

Don't Sweat "Soft Patch II"

Some recent reports on the economy have been tepid and that's likely to continue for at least a few more weeks. For example, back in early March the four-week average for initial unemployment claims hit a recovery low of 389,000; now they're 439,000. Continuing claims are lower than in early March, but not much.

Manufacturing production dropped the most in April for any month since the start of the recovery. Meanwhile, for May, we witnessed declines for both the Empire State index and Philly Fed index, which are measures of manufacturing activity in their respective regions. Both were still in positive territory, signaling expansion, but not as rapid as earlier this year.

In addition, housing starts fell steeply in April and early estimates suggest a noticeable drop in auto sales in May. The consensus expects a decline in durable goods orders for April when that's reported Tuesday. We expect an even bigger drop.

So what gives? Is this the end for the recovery, which is still shy of the tender age of two full years? Are the double-dippers finally getting the chance to uncork their champagne? Is a third round of quantitative easing back on the table?

Don't even think it. What we have here is an eerie combination of one-off events that have added up to a shift in some activity that would have normally happened in the second quarter into the third quarter of this year. The double-dippers need to keep their bottles on ice and, even if it could help – which we highly doubt – there is no need for QE3.

The triple disaster in Japan – earthquake, tsunami, and nuclear meltdown – is the key behind many of these events. Many manufactures around the world rely on parts made in Japan. Japan's manufacturing output declined 15% in March. That's not an annual rate. That's a one-month drop. To put this in perspective, it's a larger plunge than the US has ever suffered

since at least 1921, and that includes the Great Depression and the immediate aftermath of World War II.

As a result, many US auto plants have temporarily shutdown already due to lack of parts and others are moving up their usual summer retooling-related shutdowns into the spring. Meanwhile, with severely depleted inventories, manufacturers and dealers have cut incentives and, in turn, only motivated buyers are driving cars and light trucks off the lots.

But outside the auto sector, manufacturing production expanded in April. Meanwhile, those Empire State and Philly Fed reports that showed slower production growth in May also showed faster hiring, which companies certainly would not be doing if they thought these problems would last.

Other events that are throwing the economy for a very temporary loop are a violent tornado season and major floods. Housing fundamentals – large but rapidly declining excess inventories, low prices relative to rents and building costs – suggest the long-awaited recovery should be starting right now. But housing starts dropped 10.6% in April. They were up 5.5% excluding the South (the hardest hit region), but few are paying attention to that fact.

Tomorrow, when the report on durables arrives, we expect volatile Boeing orders to be the primary reason for a drop. In addition, there's been a pattern lately where companies make fewer orders in the first month of each quarter – for machinery, computers, appliances, and electrical equipment – and then make it up later in the quarter. Again, nothing to worry about.

Bottom-line: monetary policy is loose, tax rates remain relatively low, the productivity revolution continues, free markets are resilient, and public policy appears to be moving in the right direction. In a few months we will be looking back at recent reports as just statistical noise.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-24 / 9:00 am	New Home Sales - Apr	0.300 Mil	0.310 Mil		0.300 Mil
5-25 / 7:30 am	Durable Goods - Apr	-2.5%	-4.6%		+4.1%
7:30 am	Durable Goods (Ex-Trans) - Apr	+0.5%	-0.3%		+2.3%
5-26 / 7:30 am	Q1 GDP Second Report	+2.2%	+1.9%		+1.8%
7:30 am	Q1 GDP Chain Price Index	+1.9%	+1.9%		+1.9%
7:30 am	Initial Claims - May 21	400K	415K		409K
5-27 / 7:30 am	Personal Income - Apr	+0.4%	+0.4%		+0.5%
7:30 am	Personal Spending - Apr	+0.5%	+0.5%		+0.6%
8:55 am	U. Mich. Consumer Sentiment	72.4	72.4		72.4