THE WEEKLY **U.S.** ECONOMIC MONITOR

APRIL 1, 2019
IAN SHEPHERDSON, CHIEF ECONOMIST

Consumers' spending is transitioning to a sustainable pace, after last year's tax cut-fuelled binge...

...The story is complicated by unreliable sales data; we tentatively expect decent February numbers.

The March ISM manufacturing index likely nudged up a bit, but it's too soon to say if this is the bottom.

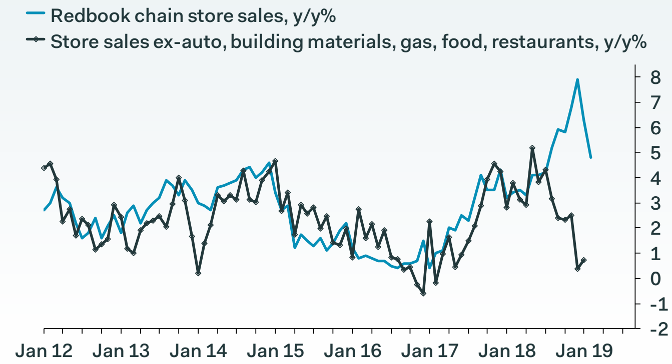
Recent Retail Sales Data Make Little Sense; Noise is Swamping the Signal

The underlying U.S. consumer story, hidden behind a good deal of recent noise, is that the rate of growth of spending is reverting to the trend in place before last year's tax cuts temporarily boosted people's cashflow. The effect of the tax cuts was huge; at the peak, retail sales ex-autos, gasoline and food jumped at a 9.9% annualized rate in the three months to July, compared to the previous three months. That was *double* the pre-tax trend rate of growth, and it could not possibly be sustained. ***As the flow of cash from the tax cuts levelled-off, sales have come back to earth.***

We think the official data failed to capture the full extent of the boost from the tax cuts and are now overstating the correction, but when the dust settles we fully expect to see nominal core retail sales rising by about 5% year-over-year. *It makes no sense at all to extrapolate the latest, soft-looking numbers into some sort of retail disaster, because personal incomes after-tax are rising at an annualized trend rate of about 4½-to-5%, and consumers' confidence remains very elevated.*

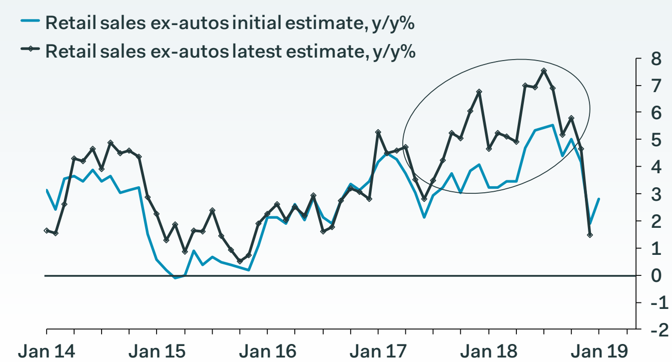
The February retail sales numbers due today are a tough call. We don't believe the data for the previous few months—especially December's—so it's entirely possible that substantial revisions will change the previous picture, changing the base for our February forecast. *The issue here is that the official numbers have substantially undershot the pace implied by the Redbook chainstore sales survey since last summer, and the gap is now very large, as our first chart shows.* It narrowed substantially in January, when the Redbook reported a clear slowing in year-over-year growth, as the kick from the tax cuts and the drop in gas prices faded, but the BEA's data are still lagging far behind.

THE OFFICIAL SALES DATA ARE *MUCH* WEAKER THAN THE REDBOOK



The Redbook numbers are never revised, but the official data often are revised substantially. ***Indeed, our second chart shows that the rate of growth of sales ex-autos has been revised consistently higher in the past two years.*** It's not clear why the initial estimates are so unreliable, but the obvious explanation is that the data are released too early, based on a partial sample. We think upward revisions to the recent data are a decent

RECENT REVISIONS TO OFFICIAL DATA HAVE BEEN UPWARDS



bet, but we have no way of knowing when the numbers will be moved higher.

The undershoot in the trend in sales growth relative to the Redbook reached its peak in December, when the BEA reported headline retail sales fell by 1.6% month-to-month, with the sales ex-autos down 2.1% and the control measure dropping 2.3%. This followed a decent core gain in November, but we suspect that the numbers for both months are wrong. *The combination of the very early Thanksgiving—November 22, the earliest possible—and the continued structural shift in spending to the Black Friday/Cyber Monday period and away from December—likely lifted reported November sales but depressed December.* The seasonals are based on repeating patterns over periods of several years, and they can't keep pace with the speed of this shift.

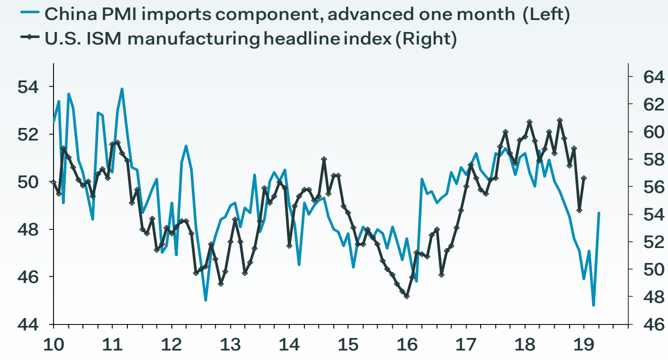
Today, we tentatively expect a 0.6% increase in headline and non-auto sales in February, with the control measure up about 1%. *Our numbers are a bit stronger than consensus forecasts, but the range of uncertainty here is huge, and big revisions to prior data are a real risk.* The November and December data are subject to revisions today.

ISM manufacturing still weak, but stable?

Today also brings the March ISM manufacturing survey, which likely won't be much different from the February report, if the key regional surveys released in recent weeks are any guide. We think the headline index likely nudged up to about 55 from 54.2. ***Any increase would be welcome, but it's too soon to call the bottom of the downshift, which began last fall in response to the sharp slowing in demand from China.*** The latest manufacturing PMI data from China are mixed, perhaps due to lunar New Year holiday distortions, but they suggest that the U.S index has further to fall.

Markets and the media overweight the importance of manufacturing, which accounts for only about 12% of GDP and 8½% of payrolls, and tend to want to extrapolate the latest number. Any increase in the ISM today, then, would be taken positively. But output,

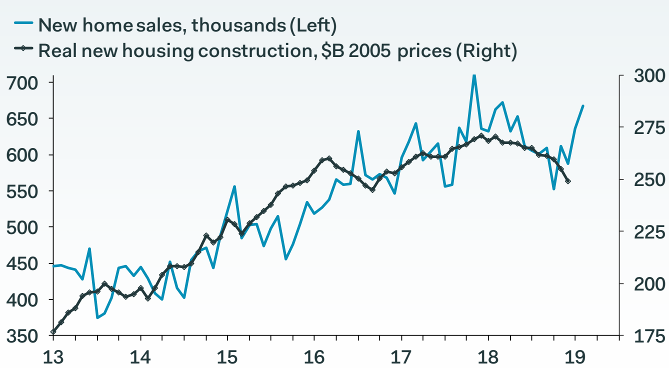
TOO SOON TO BE SURE THE U.S. ISM HAS HIT BOTTOM



employment and capital spending all lag the survey, so even if the ISM really has levelled-off, it will be some time before the previous weakness washes through the data.

Finally today, we tentatively expect to see little change in February construction spending, after the 1.3% rebound in January. But the data are so volatile, and subject to such large revisions, that the initial monthly prints aren't worth much. *What matters is the underlying pressure, which is moving to the upside, at least in the private housing component.* This accounts for one third of all private sector construction. The rebound in new home sales, if sustained, will lift new housing construction over the next few months, as our chart below shows. The good news is that the mortgage applications numbers, which lead new home sales by a few months, point to home sales holding their recent gains, at least, through the second quarter.

THE REBOUND IN NEW HOME SALES WILL LIFT CONSTRUCTION



Ian Shepherdson **+1 914 610 3830**
ian@pantheonmacro.com

THIS WEEK IN BRIEF

Note: "**D**" prefix denotes Datanotes for these releases.

Monday, April 1

• **D: Retail Sales (2)/8:30 EDT**
We think sales rose by **0.6%,** headline and ex-autos, with the control measure up by **0.7%. Consensus: Total sales 0.3%, ex-autos +0.4%, control 0.3%.**

• **D: ISM Manufacturing Survey (3)/10:00 EDT**
Regional surveys suggest that the headline index nudged up to about **55** from 54.2. **Consensus: 54.5.**

• **Construction (2)/10:00 EDT**
We think spending likely was broadly **unchanged** after January's 1.3% rebound. But the monthly data are very noisy and are subject to substantial revisions. **Consensus: -0.2%.**

• **Business Inventories (1)/10:00 EDT**
Preliminary data point to a **0.5%** increase, another solid gain after December's 0.6% rise. **Consensus: 0.5%.**

Tuesday, April 2

• **Redbook Chain Store Sales (3/30)/9:00 EDT**
We expect a modest correction in same-store sales growth after last week's **5.3%,** a bit above the recent range.

• **D: Durable Goods Orders (2)/8:30 EDT**
A sharp drop in aircraft orders means that total orders likely fell by about **2.5%.** We expect a **0.5%** dip in orders ex-transport. **Consensus: Total orders -1.8%, ex-transportation +0.1%.**

• **Auto Sales (2)/Late Afternoon EDT**
Most industry-watchers believe sales rose in March, after February's weak 16.5M, an 18-month low. A number close to **16.9M** seems a decent bet. **Consensus: 16.7M.**

Wednesday, April 3

• **Mortgage Applications (3/29)/7:00 EDT**
The purchase index jumped to an eight-week high of **267.5** last week, as the unwinding of February's seasonal drop continued. The underlying trend is rising.

• **D: ADP Employment (3)/8:15 EDT**
Our model points to a **200K** increase, but all the employment data, official and unofficial, have been wild recently. **Consensus: 175K.**

• **D: ISM Non-manufacturing Survey (3)/10:00 EDT**
The Redbook chainstore sales numbers point to a modest dip in the index, to about **59** from 59.7. **Consensus: 59.0.**

Thursday, April 4

• **D: Jobless Claims (3/29)/8:30 EDT**
Our take on the seasonals suggests claims will nudge back up to about **215K,** after last week's surprising drop to a below-trend 211K. **Consensus: 216K.**

Friday, April 5

• **D: Employment (3)/8:30 EDT**
Payrolls should revert to trend after the wild swings of recent months, rising by about **180K.** Unemployment likely was little changed, at 3.8%. We look for a **0.3%** increase in hourly earnings, but a **0.2%** rise is almost equally likely, given the underlying trend. **Consensus: Payrolls 178K, unemployment 3.8%, average hourly earnings 0.2%.**

• **Consumer Credit (2)/15:00 EDT**
We look for a **$17B** increase, in line with the recent trend. **Consensus: $17.3B.**

THIS WEEK'S FUNDING

Monday 1	Auction: $45B 3-month, $39B 6-month bills
Tuesday 2	Announcement: four-week bills, eight-week bills
Wednesday 3	Nothing
Thursday 4	Auction: four-week bills, eight-week bills Announcement: 3-month, 6-month bills (Apr. 8) Announcement: 3-year notes (Apr. 9) Announcement: 10-year notes (Apr. 10) Announcement: 30-year bonds (Apr. 11)
Friday 5	Nothing

PANTHEON'S FINANCIAL FORECASTS

		End-month:			
	4:00pm Fri.	Jun	Sep	Dec	Mar
Fed funds target	2¼-to-2½	2¼-to-2½	2½-to-2¾	2¾-to-3	3-to-3¼
2-yr	2.26	2.50	2.80	3.10	3.20
10-yr	2.41	2.70	3.10	3.30	3.30
30-yr	2.81	3.10	3.20	3.30	3.20
Curve 10-2	15	20	30	20	10
Curve 30-2	55	50	40	0	-10
S&P 500	2,834	2,850	2,750	2,650	2,650
Dollar/Yen	110.9	111	110	110	110
Euro/Dollar	1.12	1.15	1.17	1.20	1.20
Sterling/Dollar	1.30	1.36	1.38	1.40	1.40

PANTHEON'S ECONOMIC FORECASTS

GDP	Q1	2.0%	2015 year:	2.6%
	Q2	4.2%	2016 year:	1.6%
	Q3	3.4%	2017 year:	2.3%
	Q4 third	2.2%	2018 year:	2.9%
	Q1 forecast	*1-to-2%*	*2019 year:*	*2.2%*
	Q2 forecast	*3%*		

CPI	Feb. 0.2% (1.5% y/y); core 0.1% (2.1% y/y)
	June forecast: 1.6% y/y; core 2.3% y/y
	December forecast: 2.3% y/y; core 2.6% y/y

Unemployment: June 2019: 3.7%; December 2019: 3.6%.

Federal budget: FY 19 forecast: -$950B (4.5% of GDP)