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Monday Morning Outlook

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Economic Fundamentals Say No Recession

It's not hard to understand why fears of recession are elevated, or why some economists even think the US is in one right now. From their 2005 peaks, existing home sales are down 32% and new home sales are down 62%. Home prices are falling at their fastest pace in decades. Car and truck sales have been abysmal, with US-made vehicle sales down 15.3% versus a year ago.

The credit markets have seen enormous turmoil, with huge write-downs at major financial institutions, wider risk spreads, and a correction in the stock market.

These developments, or news about them, have helped drop at least one measure of consumer sentiment to its lowest level since the end of the 1981-82 recession, when the unemployment rate was up above 10%.

The conventional wisdom is not always wrong. But because it depends so much on emotion, it can often mislead. As a result, it is in times like these that economic fundamentals become so important. Rather than dwelling on the bad news coming from the financial and housing sectors, we believe it is important to look at the underlying drivers of the economy. And those look very solid.

Monetary policy is not tight. In fact, the Fed is holding interest rates below inflation. Tax rates are still relatively low and have not been hiked, yet. And productivity is still growing strongly. When these three things have been true, the US has never fallen into recession. When these three things are true, a financial market collapse is highly unlikely.

So far, the data have corroborated this historical and fundamental view. Real GDP growth remained positive in the first quarter of 2008. And although the initial report showed just 0.6% annualized growth, new data on construction and inventories suggest a revision to roughly 1.1%. Friday's trade report will probably add more to these upward revisions.

Of course, the big news on Friday was the Labor Department's report that payrolls fell only 20,000 in April, which was much less than the consensus expected decline of 75,000. The consensus also had expected an increase in the unemployment rate to 5.2% but the jobless rate fell instead, to 5% (4.953% unrounded).

In our view, the biggest news from the employment report should be the very wide gap between the two major job surveys – the payroll survey and the household survey. The payroll survey is sent to employers and asks how many people are working for them; the household survey finds people at home and asks them whether they are working.

Back in 2002-03, the household measure of civilian employment was much stronger than the payroll survey, signaling economic recovery. However, at the time, many prominent economists, including Alan Greenspan, (wrongly) argued that the payroll survey was right about the economy, not the household survey.

Then, in late 2007, the household survey was weaker than payroll growth, signaling slower growth and gaining some adherents now that it was showing weakness. But in the past few months, the household survey – which we have followed closely all along – has turned up strongly. In the first four months of 2008, when the payrolls survey shows a loss of 65,000 jobs per month, the household survey shows a gain of 179,000 per month.

Look for more positive economic data in the months ahead, as the most predicted recession in US history never comes to pass.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-5 / 9:00 am	ISM Non-Man. – Apr	49.1	**49.6**		49.6
5-7 7:30 am	Non-Farm Productivity – Q1	1.5%	**1.8%**		1.9%
7:30 am	Unit Labor Costs – Q1	2.6%	**1.5%**		2.6%
2:00 pm	Consumer Credit - Mar	$6.0 Bil	**$7.5 Bil**		$5.2 Bil
5-8 / 7:30 am	Initial Claims – May 3	370K	**376K**		380K
9:00 am	Wholesale Trade Sales – Mar	+0.5%	**+0.4%**		-0.8%
5-9 / 7:30 am	Int'l Trade Balance – Mar	-$61.4 Bil	**-$60.7 Bil**		-$62.3 Bil

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.