HOME
JOB MARKET
REAL ESTATE
AUTOMOBILES
NEWS
International
National
Nation Challenged
Politics
Business
- Media & Advertising
- World Business
- Your Money
- Markets
- Company Research
- Mutual Funds
- Stock Portfolio
- Columns
Technology
Science
Health
Sports
New York Region
Education
Weather
Obituaries
NYT Front Page
Corrections
Special: Winter Olympics
OPINION
Editorials/Op-Ed
Readers' Opinions
Topics of The Times READ MORE
FEATURES
Arts
Books
Movies
Travel
Dining & Wine
Home & Garden
Fashion & Style
New York Today
Crossword/Games
Cartoons
Magazine
Week in Review
Photos
College
Learning Network
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January 16, 2002

# Industry Still Weak, Inflation Down

By REUTERS

Filed at 7:09 p.m. ET

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WASHINGTON (Reuters) - U.S. industrial output shrank for a fifth straight month in December and consumer prices fell, according to two reports on Wednesday that highlighted the economy's fragility.

The Federal Reserve's closely watched gauge of industrial production dropped 0.1 percent in December after a 0.4 percent decline in November.

The latest drop capped a year in which industry output plunged 3.9 percent, the biggest fall since 1982.

A separate report from the Labor Department showed a 0.2 percent drop in U.S. consumer prices, which was led by plummeting energy costs. Excluding food and energy, the closely watched core CPI rose 0.1 percent.

``If we add up all the statistics we've gotten recently, they are still reflecting the economy was in a recession in December,'' said Brian Fabbri, chief economist at BNP Paribas (news/quote) in New York.

``The outlook going forward is the production side of economy will probably start to improve in the first half of the year,'' Fabbri added.

The two economic reports bolstered already widespread expectations for a quarter-percentage point cut in short-term U.S. interest rates when the Federal Reserve next meets on Jan 29-30.

U.S. Treasury prices ended the day flat after initially climbing as hopes for another interest rate cut by the Fed later this month were supported by the data.

At their 5 p.m. EST closing, two-year Treasury notes (US2YT-RR) were down 1/32 at 100-27/32, yielding 2.80 percent, and benchmark 10-year notes (US10YT-RR) were up 1/32 at 101-1/32, yielding 4.83 percent.

Economists had been hoping for a turnaround soon in the U.S. economy, which has been in recession since March.

Although some data trickling in lately have offered hope, Federal Reserve Chairman Alan Greenspan has warned that dangers remain and it is too soon to feel confident about a return to steady growth.

The production data offered a reminder of the weaknesses that still exists.

SLACK IN THE FACTORY SECTOR

Businesses in December ran at only 74.4 percent of full capacity, down from 74.5 percent in November and the lowest level of capacity utilization since April 1983.

The 0.1 percent drop in industrial output contrasted with economists' expectations for an

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unchanged reading. In addition, capacity use was lower than the 74.6 percent figure projected by U.S. economists in a Reuters survey.

Factory output fell 0.1 percent in December, after a 0.2 percent decline in November. Mining output sank 0.8 percent in December while utilities output gained 0.4 percent.

Still, the report contained a few hints of strength, mostly in the auto and high-tech sectors. Auto production rose for a second straight month to a 12.33 million unit annual rate. High-tech industries, a category including computers, communications gear and semiconductors, saw output rise by 0.3 percent, the second gain in three months.

``For the second straight month, production was lifted by rising auto output, as the manufacturers sought to replenish inventories,'' said Ian Shepherdson, chief U.S. economist with High Frequency Economics in Valhalla, N.Y.

At a time when U.S. factories are operating at a pace well below full tilt and when the economy globally is sagging, economists were not surprised to see that inflation is soft.

During all of 2001, the CPI was up only 1.6 percent, the smallest gain since a matching 1.6 percent rise in 1998. The core CPI rose 2.7 percent last year.

Analysts said such mild inflation will help give the go-ahead for an additional rate cut. Any rate cut this month would follow a total of 11 the central bank carried out last year.

``I've been adamant that the Fed will cut 25 basis points (a quarter percentage point),'' said Kurt Karl, chief U.S. economist at Swiss Re in New York. ``There are no inflation fears. That was confirmed again this morning.''

December was the third month in a row that the CPI was either negative or registered no change. It was flat in November and slid 0.3 percent in October.

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