MONTHLY
ECONOMIC REVIEW
Economic Data & Trends for the Retail Industry

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**The data for this report is released on a rolling schedule. The presented numbers are current as of publication and are subject to revision.*

SYNOPSIS

With Economy Growing, Could Inflation Follow?

With the economy growing at a 3 percent pace over the last two quarters and unemployment at a 17-year low, it would normally be expected that inflation would begin to show up on the radar screen. We have waited for some time for the tightness in the labor market to translate into higher wages and higher inflation. The U.S. economy has gained momentum over the past year and the outlook is healthy. However, trends in both consumer prices and wage growth have been lukewarm at best. Average hourly earnings in October were back down to a trend-like pace of 2.4 percent, in line with other wage measures. Inflation downshifted in October, with the Consumer Price Index increasing only 0.1 percent after two months of 0.4 percent-plus gains. October's year-over-year CPI rate took a step backward to 2 percent from 2.2 percent in September. Meanwhile, the year-over-year rise in the core CPI was 1.8 percent versus 1.7 percent in September, perhaps a tentative step in the right direction.

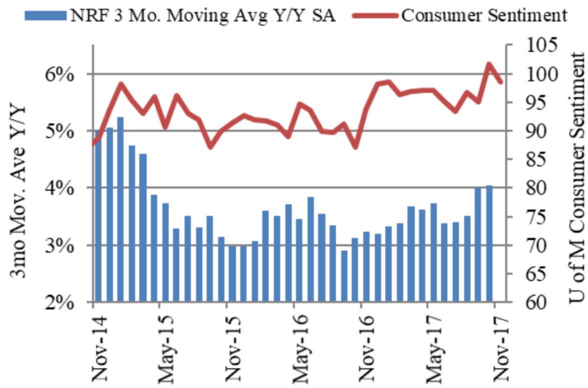
While the CPI released by the Bureau of Labor Statistics probably gets more press, the Federal Reserve's favored inflation gauge since 2000 has been the Personal Consumption Expenditures index released by the Bureau of Economic Analysis. In the latest 12 months, the PCE is up only 1.6 percent; with food and energy prices excluded, the core PCE is up only 1.3 percent. This measure of current inflation continues to fall short of the Fed's 2 percent target. Differences between the CPI and the PCE result from differences in the types of goods and services tracked by each. In addition, the CPI only covers out-of-pocket household expenditures on goods and services purchased while the PCE includes expenditures that are not paid for directly such as Medicare and Medicaid. Nonetheless, both measures have been showing stubbornly low inflation.

Keep in mind that approximately 68 percent of household consumption is for purchases of services and the remainder are for commodity-based goods. In addition, more than 85 percent of the labor force is employed in the service sector compared with 15 percent in the goods-producing sector. According to the October CPI, prices for services increased 2.6 percent over the previous 12 months, while commodity-based prices — which are partially insulated from service prices — registered an increase of 1 percent for the same period. Why such a divergence between service and commodity-based inflation? Simply put, one is determined in the global market and the other largely domestically. In the goods sector, the presence of global competition limits a firm's ability to raise product prices in response to higher labor costs. This effect is strongest in industries that have a high import-penetration ratio (apparel is a good example). As such, imports lead directly to lower prices. Much of U.S. goods inflation was negative for 2015 and most of 2016. In contrast, service inflation is very much domestically determined. In the services sector, providers of consumer services typically are much less subject to global competition than goods producers. As such, cost increases can be more easily passed on to consumers and thus any local increase in wages is expected to quickly lead to higher prices.

Looking forward, our forecast is for inflation to slowly pick up over the course of the coming year. Nonetheless, even with a stronger labor market, wage growth is not a certainty as witnessed over the last few years. Moreover, higher labor expenses do not automatically mean higher prices if profits are narrowed. As rocker Tom Petty once said in a song, "The waiting is the hardest part."

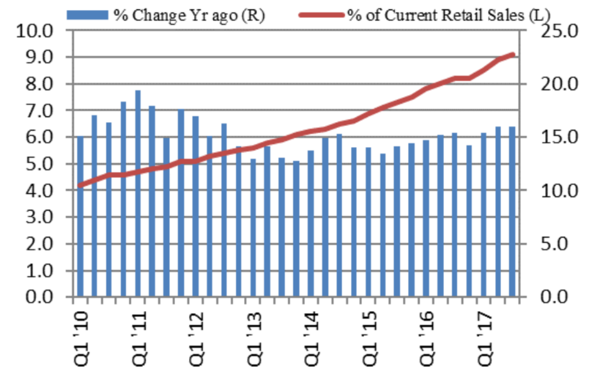
CONSUMER SENTIMENT

The uplift in October payroll and income generated a healthy pace of retail spending. Despite the November consumer sentiment dip, it remained strong and was up 4.7 points from a year earlier.



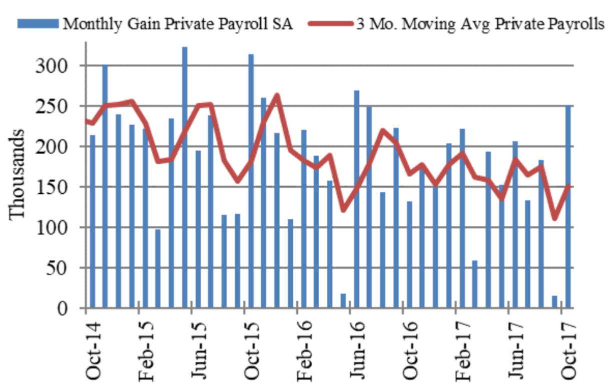
SALES

Online retail sales reached $115.3 billion in the third quarter. That was up 15.5 percent from a year earlier and amounted to 9.1 percent of total retail sales.



PAYROLL

Smoothing out weather-related payroll swings, it is apparent that the economy and the labor market remain fundamentally solid.

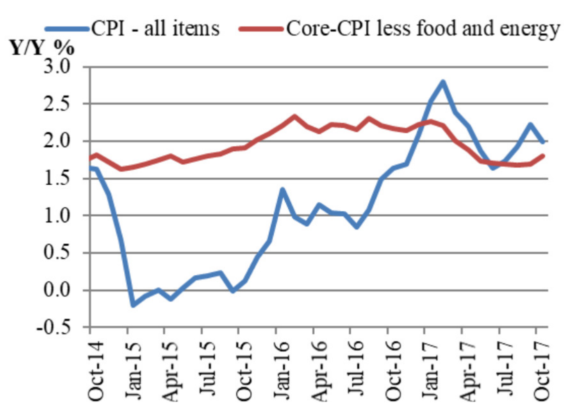


EMPLOYMENT

Retail payrolls remain steady, with 688,000 workers hired in September. There were over 600,000 openings as of the end of the month, the third-highest September since 2007.

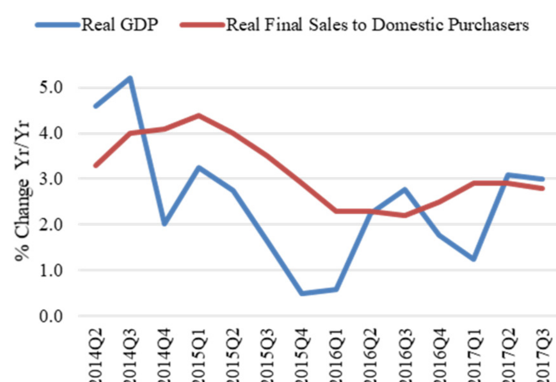
CONSUMER PRICES

October's all-items Consumer Price Index rose more slowly due to a pullback in energy prices but core inflation strengthened.

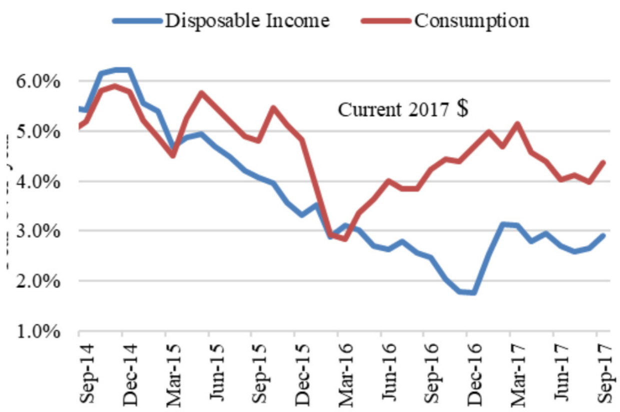


REAL FINAL SALES

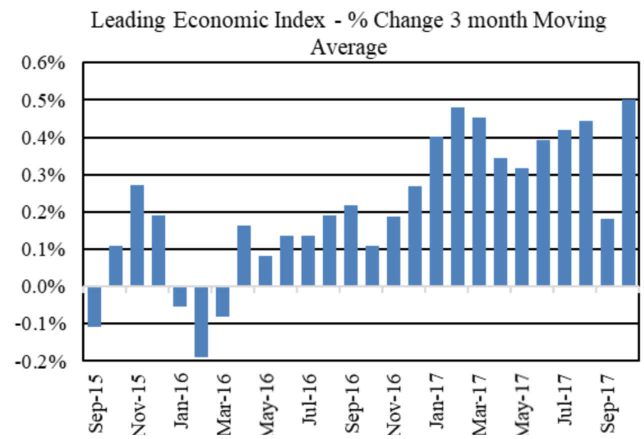
Real final sales to domestic purchasers (excluding net exports and inventories) has grown at a healthy pace of 2.9 percent throughout 2017 and signals ongoing growth.



Although there was a solid gain in aggregate disposable income in September, it did not come match the jump in aggregate spending, resulting in the savings rate falling again to 3.1 percent.



The Conference Board's leading index implies that the U.S. economy is doing well and should remain solid in the coming months.



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