Barrington Research Associates, Inc.

Economic Analysis • Equity Research • Investment Banking

STATISTICAL ECONOMIC REVIEW
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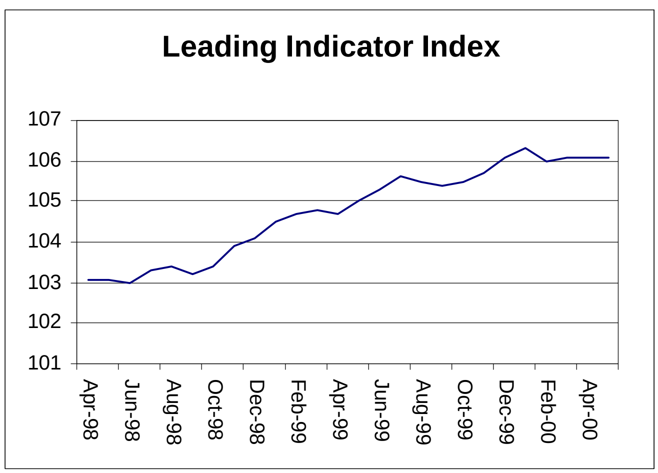
Economy Bending, But Not Breaking

Economic indicators over the past month have continued to demonstrate a picture of moderating economic growth. But, as we've warned in other publications, the slowdown is not so pronounced or conclusively sustainable that investors will continue to be nervous right up to the August 22 Fed meeting. A sustained market rally with increased speculative trading could reverse the, as yet, only tenuous decline in consumer confidence and convince the Fed that another rate hike is prudent. Though we may have concerns about a hard landing as growth slows, we believe the Fed will be successful in engineering a soft landing. It started early enough in fighting inflation and we do not have the inflationary distortions that preceded past recessions. **Inventories**, another source of steeper downturns in the past, are also under good control. They did jump a greater than expected 0.9% in May, but it was primarily due to a build-up of stocks at retail, which is understandable in light of the slowdown in consumer spending. The inventory/sales ratio, however, was still at 1.32, only modestly above the 10-year low of 1.31 in March.

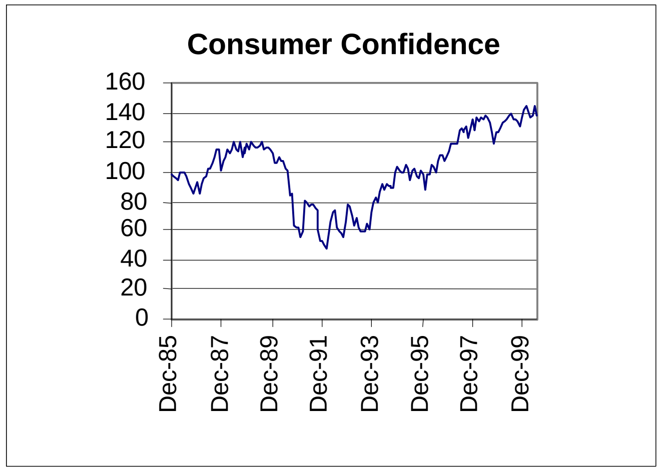
Leading Indicators

The government's composite index of **leading indicators,** for example, declined 0.1% in May, compared to consensus expectations of a 0.3% drop. Despite the better than expected report, the string of weak leading indicator reports—unchanged, up 0.1% and down 0.3% in April, March and February, respectively—indicates a definite loss in economic momentum and slower GDP growth in the second half. Over the past six months, through May, the composite index rose only 0.3% and only six of the ten components were higher.

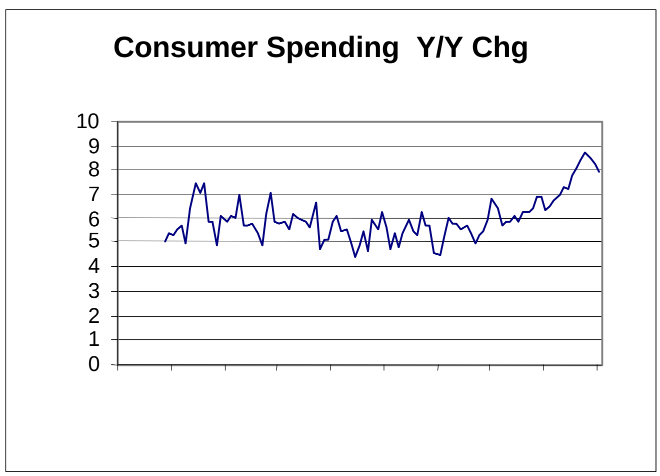


The index of **coincident indicators** rose 0.2%, from advances of 0.4% and 0.3% in March in April, respectively, indicating a slowing of current economic activity, as well. All three of the components were higher—payroll employment, industrial production and personal income, less transfer payments—so economic growth in the second quarter should remain fairly healthy, though we expect less than a 4.0% GDP increase. The composite index has also been decelerating over the past few months. **Lagging indicators** rose 0.2% in May, down from a revised 0.5% gain in April and have been in an accelerating trend lately, indicating rising business costs that should negatively impact second quarter earnings reports for many companies. The **coincident/lagging ratio**, an alternative leading indicator, was unchanged in May at 110.2.

Consumer Cautious, But Still Spending



If the Fed meant to scare consumers, it has not been very effective, judging by measured confidence levels anyway. The Conference Board reported that its consumer confidence index did slip in June to 138.8, but that followed the surprisingly big jump in May to 144.7, matching the all-time high in January of this year. According to the survey, more consumers are expecting the number of jobs to moderate and fewer said they would be buying new cars and homes. This report was consistent with the University of Michigan consumer sentiment index, which also showed a modest decline to 106.4 in June, but the preliminary report for July showed a stronger than expected rebound to 108. Its expectations index jumped to 103.9 in July from 100.8 in June, indicating that consumers are not very worried about the economy. So, the level of confidence remains very high historically. Certainly the weakness so far has not been enough to signal a substantial decline in economic growth. More than half of consumers still believe that jobs are plentiful and 88% believe that conditions over the next six months will not deteriorate much. As a consequence, retail sales have been stronger than expected recently and auto sales have been rebounding.



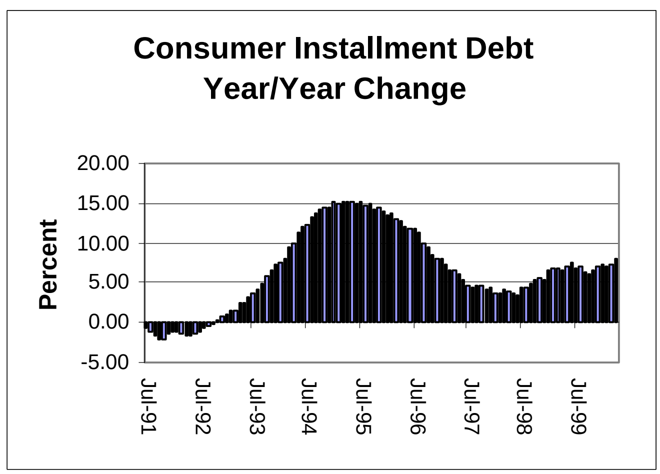
Consumer Spending

Personal income and spending growth both moderated in May, while savings increased, but in light of more recent data, the trends could reverse. **Personal income** increased 0.4%, down from a downwardly-revised 0.6% gain in April, and after-tax **disposable personal income** (DPI) moderated a little less to a 0.4% gain from 0.5%. **Personal consumption** remained at the lower 0.2% increase in both April and May, both on a reported and inflation-adjusted basis. Consequently, the **personal saving rate** (personal saving as a percentage of DPI) rose to 0.6% from 0.4% in April, continuing its slow improvement over the past few months. It is still extremely low, however, by historical standards.

Personal income growth was also not as healthy as it appeared on the surface. Private wage and salary disbursements actually decreased by $4.5 billion in May, compared to a gain of $33.6 billion in April. There were declines in both the goods-producing industries and distributive industries. Service industries payrolls increased, but by considerably less than in April. The gains were in government disbursements, mostly reflecting the hiring of temporary census workers, and transfer payments, which increased $22.5 billion compared to an increase of only $2.0 billion in the previous month. So, private sector income growth significantly slowed and that is affecting spending. The relatively flat stock market so far this year is also having a negative wealth effect impact on spending.

June Retail Sales Above Expectations

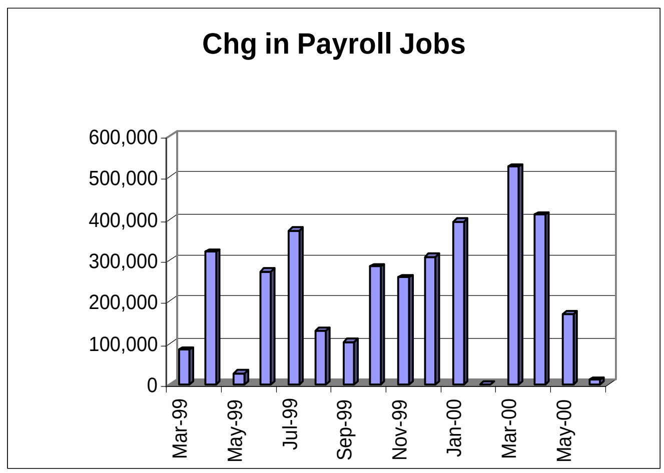
Retail sales rose a better than expected 0.5% in June, up from a sharp upwardly-revised 0.3% gain in May (from a previous 0.3% decline) and indicating that the 0.5% April decline might have been a fluke. A substantial part of the June increase was due to a strong 1.7% increase in sales by auto dealers, rebounding from a 0.5% decline in May. Excluding auto dealers, retail sales were up 0.2%, which was below expectations. Nevertheless, spending on big-ticket durables like autos has been one of Greenspan's concerns. Despite rising interest rates and the fact that large durable purchases are usually financed, consumers are obviously ignoring rising rates and continuing to spend on **durables,** which rose 0.7% in June. Spending on furniture and household furnishings did decline 0.3% in June and spending on building materials fell 1.6%, both reflecting the lagged effect of earlier declines in home purchases. Should housing activity also rebound, however, we may see a renewed upturn in these categories. Reflecting this strength in durable spending, **consumer installment debt** exceeded expectations in the most recent May report, rising by $11.8 billion, or 0.8%, from April's $9.3 billion gain. Consumer debt is also running 8% above year ago levels, despite the continued rise in interest rates.



Spending on **nondurable** goods also rose 0.4% in June, with gains in a number of retail categories. Sales were up 0.3% for general merchandise stores, up 0.6% at food stores, 1.3% higher at service stations (reflecting higher gasoline prices) and up 0.6% at restaurants and bars. They were down 0.8% at drugstores, but that category had a healthy 2.4% jump in May. Sales were off 0.9% at apparel & accessories stores. Earlier reported sales at **chain stores** were up 3.4% from a year ago, which suggested that retail spending was slowing. Growth in the index was also the slowest in almost three years, excluding those around the Easter period, a figure, which is frequently distorted because of calendar differences. This retail sales report indicates that consumers are still spending in the face of the Fed's tightening policy. We believe that overall consumer spending is slowing but obviously not a fast as many economists had expected.

Employment Growth Slowing

Employment data has been confusing over the past few months because of seasonal adjustment factors and the federal government's use of temporary census workers. But, in line with other statistics, employment growth *is* slowing. Total **non-farm payroll jobs** were little changed in June, growing by only 11,000, but that was after the government laid off 190,000 temporary census workers. Private sector jobs increased by 206,000 in June, following a revised decline of 165,000 in May, which was in turn, distorted by inadequate seasonal adjustment factors. The private sector job category is obviously the one to focus on and the 206,000 gain was before consensus forecasts of between 245,000 to 275,000. During the second quarter, private sector jobs averaged 110,000 per month, which was well below the average of 244,000 for the first quarter. For the full year to date, private sector payroll job gains averaged 177,000, compared to an average of 202,000 for all of 1999. So, job growth is slowing and that is consistent with the expected lower GDP growth in the second quarter relative to the first.



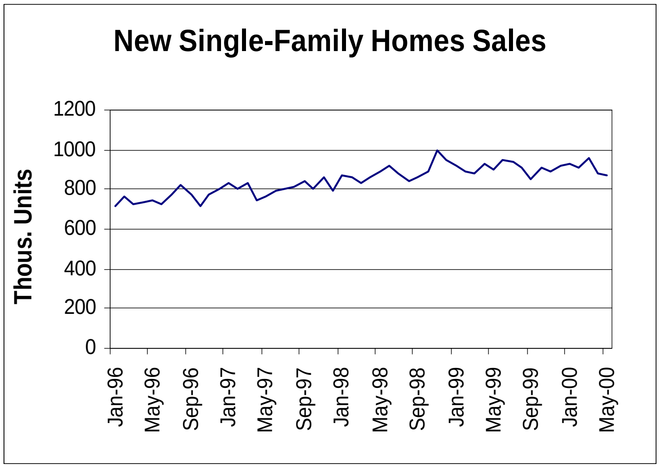
Looking at other employment related data, the **unemployment rate** declined to 4.0% from 4.1% in May, which was in line with expectations. **Average weekly earnings** rose by 5 cents to $13.71, or up 0.4% from May, and 3.6% from a year ago. Part of that gain was the result of higher **overtime hours,** which rose to 4.6 hours from 4.5 hours, and a higher **average workweek,** which rose to 34.5 hours from 34.4 hours. The average workweek in manufacturing also rose to 41.6 hours from 41.4 hours. With higher hours and wages, **average weekly earnings** also rose by $3.10 to $473.00.

Payroll jobs in the **service** sector increased by 148,000, after only a 17,000 increase in May. **Retail** trades also added 49,000 in June, led by a 35,000 increase in restaurants and bars. These two sectors comprised most of the gain in private sector jobs. In the **goods producing** sector, there was little change in manufacturing. There was a 14,000 gain in durable goods jobs, mostly in electronics and fabricated metals, partially offset by a 6,000 decline in nondurable goods. Construction employment was unchanged and mining employment edged up.

Housing Activity

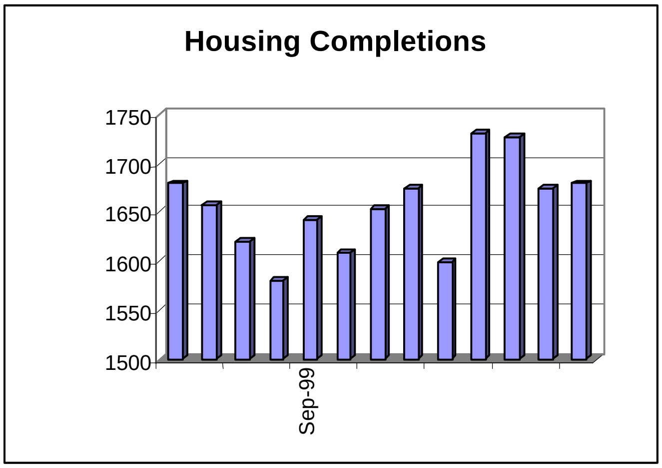
Housing reports were somewhat mixed and volatile over the past month or so, but primarily on the weak side. Sales of new homes were down, but those for used homes were higher than expected. Housing starts were down and completions were slow.

New Home Sales: Sales of new single-family homes fell 0.2% in May to an 875,000 annual rate. Geographically, the report was mixed. It was led by gains in the Midwest (+7.4%) and South (+3.1%), while sales fell 3.0% in the West and by a whopping 24.4% in the Northeast. Sales for the first five months of the year were up a modest 0.7%, but have remained at a fairly high historical level. In spite of the modest decline, we suspect new home sales will be higher in the next report, reflecting the higher sales in existing homes and a recent decline from the previous peaks in mortgage rates. The prices of new homes have also remained fairly firm, rising 4% in May from a year ago, which does not indicate a serious weakening in demand. The inventory of unsold new single-family homes is still at a reasonable 4.5 months.



Existing Home Sales: Sales of used homes surprised the experts with a 4.3% increase in May to a 5.09 million annual rate. This was well above the consensus forecast of a 2.2% increase. May's rate was only modestly below March's 5.2 million high for the year and was not much different from the average monthly gains during the record 1999 period. The inventory of unsold homes is also around last year's 1.5 million monthly average and represents a 3.6 month supply, even lower than in 1999. Prices of homes are also still rising.

Housing Completions: Privately owned housing completions declined in May to a 1,680,000 annual rate, essentially unchanged from April (+0.3%) and from a year ago. They were off significantly in the Northeast (-13.0%) and the West (-13.2%), with weakness offset by a big 15.8% increase in the Midwest, rebounding from a sharp 17.4% drop in April. Completions were up a modest 3.9% in the South. This is consistent with the government's broader report on total construction put into place, which increased 0.3% in May.



Within that report, spending on residential construction fell 0.4%, with both single-family and multi-family construction lower. Housing starts also declined 3.9% in May, with the important single-family starts off 5.4%. Building permits, a good leading indicator for starts, and therefore completions also fell 4.3% in May for the fourth consecutive monthly decline. So, we don't expect very exciting news regarding housing completions over the summer.

BARRINGTON RESEARCH

July 19, 2000

Statistical Summary

INDICATORS:		MAR/99	APR/99	MAY/99	JUNE/99	JULY/99	AUG/99	SEP/99	OCT/99	NOV/99	DEC/99	JAN/00	FEB/00	MAR/00	APR/00	MAY/00	JUNE/00
General																	
Leading Index	% AR	0.1	-0.1	0.3	0.3	0.3	-0.1	-0.1	0.1	0.2	0.4	0.2	-0.3	0.1	0.0	-0.1	--
Coincident Index	% AR	0.3	0.0	0.3	0.5	0.3	0.2	-0.1	0.5	0.4	0.3	0.4	0.1	0.4	0.3	0.2	--
Lagging Index	% AR	0.1	0.3	-0.1	-0.4	0.5	0.1	0.2	-0.1	0.1	0.3	0.1	0.5	0.0	0.5	0.2	--
Ratio: Coincident/Lagging		114.5	114.2	114.7	115.7	109.0	109.1	108.8	109.5	109.8	109.8	110.3	109.9	110.1	110.2	110.2	--
Mfg & Trade Inventories	% Chg	0.5	0.2	0.3	0.3	0.3	0.3	0.4	0.3	1.0	0.5	0.6	0.5	0.3	0.4	0.8	--
Inventory/Sales Ratio		1.35	1.36	1.35	1.34	1.34	1.33	1.34	1.33	1.33	1.32	1.32	1.32	1.31	1.32	1.32	--
Consumer																	
Retail Sales	% AR	0.0	0.6	1.0	-0.1	1.0	1.3	0.0	0.3	1.3	1.7	0.7	0.6	0.4	-0.5	0.3	0.5
New Home Sales	(000)	885	952	914	932	929	912	848	906	895	916	927	905	959	827	875.0	--
Existing Home Sales	(000)	5420	5250	5000	5630	5400	5240	5130	4880	5150	5140	4450	4760	5200	4880	5090	--
Savings Rate	% of DPI	-1.0	2.6	2.4	2.6	2.5	2.3	1.5	2.3	2.0	1.0	1.4	0.3	0.4	0.4	0.6	--
Personal Income	% AR	0.3	0.4	0.4	0.8	0.3	0.4	0.1	1.2	0.4	0.3	0.7	0.5	0.7	0.6	0.4	--
Disposable Income	% AR	0.4	0.4	0.3	0.8	0.2	0.6	-0.2	1.3	0.4	0.2	0.4	0.4	0.7	0.5	0.4	--
Real Disposable Income	% AR	0.3	-0.2	0.3	0.8	0.0	0.4	-0.5	1.1	0.3	0.0	0.2	0.0	0.3	0.4	0.4	--
Consumer Spending	% AR	0.6	0.6	0.5	0.5	0.4	0.8	0.5	0.5	0.8	1.1	0.7	1.2	0.7	0.2	0.2	--
Real Consumer Spending	% AR	0.5	0.0	0.6	0.5	0.2	0.6	0.2	0.3	0.7	0.9	0.5	0.8	0.2	0.2	0.2	--
Consumer Installment Debt	chg Bil $	7.4	1.6	9.9	5.1	7.6	8.4	1.8	5.3	11.1	10.9	15.7	9.4	10.7	8.8	11.8	--
Housing Starts	% AR	-0.1	-10.1	5.6	-5.3	9.1	-2.8	-1.7	0.5	1.6	6.4	-1.4	4.5	-10.5	1.6	-3.9	--
Housing Permits	% AR	-4.8	-5.0	1.2	3.1	0.0	-1.3	-7.0	5.8	2.6	3.0	4.7	-5.7	-3.8	-2.4	-4.3	--
Consumer Confidence	Conf Board	134.0	135.5	137.7	139.0	136.2	136.0	134.2	130.5	137.0	141.7	144.7	140.8	137.1	137.7	144.7	138.8
Consumer Expectations	U of M	99.0	97.4	97.6	99.8	99.2	98.4	101.5	97.1	101.0	101.1	108.6	107.8	101.7	103.7	104.8	100.8
Consumer Sentiment	U of M	105.7	104.6	106.8	107.3	106.0	104.5	107.2	103.2	107.2	105.4	112.0	111.3	107.1	109.2	110.7	106.4
Index Help Wanted	1967=100	88	87	89	85	85	87	83	86	85	86	90	90	88	89	83	--
Civ. Unemployment Rate	% AR	4.2	4.3	4.2	4.3	4.3	4.2	4.2	4.1	4.1	4.1	4.0	4.1	4.1	3.9	4.1	4.0
Payroll Jobs	Chg. (,000)	83	321	28	281	373	129	103	284	257	309	394	95	527	410	171	11.0
Fixed Rate Mortgages	%	7.04	6.92	7.15	7.55	7.63	7.94	7.82	7.85	7.74	7.91	8.21	8.33	8.24	8.15	8.52	8.3

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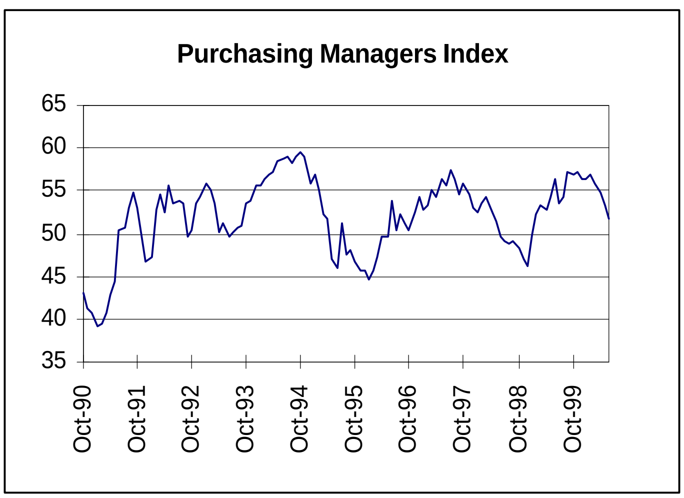
Industrial																	
Purchasing Agent Survey	%	46.3	49.9	52.1	53.3	52.7	54.4	57.3	56.9	57.1	56.8	56.3	56.9	55.8	54.9	53.2	51.8
Industrial Production	% AR	0.7	0.3	0.2	0.2	0.6	0.3	0.2	0.7	0.3	0.5	0.7	0.2	0.6	0.8	0.5	0.2
Factory Workweek	Hours	41.5	41.6	41.7	41.8	41.9	41.8	41.8	41.8	41.6	41.7	41.7	41.8	41.7	42.2	41.4	41.6
Factory Overtime	Hours	4.5	4.3	4.5	4.7	4.7	4.7	4.7	4.6	4.7	4.7	4.7	4.8	4.6	4.9	4.5	4.6
Capacity Utilization	%	80.5	80.5	80.4	80.3	80.6	80.7	80.6	81.0	80.9	81.1	81.4	81.8	81.8	82.1	82.2	82.1
Capacity Utilization Mfg.	%	79.5	79.6	79.6	79.3	79.5	79.7	79.7	80.2	80.3	80.3	80.7	80.7	81.1	81.3	81.3	81.3
Unfilled Order Backlog	% AR	0.2	(0.5)	(0.6)	-0.7	0.3	0.5	0.4	0.1	0.1	2.2	0.8	0.7	1.4	-0.5	1.0	--
Factory Durable Orders	% AR	2.9	(2.4)	1.0	0.2	4.3	0.9	-1.5	0.0	1.2	6.5	-1.9	-1.7	4.2	-5.8	6.1	--
Labor Cost Per Unit of Output	1992=100	91.8	91.8	91.8	92.0	92.4	92.0	92.1	91.8	91.0	90.6	90.5	90.5	90.0	90.2	89.6	--
Factory Orders	% AR	1.9	(1.4)	1.0	0.8	2.5	1.3	-0.9	0.0	1.4	3.8	-1.2	0.0	2.7	-3.8	4.1	--
Capital Spending																	
Orders, Nondef Cap Goods	% AR	0.1	(1.5)	1.0	-3.9	8.0	2.5	-0.7	0.4	-3.4	2.4	4.0	-3.3	4.6	1.9	-1.6	--
Production, Bus. Equip.	1992=100, S	169.3	170.7	171.4	171.0	172.2	173.9	173.7	174.8	175.0	174.9	179.4	180.6	183.0	185.1	186.2	187.0
Mfg Equip Sales/Constr Exp.	Bil $ AR	783.6	795.2	795.6	783.6	802.7	815.6	787.0	803.7	793.2	810.0	836.6	830.8	846.2	867.0	--	--
Inflation																	
Consumer Price Index	% Chg	0.2	0.7	0.0	0.0	0.3	0.3	0.4	0.2	0.2	0.2	0.2	0.5	0.7	0.0	0.1	0.6
Producer Price, Final Goods	% Chg	0.4	0.5	0.1	0.1	0.2	0.6	0.8	0.0	0.1	0.1	0.1	1.1	0.9	-0.3	0.0	0.6
Producer Price, Intermediate	% Chg	0.3	0.7	0.3	0.3	0.7	0.5	0.5	0.2	0.2	0.3	0.5	0.9	0.9	-0.1	-0.1	0.9
Producer Price, Crude	% Chg	0.8	2.1	5.7	0.2	0.2	5.1	4.6	-2.4	5.2	-4.9	2.6	3.9	2.5	-2.5	3.2	5.8
Index of Sensitive Materials	1992=100	99.1	99.2	99.5	100.2	101.1	101.4	103.4	100.8	103.1	103.1	103.9	102.6	102.2	101.9	101.4	--
Spot Prices Raw Materials	1967=100	255.1	257.3	258.1	257.0	261.5	264.1	270.9	266.8	270.4	267.3	267.8	260.9	260.4	258.3	265.4	--
NAPM Price Index	%	43.2	49.9	52.2	53.5	54.7	59.8	67.6	67.6	66.6	68.3	72.6	74.1	79.8	76.0	65.8	61.8

Two-Tiered Industrial Sector Continues

Recent statistics on industrial activity continued the same trends that have been in place for some time. Overall activity is still showing good growth, though at a decelerating pace. Industrial production is still rising and factory orders showed a good rebound in the last report. Most of the growth, however, remains in the technology sector, while non-tech industrial activity is still not making much progress recovering from what was a very difficult year in 1999.

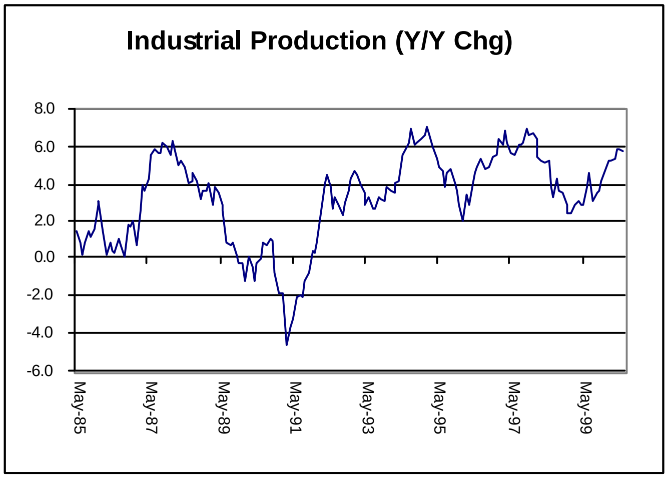
Purchasing Agent Activity Still Slowing

The purchasing managers' composite index of 51.8% indicated continued growth in the manufacturing sector in June, but at a decelerating rate. The index has fallen in each of the last four months since the 56.9% reading in February. The June reading was the lowest since January 1999 and if the June number were the monthly average for the full year, it would translate to a 3.4% increase in the GDP for 2000. All the sub-indexes associated with production showed the same moderating growth trend. The **production** index itself (53.6% vs. 56.3%) fell 2.7 points in June, also continuing a several month downturn. Aside from tobacco, electronic components and equipment had the higher rate of production growth. The **new orders** index had a similar moderating trend, falling to 50.6% in June, from 51.1% in May, and down significantly from 56.9% in March. The **backlog of orders** index rounded out the bad news, failing to grow for the second straight month. The index was 48.5% and 49.0% in June and May, respectively, with the decline being fairly broad-based. Of the 90% of respondents, 51% reported no change in backlogs and 26% reported lower backlogs. **Supplier deliveries** continued to slow, but did not change much (55.1% vs. 55.0%), and like the falling backlogs, indicated that manufacturers are catching up with slowing orders. We suspect both measures are being unduly influenced by the strong electronics area, which, if excluded, would show much lower industrial activity.



Inventories were still being liquidated in June (47.4% vs. 47.1%), but at a much slower pace. The **employment** index fell in June (50.8% vs. 54.1%), indicating slower growth in manufacturing jobs, but the index remained consistent with modest growth in the government's factory payroll report. Unfortunately, manufacturers were still paying higher prices in June, with the **price** index at 61.8%. The advance in prices, however, has been slowing for the past three months, with index readings of 79.8%, 76.0% and 65.8% in March, April and May, respectively. The index would have to remain under 46.3% over time to be consistent with actually falling prices. So, second quarter corporate earnings will still be negatively impacted by year-over-year material cost comparisons. The international trade sector was still perverse for manufacturers in June. New **export orders** rose at a slower rate (53.2% vs. 56.3%) in June from May and **import orders** growth accelerated to 56.0% from 54.7% in May. Put it all together and the report definitely depicted slower industrial growth.

Industrial Production Higher in June



The Industrial Output Index rose 0.2% in June, which was right in line with consensus forecasts. Reports for May (+0.5% vs. +0.4%) and April (+0.8% vs. +0.7%) were both revised higher. The index rose at a 7.0% annual rate for the full second quarter, up from a 6.5% rate in the first quarter. **Manufacturing** output rose 0.3% with a 0.7% gain in durable manufacturing offsetting a 0.2% drop in nondurable manufacturing. **Mining** output rose 1.1% in June, more than offsetting a 0.2% decline in May. **Utilities** output fell 2.5%, reversing a 2.5% gain in May and a 3.6% increase in April. **Capacity utilization** was flat in June, falling modestly for the overall industry from 82.2% to 82.1% and remaining unchanged at 81.3% for manufacturing. Prior to June, manufacturing output had been averaging 0.6% monthly gains since the end of 1999 and has been up close to a 7.0% annual rate in the first two quarters in 2000. However, the two-tiered market has continued at factories. Most of the strength in manufacturing has come from high technology industries such as semiconductors, communications equipment, computers and other electronics components. Excluding these industries, manufacturing has been growing at an anemic 1.0% rate so far this year.

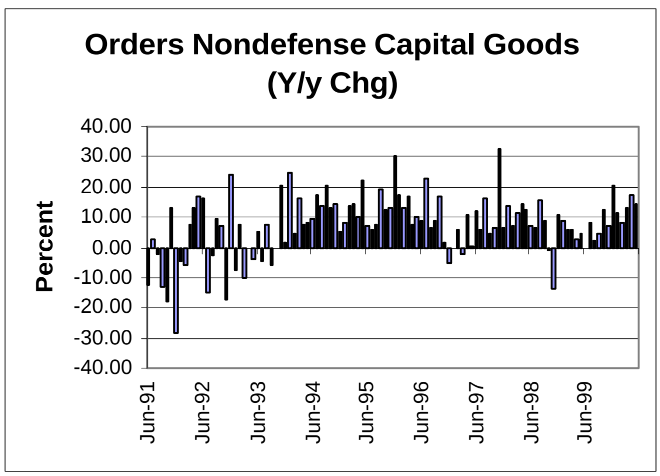
Looking at some of the major market groups, output of **consumer goods** was down 0.1% in June with a 0.5% gain in durable goods production more than offsetting a decline in nondurable consumer goods. The rise in consumer durables production resulted from a 1.7% jump in automotive products, which offset a 0.5% decline in other consumer durable goods, primarily those associated with housing activity such as furniture, appliances and carpeting. Output of **business equipment**, which had been averaging gains of around 1.2% in the first five months of the year, rose a slower 0.4% in June. Again, the category was driven by high technology equipment, which rose 1.3%, led by communications equipment and computers. But output of industrial equipment fell 0.4%, and transit equipment was also down due to weaker truck and commercial aircraft. Output of **construction supplies** fell 1.0% in June, following a 0.9% decline in May. Declines were fairly widespread in both months, reflecting slower construction activity, especially in residential. While domestic demand may be slowing, export demand has continued to grow, especially in technology, to make up for the shortfall.

Factory Orders Rose in May

Orders for manufactured goods jumped 4.1% in May, more than reversing the 3.8% decline in April and generally in line with expectations. Total **shipments** also rose 1.9%, following the 1.2% April decline, and **unfilled order backlogs** rose 1.0% from the 0.5% decline in the previous month. The **orders-to-shipments ratio** declined to 2.56% from 2.58% in April and **inventories** rose 0.2%, half the 0.4% April increase. So, what looked like the start of a sharp slowdown in the manufacturing sector a month earlier appears to have reversed. Nevertheless, the non-technology manufacturing sector is still fairly sluggish. Orders for **durable goods** rose 6.1% in May, more than reversing the 5.8% decline in April. Shipments were also 2.2% higher and backlogs were up 1.0%. **Electronics & other electrical equipment** jumped 26.4%, led by components. It was the biggest gain since August 1997. Shipments (+2.6%) and unfilled orders (+7.2%) were both strong for this sector, as well. Consistent with these trends, the semiconductor industry and individual companies have been reporting extremely strong sales gains with no signs of slowing yet in sight.

Transportation equipment was also higher, with orders (+3.3%) and shipments (+6.4%) both up significantly. The **instruments** sector saw both orders (+5.6%) and shipments (+2.6%) higher. Orders for **primary metals**, a good broad indicator of manufacturing activity, were up 1.1%, with shipments 0.9% higher. Only the **industrial machinery & equipment** segment was weak, with orders unchanged and shipments down 1.2%. **Nondurable** orders were also up 1.7%, with shipments 1.5% higher. Inventories, as mentioned, were up only modestly and the **inventory-to-shipments** ratio fell to 1.26 from 1.28.

Capital Spending Trends



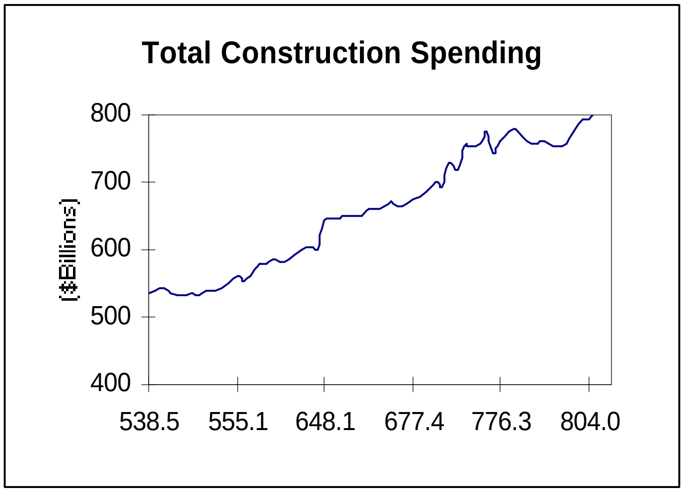
There still does not seem to be much, if any, slowdown in capital spending by business to reduce costs, substitute capital for labor and improve productivity. With aggressive global competition and the inability to pass higher material and labor costs forward, there is no reason to expect lower capital spending short of a significant global economic downturn.

These spending trends are not always clearly discernible since such a large proportion of the expenditures are for technology, both hardware and software. This spending is sometimes masked by less aggressive spending on traditional industrial equipment and for new manufacturing techniques that are not accurately measured by government statistics on capital spending. Volatile defense spending also frequently distorts overall capital spending numbers.

In the last factory orders report, defense orders jumped 11.7% in May after declining 12.7% and 6.2% in April and March. Shipments (-1.2%) and unfilled orders (-0.1%) were also down in May. Nondefense capital spending orders were off 1.6%, but that followed gains of 1.9% and 4.9% in April and March. Shipments also continued strong, gaining 3.0% in May. Business capital spending, as measured in the report, continued at healthy levels, particularly in the technology sector. PC orders were strong in both April and May, but outside of technology, spending on industrial equipment was mixed.

Spending on Structures

While residential construction activity is being negatively impacted by the Fed's tighter monetary policy, business spending on structures has remained fairly healthy. The total value of new construction put into place and completed in May rose only a modest 0.1% to $809.3 billion, but that was well over the 0.3% decline expected and up 7.0% from a year ago. Spending was also up 6% for the full five months of 2000, still fairly healthy in view of steadily rising interest rates. Total private spending on **residential** units was down 0.4% in May. However, business spending on private **nonresidential** construction was strong, with a 3.5% overall gain of $255.9 billion. This was led by particularly strong industrial construction, which rose 10.4% in May to $42.5 billion for the fourth consecutive monthly gain. The gain in this area was also fairly widespread. Hotel & motel (+1.7%), other commercial construction (+2.5%), educational (+8.5%), hospital & institutions (+5.6%) and misc. buildings (+9.8%) categories all showed increases. Spending on warehouses has also remained strong, reflecting the growing influence of e-commerce. Office building completions were lower, but that followed several months of strong gains and new office starts are on the rise again.

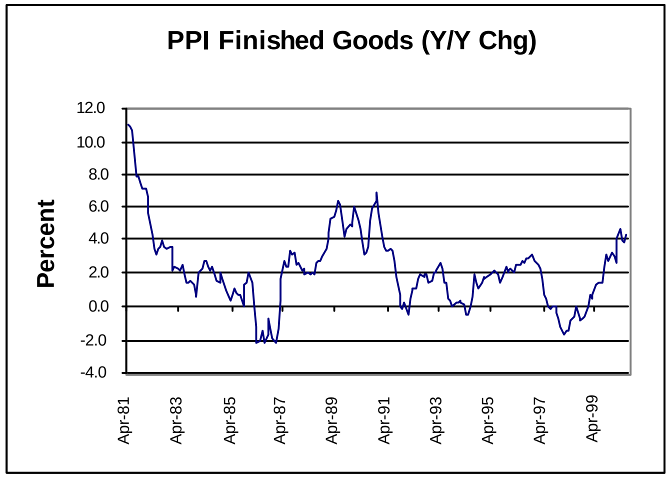


The value of overall **new construction contracts** also fell by 3% in May, with demand lower for both residential and nonresidential building. The Dodge Index of construction contracting was at 173 in May, down from 177 in April. **Residential building** contracts fell 3% to $198.7 billion, with single-family housing up 1%, but multifamily housing contracts were down 20%. **Nonresidential building** contracting fell 8% to $150.3 billion, with large drops in shopping centers and stores (-15%) and office buildings (-14%). Hotel construction, however, jumped 50% with several large projects. So, looking forward, we may see some slowdown in business spending on structures with business confidence in future economic growth slipping, as indicated in recent surveys.

Inflation Trends

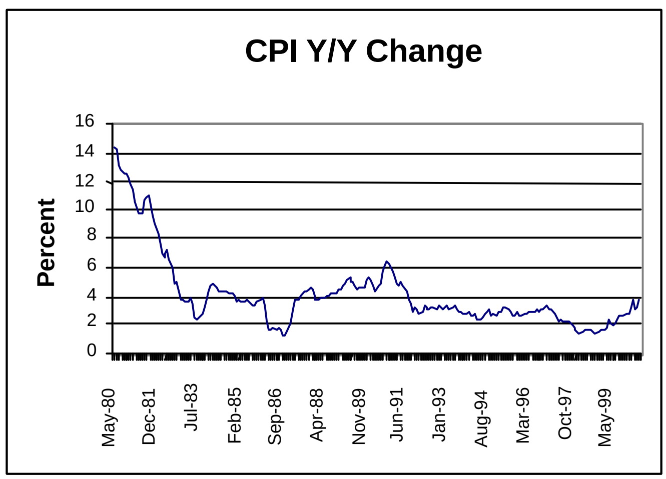
There has not been much change in the inflation picture. Employment growth has moderated somewhat, but the labor situation is still fairly tight. Material costs to business have moderated somewhat recently, but are still fairly high at crude and intermediate levels and putting pressure on margins. Fed policy has made it difficult to pass the costs along, but fortunately, as discussed above, capital spending to improve productivity has helped to maintain corporate profits. Reported consumer and producer prices are working higher due to rising energy costs and, even though the investor focus has been on the more moderate core rate growth, the higher energy costs will eventually add to the core rate, as well.

Producer Prices: The June Producer Price Index for **finished goods** rose 0.6%, accelerating from no change in May and a 0.3% decline in April. The June rise essentially reflected a 5.1% jump in finished energy goods prices (up from a 0.5% decline in May). Food prices fell 0.3% in June. The core rate, excluding food and energy, actually fell 0.1%. For the entire first half, finished goods prices rose at a 4.8% annual rate, up from a 3.8% gain in the second half of 1999. The core rate was up 1.0% in the first half, down from a 1.7% increase in the second half of 1999.



June prices for **intermediate goods** also showed a substantial 0.9% jump over May, when they declined 0.1%. But most of that increase was also related to energy prices that jumped 4.7% in June after a 1.4% drop in May. Food prices also rose 0.4% in June on top of a 0.7% rise in May. Core intermediate prices were up 0.2%, accelerating from a 0.1% gain in May. On a year-over-year basis, they were up 5.4% in June, the fifth consecutive month in which they were up 5% or more from a year earlier. Prices for **crude goods** were up 5.8% in June and 3.2% in May, mostly due to increases in crude energy materials of 16.2% and 9.9% in June and May, respectively. The overall index was also up, despite declines in crude food prices of 2.6% in June and 1.8% in May. The core rate (-1.3%) was down for the fourth straight month.

Consumer Prices: The CPI rose 0.6% in June, slightly higher than a 0.5% consensus forecast. As with producer prices, most of the gain was due to a 5.6% jump in the energy components reversing a 1.9% decline in May. The index for petroleum-based energy was up 8.1%. This was partially offset by a smaller 0.1% increase in food prices, which had increased 0.5% in May. The core rate (excluding energy and food), which investors have been focusing on, rose 0.2% for the third consecutive month. The other strong CPI component was transportation (+1.8%). More than 90% of the increase, however, was due to the sharp rise in gasoline prices. Public transportation prices rose 1.0%, led by a 1.5% increase in airline fares, which have increased at an 18.7% annual rate so far this year. This is one example of how the persistently high oil prices will eventually trickle down into the core CPI. In the six months through June, reported CPI has increased at a 4.2% annual rate, compared to a 2.7% rise for all of 1999. The core rate in the first half of 2000 rose at a 2.4% annual rate, also up from a 1.9% rate for all of 1999.



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