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Index Shows Business-Investment Slide, Contradicting Positive Economic News

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A business-investment index suggests the economy might not be turning around quite as quickly as some economists are starting to believe.

Data on areas ranging from housing construction to Valentine's Day sales have proved surprisingly robust in recent weeks. **But business investment still is contracting sharply, according to G7 Group Inc., a New York economic- and political-consulting firm that created the index in late 2001.**

The company's business-investment index stood at minus-79 in February; any number less than minus-35 is indicative of contracting investment. Any number greater than zero represents an increase exceeding the long-term 5% growth trend as measured in the U.S. Commerce Department's national income accounts. The latest reading is a slight improvement from minus-85 for the final months of 2001, yet still indicative of very weak investment. With data from past years plugged in, the quarterly index shows readings below minus-60 only nine times from 1982 onward; on three of those occasions, actual business investment, as measured by the Commerce Department, contracted at a double-digit rate.

Business investment was a pivotal driver of the economy during the boom years of the late 1990s, as companies poured new money into computers and other high-technology equipment. This investment crashed last year and was a major reason for the recession that began last March. Many economists say they believe the economy won't regain solid footing until business investment recovers.

"I have been an optimist for the last few months, and this piece of information tempers that optimism," says Princeton University professor Alan Blinder, a former vice chairman of the Federal Reserve Board and one of creators of the latest index. Even though it is off of its lows, the index "is decidedly negative," he said.

Some economists have been arguing that business investment actually is starting to turn around. According to the Federal Reserve, production of business equipment rose in January for the first time since August 2000. Orders of high-tech gear have shown signs of gaining after collapsing last year. And the Institute for Supply Management's monthly factory index suggests that manufacturing has stopped contracting. "All of that is pointing in a positive direction," says John Lipsky, chief economist for J.P. Morgan Chase & Co.

The G7 Group index, which contradicts that, is compiled using figures on gross domestic product - the total value of goods and services produced in the U.S. -- and data from surveys by the National Association of Business Economics and the National Federation of Independent Business.

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