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

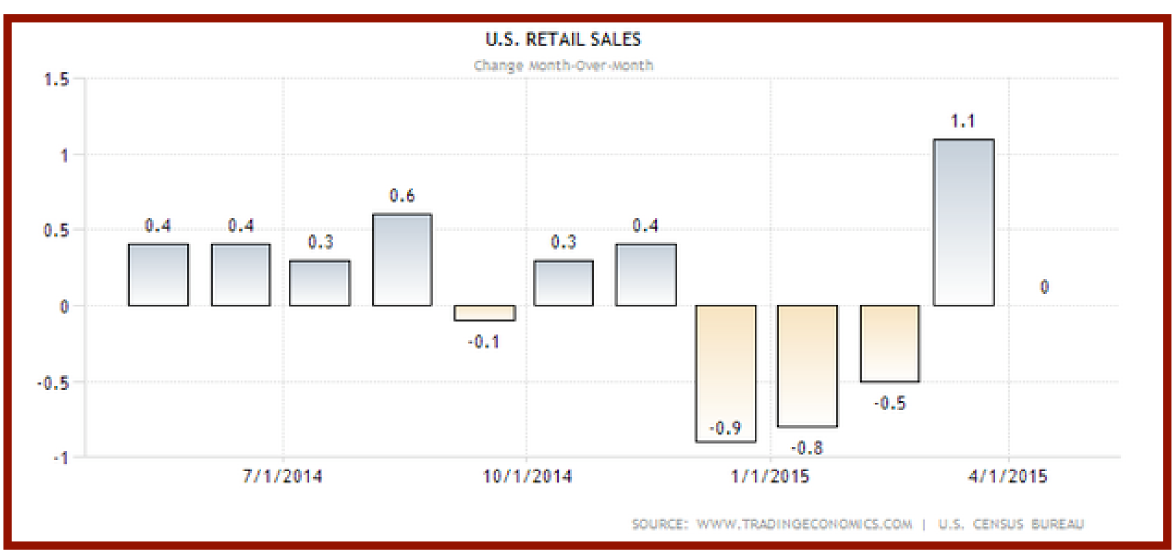
May 13, 2015

Weak Retail Sales Casts A "Brief" Shadow Over The Economy

The bland retail sales report for April certainly reduces the chance of a Fed rate hike in June. While March data on consumer spending at retail outlets was revised slightly higher, from 0.9% originally to 1.1%, the absence of any increase since then has to be viewed as a bit puzzling. The consensus forecast among economists was for sales to rise at least 0.2% in April. But it failed to do even that.

April was supposed to be the month Americans would set aside their winter shovels and demonstrate their confidence in the job market and rising real incomes by ramping up shopping. Instead, retail sales showed no growth last month and this will undoubtedly raise questions on why consumers held back and what implications this will have on overall economic growth and monetary policy (Chart 1).

Chart 1.



So what happened?

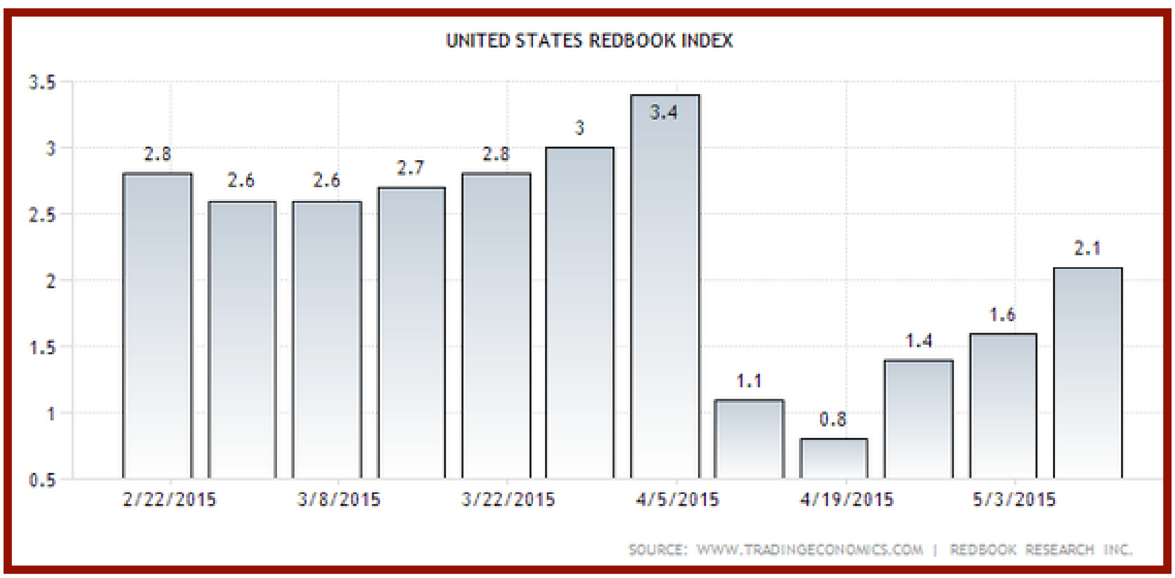
From an historical context, this pattern of weaker sales showing up in April is nothing new---if you look at the numbers **before** adjusting for seasonal factors. OK, before anyone slips into a coma reading this, let me make a quick point.

Since 2000, retail sales in March was **always much higher** than in February, while April retail sales **was below that of March in 14 of the last 16 years.** Again, this is prior to adjusting for seasonal factors. Given this historic trend, April's soft sales numbers should not be viewed with great concern since that has been the trend 88% of the time for that particular month. In other words, April's disappointing performance has little to do with a sudden shift in the business cycle. It simply conforms to a long , if head scratching, pattern.

Having said that, retail sales during the past two months have become baffling in a conceptual sense. We found it curious given brutal winter weeks in March that sales managed to surge 1.1% that month --- then flat lined a month later when weather conditions were more accommodating.

Look, the point we're making is that any argument that weak sales in April means consumers are in no mood to spend and that the expansion is faltering is simply not consistent with a host of other metrics on the consumer economy. The weekly Johnson Redbook series (Chart 2) and the Retail Chain Store Sales by Goldman Sachs and Retail Economist reported better numbers during the month of April.

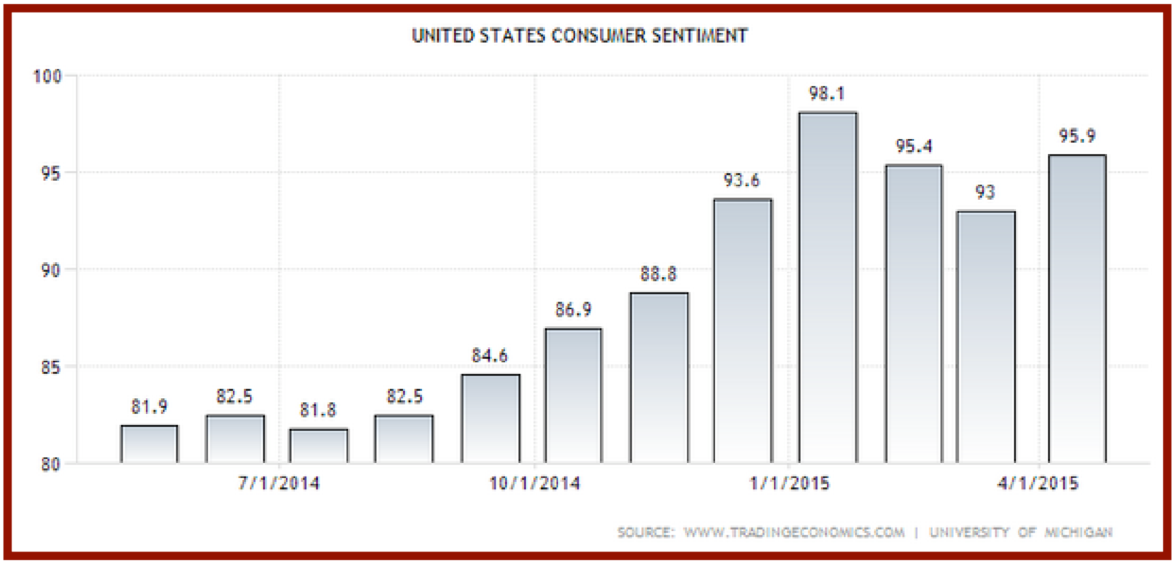
Chart 2. Johnson Redbook weekly retail sales index (YOY% Change)



But let's not stop there. The Federal Reserve noted that bank loans to consumers increased every single week last month. Credit card and other revolving forms of financing surged in April above that of March. Americans were also out purchasing homes. Pending homes sales has increased in each of the last three months.

Nor should we forget consumer optimism (University of Michigan sentiment index) jumped to its second highest level in seven years in April, with the average over the past five months the most upbeat since 2004! (Chart 3)

Chart 3. University of Michigan Consumer Sentiment Index



That boost in confidence comes at a time when the unemployment rate fell to 5.4% in April, the lowest since 2008 --- and with real disposable personal income in the first quarter up 6.2% from the previous quarter, the biggest jump in two years.

The next major report on household outlays will come in two weeks with the release of the much broader personal spending and income stats. (Retail sales do not include purchases of services.)

For now, we are resigned to expect a contraction of 0.6% in GDP growth in the first quarter. Our forecast for the second quarter has been revised down by three-tenths of a point, to a still respectable 3.1% rate.

The odds of a lift off in interest rates during the June FOMC meeting has been reduced to 25%, from 50%. While the Fed is ready, willing and mostly eager to begin normalizing rates, the retail sales report likely swayed Janet Yellen and other Fed officials to wait a bit longer before acting. The probability for a September rate hike has thus increased to 60%, from 40%.

We have said it before and we'll say it again, this expansion still has lots of forward momentum. The fundamentals supporting growth remain in place and we see this business cycle continuing for at least another two years. While we cannot fully explain why the retail sales numbers were not stronger in April, there is absolutely nothing to suggest that we are facing a sustained consumer-led slowdown in economic activity.

================================