

## Ongoing Economic Expansion

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The regional PMI continued to remain above the 50 point mark indicating that the region's manufacturing sector and the overall economy continued to expand in May. The PMI retreated from the April high of 59.2 to 56.4. The pullback in the index was largely driven by a decline in new orders and inventory and a drop in commodity prices. The economic expansion remained in tact in May and the pace of growth remained roughly unchanged from April. May marked the ninth month since the beginning of the current expansion, and the sixth consecutive month of the regional PMI remaining above 50 points. However, signs of the beginning of leveling off in growth can be seen in weakening new orders and in the decreasing growth of the production index.

The production index remained roughly unchanged, with the seasonally adjusted measure increasing by merely 1.1 points to 62.9. More survey responders indicated same levels of production (31.2%) in May than in April (18.8%). The number of responders indicating higher levels of production continued to remain strong at 50% in May, although down from 56.2% in April.

The New Orders index fell sharply to 46.6 from 54.2 a month ago. 43.8% of responders reported lower new order activity, up from 31.2% in April. The inventory levels matched the drop in the new orders activity and our Inventory Index retreated from 55 to 46.6.

The Commodity Prices Index posted a 15.6 point drop in May as energy prices dropped on European growth concerns. The European debt crisis causes European governments to effectively reduce their fiscal stimulus programs, which in turn causes weaker economic growth. The possibility of a return to recession in Europe within the next 12 months is rapidly increasing. This, coupled together with a slowdown in growth of the Chinese economy, puts pressure on all commodities apart from the precious metals. In a way, this development will help the US economy with inflation this year and allow the rates to remain low without inflationary pressure. Much of inflationary pressure we saw in the past year was originating in commodity prices. The European slowdown will help maintain low interest rates in the US and continued money printing without a serious inflationary pressure for a while. This will actually help us with economic growth this year. But the outlook into 2011-2012 continues to remain pessimistic.

Now, with two-thirds of the second quarter completed, we can argue that the US economy and the economy of WNY continue to expand, but rather than seeing an accelerating growth tracing for us a V shaped recovery from the recession, we observe the beginning of a leveling off in growth, resembling a slow U shaped recovery. The lower commodity prices will offer a temporary support to the economy and provide the monetary authority with the means of maintaining low short-term rates without risking making the yield curve steep. But the level of economic expansion will continue to slow down into the second half of the year, although it will remain positive, as the probability of a double dip in 2010 remains very low. The job growth will remain insufficient to reduce the unemployment in any substantial amount, a development that will help reduce the economic growth. The USD/CAD exchange will likely remain a little under par, and

that will reduce the supportive economic boost from our Canadian shoppers. We will continue to see economic expansion in 2010, although at decreasing rates, but 2011 and 2012 will likely present greater challenges.

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