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ECONOMIC PREVIEW

Total focus on war

Weekly data should detail how well we are coping

By Rex Nutting, CBS.MarketWatch.com
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WASHINGTON (CBS.MW) -- Markets are beginning to disregard any news that's not war-related.

Economic news, in particular, fails to impress investors the way it used to.

Case in point: Friday's benign inflation reading gave stock futures a brief bump. See full story. But all the gains evaporated when the TV screens flashed the alert about a burning oil facility on Staten Island.

Oil, gold, bonds, currencies and stocks all reacted violently, if briefly, to the black smoke rising over the harbor. See Market Snapshot.

With war perhaps only a couple weeks away, war news (or terrorism news) trumps economic or corporate news every time. See our Countdown to War coverage.

Three academics have written a paper showing that the financial markets have been closely attuned to Saddam Hussein's fortunes.

"The U.S. economy is extremely sensitive to the cost of war," said Andrew Leigh, Justin Wolfers and Eric Zitzewitz. In particular, the economy is sensitive to the probability of war with Iraq. Read their paper.

Correlating the market in Saddam futures run by the bookmakers at http://www.tradesports.com with movements in global markets, Leigh, Wolfers and Zitzewitz figure that a 10 percent rise in the probability of war lowers the S&P 500 by 1 to 2 percent and increases crude oil prices by $1 barrel.

Saddam is the new Abbey Joseph

Lehman Brothers' economists come to similar conclusions, finding that the market has not fully priced in 100 percent chance of war. The rising and falling fortunes of Saddam explain between 30 and 70 percent of the daily variation in the markets for the past five months, Lehman chief economist Ethan Harris wrote in a recent note to clients.

Taking their model to its logical conclusion, Lehman figures the certainty of war would push the S&P 500 to about 778 (from about 850 now), raise the price of crude oil to $37.50 (from $35.50) and drop the yield on the

10-year Treasury note to 3.66 percent (from about 3.90 percent).

Drag on growth

The drag from the war matters.

Leigh, Wolfers and Zitewitz figure the oil premium costs each American $250.

"Increasing oil prices will dampen economic activity," said Bob DiClemente, economist at Salomon Smith Barney, stating the obvious. "If prices were to hold steady at current levels, first quarter discretionary outlays would be curbed by about $30 billion, knocking more than a percentage point off first-quarter consumption."

"There is less disposable income for other things," said Geoffrey Somes, senior economist at FleetBoston, who figures the "energy tax" amounts to about $50 billion.

Businesses are also being hurt by the higher energy costs. Anecdotal evidence suggests that firms are not able to completely pass on those costs to consumers, which means profit margins are being squeezed.

"The enormous uncertainty ... still continues to cast a heavy pall on firms' planning for the future," said Federal Reserve Gov. Ben Bernanke in a speech Friday in which he concluded that financial conditions are ripe for a healthy recovery. See full story.

If the war were to end well and Venezuelan production were to be completely restored, DiClemente reckons oil prices would decline to about $20 a barrel, "the equivalent of a nearly $100 billion tax cut" for the economy.

The data

The monthly economic data released by the government and the private groups in the coming week can't match the war news for impact on the markets. But the numbers will help reveal how well consumers and businesses are going on with their lives despite the cloud of war.

The data will cover the gamut, from capital spending to consumer attitudes to home sales. We'll also see the first revision to fourth-quarter gross domestic product.

The big number comes Thursday, when the Commerce Department reports on January's durable goods orders. Orders fell 0.2 percent in December, including a 0.3 percent decline in core investment good orders.

Economists think orders rebounded in January, if only because some gremlin in the statistics has strengthened the first month of each quarter for the past five quarters. The consensus looks for a gain of 1.5 percent in total orders.

DiClemente looks for a much bigger spike in orders of about 6.5 percent. He thinks aircraft and auto orders rebounded sharply, but even excluding transportation, he thinks orders rose 2 percent.

Others see more modest gains. "Business investment has selectively improved, with moderate growth in high-tech orders and shipments," said Mickey Levy, chief economist at Banc of America.

Consumers

While businesses may be showing their growing confidence by increasing their investments (if only modestly), consumers have been growing increasingly pessimistic. So far, however, their poor attitudes haven't slowed their spending much.

Consumers have plenty of worries. Besides the constant threat of terrorism, they see a very weak job market and a disappointing stock market. They don't have much confidence in government to make it better, either.

The two main monthly confidence surveys will be released. The Conference Board's index should fall to about 76.8 in February from 79.0 in January, economists say. The University of Michigan index should drop to about 78.8 from 79.2 in early February, according to the **CBS.MarketWatch.com** consensus. See Economic Calendar.

The two home sales numbers will also be released during the week. Home sales can't get much stronger. New home sales probably remained well above the 1 million annualized pace in January., perhaps falling to 1.03 million from an incredible record 1.08 million in December.

Existing home sales likely fell back to a 5.73 million pace in January from the 5.86 million estimated in December, the third-highest rate ever.

Finally, the Commerce Department will revise its estimates of fourth-quarter GDP. Economists look for a modes upward revision to 1.1 percent from 0.7 percent. Inventory growth and construction spending were stronger thar the original estimates, probably enough to offset the record trade deficit.

Economists think the economy is growing at about a 2.4 percent annual pace this quarter.

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