

IS THE EXPANSION OVER? 02/20/07

Over the last several months we have written about the slowing trend in the U.S. economy along with quite benign inflation numbers. Our theme has been, and still remains, that we are very near a recession with a possible deflationary bent. The 2006 fourth quarter real GDP advance number of 3.5% came as quite a surprise to everyone except the perma-bulls. It now appears that this number will be drastically lowered to something on the order of 2.0% to 2.5%. This is more in line with what we have been seeing in the data we follow.

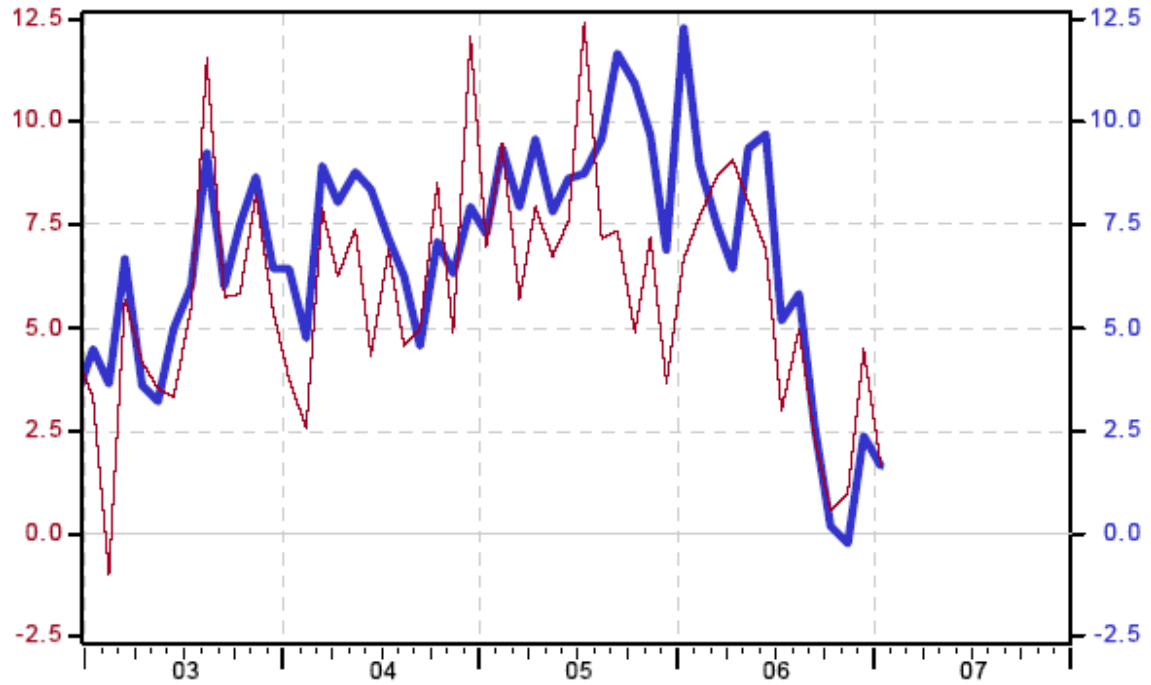
Assuming that the revised real GDP for the fourth quarter of 2006 stated above is close to correct, it fits very nicely into an impending recession. Now the trick is to ascertain what the first quarter of 2007 may look like.

As always, economic data is mostly mixed; however, the following chart of retail sales for January is very bearish. There have been numerous reports that January was going to be rather strong due to gift cards, which have become quite a favorite Christmas item over the past several years. Also, the weather for January was rather warm the first three weeks, leading many to expect a good retail sales number as well. The weakness in January fits nicely into Stephen Church's recent article "The Consumer Crunch: December 2006 Update". His analysis indicated that December of 2006 could well be the last, and best, month of the current expansion. The title of his piece was "Is the Party Over on New Year's?" We would urge you to visit his web site at www.piscataquaresearch.com.

Note: In our opinion, the analysis by Stephen Church is superb; however, his conclusions regarding inflation, deflation, and the level of long-term government interest rates are incorrect.

< Retail Sales & Food Services
6-month %Change-ann SA, Mil.\$

Retail Sales & Food Services Excl Motor Vehicles & Parts Dealers >
6-month %Change-ann SA, Mil.\$



Sources: Census Bureau/Haver Analytics, Census Bureau

Chart taken from www.northerntrust.com