

# THE ECONOMIC OUTLOOK GROUP



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## ECONOMIC TALKING POINTS

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### **The Economy Has Finally Achieved Escape Velocity**

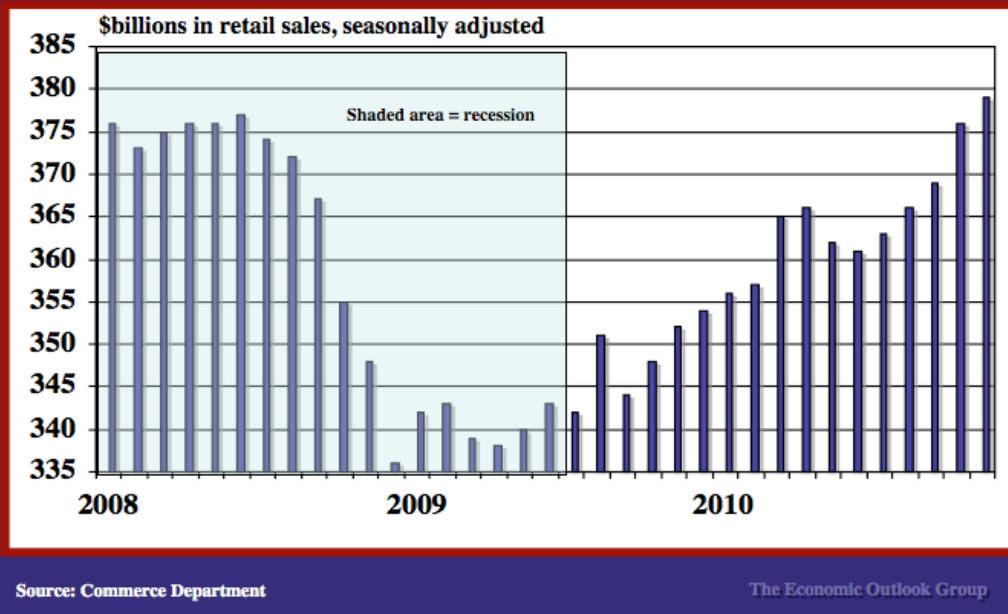
We are making the call today that the US economic recovery is finally in a self-sustaining mode. For the last several months, we have seen a consistent flow of economic reports showing business and consumer spending moving ahead with greater conviction. This morning's batch of indicators is only the latest to corroborate that trend.

#### **Retail Sales**

November's headline retail sales rose 0.8%, and that followed major upward revisions to October and September. (October sales at retailers jumped 1.7%, not 1.2% as originally reported, and September saw a pick up of 0.9%, not 0.7%.) Take out spending on autos, gasoline, and building material, and you get to the core of retail sales, which still jumped 0.9% last month, the largest increase since last summer. Also encouraging is that virtually every category of discretionary spending saw hefty increases last month. (For example, sporting goods, hobby book and music stores sales were up 2.3% in November and 12.3% for the year.)

Households have clearly shaken off the recession blues and are eager to unleash some of the pent up demand that has accumulated since 2007. Remember, all these retail sales numbers are seasonally adjusted, which means they have been corrected to discount the usual holiday shopping based on spending trends going back to 1995. This means the strong bounce back in consumer outlays is not simply because people spend more this time of year. It is because the improvement in household balance sheets and the positive outlook for the economy are enabling Americans to do lots more shopping. In other words, the rebound in retail sales will continue in 2011.

**Retail sales now strongest in 3 yrs!**  
**This holiday shopping season will be the best in five years.**



**Business Inventories**

Corroborating this trend was separate release on business inventories. Businesses, and especially retailers, have been struggling to keep with up with strong demand. Business inventories grew by 0.7% in October, but total business sales shot up 1.4%. That brought the inventory sales ratio down to a near historic low of 1.27 months. This is encouraging on two fronts. First, it tells us that as soon as trucks drop off goods on loading docks in the back, these items quickly move out the front door as a sale, making it tough for companies to build up their stock rooms. As a result, orders to rebuild inventories will remain strong. More orders keep factories humming and lead to greater employment.

**Sales are outpacing the rise in inventories.**  
**Inventories being sold as soon as they arrive in the loading dock**

	Adjusted					
	Sales			Inventories		
	Oct. 10/ Sep. 10	Sep. 10/ Aug. 10	Oct. 10/ Oct. 09	Oct. 10/ Sep. 10	Sep. 10/ Aug. 10	Oct. 10/ Oct. 09
Total business.....	1.4	0.8	9.3	0.7	1.3	6.9
Manufacturers <sup>3</sup> .....	0.3	0.7	6.8	0.9	1.1	5.8
Retailers.....	1.8	1.0	8.4	-0.6	0.8	5.7
Merchant wholesalers <sup>4</sup> ..	2.2	0.5	13.4	1.9	2.1	9.9

## **National Federation of Independent Business**

Lending more credibility to this self-sustaining economic cycle was a third indicator out this morning, this time by the National Federation of Independent Business. They reported that small businesses in December were more optimistic about the future economic climate than at any time since December 2007, when the recession began. Small business confidence has actually been climbing in each of the last four months, pushing up the index to a three-year high of 93.2. Behind the rise in optimism is the fact that consumers are back and contributing to higher sales. As sales increase, these firms are likely to expand their operations by investing more and hiring additional workers.

For example, the number of NFIB members in the December survey who believe the next three months would be a good time to expand rose to its highest in more than a year. Those prepared to increase hiring the next three months jumped to the largest in more than two years.

Since small and mid-size businesses account for 70% of all new hiring during a recovery, the latest NFIB survey suggests that the pace of job creation will accelerate in the first quarter of 2011.

## **Producer Prices**

Not surprisingly, the strengthening US economy is beginning to warm up the inflation thermometer. The BLS announced that headline producer prices increased 0.8% in November, the most in eight months. The latest increase was attributed largely to hikes in energy and fruit prices. If you remove food and energy, core PPI rose 0.3% last month. That may not be much to get excited about, but that number does match the earlier highs of the year.

## **Bottom Line:**

With one indicator after another depicting an economy that is gathering more momentum, the Federal Reserve will have to revisit the need for implementing QE2. It appears to us that the lagged effects of a near zero fed funds rate and the earlier stimulative actions from QE1 are finally having a beneficial impact on the economy. It normally takes about 18 months for a change in monetary policy to affect the real economy. It took a lot longer this time but then there was nothing normal about this last business cycle. Nevertheless, as evidence mounts that this economy is self-sustaining, the Fed should be prepared in its meeting today to back away from the next round of quantitative easing --- and say as much in its statement. To do otherwise risks having the market take control and sharply push up yields on medium and long term Treasuries -- and that ultimately will work against everything the Fed has been trying to achieve so far.