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First Trust

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Monday Morning Outlook

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Velocity Returns

Last week was a very good week for those who believe in the US economy. The stock market bounced off a new low, and while they have yet to capitulate, short-sellers are definitely on the run. Two developments put the pessimists on the defensive. Number one – velocity has apparently returned. Number two – overly strict mark-to-market accounting has finally come under attack by Congress.

The early signs of a revival in velocity were evident a couple months ago, before a dollar of new government spending got out the door. Commodity prices, such as oil and gold, the Baltic Freight Index (which measures ocean freight rates) and used car prices, all bottomed. But the coup-de-grace was last week when retail sales surprised the talking heads for the second month in a row.

After January's 1.0% rise in retail sales, TV pundits said seasonal factors distorted the data. But, last week January sales were *upwardly* revised to 1.8% growth. After a strong month like that, retail sales often give some back. But in February, even though auto sales fell 4.3%, total sales only gave back a small 0.1%. Excluding autos, February sales shocked the pundits and rose 0.7%. In the past two months, retail sales (including autos) are up 10.7% at an annual rate, while retail sales (excluding autos) are up 14.8%. Chain store sales in February were the highest since last September. Slice it anyway you want, but the consumer is coming back. This is something to write home about.

Normally, business investment is the key driver of the business cycle. But when the economy is ravaged by a loss in velocity – literally, the speed with which money makes its way through the economy – a revival in consumer spending is the key leading sign that the economic pain is soon coming to an end.

Even overall inflation data has shifted. Consumer prices fell at a 12.4% annual rate in the last three months of 2008, but were up at a 3.4% annual rate in January. We expect a similar increase in February (CPI out Wednesday). The same goes for producer prices (due Tuesday).

And after a rare decline in *nominal* GDP – real GDP plus inflation – during the fourth and first quarters, we expect the second quarter to turn up. This severely undermines the case that monetary policy is too tight.

Meanwhile, perhaps the best news from last week came at a Capitol Hill hearing on mark-to-market accounting. At that hearing, key lawmakers, including House Banking Committee Chair Barney Frank and Rep. Paul Kanjorski, strongly urged accounting rule-makers to get their act together. Last year, despite warnings from many (including Steve Forbes, William Isaac, Gary Wolfram, and here at First Trust), the accountants made only superficial changes to the rules, and as a result, took an historically average financial market problem and converted into the greatest financial panic since at least the Great Depression. But now, Congress has said no more. The heat is on, and this time we can't imagine that FASB and the SEC will disappoint the markets again.

To top all this off, what appeared to be an un-impeded march toward even more federal government spending, even higher taxes and even more economic interference seems to have finally hit a bi-partisan road block. No wonder the stock market is showing signs of life.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-16 / 7:30 am	Empire State Mfg Index - Mar	-30.8	**-25.0**	-38.2	-34.7
8:15 am	Industrial Production - Feb	-1.3%	**-1.2%**	-1.4%	-1.8%
8:15 am	Capacity Utilization - Feb	71.0%	**70.9%**	70.9%	72.0%
3-17 / 7:30 am	PPI - Feb	+0.4%	**+0.3%**		+0.8%
7:30 am	"Core" PPI - Feb	+0.1%	**+0.1%**		+0.4%
7:30 am	Housing Starts - Feb	0.450 mil	**0.435 mil**		0.466 mil
3-18 / 7:30 am	CPI - Feb	+0.3%	**+0.3%**		+0.3%
7:30 am	"Core" CPI - Feb	+0.1%	**+0.2%**		+0.2%
3-19 / 7:30 am	Initial Claims - Mar 14	659K	**657K**		654K
9:00 am	Philly Fed Survey - Mar	-38.9	**-36.7**		-41.3
9:00 am	Leading Indicators - Feb	-0.6%	**-0.6%**		+0.4%