

**ECONOMY ON THE BRINK?
MAYBE NOT JUST YET
06.04.2007**

It appears that the future of the economy has come down to a struggle between consumer spending and business capital spending. Economic numbers released Thursday, May 31st suggest that there is an upward bias in business spending for capital equipment, while at the same time retail sales have been on the weaker side.

So far in this economic recovery and expansion, capital spending has been much weaker than in past periods. Please note the chart below, which details the relationship between non-residential fixed investment (capital spending) and residential investment (housing) during this recovery and expansion and prior periods. Only the period from 1982 onward experienced a more negative comparison. We believe the reason is due to the fact that there is little need to expand capacity in many industries because of foreign competition. That being the case, most of the investment money created by lower interest rates went to housing, which is fine short term. As a home does not create income, it has no economic multiplier in the long term. It could be that a catch-up of sorts is needed in capital spending to better balance supply and demand. Exports have been helped by a foreign economic expansion as well as a weaker dollar. Be that as it may, we do not believe this will offset a probable decline in consumer spending in the long term. It may, however, increase the second quarter GDP to a level better than the reported 0.6% first quarter increase. Keep in mind 0.6% indicates a growth recession. It is 80% below normal growth.

On the consumer side, retail sales fell 0.2% in April. So far in May, three of the four weeks witnessed less than 2.0% growth year over year, which is well below normal comparisons. As has been said so many times, it's tough to bet against the consumer, but it does appear a combination of debt and gasoline prices are causing a slowdown in his spending.

Non-residential fixed investment as a percent of outlays on durable consumer goods and residential investment

Index, Trough = 100

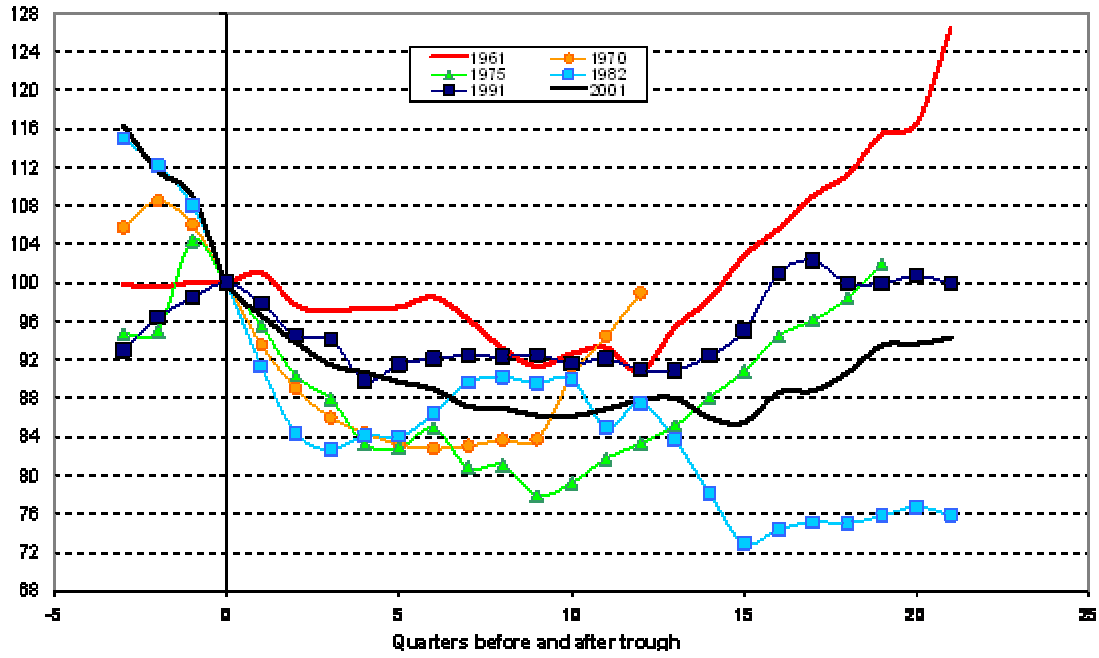


Chart Taken from www.financialsense.com