

The Resilient Economy

Imagine you were working on a 500-piece puzzle and had assembled 497 pieces, but found out that the last three pieces did not fit. In fact, you realized that they were from a completely different puzzle all together. What would you believe, that the three pieces were the right ones and the 497 were wrong, or vice-versa?

This is an important question for people looking at economic data these days. Those who think the economy is slowing focus on the 0.1% increase in retail sales during May. But, one or two-month slowdowns in economic data mean nothing. Retail sales are up 7.6% in the past year and 8.5% at an annual rate over the past six months. Excluding autos, retail sales increased 0.4% in May and are up 9.1% in the past year and 9.6% at an annual rate in the past six months.

Moreover, the future for retail sales does not look dour at all. Yes, non-farm payrolls increased by a less than expected 75,000 in May, but the household survey reported a 288,000 jump in employment. The Household Survey has been a much more accurate predictor of economic strength in this recovery than the Establishment Survey.

The unemployment rate has fallen to 4.6% and average hourly earnings have accelerated sharply in recent months, rising at a 4.2% annualized rate in the past six months. Wages and salaries have accelerated as well, rising at a 7.9% annual rate in the first four months of 2006. Tax revenues to the federal government are growing even faster (13% above last year during the first eight months of this fiscal year) and people do not pay taxes on income they do not earn.

While industrial production data showed a decline of 0.1% in May, output has climbed 5.2% at an annual rate in the past three months and 4.4% in the past year – both faster than overall GDP.

Early data for June signals a rebound. Initial unemployment claims have fallen to 295,000, while the Philadelphia Fed manufacturing survey was 13.1 in June – a level that indicates real growth in the 3.5% to 4.0% range. New orders in the Philadelphia area rebounded strongly in June with 31.8% of area manufacturers reporting rising orders and only 14.1% reporting declining orders – another signal of stronger than anticipated growth ahead.

Along with data that reflects a solidly growing economy, inflation remains elevated. The Consumer Price Index expanded by 0.4% in May, while the “core” CPI jumped 0.3%. No matter how you slice and dice it, “core” inflation is clearly running well above the Fed’s comfort zone.

The bottom line is that the economy is still in very good shape, while inflation is moving higher. It may be easy to pick out some data here, or some anecdotal evidence there, that paint a picture of slower growth. However, that evidence is in the distinct minority. When put together, a vast majority of the data reflects an economy that continues to roll along much as it has for the past three years.

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