

TRICKLE-UP BUSINESS SLOWDOWN

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Wal-Mart has now cut prices five times over the last month. Target has said they will match. Wal-Mart announced that sales for November would be down 0.1% after being flat in October. It looks very much like a trickle-up slowdown, from Wal-Mart to JC Penny to Macy's. But, of course, Wall Street has announced that Black Friday sales were up 6% from a year ago. Which makes more sense?

Stephen Church, an analyst we have followed for some time, made the observation in his extensive study of the consumer and his cash flow, that one way for the consumer to stay in the spending game is for prices to decline. Slow income growth can be offset with declining prices. It occurs to us that with profit margins robust and corporate profits at an all-time high as a percentage of GDP, businesses can afford to cut prices for a short time, but not forever.

It is true that there is good deflation as well as bad. The bad develops when debt liquidation takes hold. Our long-term and often repeated concern about the debts of the consumer has had us leaning toward the bad scenario. It all depends on the mood of the lenders when push comes to shove. Having spent 23 years in banking, this writer is left with a less than sterling opinion of the business skills of those in charge of such institutions. Even at that, however, they seem superior to those who inhabit the streets of lower Manhattan.

On another matter, the leading economic indicators have moved upward over the last two months. This is a sign that business conditions are not yet falling out of bed. On the other hand, the Northern Trust Economics Department trades the LEI on a year-to-year percentage change basis. Please note the correlation between the above when applied to real GDP (see chart below). A trickle-up business downturn seems most likely.

Index of Leading Economic Indicators (LEI) vs. Real GDP
year-to-year percent change

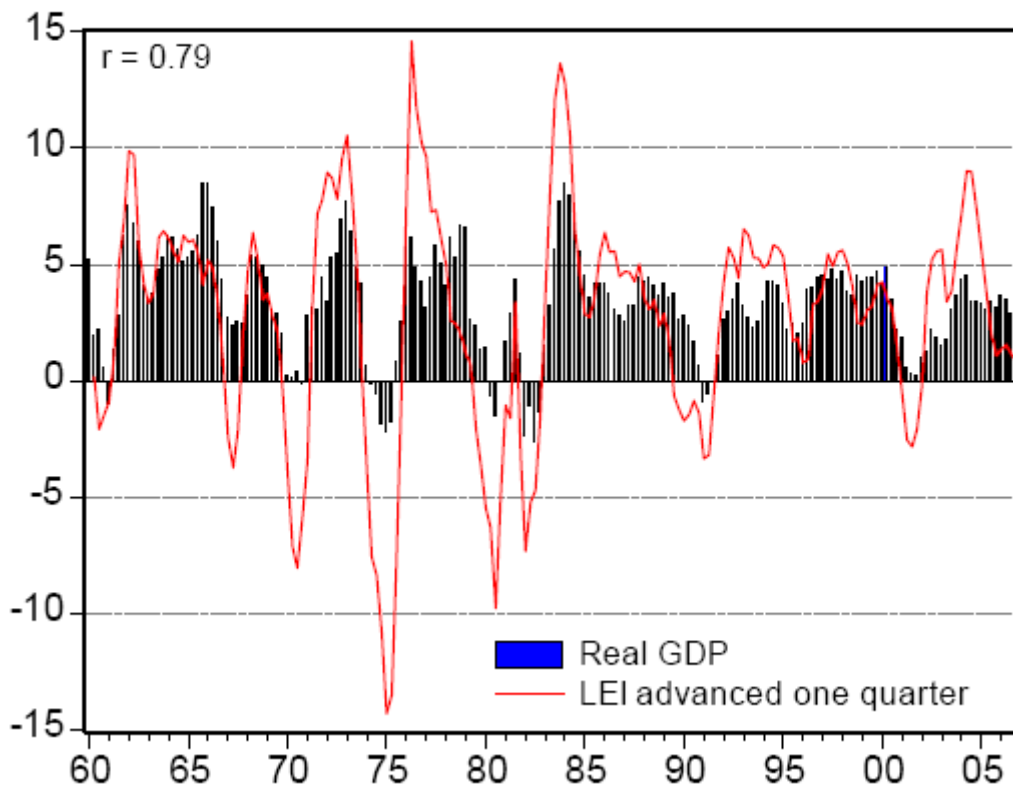


Chart taken from www.northerntrust.com