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ECONOMIC TALKING POINTS

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Retail sales, Industrial Production and Consumer Sentiment

As the final economic reports for 2021 trickle out, we can easily see the hardships consumers faced toward the end of the year.

To begin with, retail sales data for December turned out to be a surprise --- not because it turned down, but by the steepness of the drop.

The 1.9% collapse in spending, the worst decline in 10 months, reflected declines across virtually all major categories --- motor vehicles, furniture, electronics and appliances stores, food and beverages, clothing, sporting goods, and restaurants and bars. All were down.

Even the usually reliable strength with nonstore retailers, mostly e-commerce shopping, reversed course with a 8.7% fall in sales.

One of the few groups that managed an increase in purchases were at health and personal care stores. But that was to be expected given how everyone was coping with the twindemic of Omicron and the flu.

So what was behind December's broad crash in general household outlays?

First, consumers smartly chose to do their holiday shopping early last fall. The well-publicized distress in the global supply chain led shoppers to realize they had better accelerate the timing of their purchases---or risk hearing the dreaded words "out of stock."

Second, inflation was also very much on the minds of Americans. Not only was it difficult for shoppers to find their favorite products, but if even they did manage to

locate one, there was often sticker shock. And yet, fearful that inflation would only push prices higher, shoppers grudgingly decided it was better to buy now to avoid paying even more later.

If that wasn't painful enough, making matters worse was the damage inflation inflicted on household income. Rising inflation had withered away the purchasing power of consumers. Real average hourly pay eroded 2.4% over the last 12 months, while real average weekly earnings sank 2.3%. A collective ouch! may not have been inaudible but it was palpable.

Third, we incessantly hear how household savings have ballooned since the onset of the pandemic. Look, it is true that Americans have accumulated an aggregate $2.5 trillion in so-called excess savings. This came after consumers thoroughly shut down spending in the spring of 2020, which was then followed by multiple government paychecks to households under the CARES Act in 2020 and the ARP Act in early 2021.

But let's keep this in perspective. Behind all the glossy rhetoric of how flush Americans are with extra funds is the sobering reality of how uneven those funds now rest among different income groups. Low-income households tend to burn through savings much faster than the wealthy, and the former likely now have far fewer resources to sustain the spending seen in early fall.

One need only look at how little Americans are saving from each paycheck. The personal savings rate plunged to a 4-year low of 6.9% in November.

Finally, it is axiomatic that retailers can't make money if they don't have anything to sell. As the Delta variant in December gave way to the far more contagious Omicron pathogen, it deepened the chokehold on the entire supply chain distribution systems. There were fewer dockworkers unloading containers at ports, truckers were lacking as well and warehouse employees were also struggling to recover from the virus. The results? Retailers were often left standing hapless as shelves went bare and shoppers looked elsewhere to spend.

Industrial Production:

We also received fresh news this morning on how all supply chain disruptions affected the flow of raw material and intermediate goods to factories. The Federal Reserve reported industrial production slipped 0.1% last month, with manufacturing output down 0.3%. Case in point: many automakers slowed their assembly lines or had to halted them because of the chronic lack of semiconductor chips and other critical components. The production of motor vehicles and parts fell 1.3% in December and 6% over the year.

Consumer sentiment:

What did you expect? Inflation, Omicron and the scarcity of goods have dampened the moods of Americans this new year. Consumer sentiment in January dropped to 68.8, from 70.6 last month. This slippage in confidence was seen in both current conditions and expectations. Consumers in the survey saw higher inflation in both the one-year outlook (to 4.9% from 4.8%) and that of 5 – 10 years (3.1% from 2.9%).

Federal Reserve:

All of the above highlights the complicated backdrop with which the Fed has to consider monetary policy. One the one hand, economic activity slowed markedly at the end of the year (retail sales, industrial output and the hit to consumer spirits), yet inflation rocketed up to a 39-year high in December.

The Fed, though, has to stick to satisfying its two key mandates ---full employment and price stability The former has essentially been achieved, while the latter is way off target. For that reason pressure will build on them to begin raising interest rates as early as this March.

United States

	I 2021	II 2021	III 2021	IV 2021	I 2022	II 2022	III 2022	IV 2022	I 2023	II 2023	III 2023	IV 2023	I 2024	II 2024	III 2024	IV 2024
Real Gross Domestic Product (GDP):																
%	6.3	6.7	2.3	6.2	2.2	3.6	4.1	3.3	1.8	2.7	2.5	2.6	2.2	2.7	3.0	2.2
Personal Consumption Expenditures:																
PCE %	11.4	12.0	2.0	6.8	2.4	4.2	3.7	2.9	1.5	2.9	2.8	2.7	2.0	2.7	2.5	2.8
Inflation, end of period, year-over-year:																
CPI %	2.6	5.3	5.4	7.0	6.5	6.1	5.5	3.8	3.3	2.8	2.6	2.3	2.2	2.3	2.3	2.4
Unemployment Rate (end of period):																
%	6.0	5.9	4.7	3.9	3.9	3.9	3.8	3.9	3.7	3.6	3.5	3.7	3.6	3.6	3.6	3.5
Non-farm Payrolls, monthly avg. thousand:																
	513	615	651	365	455	625	665	640	385	510	495	410	275	310	315	325
Treasury 10-yr Note Yield % (end of period):																
	1.75	1.44	1.52	1.51	1.75	1.85	1.88	1.90	2.10	2.10	2.26	2.35	2.35	2.45	2.53	2.45
Federal funds rate % (end of period):																
	0.13	0.13	0.13	0.13	0.38	0.63	0.63	0.63	0.88	1.13	1.38	1.38	1.63	1.63	1.88	1.88

GDP Growth - Global Economy

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
US	2.6	1.6	2.2	1.8	2.5	3.1	1.7	2.3	3.0	2.2	-3.5	5.4	3.3	2.4	2.5
Eurozone	1.7	1.4	-0.9	-0.2	1.4	2.1	1.9	2.5	1.9	1.2	-6.7	4.9	3.9	2.4	1.7
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.9	1.3	1.5	-9.8	5.7	4.6	2.5	2.0
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	0.5	1.7	0.6	-0.2	-4.5	2.0	2.8	2.2	1.4
Canada	3.1	3.1	1.8	2.3	2.9	0.7	1.0	3.2	2.0	1.6	-5.3	5.0	4.2	2.7	2.2
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.8	4.8	-7.5	7.8	7.0	6.4	5.7
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.6	6.1	2.3	6.6	4.9	5.2	5.1
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.2	1.2	1.1	-4.4	4.4	2.3	3.3	2.7
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.7	2.4	2.1	-0.1	-8.4	5.9	2.9	2.7	2.4
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	1.8	-1.1	4.3	3.1	2.6	2.7
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.5	1.2	-2.9	4.1	2.9	2.4	2.1
World	4.2	3.1	2.5	2.6	2.8	2.8	2.6	3.4	3.2	2.7	--3.4	5.4	4.4	3.4	3.2

Key Economic & Geopolitical Projections for 2022 & 2023

- Latest revision: January 4, 2022

PROBABILITY	U.S.
HIGH	**Odds of recession from 2022 thru 2024 are about 20%, absent any major geopolitical shocks.**
Moderate	**Federal Reserve begins to fed funds rates end of 1Q 2022. Expect two 25 bp increases this year. Three in 2023**
HIGH	**CPI inflation drops to 3% range late 2022 as supply chains improve, wages stabilize and WTI oil slips to mid $60s bbl.**
Moderate	**Treasury 10-yr. yields to hover between 1.65% to 2.00% in 2022, and peaks at 2.55% in 2024.**
HIGH	**Covid-19 becomes an endemic. Low vaccination rates in Africa & parts of Asia remain breeding grounds for new variants.**
Moderate	**Congress to pass a more modest ($1.5 trillion) "Build, Back Better" plan by 1Q 2022, with minor changes in tax rates.**
	FOREIGN
HIGH	**China's economy to sharply decelerate due to shakeout in property market, broad deleveraging & fresh Covid outbreaks.**
HIGH	**Beijing fortifies naval presence in SCS and ramps up threats against Taiwan.**
HIGH	**Biden orders greater US naval presence in SCS to defend International Law of the Sea and support regional allies.**
Moderate	**US - Russia tensions worsen as Moscow destabilizes Ukraine and considers sending Russian troops back to Cuba.**
HIGH	**A cyber World War is underway; likely to result in periodic disruptions to global financial networks and power grids.**
HIGH	**Iran secretly moves ahead to produce enough fissile material for a nuclear weapon. Israel readies pre-emptive action.**
Moderate	**Economies of US & Europe to steadily improve in 2022, but recoveries in Africa & Latin America to lag behind 1 - 2 years.**