THE ECONOMIC OUTLOOK GROUP

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ECONOMIC TALKING POINTS

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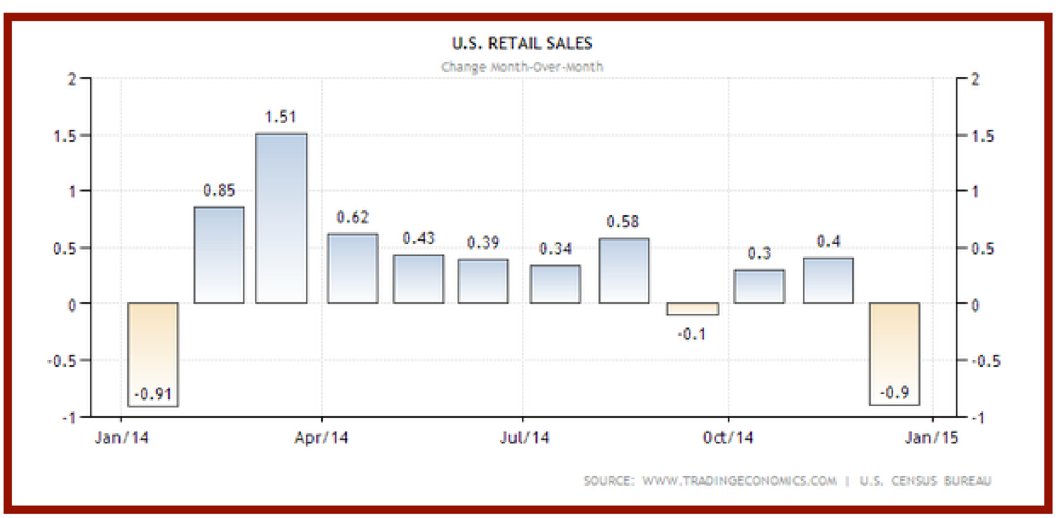
Where were consumers last month? And why is that not even important!

Many analysts struggled this morning to make sense of the sharp drop in December's retail sales. The 0.9% decline in spending was unexpected and it raised new fears that consumers may contribute less to growth this year than previously thought. Could that be true?

Part of the decline in sales can be attributed to the 60-cent drop in the average retail price of gasoline last month, which meant Americans spent 6.5% less at the pump. But even if you exclude the shrinking outlays for fuel, purchases of other retail items also fell 0.4%. This bad news on retail sales followed another disconcerting report on Friday that showed average hourly earnings tumbled 0.2% in December. So now come a cascade of questions.



Have we been too optimistic about the health of the consumer and their willingness to spend? Why were households so cautious? If Americans are indeed pulling back, what impact will this have on the overall economy? Is the business cycle about to plateau?

Lots of questions. ***Our answer for all is simple and to the point: Get over December's soft sales numbers!***

Why make such a statement? Look, there are moments when some analysts display an historical memory that goes back to breakfast! They simply relegate the broader reality that rarely in the last century have we seen a more positive confluence of forces that promises faster growth, more hiring, greater household spending and higher cap ex outlays this year. Instead, these observers of the economy will dwell excessively on an economic tick that does disappoint, and often follow that up with a new, more negative assessment of the economic outlook. It's a bad practice because it ignores context and other the nuanced messages the economy sends out.

There can be no mistaking what the positive forces acting on the economy are right now:

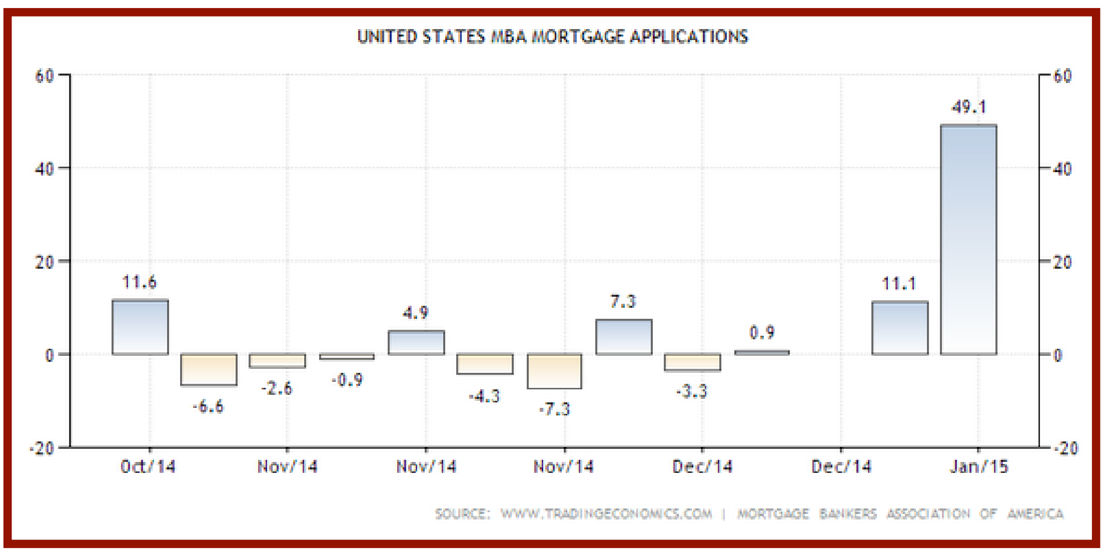
- The plunge in energy prices.
- Historically low interest rates
- Stable inflation of 1% to 2%
- **Real wage increases for the year in every category** (average hourly earnings, average weekly earnings --supplied by the BLS, and the wages and salaries component of personal income as well as disposable income --- by the BEA)
- Much healthier household balance sheets. Debt service burdens now among the lowest in history.
- The best hiring climate since 1999.
- Consumer confidence levels near decade highs.
- Businesses expressing far more confidence on the sustainability of this expansion. So much so they have posted the largest number of job openings in nearly 14 years!
- Firms are even starting to ramp up capital spending projects to replace or update their aging stock.
- Banks have seen loan demand accelerate.
- The government has approved new measures that would relax on rules for mortgage lending.

Trust us, this list is not even complete.

But we have to return to the initial question of why Americans held back on spending last month?

It's not worthwhile spending much time searching for a definitive answer. There may not be any. Many Americans could have been preoccupied last month with deadlines to register for health insurance coverage in 2015, and in the process reacted to the sticker shock on the cost of premiums. Or perhaps millions simply clustered around living rooms on weekends to download and view "The Interview." Or you could blame it on the Geminids Meteor Showers mid-month for keeping people away from stores.

The point is let's not sweep under the carpet other important economic data points. For example, one very encouraging statistic out today, since it offers clues on where the economy is headed, was the latest on applications for home mortgages. They jumped by the most in more than six years last week as 30-year mortgage rates plummeted below 4%, the lowest since May 2013!!



Americans rushed to refinance, which translates to even more savings for households. In addition, mortgage applications to purchase a home surged to its highest level since September 2013. All very good news.

If housing activity regains its momentum, then we can say with confidence that the US has finally shaken off the last vestiges of the great recession. Bottom line: We are dismissing December's retail sales report and sticking with our forecast for the US economy to grow better than 3% this year and next, and leading that charge will be the consumer.

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United States

	I 2014	II 2014	III 2014	IV 2014	I 2015	II 2015	III 2015	IV 2015	I 2016	II 2016	III 2016	IV 2016
Real Gross Domestic Product (GDP):												
%	-2.1	4.6	5.0	3.7	3.0	4.1	3.4	2.8	2.8	3.2	2.7	2.8
Personal Consumption Expenditures:												
PCE	1.2	2.5	3.2	3.0	2.5	3.1	2.9	2.8	2.5	2.8	3.0	2.7
Inflation, end of period, year-over-year:												
CPI %	1.5	2.1	1.7	1.5	1.3	1.0	1.7	2.0	2.2	2.3	2.6	2.7
Unemployment Rate (end of period):												
%	6.7	6.1	5.9	5.6	5.6	5.3	5.3	5.4	5.5	5.3	5.3	5.3
Non-farm Payrolls, monthly avg. thousand:												
	189	267	239	289	250	270	255	275	235	245	250	250
Treasury 10-yr Note Yield % (end of period)												
	2.72	2.52	2.51	2.17	2.48	2.60	2.85	3.10	3.35	3.50	3.75	4.05
Federal funds rate % (end of period)												
	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.00	1.50	2.00	3.00	3.00

GDP Growth - Global Economy

Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
US	1.8	-0.3	-2.8	2.5	1.6	2.3	2.2	2.4	3.3	2.9
Eurozone	2.6	0.6	-4.1	1.7	1.4	-0.6	-0.4	0.6	1.2	1.7
United Kingdom	3.1	0.6	-5.2	1.7	0.7	0.3	1.8	3.0	2.5	2.9
Japan	2.1	-0.7	-5.4	4.6	-0.7	1.6	1.5	1.2	1.4	1.9
Canada	2.7	0.7	-2.8	3.2	2.5	1.7	2.0	2.2	2.3	2.9
India	9.1	8.8	6.3	8.4	8.6	6.7	4.9	5.5	6.5	7.0
China	14.2	9.6	9.2	10.5	9.3	7.8	7.7	7.1	6.7	6.4
Brazil	5.7	5.1	-0.3	7.5	2.7	0.9	2.3	0.1	0.8	2.3
Mexico	3.3	1.4	-4.7	5.2	4.0	3.9	1.1	2.7	3.4	4.0
Australia	4.0	2.3	1.2	2.8	2.6	3.6	2.4	2.6	2.7	3.0
Russia	8.1	5.6	-7.9	4.0	4.3	3.4	1.3	-1.5	-3.7	1.0
World	5.4	1.6	-1.9	4.2	3.0	2.6	2.9	2.9	3.3	3.7

Key Currency Values

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016
USD/Yen	91	93	81	77	87	105	119	125	110
Euro/USD	1.40	1.43	1.34	1.29	1.32	1.37	1.21	1.18	1.26

Oil (Brent spot) & Gasoline (Average retail unleaded, $)

	End 2008	End 2009	End 2010	End 2011	End 2012	End 2013	End 2014	End 2015	End 2016
Crude oil per barrel	46	78	95	107	111	111	58	80	90
Gasoline	1.61	2.57	3.00	3.27	3.30	3.32	2.26	2.70	2.85