Retail sales figures disappointed in December and January. The Bloomberg/University of Michigan Consumer Sentiment Index fell back in mid-February. This news has cast some doubt about whether the drop in gasoline prices will propel consumer spending growth in the near term. However, economic data are notoriously unreliable in the winter months. The spring economic data reports should provide a better picture of the underlying strength in jobs, consumer spending, and housing.

Seasonal adjustment is often difficult, but is especially challenging in the winter months. Prior to seasonal adjustment, core retail sales (which exclude autos, building materials, and gasoline) rose 20.2% in December and fell 24.9% in January. The total for the last three months was up 4.6% y/y.
The impact of lower gasoline prices shows up with a lag. Prices fell more sharply in January, but have now risen off their lows. That’s not a surprise. Gasoline prices normally rise from December to May and then trend lower in the rest of the year.

The drop in gasoline prices has freed up about $10 billion per month to spend on other things. Note that the household sector typically pays down debt in January and February, making up for its holiday season generosity. The drop in gasoline prices should speed that adjustment and consumers will be better able to spend in March (the early Easter ought to boost spending).

Consumer sentiment spiked higher in January, but fell back somewhat in the reading for mid-February. That’s not an indication of weakness. Rather, there is a fair amount of noise in the data from month to month. The overall trend is still significantly higher. More detailed surveys have long shown a wide difference in ratings of the economy by income. Those at the top have maintained a rosy outlook for
much of the economic recovery, while those at the bottom of the income scale still see conditions as troubled. Those in the middle have grown more optimistic, the most since before the recession.

Spring is the most important time of the year for the economy. It’s when most firms expand their hiring. Last year, for example, we added 4.4 million jobs between January and June (prior to seasonal adjustment) – that works out to an average of 880,000 jobs per month. Spring usually marks the seasonal peak in new home sales and construction activity. Housing has disappointed in this recovery, but anecdotal evidence points to a solid pickup in the near term. There is scope for substantial further improvement as housing activity works back toward normal conditions over the next few years.

Most investors should be aware of the noise that seasonal adjustment can generate in the economic data reports. Most of these figures are based on statistical samples, which also generates some uncertainty from month to month.

In setting monetary policy, Federal Reserve officials look at a wide range of economic data and also put a lot of emphasis on anecdotal information. That means looking beyond the noise as they attempt to judge the underlying strength.

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