



THE UNITED STATES ECONOMIC MONITOR

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The official core retail sales data are hugely underperforming the Redbook; expect upward revisions.

The very early Thanksgiving this year, coupled with slow-moving seasonals, hurt December sales.

Manufacturing is under pressure; expect output to fall over the next few months.

Seasonal Problems and Sampling Error Explain December's Sales Drop

We can't remember the last time a single economic report was as surprising as the December retail sales numbers, released yesterday. Sales ex-autos reportedly fell by 1.8%, undershooting the consensus forecast by an enormous 1.9 percentage points. ***This is a 4.2 standard deviation error, which means that these are very strange data indeed, and the explanation for the reported plunge in sales probably is not that sales actually plunged.*** We think the numbers are wrong, and that the Redbook chainstore sales data probably are a better guide to what happened to core retail sales late last year. The contrast between the series, shown in our first chart, is startling.

We don't dismiss the official data lightly. *We are not conspiracy theorists, and we don't believe the data are subject to political interference.* The problems with the sales numbers probably are much less dramatic. ***Part of the story, we think, is that the seasonal adjustment***

isn't keeping pace with the shift in holiday spending from December to the days after Thanksgiving. Black Friday promotions have expanded dramatically in recent years, and Cyber Monday has become a very big deal.

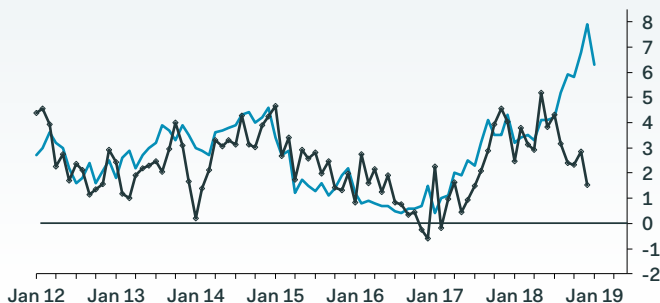
The path of the December and November seasonals over time captures at least some of this shift. Remember, to adjust the data, the unadjusted level of sales is *divided* by the seasonal factor, so seasonal factors greater than one depress the reported adjusted level of sales. As sales migrate into November from December, therefore, you should expect to see the November seasonal factor rising and the December factor falling. That's exactly what has happened in recent years.

Seasonal adjustments evolve slowly over time in response to movements in the raw data, though, and it appears that the speed of the shift in sales to late November from December has left the seasonals behind. ***The extra twist in the story this year is that Thanksgiving fell on the earliest date possible, November 22, so the entire post-holiday week and Cyber Monday fell in November, hurting December sales.*** In the three Decembers since 2005 when Thanksgiving has fallen on November 22, the month-to-month change in December control sales has been 1.0 percentage points *below* the average for the previous three months. In November in these years, the monthly change in sales is reported averaging 0.9pp *higher* than the average for the previous three months.

This does not *prove* anything. The sample of previous early Thanksgivings in the internet shopping era is

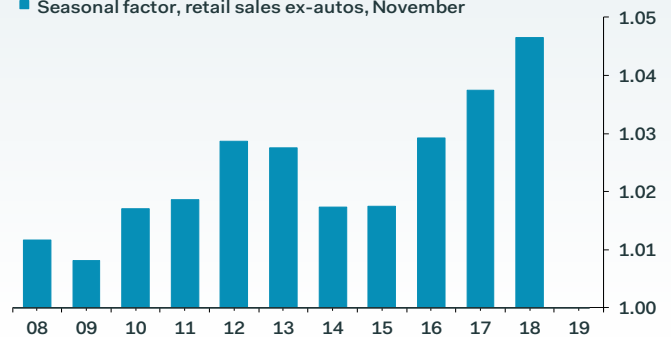
WHICH RETAIL SALES DATA SHOULD YOU BELIEVE?

— Redbook chain store sales, y/y%
— Store sales ex-auto, building materials, gas, food, restaurants, y/y%



ARE THE YEAR-END SEASONALS MOVING FAST ENOUGH?

■ Seasonal factor, retail sales ex-autos, November



too small to be definitive. But something needs to be explained here, because the Redbook numbers don't lie. *They're not perfect, because the sample changes over time, but they capture same-store sales across the country and the numbers are never revised.*

The official data, by contrast, often are revised substantially—revisions of +/-1% to sales ex-autos are not rare—and the biggest ever was a huge +2.0%, in February 1992. ***In the first nine months of 2017, when sales initially undershot compared to the Redbook, the cumulative revision to sales ex-autos now stands at +1.9%.*** Accordingly, we think the odds favor hefty upward revisions to the December data, both because of the seasonal issues and, we think, sampling error.

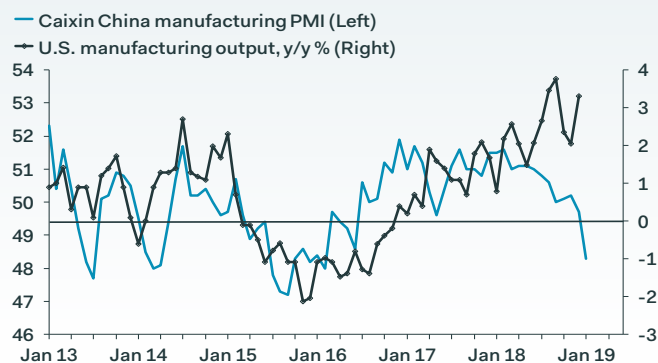
In the meantime, though, the numbers as reported mean that fourth quarter consumption will be weaker than we expected, so we're pulling down our Q4 GDP forecast to 2.6% from 3.3%. Looking ahead, we have argued for some time that the end of the lift from tax cuts and the drop in gas prices would mean slower growth in retail sales in the first half of this year, and we're sticking to that view. The Redbook numbers in recent weeks have hurtled down towards their early 2018 pace. But the official data will slow much less, having not risen so far in the first place. The rate of growth of real consumers' spending will settle at about 2½%, in line with the rising trend in real after-tax income. *The transition will be uncomfortable, but it won't last long, and it would be a big mistake to extrapolate it into an end-of-cycle event.*

Manufacturing is set for a difficult few months

We have been pretty clear in recent months that we expect a sharp slowdown in manufacturing output in the first half of the year, to the point where a mild recession in the sector is a reasonable bet. *Mostly, this is a story about China's slowdown—exacerbated by the trade war—which has triggered a downturn in the global manufacturing cycle.* Where China's manufacturing PMI leads, other countries' numbers tend to follow. That means the U.S. ISM manufacturing index likely has not yet hit bottom, which means that output is likely to be under pressure for some time.

We appreciate that December's 1.1% jump in manufacturing output appeared to contradict our thesis, but one good month does not make a trend. December appears to have benefited from warmer-than-usual weather, and after three months in which monthly output

THE NEAR-TERM OUTLOOK FOR MANUFACTURING IS BLEAK



growth averaged a magnificent 0.0%, a correction was due. *January, by contrast, is due no catch-up effects, and the weather on average was colder than usual, thanks to the blast from the polar vortex in the latter part of the month.*

Our model of month-to-month manufacturing output, based on survey and employment data, points to a 0.2% dip in January. That would not be a disaster, but we expect further declines will follow, putting downward pressure on labor demand in the sector. *Manufacturing job growth averaged some 19K per month in the six months through January, but we expect that to fall to zero, by the spring, and net job losses can't be ruled out.* The sector accounted for only 10% of the increase in private payrolls last year so that would not be a macro problem, but it would certainly attract the attention of the markets and the commentariat, both of which overweight the importance of manufacturing.

The headline industrial production reading for December should be better than the manufacturing number, because the weather was colder than usual—especially in the final week of the month, when the polar vortex hit—so utility demand likely jumped sharply. *We look for unchanged total production, with utility output up 2%.* Note that the increase in utility demand will be reflected in rising real consumption of utility energy services, and will offset some of the hit from the reported drop in retail sales. This boost, however, likely will reverse in February.

The U.S. Monitor will not be published from February 18 through February 22. Publication resumes February 25.

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THIS WEEK IN BRIEF

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

Monday, February 11

- **No significant data released.**

Tuesday, February 12

- **D: NFIB Small Business Survey (1)/6:00 EST**

The headline index fell again to a 26-month low of **101.2**, from 104.4 in December. But capex intentions rose a point and selling prices hit a 12-year high, adjusted for the impact of lower gas prices.

- **Redbook Chain Store Sales (2/9)/9:00 EST**

Sales growth slowed to **4.6%** year-over-year from 5.7% last week; the surge triggered by the plunge in gas prices is over.

- **JOLTS (12)/10:00 EST**

The number of job openings had appeared to be levelling-off, but it jumped in December to a new all-time high of **7,335K** from an upwardly-revised 7,166K.

Wednesday, February 13

- **Mortgage Applications (2/8)/7:00 EST**

The purchase applications fell for the fourth straight week, dropping 6.4% to **237.7**, a six-week low, but all the decline is due to a very persistent seasonal adjustment problem.

- **D: Consumer Prices (1)/8:30 EST**

The headline index was **unchanged**, depressed by a further sharp fall in gasoline prices. The core rose **0.2%**, thanks to higher prices for apparel and a range of services. Used auto prices again failed to correct and still look very overextended compared to auction prices.

- **Treasury Budget (12)/14:00 EST**

The deficit fell to **\$14B**, a bit less than the \$23B shortfall in December 2017., but all the apparent improvement was due to calendar effects.

Thursday, February 14

- **D: Jobless Claims (2/8)/8:30 EST**

Claims rose to **239K** from 234K. The trend is rising.

- **D: Producer Prices (1)/8:30 EST**

Lower food prices, after a run of increases, and another dip in energy prices, meant the headline PPI fell by **0.1%**. But the core rose **0.3%**, rebounding after December's 0.1% decline.

- **D: Retail Sales (1)/8:30 EST**

Total sales fell **1.2%**, with sales ex-autos plunging **1.8%** and the control measure down **1.7%**. These numbers are impossible to square with surveys and probably are due to a combination of seasonal adjustment and sampling problems. We expect big upward revisions.

- **Business Inventories (11)/10:00 EST**

Total inventories rose dipped **0.1%**, dragged down by declines in the non-durable manufactured goods and non-auto retail sectors.

Friday, February 15

- **D: Empire State Survey (2)/8:30 EST**

Downward pressure on global manufacturing emanating from China suggests that the Empire State index will be reported down to **zero**, from +3.9. **Consensus: 7.0.**

- **Import Prices (1)/8:30 EST**

The modest rebound in oil prices suggests import prices rose **0.3%**, after two steep falls. **Consensus: -0.1%.**

- **D: Industrial Production (1)/9:15 EST**

Production likely was **unchanged**, a 0.2% correction in manufacturing, following December's jump, offset by a 2% weather-driven rebound in utility output. **Consensus: 0.1%.**

- **D: Univ. of Michigan Consumer Sentiment (2p)/10:00 EST**

The end of the government shutdown and the partial reversal of the Q4 drop in stock prices should lift the headline index to about **94** from 91.2. **Consensus: 93.5.**

THIS WEEK'S FUNDING

Monday 11 Auction: \$45B 3-month, \$39B 6-month bills

Tuesday 12 Announcement: four-week bills, eight-week bills

Wednesday 13 Nothing

Thursday 14 Auction: four-week bills, eight-week bills

Announcement: 3-month, 6-month bills (Feb. 20)

Announcement: 2-year FRN (Feb. 20)

Announcement: 30-year TIPS (Feb. 21)

Friday 15 Nothing

PANTHEON'S FINANCIAL FORECASTS

	End-month:				
	4:00pm Thurs.	Mar	Jun	Sep	Dec
Fed funds target	2½-to-2¾	2½-to-2¾	2½-to-2¾	2¾-to-3	3-to-3¼
2-yr	2.50	2.60	2.90	3.20	3.10
10-yr	2.66	2.80	3.10	3.50	3.00
30-yr	3.00	3.10	3.20	3.40	2.75
Curve 10-2	16	20	20	30	-10
Curve 30-2	50	50	30	20	-45
S&P 500	2,746	2,700	2,750	2,750	2,650
Dollar/Yen	110.5	112	112	112	114
Euro/Dollar	1.13	1.15	1.15	1.17	1.20
Sterling/Dollar	1.28	1.35	1.36	1.38	1.40

PANTHEON'S ECONOMIC FORECASTS

GDP	Q1	2.0%	2015 year:	2.6%
	Q2	4.2%	2016 year:	1.6%
	Q3 third	3.4%	2017 year:	2.3%
	Q4 forecast	2.6%	2018 year:	3.0%
	Q1 forecast	1%	2019 year:	2.2%
	Q2 forecast	3%		
CPI	Dec.	-0.1% (1.9% y/y); core 0.2% (2.2% y/y)		
	Mar. 2019 forecast:	1.6% y/y; core 2.1% y/y		
	Sep. 2019 forecast:	1.9% y/y; core 2.5% y/y		

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

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