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First Trust

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Monday Morning Outlook

Brian S. Wesbury - Chief Economist
Robert Stein, CFA - Senior Economist

Are Consumers Ignoring Soaring Commodity Prices?

At the very beginning of 2010, Federal Reserve Chairman Ben Bernanke defended Alan Greenspan's 1% interest rate policy of the early 2000s, saying that it did not cause the "housing bubble." At the time, we wrote that, reading between the lines, Bernanke was doing more than protecting the Fed's integrity: He was preemptively absolving himself and his zero percent interest rate policy from causing any problems.

Since then, oil prices have gone from $80 per barrel to above $110, a jump of 40%. The Goldman Sachs Agricultural Index is up 55%. Gold is up more than 30%. But of course, the very top decision-makers at the Fed – the "three amigos" of loose money, Bernanke, Yellen, and Dudley – do not see this as a problem that warrants a change in monetary policy. They are still dead set on using measures of "core" inflation, which exclude food and energy.

In the meantime, the recent spike in oil prices has yet to make a noticeable dent in consumer spending. Like the consensus, we are forecasting that retail sales increased 0.5% in March and 0.7% excluding autos (see table below).

Last week, the International Council of Shopping Centers reported that chain store sales were up 2% in March versus a year ago, with sales at wholesale clubs up 7.2% (even excluding fuel). And all this despite the fact that Easter, this year, is the latest since the 1940s, which will shift some Spring sales that happened in March last year into April this year. In other words, any softness in March sales is likely to be offset by faster growth in April. Meanwhile, employment growth has accelerated and jobless claims signal more strong growth ahead.

The reason commodity prices and aggregate demand (spending) can both increase at the same time is because money is loose. Some of the commodity price increase (especially for energy) may reflect supply issues (or fears about *future* supply issues) due to turmoil in North Africa and the Middle East. If so, then any "nominal" growth created by a loose Fed policy will shift more toward inflation and away from real GDP growth. By keeping monetary policy even more accommodative, the Fed is trying to counteract this.

This does two things. It creates even more inflation and allows the economy to absorb higher prices with less of a hit to real growth in the short-term. As a result, we do not expect higher commodity prices to cause a derailment of the economic expansion. Nonetheless, accommodative monetary policy creates damage in many ways.

And, like happens so often, the Fed refuses to admit it. Despite Bernanke's denials, easy money and 1% interest rates were the primary cause of the housing bubble. And despite the denials of the "three amigos" today, easy money is boosting inflation and commodity prices right now. So far, the damage can be contained. But letting this run for much longer would be a big mistake. The Fed doesn't want to raise rates, and probably won't for the foreseeable future, but it should and the economy would be fine if it did.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-12 / 7:30 am	Int'l Trade Balance - Feb	-$44.0 Bil	**-$41.9 Bil**		-$46.3 Bil
7:30 am	Export Prices - Feb	+0.8%	**+1.0%**		+1.2%
7:30 am	Import Prices - Feb	+2.2%	**+2.5%**		+1.4%
1:00 pm	Treasury Budget - Mar	-$189.0 Bil	**-$189.0 Bil**		-$222.5 Bil
4-13 / 7:30 am	Retail Sales - Mar	+0.5%	**+0.5%**		+1.0%
7:30 am	Retail Sales Ex-Autos - Mar	+0.7%	**+0.7%**		+0.7%
7:30 am	Business Inventories - Feb	+0.8%	**+0.8%**		+1.0%
4-14 / 7:30 am	PPI – Mar	+1.0%	**+1.2%**		+1.6%
7:30 am	"Core" PPI – Mar	+0.2%	**+0.2%**		+0.2%
7:30 am	Initial Claims - Apr 9	380K	**378K**		382K
4-15 / 7:30 am	CPI – Mar	+0.5%	**+0.5%**		+0.5%
7:30 am	"Core" CPI – Mar	+0.2%	**+0.1%**		+0.2%
7:30 am	Empire State Mfg Index - Apr	17.0	**20.0**		17.5
8:15 am	Industrial Production - Mar	+0.5%	**+0.9%**		+0.0%
8:15 am	Capacity Utilization - Mar	77.4%	**77.6%**		77.0%
8:45 am	U. Mich. Consumer Sentiment	69.0	**70.0**		67.5