First Trust
Monday Morning OUTLOOK
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Keynes And Retail Sales

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No, just because retail sales fell 0.4% in March does not mean Keynes was right. Sequestration did not cause the decline. Nor did the end of the temporary 2% payroll tax cut, back in January, cause it either.

As you can probably guess, we find these arguments without merit. Early last week we posted on our blog an analysis showing that the last three times Easter was so early and occurred in March, the actual report on retail sales has come in well below what our models were projecting. (Link) As a result, we trimmed our forecast for overall sales to -0.1%.

The actual report was -0.4%, which, statistically, is barely different than -0.1% for this data series. So, even though our revised forecast was still higher than the actual, we are not overly concerned about the decline. In other words, we think an early Easter is the key culprit behind the soft retail report for March – not some external government influence.

But even if you take the sales report at face value, it's not evidence that the trajectory of economic growth has changed course. Last April and June, retail sales slumped by more than they did last month. But there was no payroll tax hike or major cut in spending.

In fact, volatility in sales data is normal. Between 2003 and 2006, a period of relatively strong growth lasting 48 months, retail sales dropped 0.4% or more in eleven different months. In other words, there is a very strong case that this is just normal statistical noise – possibly driven by seasonal factors.

To jump to any other conclusion is what Keynesians always try to do. They want to tie every drip, drop and dribble of economic activity to something the government has done. But, this is nonsense. And part of their problem is that what was supposed to happen when government spending soared and monetary policy got easy didn't happen.

The economy never boomed; instead, it's been a Plow Horse economy with moderate growth and a gradual decline in joblessness. We think big government has held back the economy and temporary tax cuts have nothing to do with creating sustained real growth. The sequester itself is good for the economy, because it means the private sector will grow relative to government. As a result, we take recent signs of economic weakness as a head fake.

Despite weak retail sales in March, consumer price inflation should be quiet for the month, and so we estimate that real (inflation-adjusted) consumer spending was up at a 2.3% annual rate in Q1. To put this in perspective, real spending is up 2% in the past year. Once again, no evidence of the higher payroll taxes taking a toll.

The same goes for the argument that the prior week's reports on employment and manufacturing show the effect of higher payroll taxes. Private payrolls are up 171,000 per month so far this year and total hours worked up at a very solid 2.9% annual rate. Companies are hiring, but they are even more inclined than usual to increase hours for the workers they already have on staff. That suggests the health care law is a bigger problem than the payroll tax.

Yes, the ISM manufacturing index fell to 51.3 in March from 54.2 in February, but the index still signals growth and was 49.9 late last year.

None of this is to say that the economy will grow at exactly the same speed all year long. It won't. Month to month variation is completely normal. But taking all of the data we've seen so far into account, it looks like real GDP grew at a 3% annual rate in Q1 and looks set to grow at about that rate again in Q2. After two years of roughly 2% real GDP growth, these are hardly the kind of numbers that say sequestration or the end of a temporary tax cut are hurting consumers.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-15 / 7:30 am	Empire State Mfg Survey - Apr	7.0	**10.5**	3.1	9.2
4-16 / 7:30 am	CPI – Mar	+0.0%	**+0.0%**		+0.7%
7:30 am	"Core" CPI – Mar	+0.2%	**+0.2%**		+0.2%
7:30 am	Housing Starts – Mar	0.930 Mil	**0.930 Mil**		0.917 Mil
8:15 am	Industrial Production – Mar	+0.2%	**+0.2%**		+0.8%
8:15 am	Capacity Utilization – Mar	78.4%	**78.4%**		78.3%
4-18 / 7:30 am	Initial Claims – Apr 13	350K	**345K**		346K
9:00 am	Leading Indicators – Mar	+0.1%	**+0.2%**		+0.5%
9:00 am	Philly Fed Survey – Apr	3.0	**2.5**		2.0