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FIRST Trust ADVISORS L.P.

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# Monday Morning Outlook

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## No Oil Recession

The price of oil jumped $11 per barrel last Friday (a record daily dollar amount), after a $5 move on Thursday. For perspective; just seven short years ago, in 2001, oil was trading at about $20/barrel.

The spike in oil was due to a confluence of factors. A senior Israeli official suggested an attack on Iran – to prevent the latter country from acquiring nuclear weapons – was a possibility. The European Central Bank raised the specter of a rate hike, which hurt the dollar, especially after the unemployment rate jumped to 5.5%, possibly pushing any Fed rate hikes further off into the future.

A re-ignited oil price has re-energized the outlook for recession from some analysts. Despite avoiding one so far, these analysts are convinced that a teetering consumer will be pushed over the edge by $4 gasoline.

The problem with this theory is that when you go through the math there is much less there than initially meets the eye. According to the US Department of Energy, our country imports (net of a very small amount of exports) about 10 million barrels of crude oil per day.

At the current price of $138/barrel, the US will spend $425 billion more per year for imported oil, compared to what we would have spent if the price were still at the average $21/barrel that prevailed in 2001: (10 million barrels * 365 days * ($136 - $21)) = approx. $425 billion.

This is a great deal of money, and it is money that US citizens or companies would keep if the price of oil had not gone up. However, it is still a small amount of the resources that the US economy produces. In fact, first quarter 2008, total US output (GDP) was running at an annualized $14.2 trillion; or $4.1 trillion more than it was in 2001. And personal income is $3.4 trillion higher this year than it was in 2001. In other words, the US consumer has roughly $3 trillion more in income to spend this year than it did in 2001, even after subtracting the higher cost of imported fuel.

Some may say that imports are only part of the energy story, and this is true. But money US consumers spend on domestic energy is income to other US citizens who produce or distribute energy products.

This is why rising oil prices are not the major cause of recessions. A careful look at history shows that excessively tight monetary policy caused recession in 1974, 1980, 1990, and 2001. Yes energy prices climbed in each of those instances, but tight money was the true cause of the contraction. This explains how energy prices, which have been on the rise for over five years now, have yet to undermine economic growth.

Federal Reserve policy is still highly accommodative and productivity is still strong. These two factors alone are enough to keep the economy expanding in the months ahead, despite the massive jump in oil prices.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|---|---|---|---|---|---|
| 6-10 / 7:30 am | Int’l Trade Balance - Apr | -$60.0 Bil | **-$56.3 Bil** | | -$58.2 Bil |
| 6-11 / 1:00 pm | Treasury Budget - May | -$164.0 Bil | **-$165.0 Bil** | | $159.3 Bil |
| 6-12 / 7:30 am | Retail Sales - May | +0.5% | **+0.6%** | | -0.2% |
| 7:30 am | Retail Sales Ex-Autos - May | +0.7% | **+1.3%** | | +0.5% |
| 7:30 am | Import Prices - May | +2.5% | **+2.0%** | | +1.8% |
| 7:30 am | Export Prices - May | +0.6% | **+0.5%** | | +0.3% |
| 7:30 am | Initial Claims - Jun 7 | 370K | **362K** | | 357K |
| 7:30 am | Business Inventories - Apr | +0.3% | **+0.5%** | | +0.1% |
| 6-13 / 7:30 am | CPI - May | +0.5% | **+0.5%** | | +0.2% |
| 7:30 am | "Core" CPI - May | +0.2% | **+0.2%** | | +0.1% |
| 8:45 am | U. Mich. Consumer Sentiment | 59.3 | **60.0** | | 59.8 |