



A GLOBAL INSIGHT COMPANY

DBI•METV

The US Business Cycle and Telecoms

Presented to

ICFC Conference

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Presented by

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GLOBAL INSIGHT

Earlier Cycles (7)

Greenspan Cycles (2)

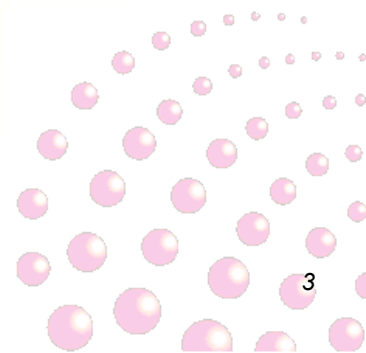
- ◆ **Policy miss: Inflation up. Fed funds way up but late.**
- ◆ **Inventory cycle lags**
- ◆ **Violent housing declines**
- ◆ **Strong Recoveries: 5-7% Real GDP Qtrs**
- ◆ **Most had double dips in GDP, but not on National Bureau basis**
- ◆ **Fed Rates peak early, and cuts start before recession**
- ◆ **Milder rate peaks, but other items add to slowdown**
- ◆ **Inventories lead- some output cuts before sales**
- ◆ **Stall speed slowdown tips into recession (accidents)**
- ◆ **Mild (no) housing cycle**
- ◆ **Milder, lagged recoveries (still above capacity)**

UNFAVORABLE

- ◆ Capital Goods Cycle
- ◆ Foreign Sector/Exports
- ◆ State and Local Govt Spending
- ◆ Profits
- ◆ Computer Demand
- ◆ Telecom Equipment
- ◆ Employment?

FAVORABLE

- ◆ Early, deep rate cuts
- ◆ Fed Govt; Size and timing of spending and tax cuts
- ◆ Inventories
- ◆ Housing
- ◆ Consumer/Autos



Real Side Indicator Turns Up

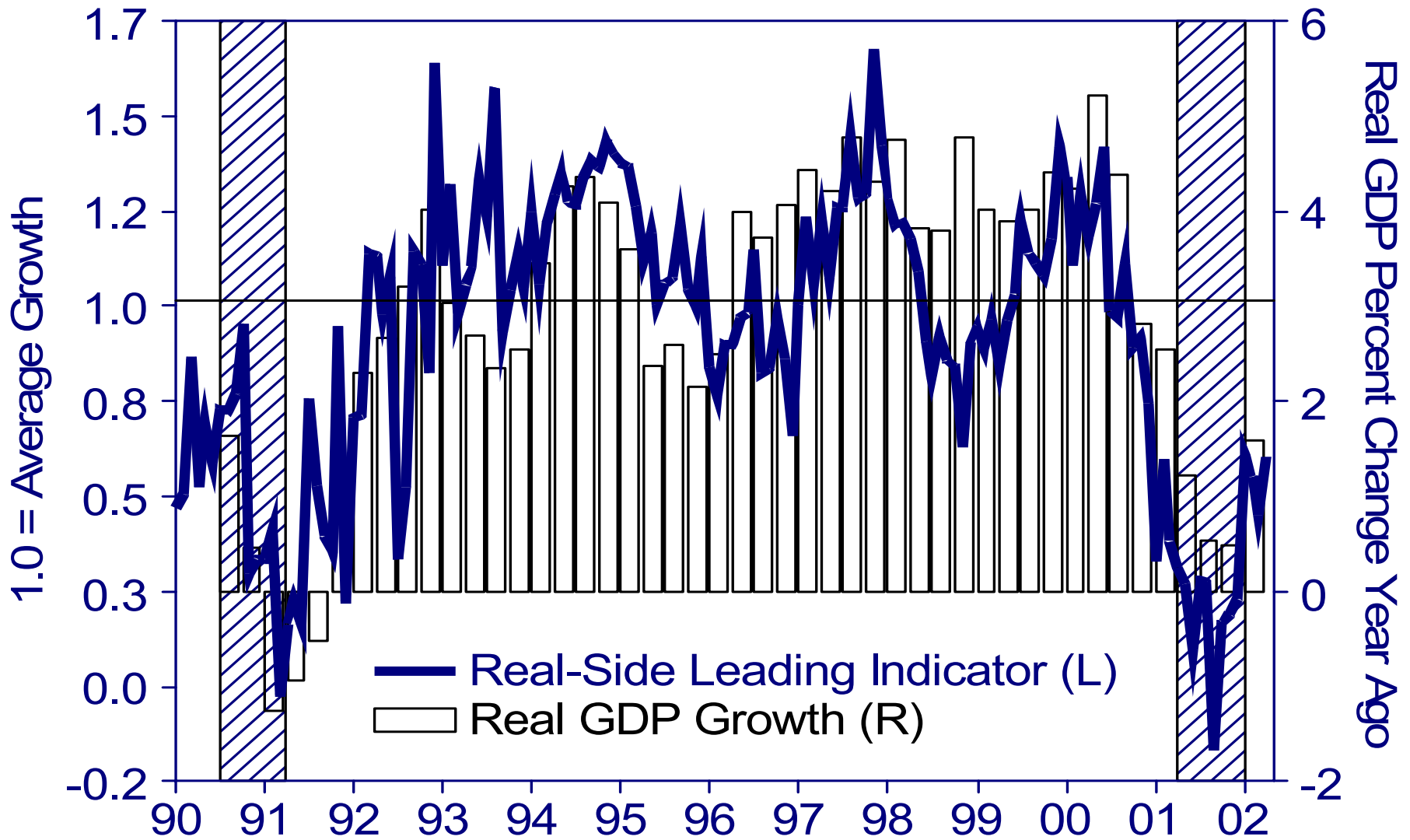
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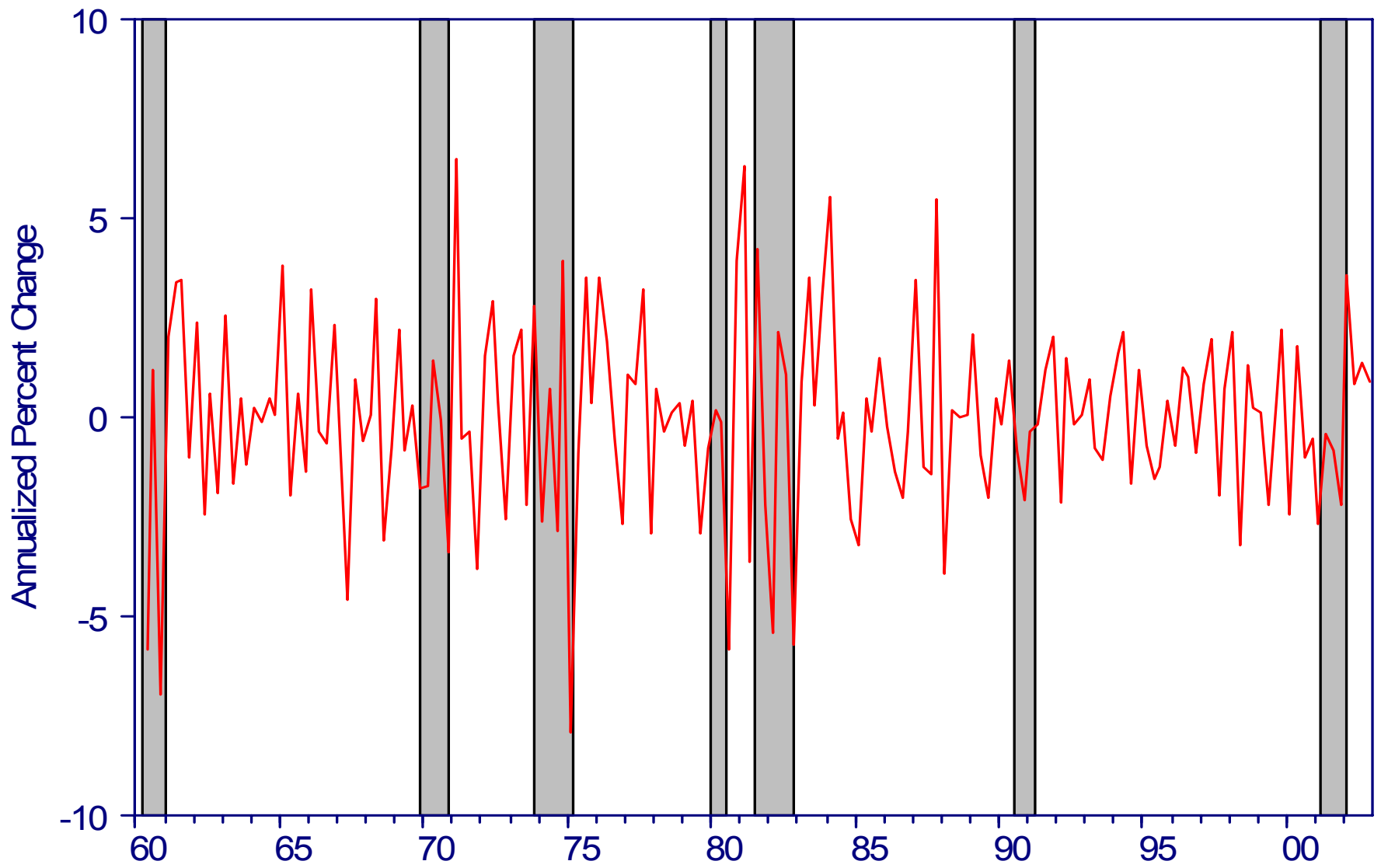
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Big Inventory Boost Now

(Real GDP contribution from inventories)

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Big in 2002

More in 2003

- ◆ Spending already on uptrend, pre Sep 11
- ◆ Discretionary outlays now up \$63 BIO FY 2002-9.0%
- ◆ Real Federal spending Ex Transfers up 7.5% calendar 2002
- ◆ 2002 tax cuts agreed last Yr.
- ◆ Recent stimulus package extended unemployment comp, accelerated depreciation

- ◆ Real spending up 4.6%
- ◆ \$38 billion more military
- ◆ Further phase-in of 10 yr tax cuts

Consumer Downturn Mild-- Recovery also mild

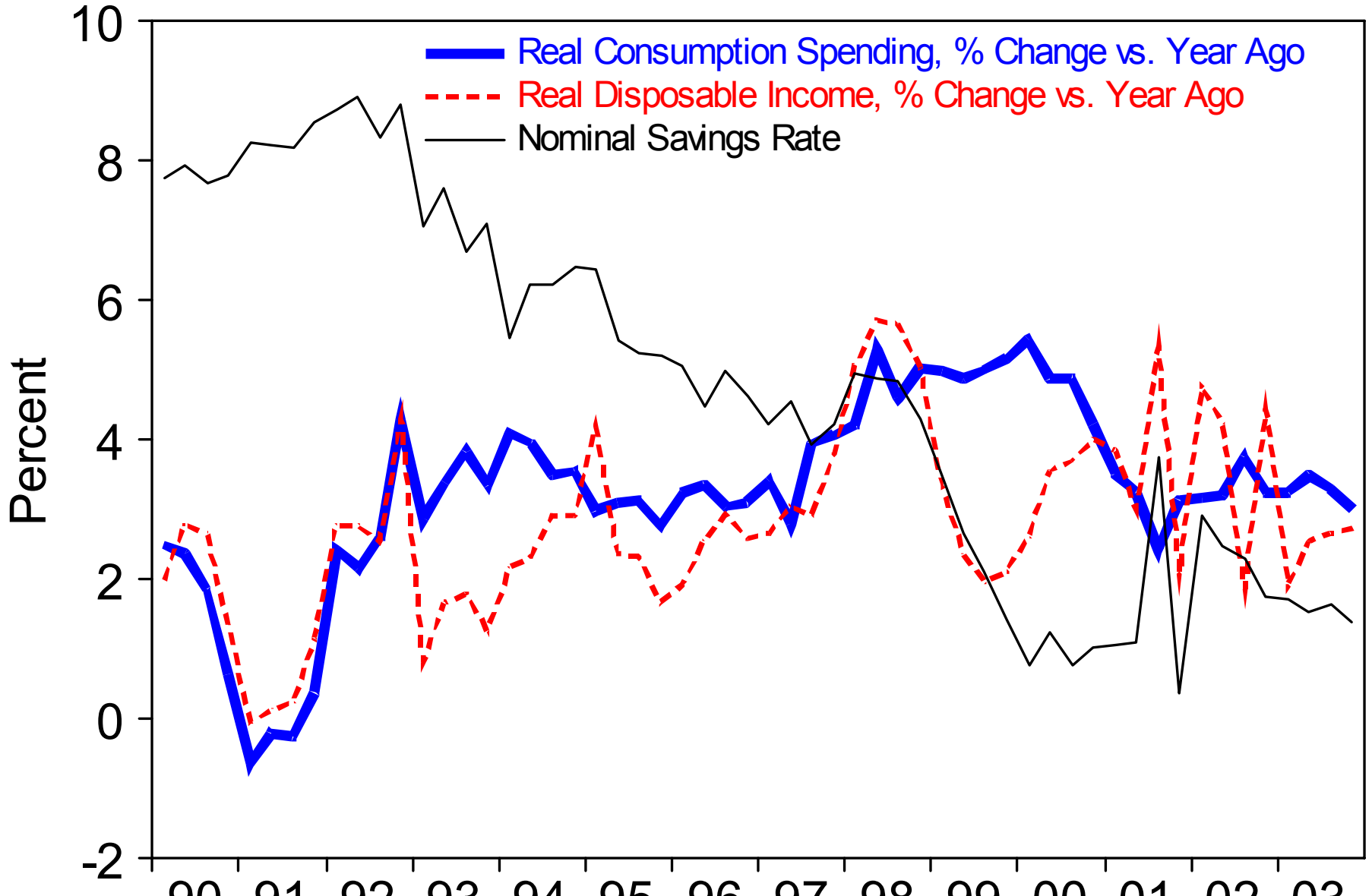
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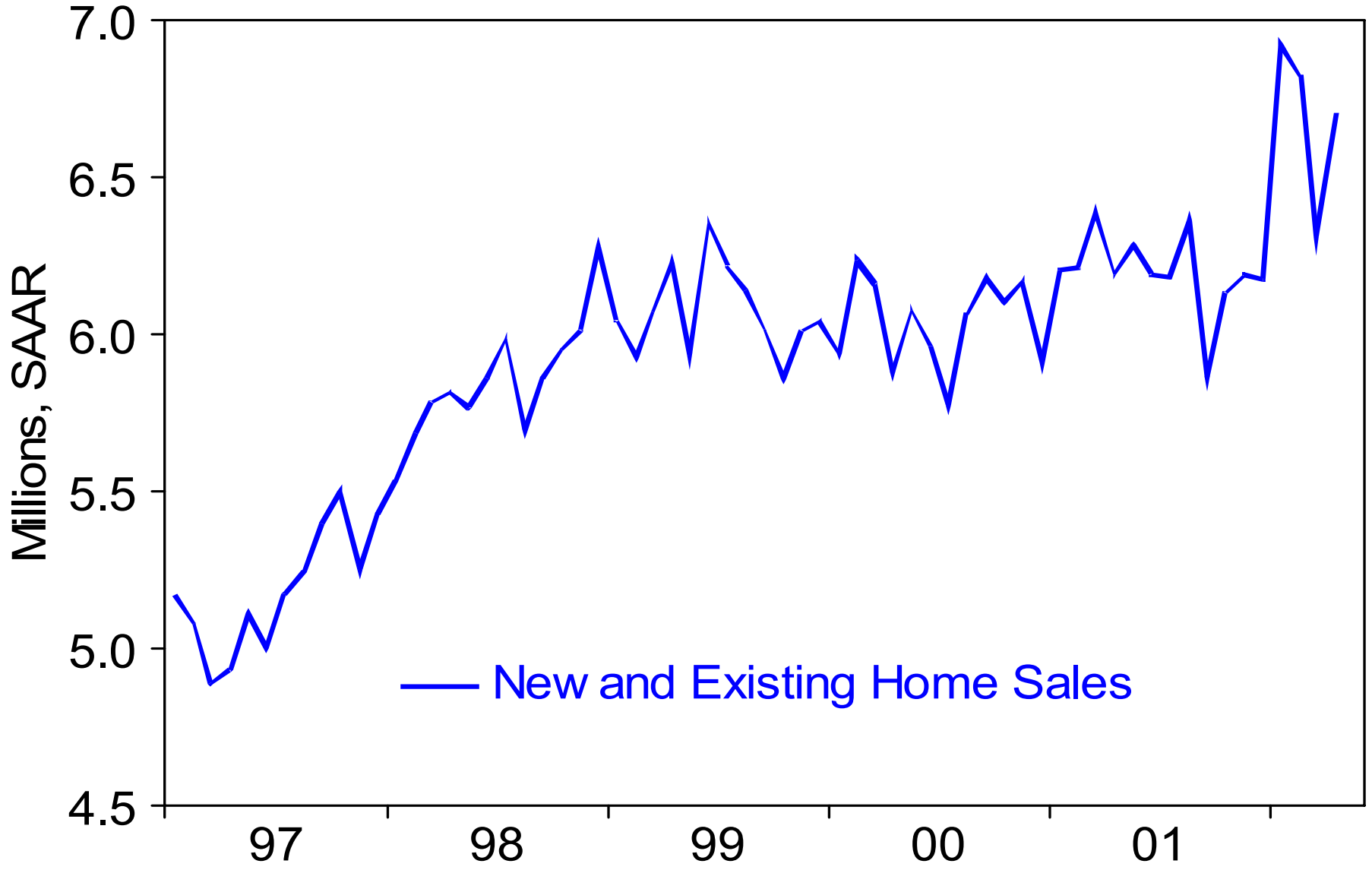
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Exports Down in 2002 : Imports Reverse and Grow

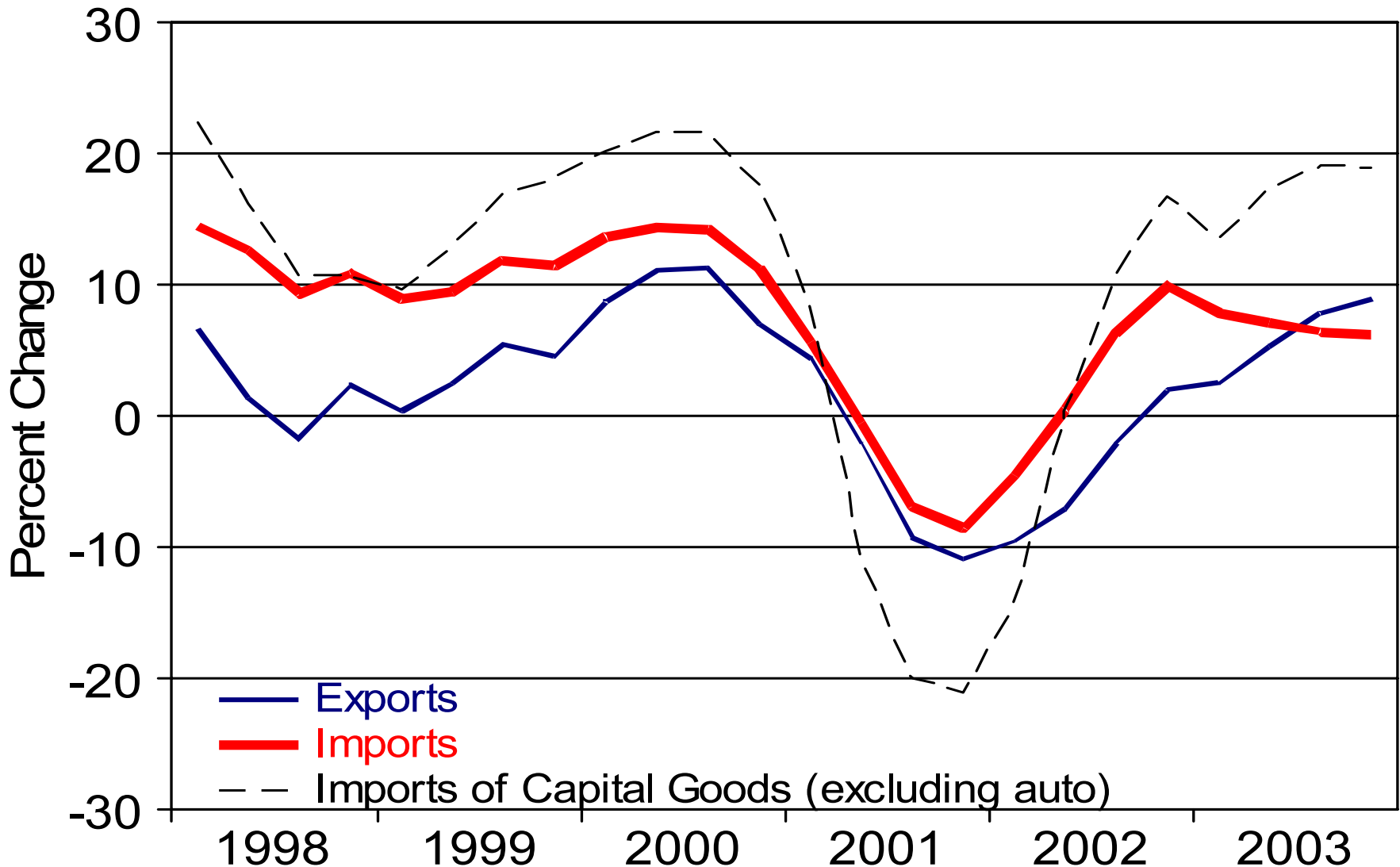
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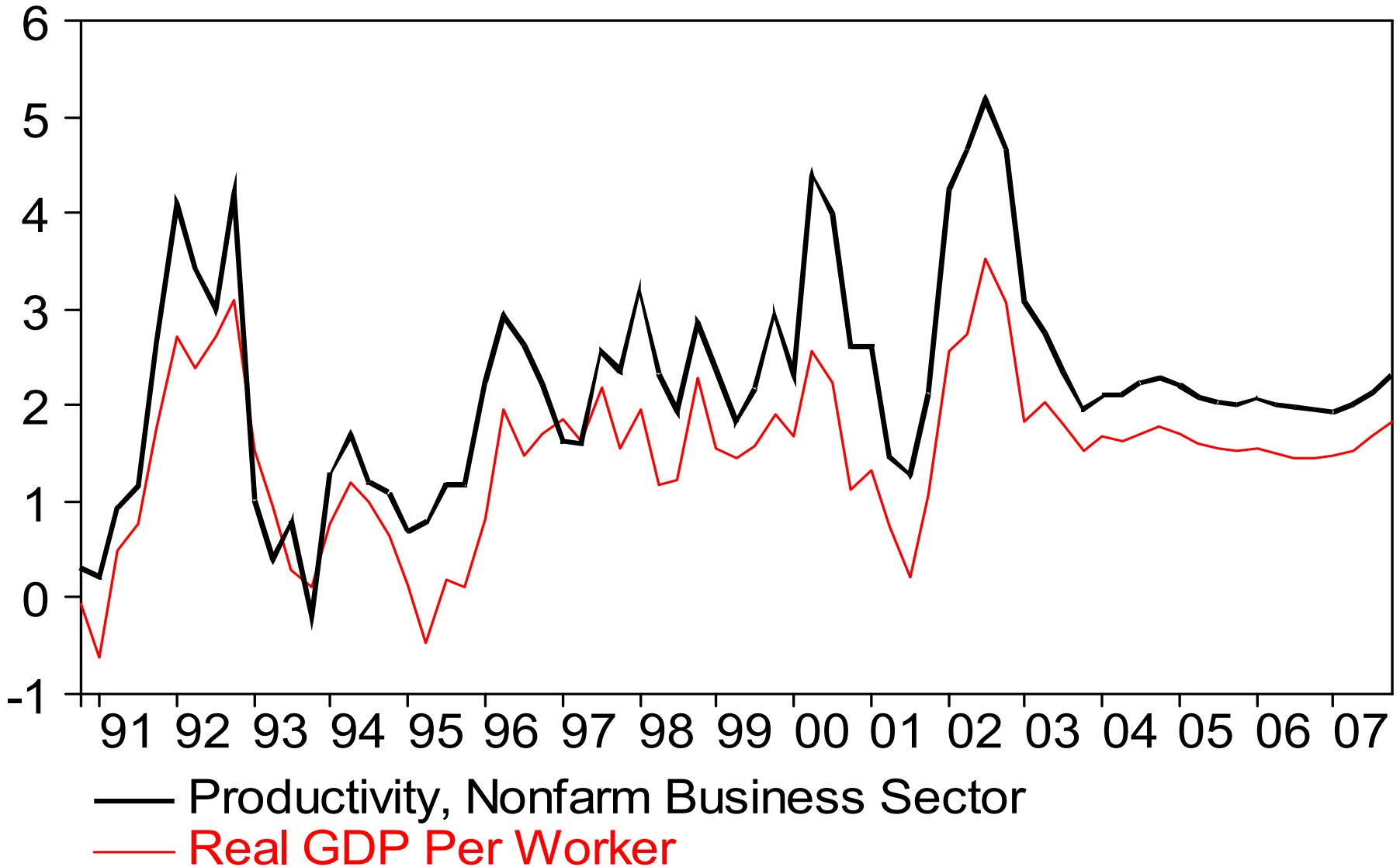


Near Term Outlook

- ◆ **Output/Hr Productivity holding up now, computers, defense, manufacturing help**
- ◆ **..but partly spurious or not comparable-- Big Hrs decline and hedonics**
- ◆ **Good early cyclical boost (output/worker) expected**
- ◆ **Near term risk: “real” productivity higher than output? Employment falls in a “jobless recovery”**

Medium Term Outlook

- ◆ **Huge late 90’s boost from 30+% high tech producer growth will not repeat soon**
- ◆ **User productivity gains from applications will remain strong**
- ◆ **Innovations and new product spending will resume.**



Income Share Stays High: Profit “Boomlet” Now but Share Stays Low

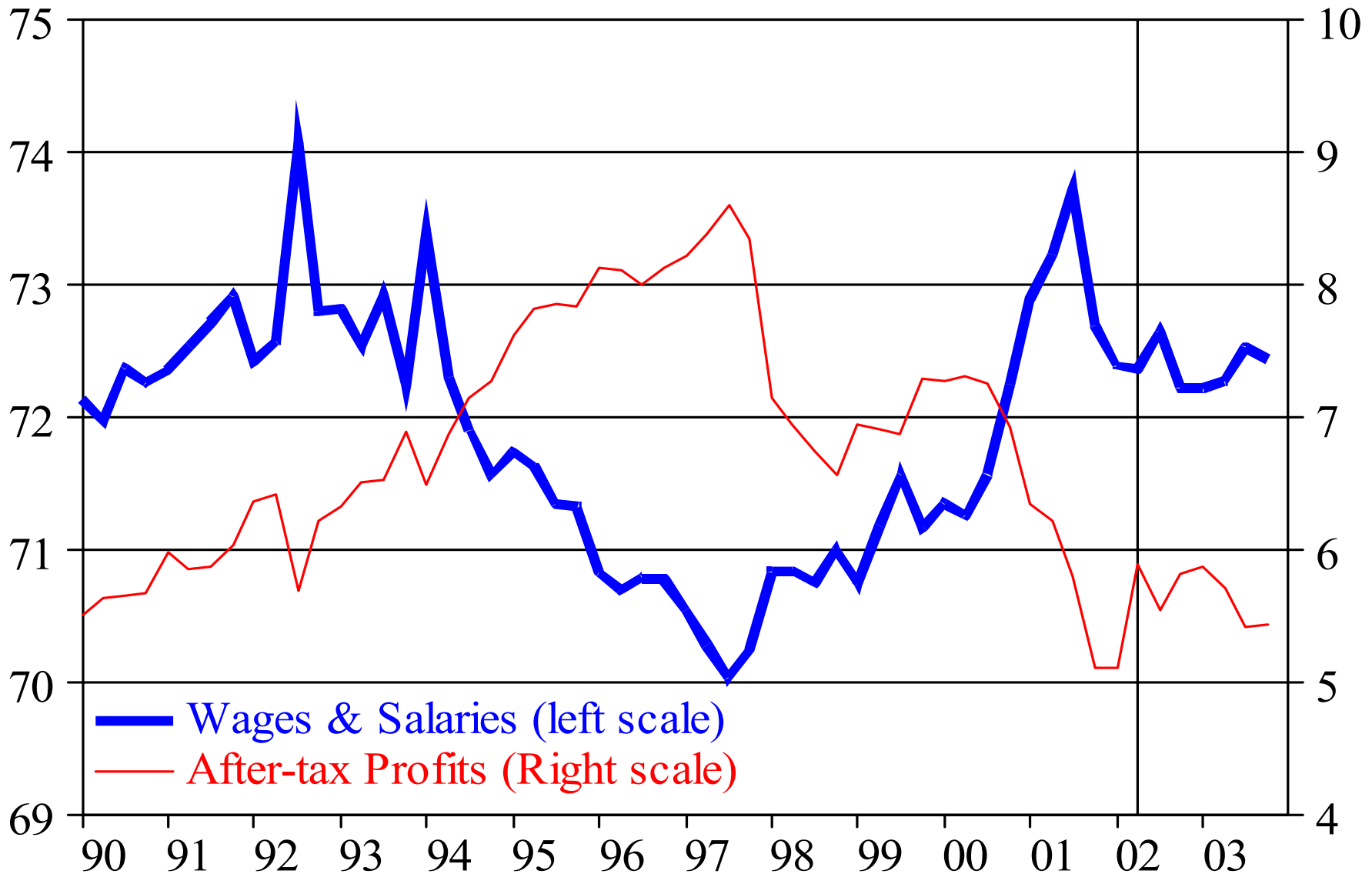
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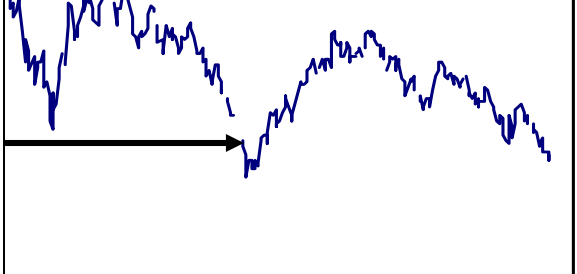
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**“Owning Nasdaq stock is like owning confederate money.”
Robin, April 2000**



“..tech sector may not bounce back as quickly ..you’ve got a valuation problem” Andrew Hodge, TIME Magazine, Sep2001



- ◆ **APRIL 2000** ..we project (NIPA profit) growth rates less than nominal GDP. Company reported data, S&P 500 for example, showsrecent gains are now higher than NIPA. Why are they higher?**there may be a recent erosion of company reporting standards, as suggested by the SEC...** The above profits view suggests that the stock market is overvalued and that tech stocks remain substantially overvalued.

- ◆ **FEB 2002** What will the profits recovery look like? it is in a V-shaped quarterly pattern, namely down all last year and up this year..... While we see seasonally adjusted gains starting this quarter..we do not see profits rising significantly **above a year earlier** until the **third quarter**. By contrast the First Call estimates (are) way too optimistic and creates grounds for a **major near term market disappointment**

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| | 2000 | 2001 | 2002 | 2003 |
|---------------------------|-------------|-------------|-------------|-------------|
| Real GDP | 4.1% | 1.2% | 2.4% | 3.4% |
| Unemployment | 4.0 | 4.8 | 6.0 | 5.7 |
| Inflation (CPI) | 3.4 | 2.8 | 1.8 | 2.9 |
| \$pretax Income | 6.3 | 4.9 | 3.3 | 5.4 |
| T-Bond Rate (10yr) | 6.0 | 5.0 | 5.3 | 6.3 |
| Fed Funds Rate | 6.2 | 3.9 | 2.0 | 4.0 |

Recession Over. 1Q growth up 5.6%.

Fed Funds now 1.75%: hikes begin November 2002

Unemployment peaks at 6.1% 3Q 2002

Government Spending and Tax cuts: Boom by 2003

EXPANSION COMING

- ◆ Government spending ramping up, earlier tax cuts
- ◆ Interest rates highly expansionary
- ◆ Huge early inventory boost
- ◆ unemployment, investment and exports will be unfavorable most of this year, only turn later.
- ◆ Solid expansion end year: over 4% by 4Q and 3.4% 2003 yearly avg. real GDP

RISKS

- ◆ A Double Dip Risk is 25% but better seen as extended weakness
- Risks include
- ◆ Hiring lags
 - ◆ Stocks/profits weakness
 - ◆ Oil shock
 - ◆ Deeper Investment cycle
 - ◆ Major dollar decline (long term only)

OVERINVESTMENT: Capacity Growing While Output Falls

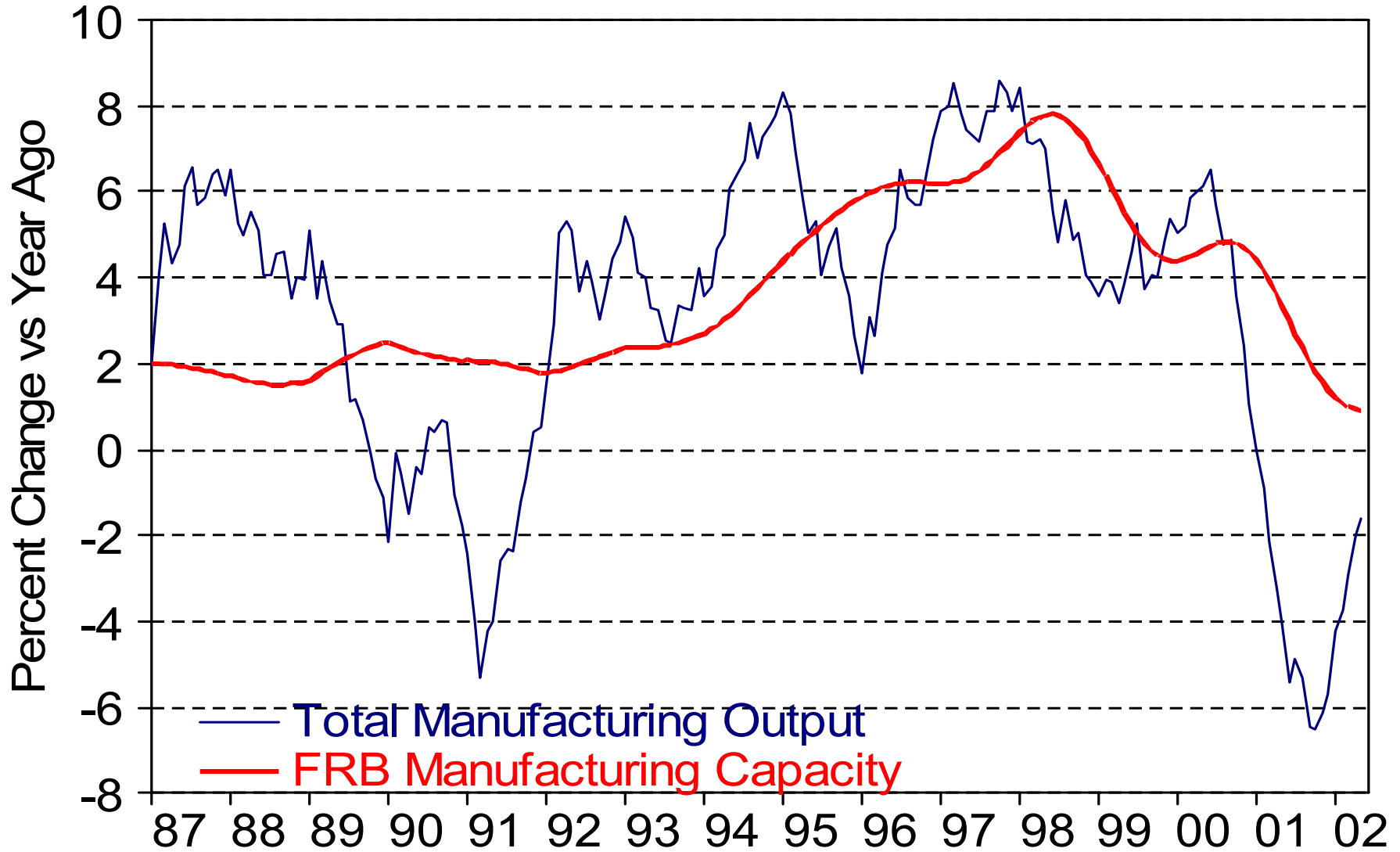
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Mfg Capacity Utilization Down; Telecoms Way down

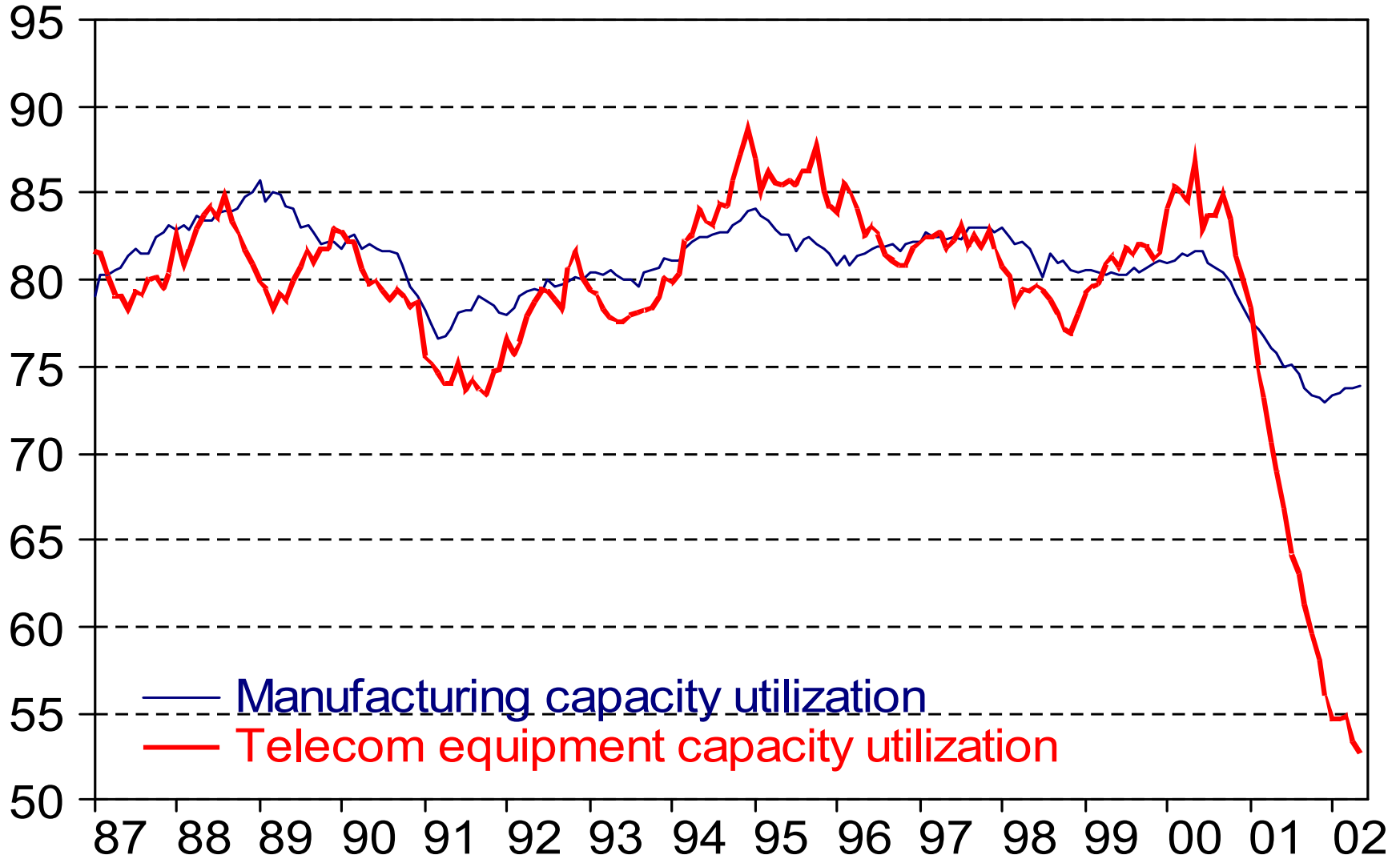
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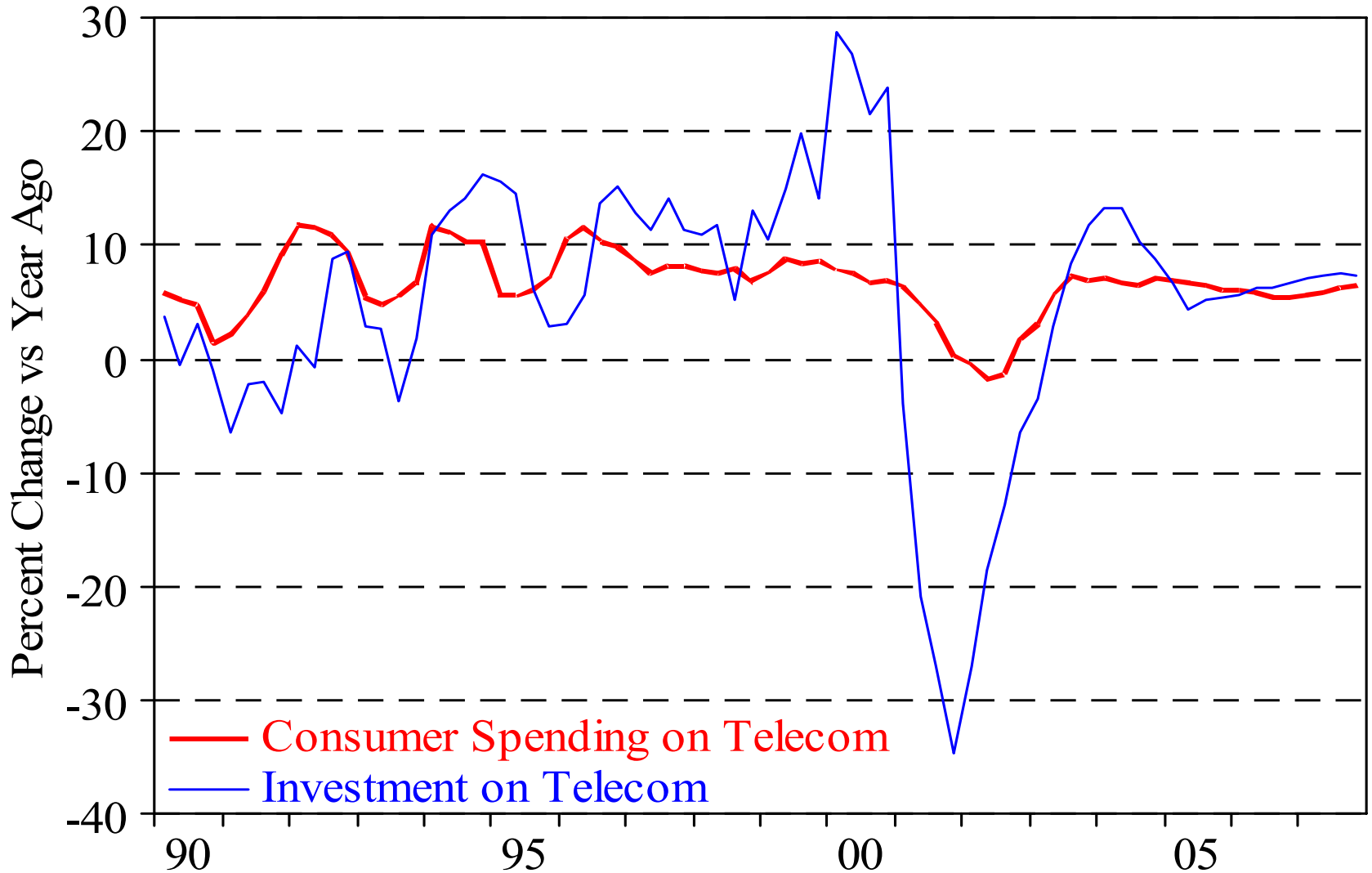


RISKS

PROTECTIONS

- ◆ **Excess Capacity-US is high-investment now**
- ◆ **Investment growth can't last-- Real PDE 14.5% 98-99, 11%+ since 1993**
- ◆ **Profits growth slowing-high investment cuts return to capital?**
- ◆ **Housing to decline**
- ◆ **Other construction overbuilt-flat now.**
- ◆ **Labor saving productivity needs**
- ◆ **Diverse Sector-- Computer/Net Needs**
- ◆ **Supply Computers/ Information to Rest of World**
- ◆ **ROW recovery**

Conclusion: Most likely long term risk of the three scenarios. May take years, but either soft landing or major correction expected



Producer Durable Equipment Real Growth by Major Sectors

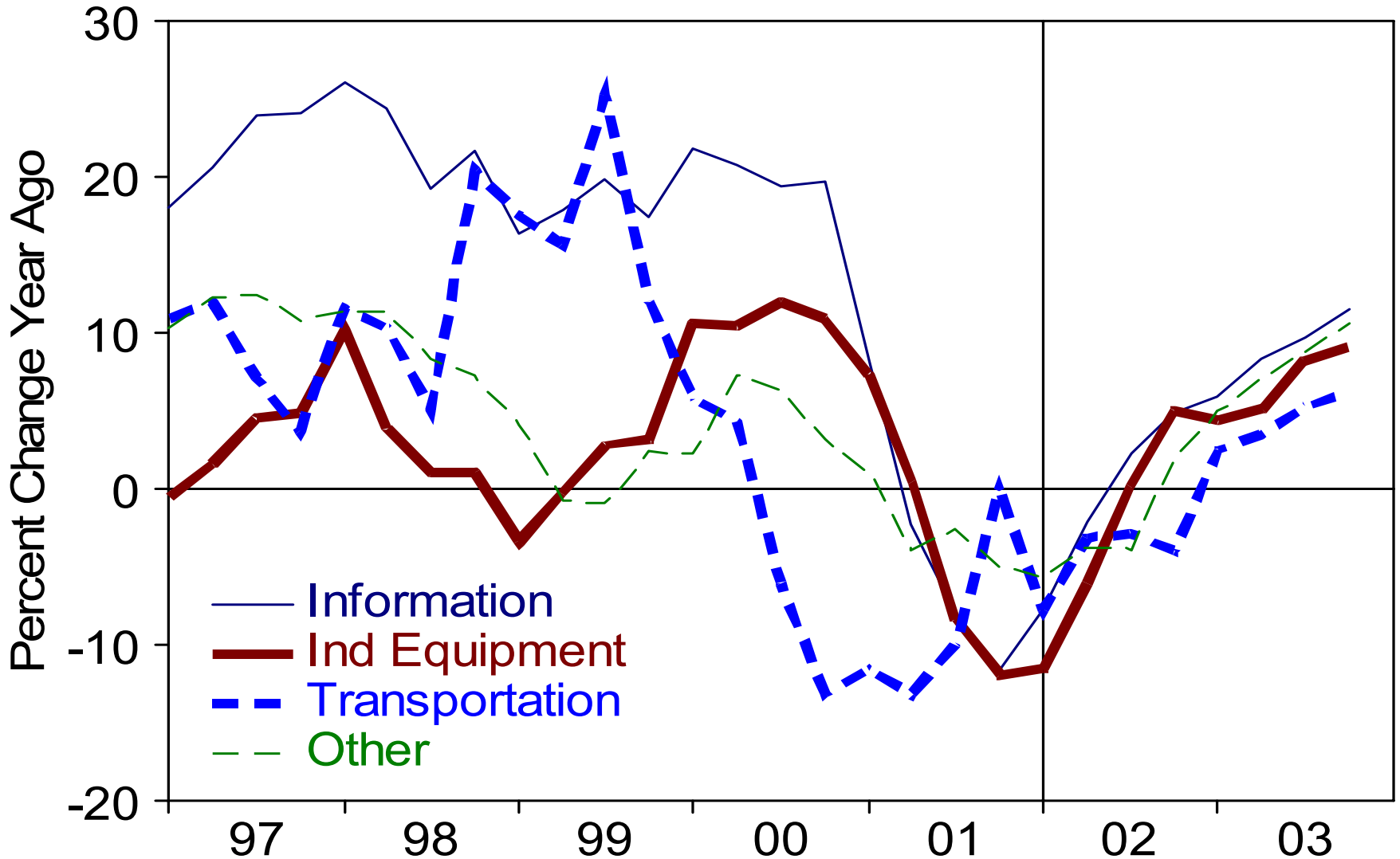
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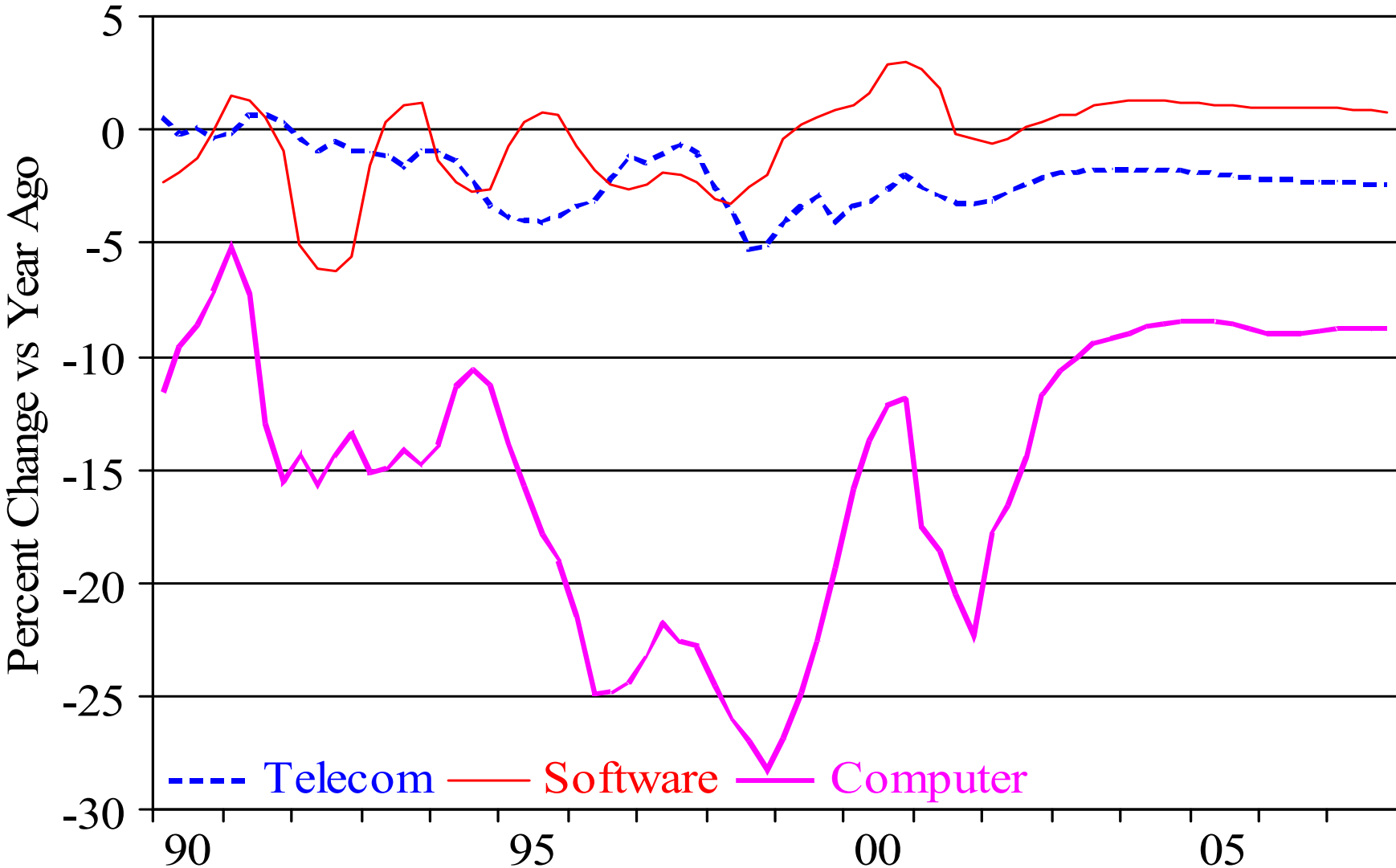


COMPUTERS

- ◆ Many equipment end users
- ◆ Moderate capital intensity
- ◆ Rapid depreciation—capital stock needs renewing
- ◆ Large price declines- tech advance
- ◆ Drives Innovation cycle—so far

TELECOMS

- ◆ Few equipment users
- ◆ Highly Cap. Intensive
- ◆ Slow depreciation—capital stock stays
- ◆ Price Declines but smaller
- ◆ Follows innovation cycle



Telecom Orders and Shipments Bottoming

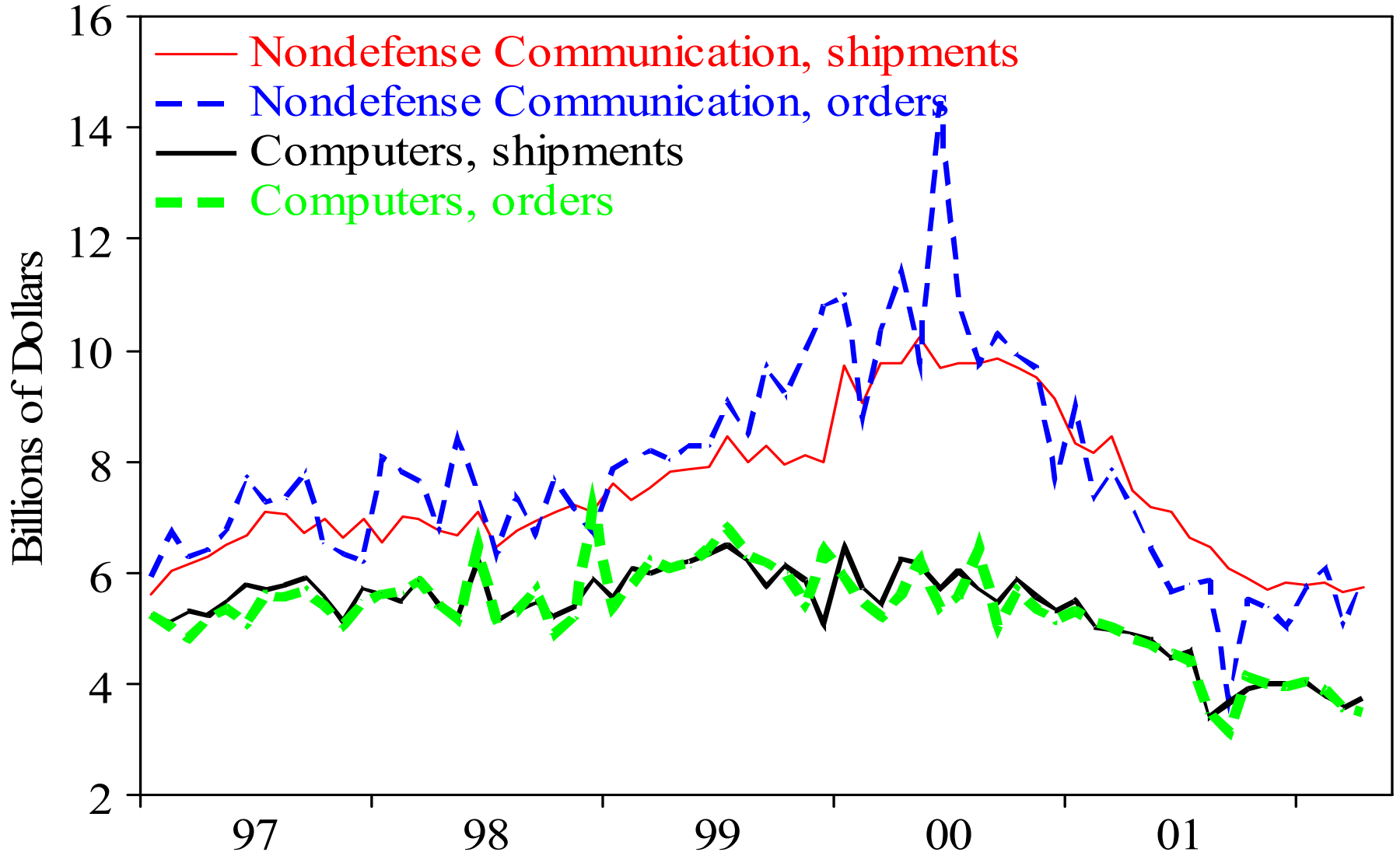
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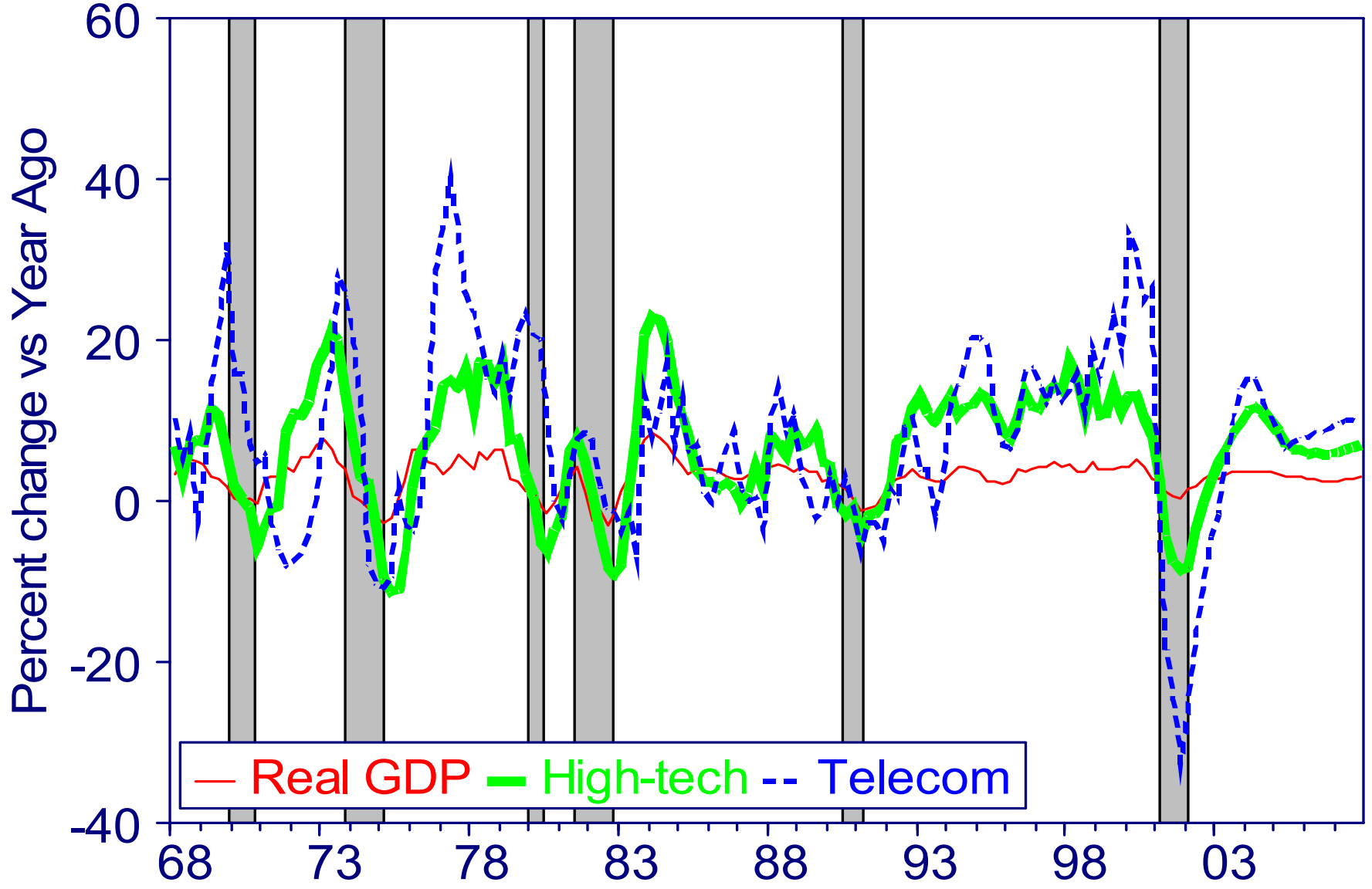
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The Baddest Telecom Cycle (but it will end)

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- ◆ **The telecom cycle was an excess capacity cycle**
- ◆ **It was driven mainly by regulations changes, expectations and funding, final demand held up**
- ◆ **All capacity cycles end, there is early evidence this one is also**
- ◆ **We only expect active equipment demand growth in 1Q 2003**
- ◆ **Equipment demand will grow even without technological advance.**
- ◆ **Tech advance will add to future growth**