

Nov 13, 2006

Monday Morning Outlook

| Date/Time (CDT) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|-----------------|-------------------------------|-----------|--------------|--------|----------|
| 11-14 / 7:30 am | October PPI | -0.5% | -0.6% | | -1.3% |
| | October "Core" PPI | +0.1% | +0.2% | | +0.6% |
| | Oct Retail Sales | -0.4% | -0.4% | | -0.4% |
| | Oct Ex-Auto Retail Sales | -0.2% | -0.1% | | -0.5% |
| | Sept Business Inventories | +0.5% | +0.6% | | +0.6% |
| 11-15 / 7:30 am | Empire State Mfg Survey | 15.5 | 17.5 | | 22.9 |
| 11-16 / 7:30 am | October CPI | -0.3% | -0.3% | | -0.5% |
| | Oct "Core" CPI | +0.2% | +0.3% | | +0.2% |
| | Initial Claims | 311K | 306K | | 308K |
| 8:15 am | October Industrial Production | +0.3% | +0.1% | | -0.6% |
| | Oct. Capacity Utilization | 82.0% | 81.8% | | 81.9% |
| 11:00am | Philadelphia Fed Survey | 5.0 | 8.5 | | -0.7 |
| 11-17 / 7:30 am | Oct Housing Starts | 1680K | 1720K | | 1772K |

It Was A "Thumpin"

President Bush said Democrats gave his party a "thumpin" last week when they picked up 29 seats in the House of Representatives and six seats in the Senate. Democrats control the Senate 51-49, and will likely control the House 232-203.

My analysis of the polls, suggesting that Republicans might not lose control of Congress, was off the mark. Nonetheless, Peter Roskam, the Republican running in the sixth district of Illinois to replace Henry Hyde (R), won his election 51%-49%, even though polls showed him down by as much as 14%. I was right about Roskam, but wrong in my attempt to extrapolate what was true in IL-6 to the rest of the country.

In a separate piece, to be posted online later this morning, we look more deeply at the election, and analyze its impact on the economy and financial markets. In summary, Republican losses were actually smaller than historical averages for the sixth year of a two-term administration and many of the new Democrats are centrists. Moreover, polls taken near the election, and the results from referendums in many states, suggest that the 2006 election was not a harbinger of massive change in economic beliefs.

The other "thumpin" taking place is coming from massive declines in energy prices. Oil prices are down more than 20% in the past few months and gasoline prices have fallen roughly 30%. Natural gas prices fell earlier in the year, but still stand at less than half of what they were last winter. These massive declines in energy prices have "thumped" headline inflation numbers and retail sales.

The overall producer price index fell 1.3% in September, but the "core" PPI was up 0.6%. The CPI was pummeled and fell by 0.5%, but once food and energy were removed, the "core" CPI

Week of November 20, 2006

| Date/Time (CDT) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|-----------------|--------------------|-----------|--------------|--------|----------|
| 11-21 / 9:00 am | Leading Indicators | +0.3% | +0.2% | | 0.1% |

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was up 0.2% in September. In fact, the drop in the headline data for the CPI masked a pick-up in the year-over-year change in the "core" CPI to 2.9% - its largest increase in more than 10 years.

Retail sales data has also been dramatically affected. Gasoline station sales fell by 9.3% in September, the largest decline ever recorded. This pulled down retail sales by 0.4%, and after excluding autos by 0.5%. New orders for non-durable goods, which include energy orders, declined 4.6% in September – the largest drop since December 1974.

And even though industrial production is supposed to measure units of output and ignore prices, it appears that rapidly falling energy costs in recent months have pulled it down. This also helps explain recent weakness in regional and national manufacturing surveys as well.

All of this is important because data this week will continue to reflect the impact of falling energy prices. The headline inflation data will be down again in October, as will retail sales (both overall and after excluding autos). Industrial production and the Philly Fed survey of regional manufacturing are expected to reflect stronger growth, but a negative surprise may occur.

Recognizing these distortions is important and after adjusting for them, the economy appears much more sturdy and robust than the headline data suggest. Continued strength in employment, non-gasoline retail sales, non-energy related factory orders, and rising real incomes, all point to a rebound in growth during the months ahead.

Energy prices may have "thumped" economic data, but just like the whooping that Republicans took in the election, the end result is less change than meets the eye.