

## Philadelphia Fed: Trend shift?

The headline Philadelphia Fed index unexpectedly declines 14.6 points (Consensus: +1.5 points; Decision Economics: +6.0 points), to a barely positive 3.9 reading--corresponding to a flat month for manufacturing.

This brought the total decline over the last two months to 39.5 points--but from a March level of 43.4, the highest seen since the early 1980s, and in a range even approached only twice since then. In a way, the breadth of increasing optimism seen in March could not be improved upon, or even sustained.

Still, some less-flightly activity indexes included in the report showed serious deterioration too, with the orders index down 13.4 points from April, and off 34.9 from the ultra-high 43.4 March reading. The shipments index fell 22.6 points from April, to 6.5, and 28.4 points from March.

Meanwhile, the employment index--giving some indication on decisionmaker confidence in the outlook--rose 9.8 points from April, to 22.1, and 3.9 points from March.

Obviously, there was a great flattening out of optimism over the last two months, with significant basis in a flattening out of demand. Companies adjusted production growth very quickly to the new demand path--but apparently did not yet regard the shift as lasting, continuing to add to capacity by hiring workers.

The question is whether this marks a trend shift in the manufacturing outlook, and the jury remains out. Given the highly disruptive backdrop of earthquakes, floods, tornadoes, and oil prices, some damage to optimism was unavoidable--particularly from the sky-high March levels.

The real test will come next month--but, obviously, the momentum is in the wrong direction and most Fed officials will be disturbed. Implications for the more-credible national ISM are not mechanical, and it might still be the case that results there--smoothing out purely regional volatility--will be less threatening, putting concerns to rest. Comments from Philadelphia Fed President Plosser, an optimist on the economy, will be closely watched for.