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## CLIENT ADVISORY

(April 2004)

**Economic Outlook Bodes Well For Creditors And Their Customers**  
*PNC's Chief Bank Economist says interest rates will stay low and businesses will see growth despite stagnant job growth*

How is the economy shaping up for 2004 and what can creditors expect as far as collecting on their customers' obligations? Will there be a slowdown of corporate and personal bankruptcies or is the much-touted economic recovery too little, too late?

Recently, Bernstein Law Firm Managing Partner Bob Bernstein sat down with Stuart Hoffman, Senior Vice-President and Chief Economist for PNC Financial Services Group to discuss these pressing questions. The following is an excerpt from that conversation:

**Bernstein:** Many of our clients are merchants and manufacturers that extend credit to businesses and consumers. What can you tell us about where the economy is headed and how it might affect our clients' ability to collect from their customers?

**Hoffman:** There is no doubt that the economy is getting stronger and that this is having a positive impact on creditors. But just because the economy is growing doesn't mean that every customer will necessarily benefit. Much of the economic growth we are seeing is due to an increase in productivity. In part, this is the result of mergers. Both large and small companies are finding that there are benefits to joining forces. They can keep sales, keep customers, and at the same time eliminate some of the overhead. Two merged companies can be more profitable than two separate companies. The result is people are working harder and they're bringing in more profit per sales per dollar. This is often the motivation behind the mergers. It results in greater productivity but doesn't necessarily create jobs.

**Bernstein:** So is it fair to say that more customers will indeed be able to meet their financial obligations, even though some will be left out of this rising economic tide?

**Hoffman:** Some companies are going to be weighed down by bad management or bad location or bad products and services and they're not going to be lifted by the rising tide. But I think they are the exception, rather than the rule. The vast majority of businesses will benefit from an improvement in the economy. Of course, the best of the businesses out there will benefit immensely in the form of more opportunities for sales, new customers and new clients. Obviously, this is a very broad generalization and the effects of a strengthened economy will be different from region to region.

**Bernstein:** Does the recovery mean that there will be an increase in the ability of businesses to borrow money?

**Hoffman:** Surveys suggest that there is a bit more interest in borrowing. For the last few years, business borrowing has been going down, especially with respect to banks. Part of the reason for the decrease in borrowing is that businesses have been cutting back on inventories and with interest costs going down, their cash flow has improved and corporate profits have been much better. Retained earnings have been covering financing needs. As the economy gets stronger and there is more merger and acquisition activity and as companies add to their staff and begin investing again in the company, cash needs will rise and borrowing will also rise. I think that banks will begin to actively look for good borrowers and will be willing to take a little bit more credit risk. Banks are going to become more willing to work with their customers—large and small—to fund their expansion needs in cases where the business plan looks good.

**Bernstein:** Is it reasonable for those clients of ours who are worried about the collectibility of their accounts receivable, to conclude that their customers are going to be in a better position to pay either because their businesses are doing better or due to improved opportunities to borrow money that can be used to pay debts?

**Hoffman:** Not only will businesses be doing better and funds become more available, but interest rates look like they are going to stay quite low for most of the rest of the year. Interest rates are going to remain very favorable, basically at the lowest point they've been in 40 years, and rates won't rise much until very late this year or more significantly in 2005.

**Bernstein:** Do you see bankruptcies increasing over the next several years?

**Hoffman:** It looks like business bankruptcies may have peaked about a year ago. My view is that the number of business bankruptcies will remain stable or start to decline over the next 12-to-18 months. Consumer bankruptcies, on the other hand, have continued to rise even though the economy has done better. It is very disconcerting to see that almost one-and-a-half percent of all the families in the U.S. – that's over a million households - will declare bankruptcy this year. It looks like as many as five percent of American households will go bankrupt between 2000 and 2005. As the economy gets better and we see some job growth, we will see personal bankruptcies start to plateau and then come down. But having said that, anytime you see one percent or more of your households going bankrupt, those are still high numbers.

**Bernstein:** Generally, for the rest of 2004 and going into 2005, what do you see in terms of general economic growth? Can you give us some highlights of where you see the economy heading?

**Hoffman:** In 2004, we're expecting about four percent of real GDP growth, which is a pretty good, above-trend, pace and about the same as we experienced in the fourth quarter of last year. We think that productivity will rise at around three percent, which isn't as strong as last year. So there is going to be a one percent difference between real GDP growth and productivity and that difference has to come from somewhere and we think it will come in the form of jobs. We think that a million and a half more jobs will be created in 2004.

Inflation looks like it will remain low, about two percent. Right now we're experiencing a spurt in energy and commodity price inflation at the wholesale level, but not a lot has been passed on to the consumer other than a spike in gasoline prices.

We think business profits will be up about ten percent this year. Of course, that's a broad measure that cuts across a lot of industries. We think technology will be making somewhat of a comeback this year so hot tech spots like Silicon Valley, New England and parts of Pennsylvania will benefit from that. Housing will continue to be hot and that will provide coattails for people in related industries like mortgage financing and sales of furniture and appliances. Apparel manufacturing and heavy industry will be on the weaker side, but services in the engineering, marketing and financial fields will pick up.

In terms of regional growth, it's more likely the southeast, upper Midwest, New England and probably southern California will be stronger than places like Pennsylvania, Ohio or Illinois.

**Bernstein:** What could go wrong and cause the economy to do worse than you expect?

**Hoffman:** Of course there is certainly still the risk of terrorism that could set us back. If energy prices continue to move up and oil goes above \$40 a barrel and gasoline tops \$2 a gallon that would really hurt the U.S. and global economies. The value of the dollar relative to the yen, the Euro and the Canadian dollar has been going down, but so far in an "orderly" fashion. If the dollar were to take a sharp drop it could scare away foreign investors and that would hurt the bond market and the stock market and could bring more inflation to the U.S. economy which, in turn, could put more upward pressure on interest rates. These are the downside risks to my "cautiously" optimistic outlook on the U.S. economy.

For more information on how you can protect your interests in this volatile economy, please contact Bob Bernstein at the Bernstein Law Firm, P.C. at 412-456-8100 or toll free at 1-800-927-3197; email: [rbernstein@bernsteinlaw.com](mailto:rbernstein@bernsteinlaw.com) or visit [www.bernsteinlaw.com](http://www.bernsteinlaw.com).

To find out more about the PNC Financial Services Group or to review the latest issues of Stuart Hoffman's newsletter, PNC National Economic Outlook, visit [www.econ.pncbank.com](http://www.econ.pncbank.com)

*Editor's Note:*

- *Bernstein Law Firm has been named a "Pennsylvania Super Lawyer" for 2004, a designation awarded to the top five percent of Pennsylvania lawyers. We thank our staff for helping us reach that pinnacle.*
- *We are pleased to announce that attorney Deborah Erbstein has joined Bernstein Law Firm on our collection litigation team.*
- *Bob Bernstein has recently been appointed Legal Representative of Future Asbestos Claimants in the bankruptcy case of Skinner Engine Company in Pittsburgh.*
- *Bob will also present "Bankruptcy for the Uninitiated: Finding Your Way Through the Maze" at the Commercial Law League of America Meeting on April 16 in Chicago, Illinois.*

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