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Christmas sales plunge

Retail sales were solid in October and November; what happened in December?

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BOTTOM LINE

Despite a healthy labor market and declining gasoline prices, our worst fears were realized in December as nominal retail sales plunged 1.2%, their largest month-over-month (m/m) decline in nine years. Moreover, control results (which strip out autos, gasoline, building materials and food-service, and feed directly into the quarterly GDP report), plummeted 1.7% in December, their sharpest m/m decline since the 9/11 terrorist attacks in New York City in 2001.

After relatively solid October and November retail sales results, what happened in December? In our view, investors' overblown fear of a recession sparked a 20% collapse in fourth-quarter stock prices, which included a 9.2% waterfall decline in the S&P 500 during December alone, marking the stock market's single-worst month since 2001 and its worst December since 1931. Our research friends at Evercore ISI note that over the past 20 years, there has been an 86% correlation between the S&P's fourth-quarter performance and holiday sales. So we believe that December's plunging stock prices clearly weighed on investor sentiment and spending. The problem was exacerbated when consumer confidence began to fall from multi-decade cycle highs and the government shutdown began on Dec. 22 (preceded by plenty of harsh rhetoric).

The silver lining is that the Federal Reserve likely will remain firmly on the sidelines through the first half of this year, allowing us to see if this decline in retail sales is resurrected with stronger "Mapril" sales during this year's late Easter on April 21.

Much weaker-than-expected retail sales The Commerce Department reported this morning that nominal retail sales in December unexpectedly plummeted 1.2% m/m compared with expectations for a modest 0.1% increase. November sales had inched up 0.1%, while October leapt by a strong 1%.

Control results in December plunged 1.7% versus an expected m/m gain of 0.4%. That compares with a strong 1% increase in November and a 0.3% gain in October. Because consumer spending accounts for 70% of GDP, December's control results puts at risk our estimated 2.8% for fourth-quarter GDP growth, which will be flashed on Feb. 28.

Labor market remains solid And it should have supported strong holiday retail sales:

- Unemployment rate (U-3) hit a 49-year low of 3.7% in November.
- Wage growth hit a 9-year high of 3.3% on a y/y basis in December.
- Initial weekly unemployment claims (a leading economic and employment indicator) established a new 49-year low of 200,000 for the week ended Jan. 19.
- Participation rate hit a 5-year high of 63.2% in January.
- Job Opening & Labor Turnover Survey (JOLTS) hit an all-time high of 7.34 million jobs in December.

Gasoline prices fall December saw gas prices drop 9%, from $2.48 per gallon to $2.25, thanks to a 13% decline in crude oil (WTI) prices over the same time (from $52 per barrel to $45). The rule of thumb is that every 1 cent decline at the pumps adds $1.2 billion in consumer discretionary spending, which could translate into a quarter point of stronger GDP growth annually.

But business and consumer confidence has declined After hitting multi-decade cycle highs, confidence took a hit likely due to recession fears:

- Leading Economic Indicator (LEI) had risen for 25 consecutive months to a new 58-year cycle high of 111.9 in September but slipped to 111.7 in December.
- Conference Board's Consumer Confidence Index surged to a new 18-year high of 137.9 in October but plunged to 120.2 in January.
- NFIB Small Business Optimism Index soared to a 44-year high of 108.8 in August but fell to 101.2 in January.
- ISM Manufacturing Index increased to a 14-year high of 61.3 in August but dropped to 56.6 in January.
- ISM Non-Manufacturing Index rose to a 13-year high of 60.8 in September 2018 but fell to 56.7 in January.
- Michigan Consumer Sentiment Index rose to a 13-year high of 101.4 in March 2018 but declined to 91.2 in January.

January retail sales probably won't be great either We typically include January in our analysis of Christmas sales because of post-holiday gift-card redemptions. Gift cards only count as a sale when they're redeemed, not when they're purchased. About 15% of them are typically redeemed the week after Christmas, and 60-65% are usually redeemed during the first half of January. So including January gift-card redemptions will help determine the overall weakness of the holiday season.

Thank you, government shutdown It likely cost the U.S. economy about 0.5% of GDP growth, according to Kevin Hassett, chairman of the Council of Economic Advisors under President Trump. We're not expecting the government to be shuttered again, but the decline in GDP growth—about 0.1% for each of the five weeks in which the government was closed—will likely be forfeited.

Weather problems, too The Pacific Northwest is currently experiencing its snowiest winter in 70 years, while the Polar Vortex has dealt the Midwest and Northeast their coldest winters in a half century. This is our fourth brutal winter in the past five years, which has negatively impacted first-quarter GDP in the past as consumers typically stay indoors during extreme weather.

“Frugal February” Consumers tend to overspend during the Christmas holidays, leading them to hunker down in February to right-size their budgets before resuming their Easter spending during “Mapril.” So we’re not expecting an immediate reversal of December’s sobering figures.

Happy 20th Valentine’s Birthday, Jen!

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DISCLOSURES

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

The Conference Board's Consumer Confidence Index measures how optimistic or pessimistic consumers are about the economy.

The Conference Board's Coincident Economic Index is a gauge of how the economy currently is performing.

Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

The Job Openings and Labor Turnover Summary (JOLTS) is conducted monthly by the U.S. Bureau of Labor Statistics.

The National Federation of Independent Business (NFIB) conducts surveys monthly to gauge how small businesses feel about the economy, their situation and their plans.

The Institute of Supply Management (ISM) manufacturing index is a composite, forward-looking derived from a monthly survey of U.S. businesses.

The Institute of Supply Management (ISM) nonmanufacturing index is a composite, forward-looking index derived from a monthly survey of U.S. businesses.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

The University of Michigan Consumer Sentiment Index is a measure of consumer confidence based on a monthly telephone survey by the University of Michigan that gathers information on consumer expectations regarding the overall economy.

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