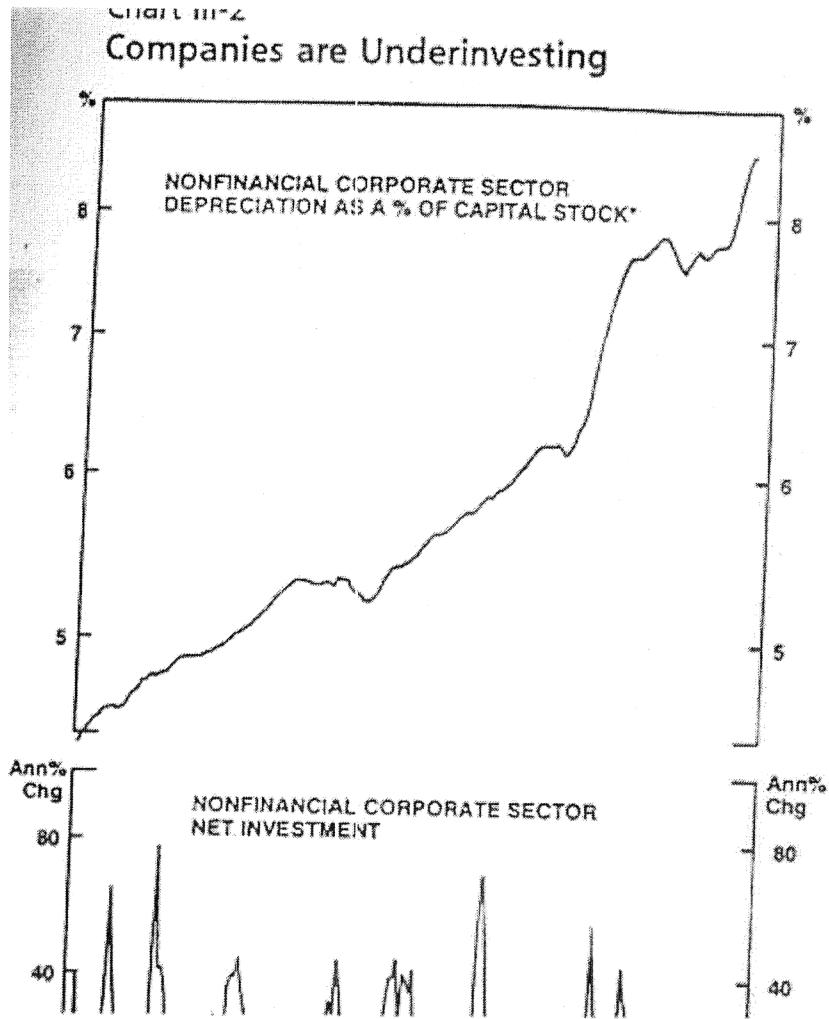
Stimulating Growth ✓ BV



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SEP '03: CORPORATE CASH FLOW IMPROVES.... ...BUT COMPANIES ARE RELUCTANT TO INVEST



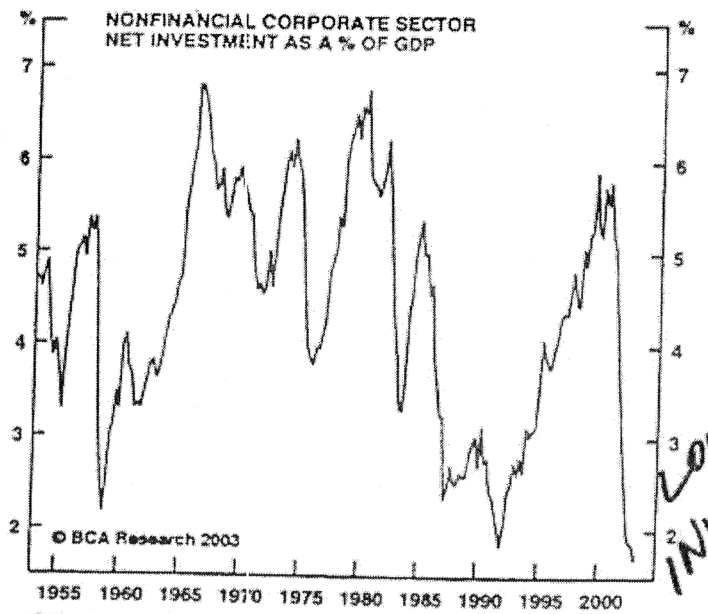
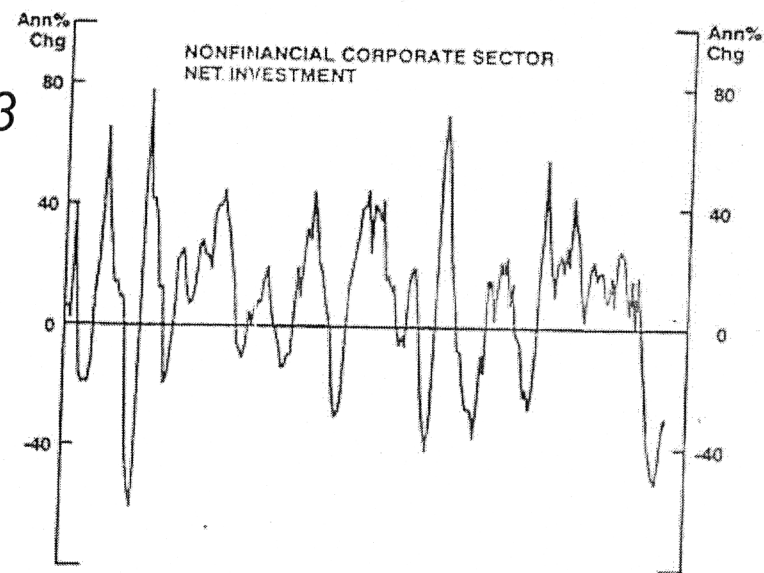
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IMPROVED FINANCIALS + (LOW INVESTMENT & HIRING) = HIGH PROFITS & PRODUCTIVITY...WILL JOBS FOLLOW?

9-03



FIN

Low INVESTMENT

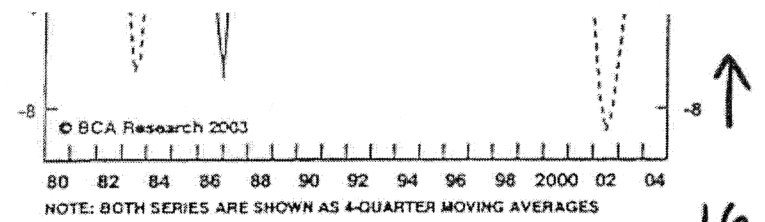
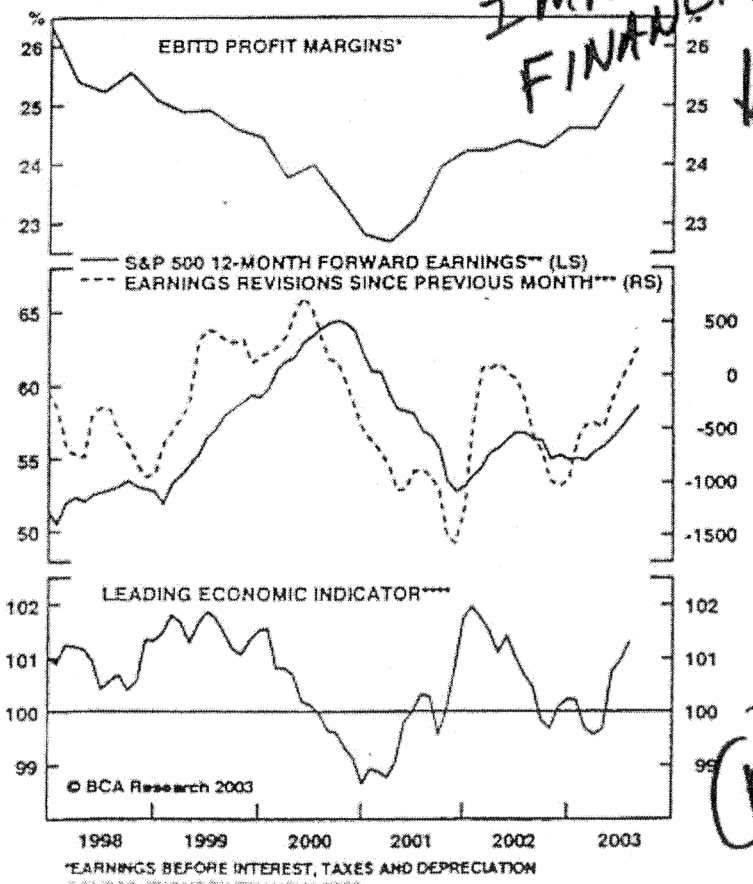


Chart III-7
... As Have Profits



IMPROVING FINANCIALS

10

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CHART III-8
Investment is Lagging

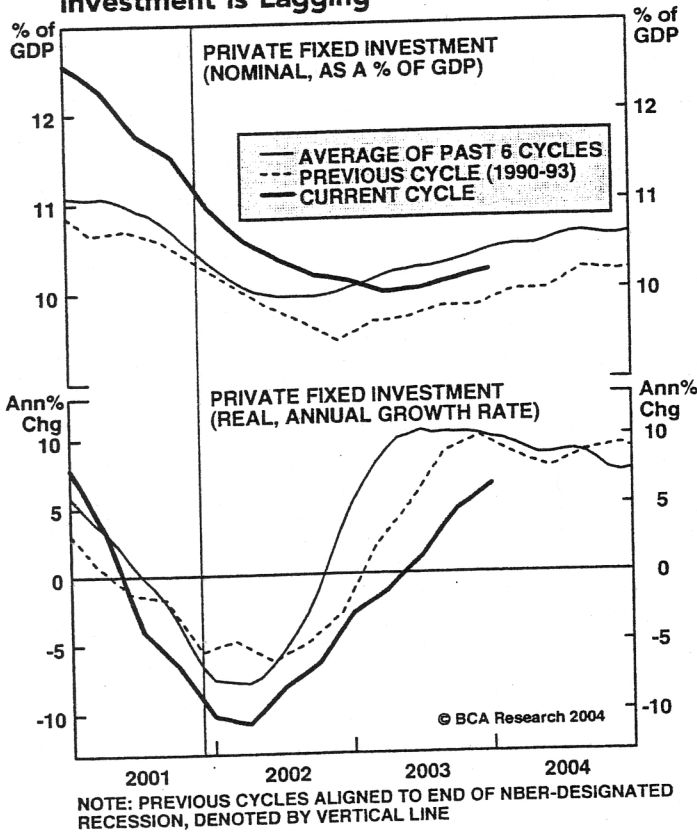
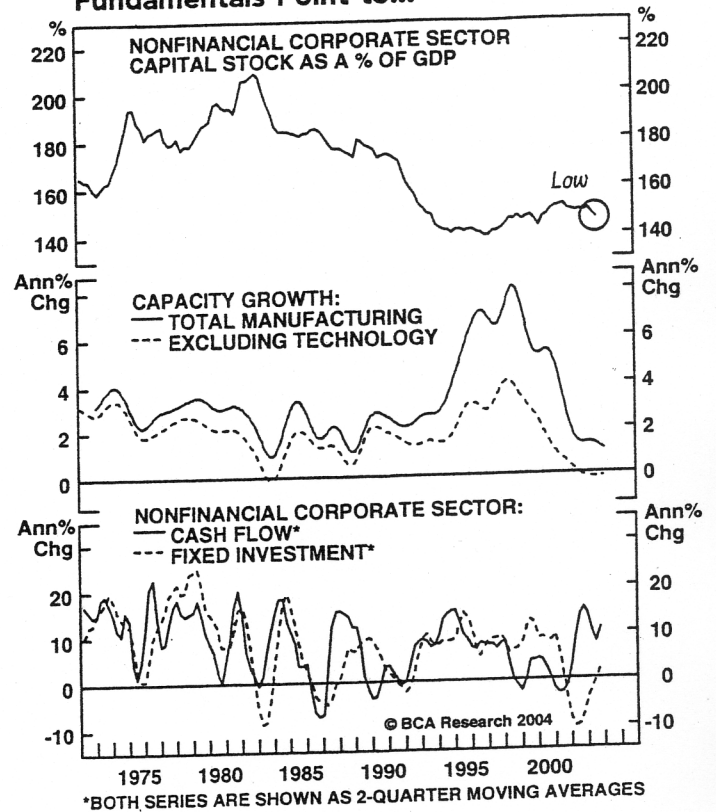


CHART III-9
Fundamentals Point to...



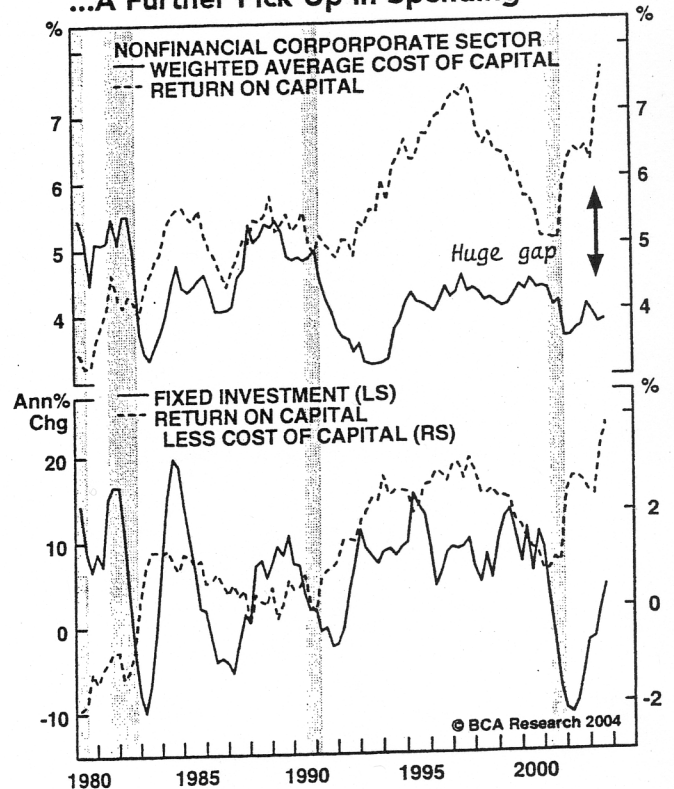
... While Spending will Accelerate

Capital spending has lagged in the current expansion relative to previous cycles. Chart III-8 shows that while private fixed investment has bounced back in the two years since the current expansion began, it lags well behind the experience of previous cycles.

The fundamentals would seem to support a much stronger upturn (Chart III-9):

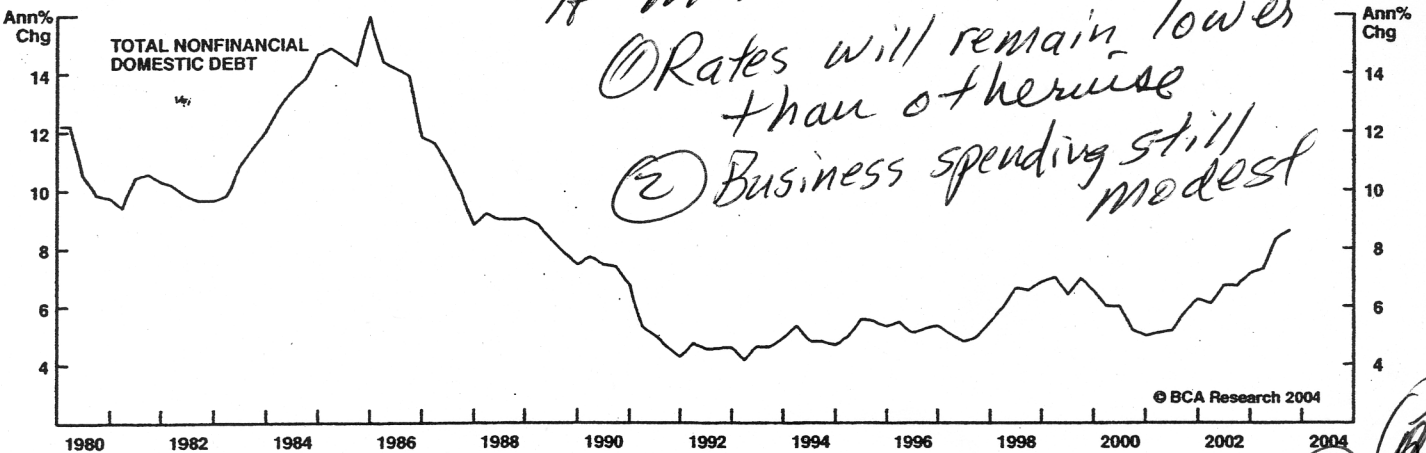
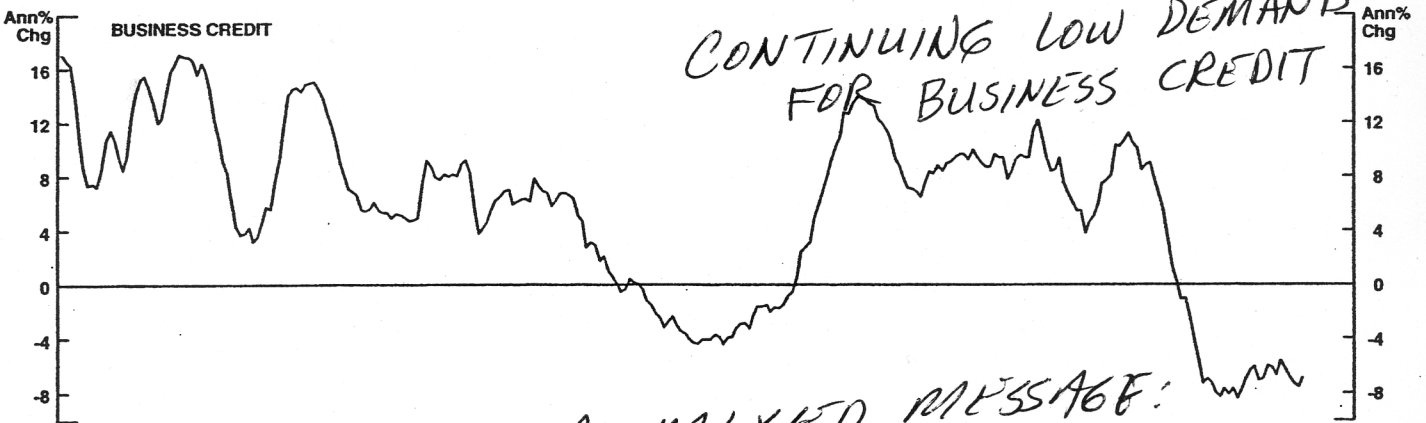
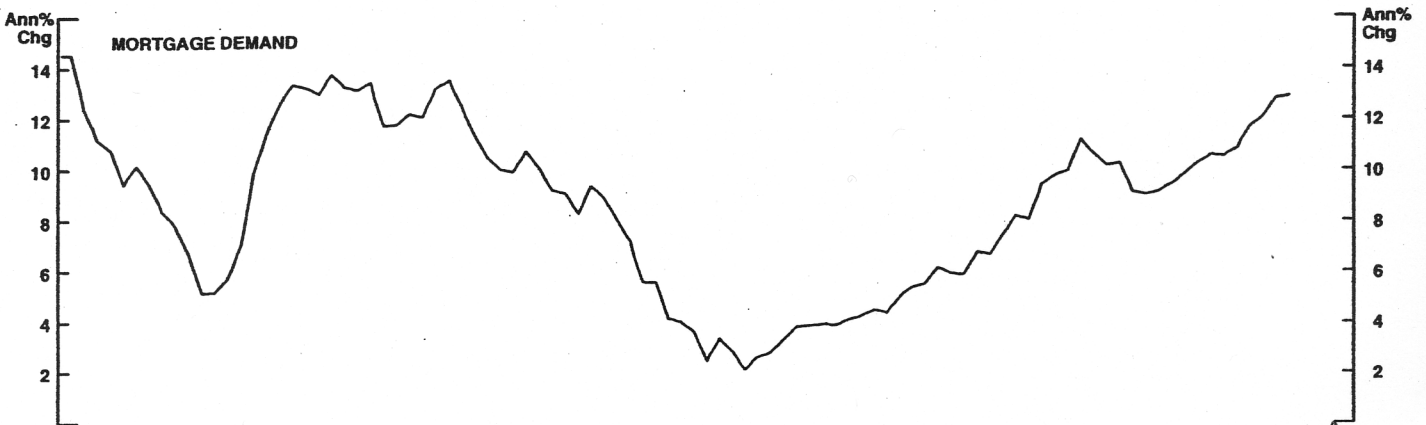
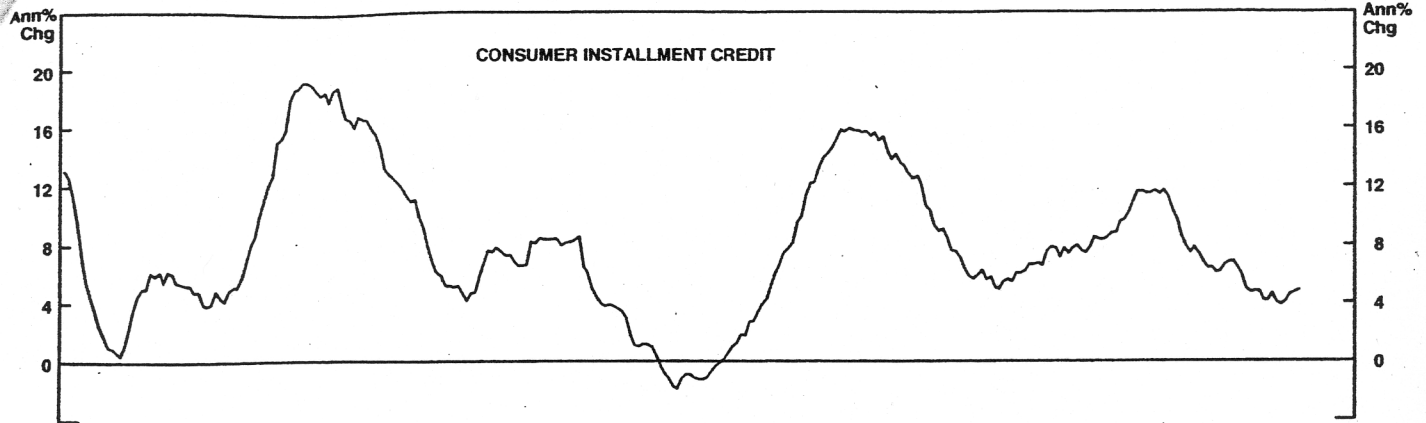
- There is no capital stock overhang. The corporate sector's capital stock as a percent of GDP is near the bottom of its range.
- Capacity growth is low. Manufacturing capacity is growing at a 1% rate, its lowest level since 1984. Excluding technology sectors, manufacturing capacity is shrinking.
- Cash flow is exceptionally strong. Capital spending traditionally follows the trend in cash flow. Moreover, the corporate sector's focus on retrenchment during the past few years has paid off. Leverage is shrinking and companies are well positioned to increase spending.

CHART III-10
...A Further Pick Up in Spending



E15

Trends in Credit Demand



CONTINUING LOW DEMAND FOR BUSINESS CREDIT

*A MIXED MESSAGE:
 (1) Rates will remain lower than otherwise
 (2) Business spending still modest*

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(BIB)

Companies flush, with nothing to splurge on

Microsoft payout points to fewer opportunities

By Elliot Blair Smith, Matt Krantz and Jon Swartz
USA TODAY

Microsoft's \$75 billion gift to shareholders represents the happy end to an amazing chapter in American history. Yet the investor giveback — cash, wrapped in cash — also heralds a more challenging future for the software giant, the technology sector and for American ingenuity awash in capital with apparently too little to spend it on.

After 2½ years of skyrocketing profits, the Standard & Poor's 500's non-financial companies amassed a record \$555.6 billion in cash and short-term securities, a total about to be surpassed with the disclosure of second-quarter profits. Cash hoards were up 11% from a year ago and more than double cash holdings five years ago.

However, in the absence of new, emerging markets for the USA's companies to sell to, or the next transformational technology as a reward for risk capital, too few opportunities exist for the many dollars now chasing them. Consequently, at just the point when profitable companies should be investing their good fortunes in new plants, products and intellectual property to maintain the momentum, Microsoft's giveback maps a near-term retreat from an age of expanding possibilities.

"If you have that kind of cash and give it back, it shows you can't find anything better to do with it," says Robert Maltbie, portfolio manager at Millennium Asset Management. Kirk Walden, research director at PricewaterhouseCoopers, affirms, "There is no Internet-like phenomenon to splurge on."

Big-company executives aren't alone in confronting the problem.

Hedge fund investors and venture capitalists report turning away streams of cash. "There aren't that many teams with great ideas worth investing in," says Steve Domenik, a general partner at Seven Rosen Funds, a venture-capital firm that raised \$300 million this month while turning away \$1 billion. In the first quarter, venture capitalists bet \$5.1 billion on start-ups, the first time quarterly investing topped \$5 billion in nearly two years, says MoneyTree Survey. But that was still down considerably from the record \$28.5 billion in the first quarter of 2000.

Corporate cash reserves balloon while ...

Cash and cash equivalents at 374 non-financial companies in the Standard & Poor's 500: (in billions, adjusted for inflation)



Source: Standard & Poor's
By Jim Sargent, USA TODAY

Microsoft

Microsoft
\$56.4
Information technology

Aetna
\$16.4
Health care

ExxonMobil
\$15.9
Energy

Hewlett-Packard
\$15.0
Information technology

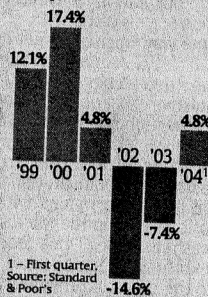
Pfizer
\$14.0
Health care

Intel
\$13.1
Information technology

Johnson & Johnson
\$10.4
Health care

... spending slows

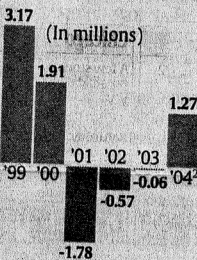
Changes in capital expenditures for S&P 500 companies:



1 - First quarter. Source: Standard & Poor's

... jobs turn around

Change in U.S. payroll employment due to jobs created or lost:



2 - In the first six months. Source: Department of Labor

By Frank Pompa, USA TODAY



Digitart

"The next thing": This is a rendering of tony condominiums in Miami called Blue. Many investors are turning to real estate.

COMPANIES
NOT AGGRESSIVELY
SPENDING AS
ECONOMISTS
FORECAST in
JAN. '03

See COVER STORY next page ▶

E17

Fed chief: Companies too cautious

Terrorism fears partly at fault

By Sue Kirchhoff
USA TODAY

7-22-04

WASHINGTON — Federal Reserve Chairman Alan Greenspan Wednesday bemoaned business caution about investment and hiring, said there was little evidence new jobs in the USA paid less than those they replaced and called high African-American joblessness a societal failure.

The economy In testimony to a House committee, the Fed chairman also said that while tax cuts had helped the economy, Congress must now de-

velop policies to control long-term programs and deficits that could stunt growth.

As he did Tuesday before a Senate committee, Greenspan forecast solid growth this year with relatively low inflation — despite signs business activity softened in June. He said the Fed anticipates raising interest rates at a “measured” pace, while reiterating it would move faster if inflation speeds up.

In a separate speech Wednesday, Federal Reserve Bank of Philadelphia President Anthony Santomero predicted about 200,000 new jobs a month and healthy consumer spending. But he said that if those expectations aren't met, the Fed might go slower at raising rates.

“Some recently released data have been on the soft side. If such signs were to persist and the expansion seemed to be losing mo-

mentum, we would need to consider slowing the pace at which we (raise rates),” Santomero said, adding if inflation speeds up, the Fed will, too.

In another speech, Fed Vice Chairman Roger Ferguson said the recovery appeared “firmly on track.”

On June 30, the Fed raised its short-term interest rate target to 1.25% from 1%. Economists expect quarter-point rises into 2005.

In response to questions Wednesday, Greenspan said it didn't appear the economy was producing subpar jobs as Democrats and some economists say.

“We've not been able to find a significantly meaningful change in the quality of the jobs being produced relative to the quality of jobs being lost for the nation as a whole over the past year,” he said.

Rep. David Scott, D-Ga., asked about the fact black joblessness was 10.1%, compared with 5% for whites. “No matter any way we cut it, part of it is discrimination,” Greenspan said, calling education the answer.

The Fed chairman also said businesses have shown the most reluctance in decades to invest relative to the cash they hold. He blamed the situation on unease about terrorism, a hangover from corporate scandals and the stock bubble.

“To the extent that these (concerns) are capable of being assuaged, what it probably will be doing is, rather than creating a large surge in economic activity, is to gradually stretch it out,” Greenspan said, adding that could help the economy next year.

Contributing: Wire reports

1 52-week Stock

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services, Eaton Corp.
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 publik Stephens;
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 Economic Anal-
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 Economics in Val-
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 level in May,
 in home con-

The Wall Street Journal Forecasting Survey for 2004 and 2005

In percent except for dollar vs. yen and dollar vs. euro

Estimates probably too rosy overall!

	JANUARY 2004 SURVEY						NEW FORECASTS FOR 2004 AND 2005									
	3-MO. TREASURY BILL ¹ JUNE	10-YR NOTE JUNE	GDP ² Q1 2004	CPI ³ MAY	U.S. VS. EURO JUNE	UNEMPLOYMENT MAY	3-MO. TREASURY BILL ¹ DEC.	10-YR NOTE DEC.	GDP ²				CPI ³ NOV.	U.S. VS. YEN DEC.	U.S. VS. EURO DEC.	UNEMPLOYMENT NOV.
	Q3 2004	Q4 2004	Q1 2005	Q2 2005												
James F. Smith, University of North Carolina	1.45	4.33	5.30	1.4	0.98	5.4	1.94	4.53	6.0	4.2	3.1	3.6	1.4	117	0.99	4.7
Gail Fosler, Conference Board	1.50	5.10	5.81	2.6	1.25	5.5	1.75	4.75	5.7	5.4	5.0	4.4	2.6	118	1.08	5.0
Lawrence Kudlow, Kudlow & Co.	1.40	4.60	6.10	2.0	1.18	5.5	2.50	5.25	5.5	5.3	5.3	5.3	3.0	116	1.15	5.4
Brian S. Wesbury, Griffin, Kubik	1.60	5.50	6.30	2.5	1.29	5.7	2.30	5.50	5.3	5.6	4.8	4.8	3.3	115	1.15	5.4
Susan M. Sterne, Economic Analysis Assoc.	2.50	5.00	5.40	2.2	1.20	5.6	3.00	5.50	5.0	5.2	4.5	2.8	3.1	112	1.18	5.0
Ian Shepherdson, High Frequency Economics	1.50	5.00	5.00	2.1	1.30	5.5	2.50	5.25	5.0	5.0	5.0	5.0	3.2	115	1.15	5.1
Peter Hooper/Joseph LaVorgna, Deutsche Bank	1.35	5.25	4.70	1.9	1.25	5.4	2.00	5.40	5.0	4.8	4.1	4.0	3.0	96	1.30	5
Henry Willmore, Barclays Capital	1.15	5.25	4.50	1.7	1.23	5.6	2.20	5.35	5.0	5.0	4.5	3.0	3.0	105	1.10	5.0
Nariman Baharvash, Global Insight	1.48	4.75	4.40	1.5	1.25	5.8	2.15	5.15	5.0	4.8	3.8	3.1	3.2	103	1.28	5.4
Donald H. Straszheim, Straszheim Advisors	2.00	4.75	4.00	2.0	1.20	5.8	2.25	5.50	5.0	4.0	4.0	4.0	2.3	106	1.20	5.4
John Ryding/David Malpass, Bear Stearns	1.40	5.40	4.90	2.0	1.18	5.6	2.20	5.00	4.9	4.8	4.5	4.1	2.7	100	1.20	5.3
David Wyss, Standard & Poor's	1.00	4.50	4.20	1.5	1.25	5.7	2.00	5.10	4.9	4.5	4.0	3.0	3.1	108	1.28	5.4
Robert DiClemente, Citigroup	1.10	4.35	5.50	1.2	1.15	5.8	2.00	5.00	4.8	3.2	3.2	3.7	2.8	104	1.27	5.4
John Silvia, Wachovia	1.50	4.90	4.20	2.2	1.24	5.8	2.15	5.10	4.8	4.6	2.9	3.4	2.2	112	1.16	5.4
Richard Berner/David Greenlaw, Morgan Stanley	1.30	5.00	4.20	1.6	1.20	5.8	2.22	5.10	4.8	5.1	3.0	3.0	3.0	105	1.20	5.4
Richard DeKaser, National City Corporation	1.72	4.88	4.20	2.2	1.27	5.7	2.00	4.80	4.8	4.5	4.0	4.1	2.9	104	1.26	5.3
Tracy Herrick, The Private Bank of the Peninsula	1.35	4.80	3.80	2.5	1.25	5.6	2.05	5.60	4.8	4.0	3.5	3.0	3.2	105	1.27	5.2
Nicholas S. Perna, Perna Associates	1.62	4.79	4.20	1.9	1.20	5.6	2.35	5.29	4.1	3.7	4.1	3.1	3.2	110	1.11	5.3
Robert McGee, US Trust Co.	1.30	4.50	4.20	1.9	1.25	5.7	2.25	5.05	4.1	5.1	3.0	4.8	2.9	110	1.20	5.3
Ellen Hughes-Cromwick, Ford Motor Co.	1.50	4.50	3.70	2.0	1.25	5.8	1.60	4.75	4.0	3.8	3.2	3.2	2.1	110	1.22	5.5
Richard Rippe, Prudential	1.00	4.70	5.10	1.7	1.25	5.7	1.80	5.00	4.0	5.0	2.8	4.1	2.6	108	1.25	5.4
Douglas Duncan, Mortgage Bankers	1.00	4.40	4.60	1.5	N.A.	5.8	1.80	5.20	4.0	3.6	3.6	3.6	3.4	N.A.	N.A.	5.4
Robert Shrouds/Robert Fry, DuPont	1.50	5.00	4.50	2.1	1.18	5.8	2.00	5.20	4.0	4.0	3.0	3.5	3.1	105	1.22	5.3
Maria F. Ramirez, MFR Inc.	1.40	5.25	4.40	2.4	1.28	5.8	2.30	5.25	4.0	4.3	3.8	3.8	3.0	110	1.20	5.4
Mark Zandi, Economy.com	1.20	4.80	4.20	1.7	1.18	6.0	1.90	5.25	4.0	3.7	3.5	3.2	2.5	105	1.20	5.6
Paul L. Kasriel, Northern Trust Co.	0.97	4.70	4.00	1.9	1.27	5.7	1.90	5.05	4.0	3.7	3.5	3.3	3.1	102	1.25	5.2
Stuart G. Hoffman, PNC	1.20	4.63	4.00	2.3	1.19	5.7	1.95	5.20	4.0	3.7	3.5	3.5	2.9	106	1.18	5.4
Maury Harris, UBS	1.30	4.50	3.90	2.0	1.25	5.9	2.15	5.00	4.0	3.5	3.0	3.0	2.7	100	1.32	5.5
William Dudley, Goldman, Sachs	1.00	4.10	3.75	1.7	1.30	5.7	2.10	4.70	4.0	3.0	2.5	3.5	2.9	100	1.30	5.4
David Resler, Nemura	1.10	4.50	4.20	2.0	1.21	5.7	2.25	5.30	3.8	3.5	3.9	3.5	3.3	110	1.17	5.5
Allen Sinai, Decision Economics	1.53	5.00	4.70	1.9	1.34	5.6	2.41	5.47	3.7	3.9	3.5	3.3	3.6	101	1.25	5.1
Mike Cosgrove, Econoclast	1.10	4.50	3.50	1.2	1.25	5.8	1.85	5.00	3.7	3.5	3.2	3.2	2.0	110	1.15	5.3
Neal Soss, CSFB	0.95	4.00	4.97	1.7	1.25	6.0	N.A.	5.10	3.5	3.5	3.7	3.7	3.3	115	1.20	5.4
Mickey Levy, Bank of America	1.00	4.60	3.60	1.6	1.28	5.7	2.20	5.10	3.5	3.8	3.9	3.8	2.9	114	1.14	5.4
David Rosenberg, Merrill Lynch ⁵	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	5.25	3.5	3.5	3.0	3.0	3.0	100	1.33	5.5
Jim Meil/Arun Raha, Eaton Corp.	1.30	4.50	4.60	2.6	1.24	5.7	2.10	4.70	3.4	4.6	4.0	4.3	3.5	106	1.18	5.4
Gene Huang, FedEx Corp.	1.40	4.50	3.40	2.2	1.20	5.7	1.40	5.00	3.3	3.2	3.3	3.2	2.8	110	1.22	5.5
Edward Leamer, UCLA	1.50	4.60	2.70	2.1	1.26	6.2	1.74	5.25	3.2	3.1	3.1	3.1	4.0	N.A.	N.A.	5.8
AVERAGES	1.32	4.75	4.49	1.9	1.23	5.7	2.08	5.14	4.4	4.2	3.7	3.7	2.9	108.2	1.20	5.3
ACTUAL Numbers on June 30	1.32	4.59	3.90	3.1	1.22	5.6	LOOK TOO HIGH									

N.A. Not Available; ¹Treasury bill rates are on a bond-equivalent basis; ²Real gross domestic product; annualized growth rate; ³Year-to-year change in the consumer price index; ⁴Averages are for economists polled at time of survey ⁵Did not participate in January survey

→ GIVEN 3.970 Q1 ACTUAL

Auto Sales Fell 2% in Dreary June for GM and Ford

By LEE HAWKINS

DETROIT—U.S. auto sales eased 2% in June, mainly because of sharp declines at General Motors Corp. and Ford Motor Co. An escalation in the U.S. industry's price war seemed imminent as GM declared it intended to accelerate sales in the second half of the year to work off bulging inventories.

U.S. economic recovery, which has been stronger for upper-income consumers than for many blue-collar and middle-income Americans. In June, mass-market brands such as Chevrolet and Ford suffered sharp declines from a year ago, while certain luxury brands, notably BMW, Lexus and Acura, had strong gains.

sales and gained market share in June, as did South Korean auto maker Hyundai Motor Corp.

Overall, June light-vehicle sales translated to a seasonally adjusted annual sales pace of 15.4 million vehicles, down from 16.5 million vehicles a year ago and an abnormally strong 18 million selling pace in May. Industry officials said June's weakness was at least partly a pay-

"We are all going into the summer