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First Trust

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Monday Morning Outlook

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The Phantom Recession is Already Over

A funny thing happened on the way to the most predicted recession in US history: it didn't happen.

The theory behind the widespread recession forecast was that the declining value of US homes, the shrinking amount of mortgage equity withdrawal, or a credit squeeze would lead to either a severe slowdown or outright decline in consumer spending. Prominent economists – including one Nobel Prize winner – made comparisons to the Great Depression, predicting a long and deep downturn. Alan Greenspan declared a recession was likely and said this was the worst financial crisis since the end of World War II.

Trouble is, someone forgot to convince consumers they had to stop spending. Despite consumer confidence readings that are downright awful, "core" retail sales are up at a 10.2% annual rate in the past three months. In other words, consumer confidence statistics may express how people *feel*, but not how they *act*. And with all the doom and gloom being reported on a daily basis, no wonder they feel so bad. But consumers have refused to capitulate to the emotional turmoil.

And so have businesses. The construction of business-related buildings is up 15.4% versus last year, led by hotels, utilities, power plants, and offices. Meanwhile, foreign demand for US products continues to boom, with exports up 19.2% versus last year. All of this has pushed non-housing real GDP up 3.6% during the past year.

While some of the analysts who had forecast a recession are willing to admit they were wrong, others are now claiming the reasons we are not in recession are (1) the tax rebate checks that started going out at the very end of April and (2) the Federal Reserve's interest rate cuts that started in September.

First take the rebate argument. What this theory ignores is that "core" retail sales were as strong in March and April as they were in May. At least one group of economists at a prominent investment bank have tried to explain this by arguing that the *anticipation* of rebates lifted consumption even before consumers got checks. But, at the same time, this economics group was forecasting inflation-adjusted consumption would show zero growth in the second quarter. In other words, they did not believe their own theory until it became a useful explanation for why they were wrong.

The argument that the Fed saved the economy by cutting interest rates ignores the fact that there is a lag time of at least nine months between changes in the stance of monetary policy and its influence on real economic growth. More importantly, as history shows, the full force of looser money is felt only when investors and consumers believe the Fed is going to stop cutting rates. At that point, there is no need to postpone economic activity (to wait for lower rates) and the benefits of looser money begin.

The *end* of rate cuts may explain some of the retail bounce in April and May, but lower interest rates do not explain the failure to fall into recession beforehand.

Despite the obvious timing issues with these popular arguments about why the US avoided recession, there are many who still believe that once rebate check spending subsides the economy will have trouble again. We disagree. The Fed is loose, tax rates are still low and productivity is strong. As a result, the economy will remain resilient, and avoid the most predicted recession in history all over again.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-16 / 7:30 am	Empire State Mfg Index - Jun	-2.0	**5.0**		-3.2
6-17 / 7:30 am	PPI - May	1.0%	**+1.4%**		+0.2%
7:30 am	"Core" PPI - May	0.2%	**+0.1%**		+0.4%
7:30 am	Housing Starts - May	.980 Mil	**0.960 Mil**		1.032 Mil
8:15 am	Industrial Production - May	+0.1%	**+0.1%**		-0.7%
8:15 am	Capacity Utilization - May	79.7%	**79.7%**		79.7%
6-19 / 7:30 am	Initial Claims - Jun 14	375K	**381K**		384K
9:00 am	Philly Fed Survey - Jun	-10.0	**-11.3**		-15.6
9:00 am	Leading Indicators - May	0.0%	**+0.1%**		+0.1%