THE ECONOMIC OUTLOOK GROUP

475 WALL STREET
PRINCETON, NEW JERSEY 08540 TEL: 609 - 529 - 1300
WWW.ECONOMICOUTLOOKGROUP.COM

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

March 12, 2009

Jump In Ex-Autos Retail Sales Trumps Jobless Claims

The latest retail sales report is an important one because it supports the notion that this recession is starting to wind down. February's improvement in consumer spending was a surprise for many forecasters, but not to us. In our previous ***Economic Talking Points***, we pointed out that employee real earnings (i.e., the change in wages after adjusting for inflation) have begun to climb the last several months, thereby increasing purchasing power. Greater purchasing power is an essential prerequisite for stronger consumer spending. That is now manifest in the today's release on retail sales.

Though overall retail sales slipped 0.1% in February, that decline was largely the result of the plunge in auto sales. But if you exclude autos, expenditures on retail goods jumped 0.7%. That rise followed an upward revised 1.6% increase for the same ex-autos category in January. This improvement comes after five straight months of decline in ex-auto sales.

We're also seeing more retail sectors benefit from increased household spending. Stores that have seen better sales in the last two months are electronic and appliance stores (products that are normally bought on credit!!), health and personal care stores, clothing stores, sporting goods and hobby shops, general merchandise stores, and nonstore retailers (which consists of purchases from online web sits and via catalogues).

Greater household purchasing power and aggressive discounting are working their magic to lure customers back into stores. This is a crucial part of the recovery process.

As businesses work off excess retail inventories, they get closer to the point of having to replenish emptying store shelves. As order for more goods are received by factories, they rev up their assembly lines, order more production material, and begin to hire workers, thereby touching off a virtuous cycle.

A resumption in consumer spending, mild as it may be, couldn't have come at a better time. We're in the second year of recession and economists have been debating for months whether the dynamics underway in the economy resemble more a depression than a typical (if harsh) business downturn. We've had a cascade of dismal reports over the past year. For instance, since last summer consumer spending had collapsed on a scale we have not seen in half a century. The economic clouds were darkening by the day and it gave star status to pessimists who argued the economy would not see a recovery until 2010, or even later.

Some of the same pessimists many now argue the improvement in January and February retail sales was just a fluke and couldn't be sustained given the disastrous job market. There is certainly an inherent logic to this argument. This morning we got another depressing report that first time applications for unemployment benefits jumped by 9,000 to 654,000. This would make it six straight weeks where new filings held above 600,000. Equally troubling is that the total number of Americans now collecting unemployment surged to a record 5.3 million.

Clearly the economy is still writhing in pain over the banking and housing crises. But the pessimists who view the jump in jobless claims as yet more evidence that the economy will remain lifeless for sometime may be ignoring an important fact. History has shown us time and again that recessions end and recoveries begin LONG BEFORE we see an improvement in the labor market. Look back at the recession in 1991. It ended in March of that year, yet the unemployment rate kept creeping up for another 15 months. After the 2001 recession concluded in November, joblessness continued to rise until the middle of 2003. We will almost certainly have another jobless recovery once this recession ends, but at least we expect to see a resumption of positive GDP growth in the second half of the year, thanks to higher consumer and government spending.

The bottom line: We're assigning more analytic weight to January and February's retail sales number than the weekly jobless claims numbers. Before firms will hire workers back, they want to see a pick up in revenues and earnings. If retail sales continues to improve in the months ahead, it could well be the long awaited sign that this economy is beginning to transition out of recession.

© Copyright 2009 ALL RIGHTS RESERVED
THE ECONOMIC OUTLOOK GROUP, LLC