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ECONOMIC TALKING POINTS

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Retail Sales: A Note of Caution About Future Consumer Spending

Before you get too far marveling at the resilience of consumers from the latest report on retail sales, a note of caution needs to be said.

There's no doubt this past holiday shopping period was a robust one. Based on November and December's retail sales, it was the strongest holiday season since 2010. Last year alone, retail sales increased by 4.2%, the most since 2014 — and if you remove autos, which can inflate the headline figure, household outlays turned out to be the highest since 2011.

When you adjust for inflation, the actual volume of total goods purchased ("i.e., real retail sales and food services") jumped by 2.4% in 2017, far outpacing the 1.7% the year before.

Having said all this, a note of caution is now warranted.

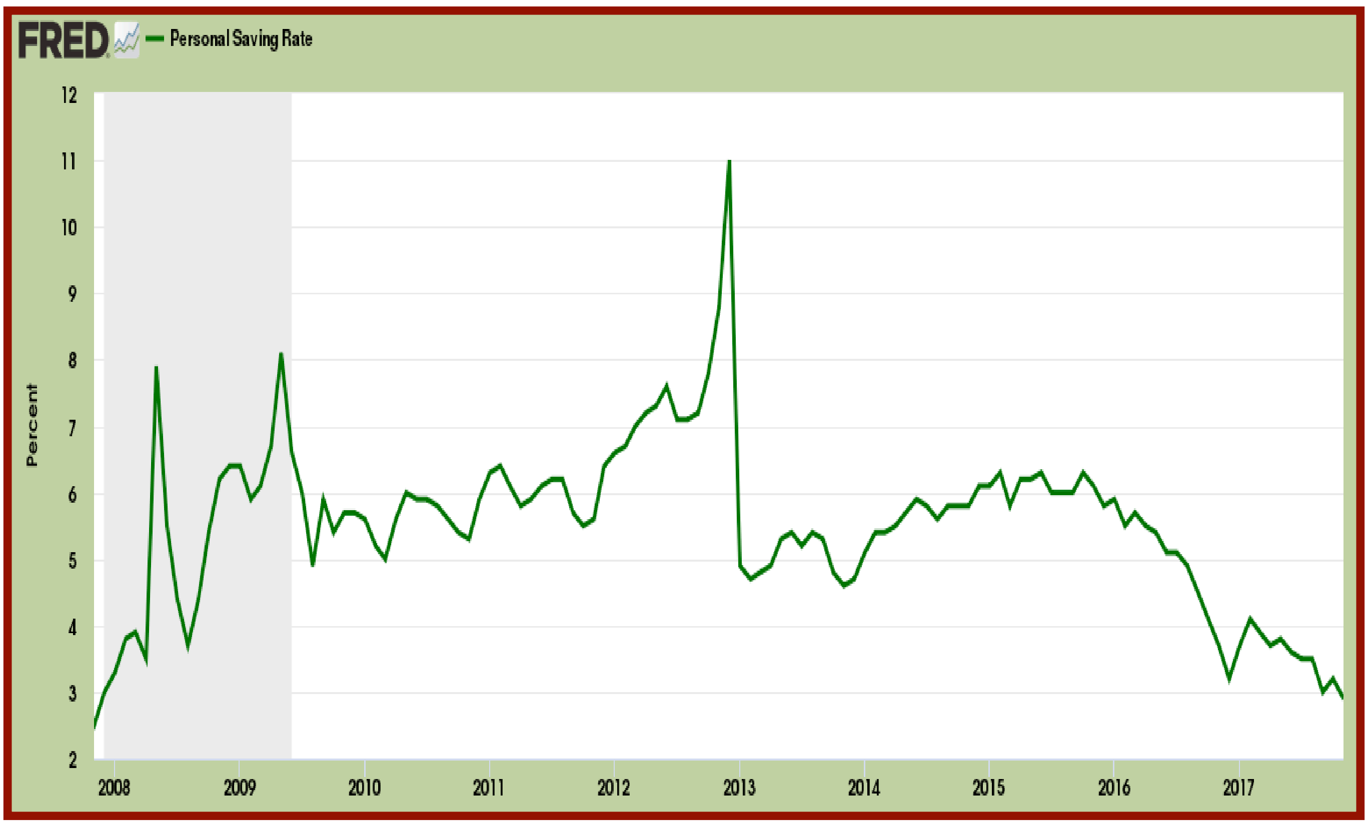
Expect to see a slowdown in household expenditures in the coming months, enough to impact both overall GDP growth and possibly the direction of interest rates. Simply put the seeds are now in place where we believe shoppers will become more frugal in the first quarter, and perhaps beyond.

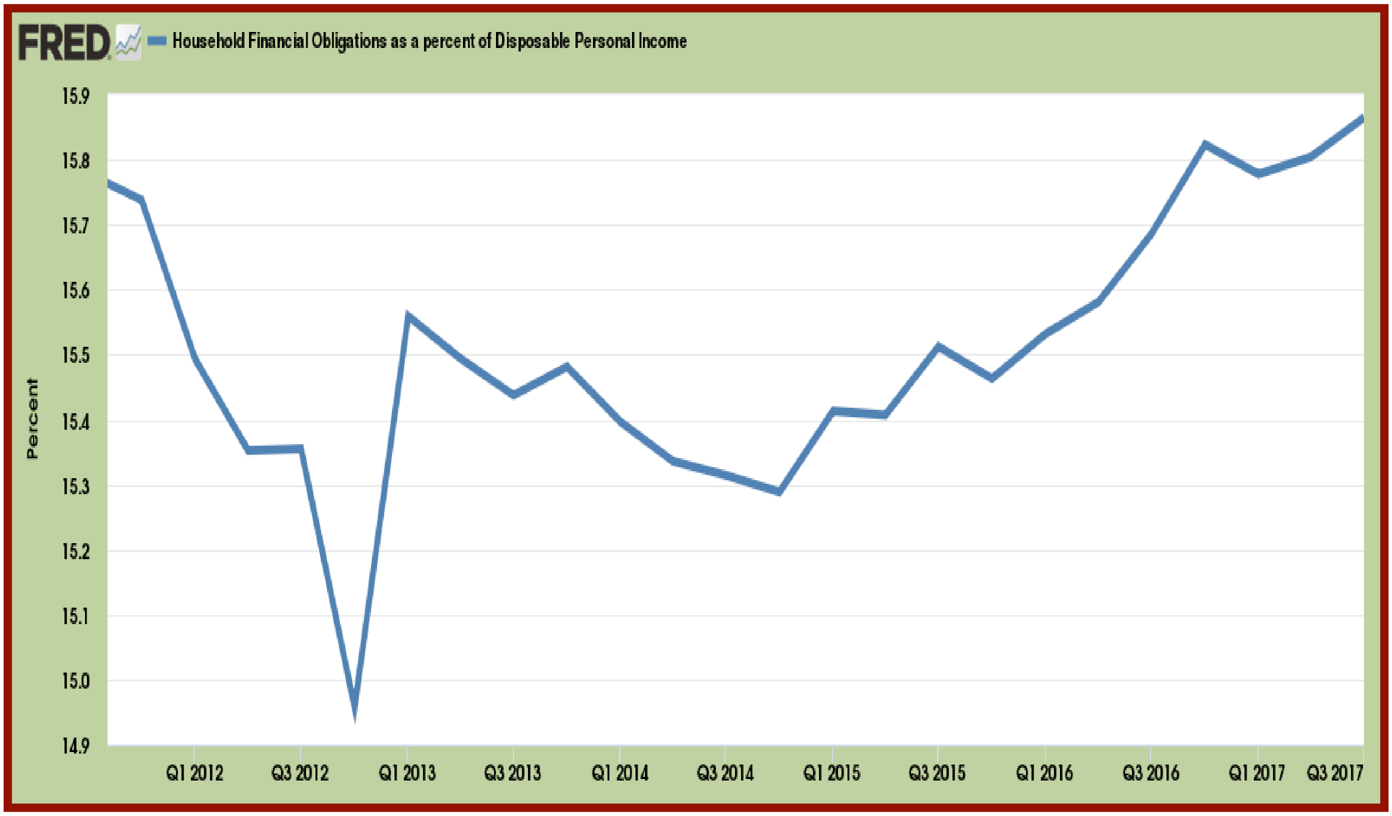
This projection is based on several factors:

1. Oil prices have posted their strongest opening this year since 2014 and that will propel gasoline prices higher. In just the past month, the national average retail price of gasoline already rose 2.6%, to $2.52 a gallon (as of January 12th). While the latest CPI report showed the cost of gasoline strangely falling 2.7% in December, be prepared to see it reverse course to reflect the climb in WTI crude prices. Higher prices at the pump will sap some purchasing power from consumers and dampen non-fuel spending.

2. Then there's the broader issue of the business cycle. Shoppers have supported this expansion for nearly nine years, which raises an obvious question. Are we approaching a point where consumer demand has been satiated? After all, how many more cell phones, autos and home electronic gadgets do households need at this juncture in the economic cycle? December's report on retail sales already showed fewer purchases of sporting goods, clothing, electronics and appliances.

3. Americans have also financed much of these purchases by taking on an unprecedented amount of debt and saving far less. Total household debt now stands at a record high $12.96 trillion. That may be manageable when interest rates were historically low, but it could be more problematic now that we're in a rising rate environment. Total household debt service in the 3rd quarter last year (latest available by the Fed) was 15.86% of disposable personal income, the highest since the second quarter of 2011! Americans have also dug deep into their savings, and in the process slashing their personal savings rate down to 2.9%, the lowest in ten years. If households chose to replenish some of their savings and/or reduce indebtedness, we will see less discretionary spending in 2018.





4. Another important factor that should impact consumer outlays is demographics. Baby boomers have had a profound impact on the economy at every stage of their life cycle. It will be no different now that they are retiring. These boomers will be downsizing, selling off their possessions, moving into smaller homes and showing less interest in purchasing "stuff." What's especially noteworthy is that as the larger millennial generation takes center stage, they show no inclination to take over and become big spenders. Large college debts, skepticism over the solvency of social security, higher health care costs and seeing first hand the painful consequences of the last financial crisis have left them with a set of values that discourages superfluous spending.

Bottom line:

To be clear, we are not forecasting an abrupt retrenchment by consumers, one that could endanger the entire expansion. After all, job and income security remains strong, and confidence levels are still high. Moreover, the latest tax cut will leave households with a little more disposable income. But for reasons cited above there is a high probability that real consumer spending will plateau in the coming months and take some of the wind out of the economy.

(Forecasts below)

Key Economic Forecasts

- Actual
- Forecast

United States

	I 2017	II 2017	III 2017	IV 2017	I 2018	II 2018	III 2018	IV 2018	I 2019	II 2019	III 2019	IV 2019
Real Gross Domestic Product (GDP):												
%	1.2	3.1	3.2	2.8	2.4	3.2	3.0	2.5	1.9	2.5	2.6	2.8
Personal Consumption Expenditures:												
PCE %	1.9	3.3	2.2	3.6	2.4	3.1	2.6	2.4	2.2	3.1	2.9	2.7
Inflation, end of period, year-over-year:												
CPI %	2.4	1.6	2.2	2.1	1.8	2.0	2.1	2.3	2.4	2.4	2.5	2.7
Unemployment Rate (end of period):												
%	4.5	4.4	4.2	4.1	4.2	3.8	3.8	3.9	4.2	4.4	4.4	4.5
Non-farm Payrolls, monthly avg. thousand:												
	166	187	128	204	190	185	160	160	150	145	140	140
Treasury 10-yr Note Yield % (end of period):												
	2.39	2.30	2.33	2.41	2.45	2.55	2.85	3.10	3.35	3.38	3.40	3.40
Federal funds rate % (end of period):												
	0.88	1.13	1.13	1.38	1.63	1.63	1.88	2.13	2.38	2.63	2.63	2.63

GDP Growth - Global Economy

Country	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
US	-2.8	2.5	1.6	2.2	1.7	2.6	2.9	1.5	2.4	2.8	2.4
Eurozone	-4.1	1.7	1.4	-0.9	-0.3	1.2	1.6	1.7	2.3	2.4	1.7
United Kingdom	-5.2	1.7	0.7	0.3	1.8	2.9	2.2	1.8	1.4	1.0	1.4
Japan	-5.4	4.6	-0.4	1.6	1.5	-0.1	1.1	1.0	1.6	1.9	0.9
Canada	-2.8	3.1	3.1	1.7	2.2	2.5	0.9	1.4	3.2	2.7	2.5
India	6.3	8.4	8.6	6.7	4.9	7.4	7.9	7.1	6.8	7.5	7.5
China	9.2	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.3	6.2
Brazil	-0.3	7.5	2.7	0.9	2.3	0.1	-3.8	-3.6	0.9	2.3	2.8
Mexico	-4.7	5.2	4.0	3.9	1.4	2.3	2.7	2.0	2.1	2.0	2.5
Australia	1.2	2.8	2.6	3.6	2.4	2.6	2.4	2.4	2.7	2.8	3.0
Russia	-7.9	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.4	2.1	2.0
World	-1.9	4.2	3.0	2.6	2.9	3.0	2.7	2.4	3.5	3.7	3.9