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Financial Markets This Week

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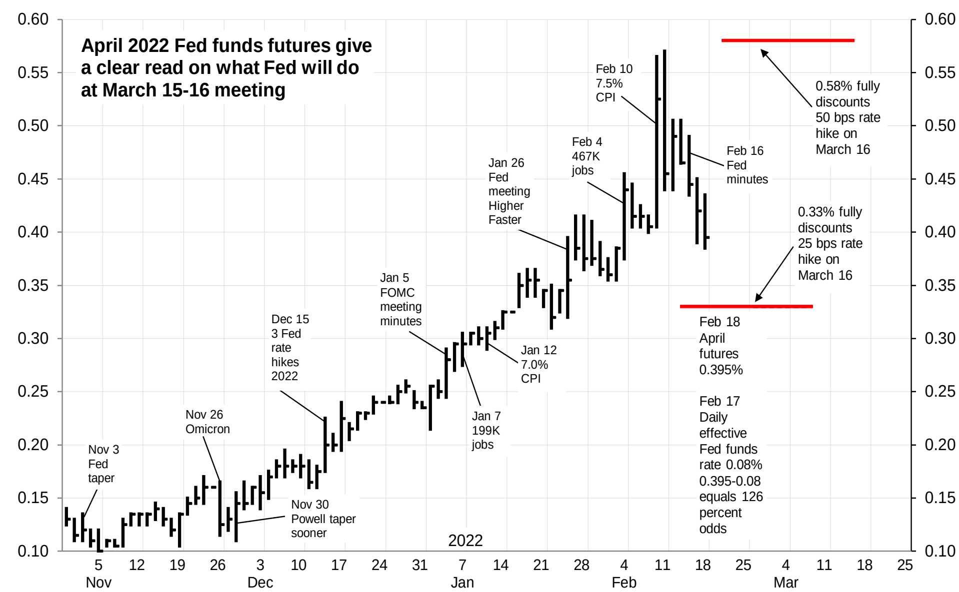
PPI INFLATION HOT, RETAIL SALES SURPRISINGLY TOO

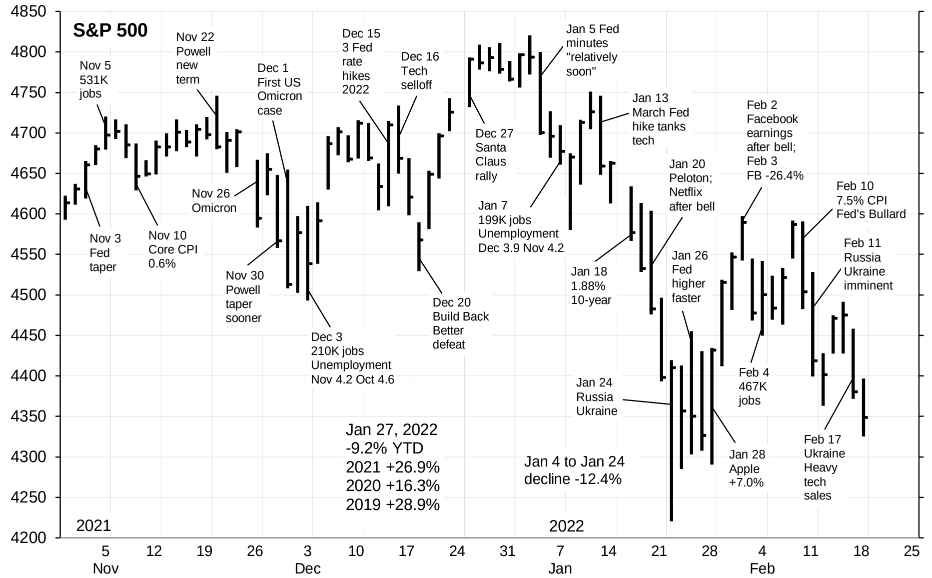
Most of the headlines this week were Russia and Ukraine, are the troops going home or are they still there. The economy wasn't as much of a focus for the market, stocks and bonds, even if the PPI inflation fire is still burning bright, and retail sales came in stronger than expected in January following a sharp decline in December. The consumer is two-thirds of the economy, so we want to make sure they are pulling their weight, especially after the University of Michigan survey last Friday which showed consumers were pessimistic on the outlook to a degree hardly seen if ever outside of recessions.

50 bps rate hike less likely with war ahead and Fed minutes didn't say 50

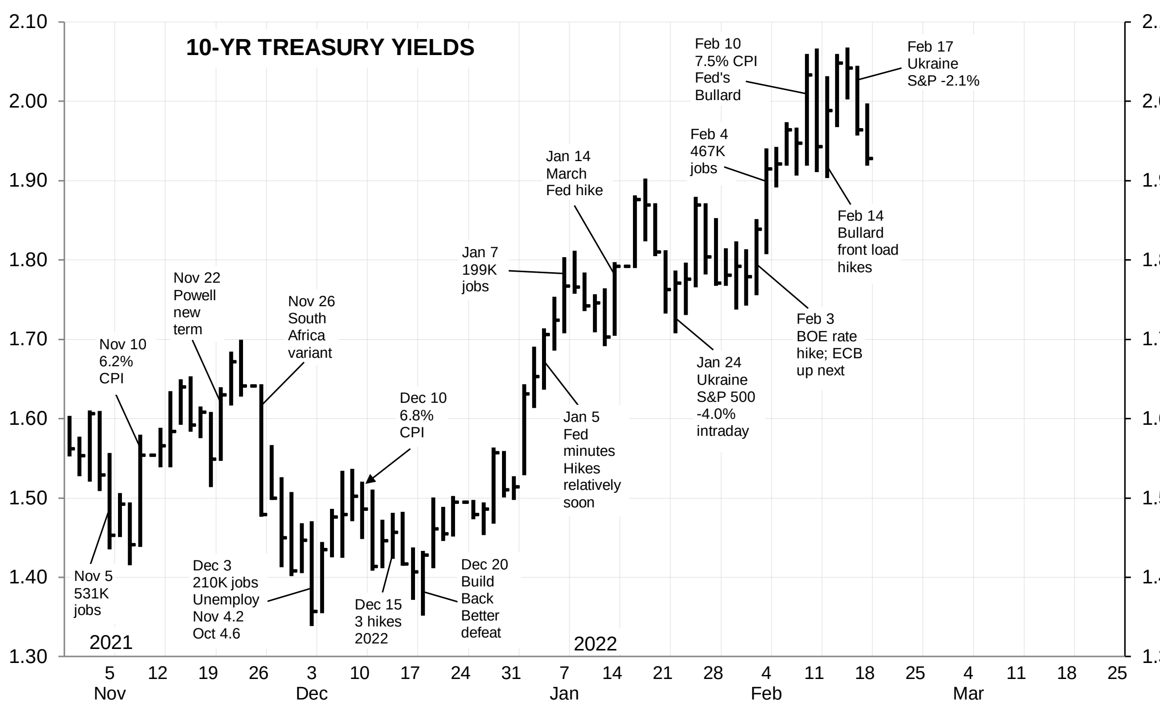


Real consumer expenditures are what count, so retail sales is an incomplete picture. Real consumer spending was 11.4% in Q1 2021, and 12.0% in Q2 2021: over the top spending partly pent up demand following the pandemic that never ends, and probably, mostly, the result of those Federal government economic impact payment checks of $600 in January and $1400 in March last year. Those consumer trips to the mall or orders from their smartphones couldn't last at that rate. Average growth in quarterly real consumption, booms and downturns, since the 70s is 3.1%. Consumer spending same-basis was 2.0% in Q3 2021 and 3.3% in Q4 2021. Last quarter's 3.3% was "normal" and it looks like Q1 2022 after this week's data will not be much slower than normal now that retail sales bounced back in January. Q1 2022 growth depends on how much the 4.9 percentage point contribution of inventories to Q4 2021's 6.9% GDP growth reverses.

The Fed, well the January meeting minutes didn't sound like a decision had been made for a faster pace of rate hikes from zero. Powell lit a fire under the faster higher speculation on Fed rate hikes at the January press conference of course: "So more to your question, we know that the economy is in a very different place than it was when we began raising rates in 2015. Specifically, the economy is now much stronger. The labor market is far stronger. Inflation is running well above our 2 percent target, much higher than it was at that time. And these differences are likely to have important implications for the appropriate pace of policy adjustments. Beyond that, we haven't made any decisions."



We will see. It isn't clear how fast they need to go. In a way, it is the opposite of Fed easing. We haven't liked the speed of Fed rate cut moves the last two decades. Disliked the magnitude too: 550 bps 2001 recession 6.5 down to 1.0 percent; 500 bps 2007-09 recession 5.25 down to 0.25 percent. The public isn't going to borrow in a recession even if the Fed slashes rates; they are running for the hills even before global warming comes and brings coastal flooding. Almost, not quite the same thing on the upside with rate hikes. Don't go too fast even if you are behind the curve. It's probably better to proceed in a measured pace, meaning in a predictable gradual manner. We wouldn't recommend a 50 bps first-strike start in March, and don't really like the 25 bps, eight rate hikes a year pace, totaling 200 bps, from the Bernanke era. Inflation is probably two or three months from peaking, albeit from an absurdly high level. Not sure social media chatter will allow the Fed to raise rates faster or higher for all that long a time.

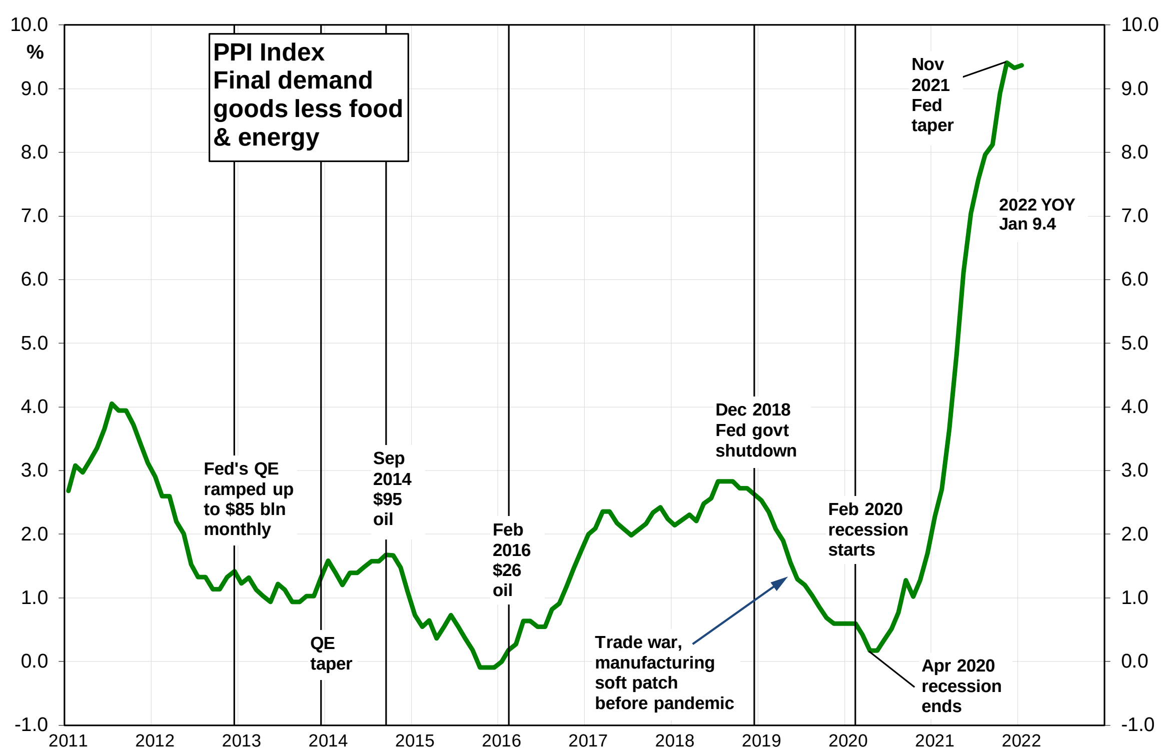


OTHER ECONOMIC NEWS

Producers will continue to jack up prices until the consumer cries uncle (Tuesday)

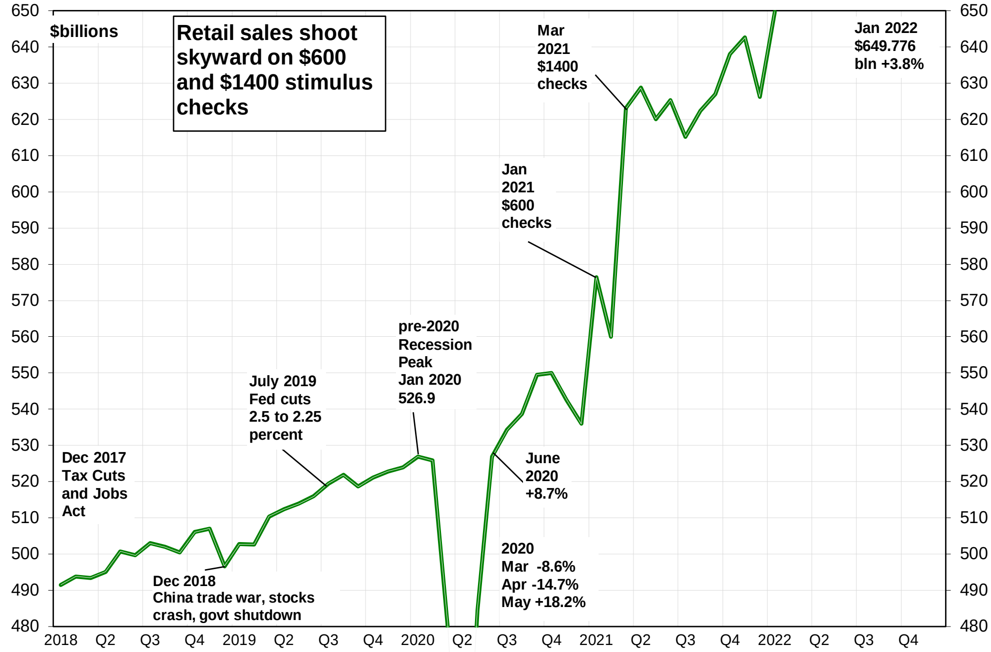
Breaking economy news. Producer prices jumped 1.0% to start the year which is the highest one-month change since May 2021. Factories are producing more inflation than goods at this point and with supply and labor shortages not going away, inflation is going to stay on the front burner of Federal Reserve officials' concerns for now. Inflation shows no sign of stopping with today's 1.0% print. The year-year percent changes may peak and actually come down when we get to April and May, but the economy won't see much relief. When inflation pivots this spring, the price pressures will simply move from scalding to boiling. The American public is losing confidence in Washington's ability to rein in the upward spiral of prices which is at risk of impoverishing the elderly living on fixed incomes and sapping the buying power of low to moderate income workers. No wonder consumer confidence is down in the dumps when the cost of living continues to move higher every time they fill up the tank or visit the grocery store. The Fed is going to start moving up interest rates until to curb economic demand, but if inflation keeps going, consumers will stop buying all on their own because they can't afford it.

Net, net, producers are saying don't look to us to stop the worst inflation outbreak in decades. Factories are producing more inflation than ever. Producers will continue to jack up prices and pass on their higher costs until consumers cry uncle. Don't look for that to happen anytime soon. If out-of-control price increases and soaring inflation can't be stopped soon, this economy is going to change from the best economy in fifty years to the worst economy in fifty years fast. Bet on it.



Depressed consumers flood the malls (Wednesday)

Breaking economy news. Retail sales jumped 3.8% in a report filled with contradictions. Consumer sentiment from the Michigan survey in February showed the consumer trembling at the outlook of what lies ahead, but apparently consumers flooded the malls in a shopping spree designed to cheer themselves up in January. The Omicron virus did nothing, absolutely nothing, to keep the consumer away from the shops and malls across the country. Ditto for the stock market turbulence. It must be the abundant wages story where consumers in 2021 received one of the biggest salary boosts in decades.



There are some problems with the bounce in retail sales today. The seasonal factors seem on the generous side adding back for the January seasonal drop in sales after the holiday shopping spree in December each year. Not seasonally adjusted sales fell 18.5% in January which is fairly normal, and the seasonal factor perhaps over-added 1 or 2 percentage points to the 3.8% jump seen today. The other thing to keep in mind is that this is not a flat out acceleration in purchases because retail sales fell 2.5% in December and have now bounced 3.8% in January. Is the consumer still contributing to the forecasts of zero or negative real GDP in Q1 2022? No, they are not. January retail sales are running strong at over 9% at an annual rate from the fourth quarter of 2021.

Net, net, consumers returned to the shops and stores across the country in January in a report filled with anomalies. A downturn in the economy forecast in the first quarter this year is wiped away with today's retail sales report as consumer spending looks completely, well, normal if that's possible. Omicron cases didn't start rising until a couple days before Christmas bringing back social distancing if not plain fear in much of the country and yet retail spending soared in January. Perhaps there will be a downward revision next month. No one buys a car in January and there are none on dealer lots and yet auto sales jumped 5.7%. Another anomaly that makes today's report suspect is that much of the increase is inflation based. Store bought goods are more expensive using just the January CPI inflation rise the last year of 7.5%. Retail sales are still up 13.0% on a year-year basis so there is real growth, but still, how much of today's report is real?

Retail spending, actual dollars, each month

	$million	% to	Percent Changes %		
	Jan 2022	Total	Jan	Dec	Year/year
Total Retail Sales	649,776	100.0	3.8	-2.5	13.0
Motor vehicles/parts	132,507	20.4	5.7	-1.6	11.3
Furniture/furnishings	12,425	1.9	7.2	-7.4	2.7
Electronics/appliances	7,316	1.1	1.9	-4.1	-2.9
Building materials/garden	44,072	6.8	4.1	1.2	12.2
Food & beverage	78,568	12.1	1.1	-0.2	8.0
Health/personal care	32,502	5.0	-0.7	0.3	7.6
Gasoline stations	54,382	8.4	-1.3	0.4	33.4
Clothing/accessories	26,120	4.0	0.7	-3.4	21.9
Sporting goods, books	8,692	1.3	-3.0	-6.0	1.3
General merchandise	72,068	11.1	3.6	-1.7	7.6
Department stores	11,929	1.8	9.2	-7.0	11.5
Miscellaneous retailers	14,816	2.3	-0.1	-0.7	15.3
Nonstore retailers (internet)	94,272	14.5	14.5	-11.4	8.4
Eating & drinking places	72,036	11.1	-0.9	-0.6	27.0

Despite some caveats to the retail sales report for January this year, at least we can be assured that consumers are not pulling back their crucial support for the economy even though they are experiencing a marked decline in confidence if not being downright depressed about what the future holds. Consumers still have to eat, even if it was at home with grocery store sales up 1.2% in January and restaurant and bar sales down 0.9%. The good news is depressed consumers flooded the malls in January, the million dollar question is for how long?

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