

COMMENTARY NUMBER 351
January Retail Sales

February 15, 2011

Retail Gains Were Offset Fully by Inflation for Second Month

"Core" Retail Sales Activity (Net of Gasoline Stations and Grocery Stores) Was Unchanged

PLEASE NOTE: This morning's brief update on retail sales will be followed by a Commentary tomorrow, Wednesday, February 16th, after release of the details on January Producer Prices, Housing Starts and Industrial Production. The final and most extensive Commentary of the week will on Thursday, February 17th, after the release of the January Consumer Price Index.

-- Best wishes to all, John Williams

"Rebounding" Retail Sales Have Stalled. Broad economic activity generally is viewed in real (inflation-adjusted) terms, as seen in headline Gross Domestic Product (GDP) reporting, for example. With sales numbers stripped of inflation gains, or of pricing effects from distortions in monetary policy, the residual growth is a measure of straight economic activity. Accordingly, when retail sales increase by the same amount as the underlying prices in those sales, underlying demand is flat.

The reported monthly gain of 0.3% in January 2011 retail sales matched the consensus estimate of the headline 0.3% inflation gain for January CPI-U (due for release on Thursday, February 17th; see the *Week Ahead* below). Along with January's retail estimate came a downside revision to December's monthly retail sales growth, from an initial 0.6% to 0.5%, where the December CPI-U was reported up by 0.5%. (The CPI-U is the inflation measure usually used to deflate retail sales.)

Subject to actual January CPI reporting and seasonal-adjustment revisions to the CPI series, the best estimates in hand show that seasonally-adjusted monthly retail sales growth has been unchanged for the last two months, including the retail industry's all-important month of December.

In like manner, the "core" retail sales growth for January -- net of gasoline-station and grocery-store sales, which tend to move with gasoline and food prices -- was unchanged (see *Core Retail Sales* below).

The real retail numbers should turn negative monthly, in revision, and in new reporting of the months ahead.

The annual benchmark revision for retail sales has been scheduled for April 29th. At that time, retail sales levels and growth of at least the last year should be subject to major downside revisions, showing a weaker economy than has been recognized previously. As with the recent, major downside revisions to payroll employment, and the pending downside revisions to industrial production in March, the retail sales downgrade will be a precursor of major downside revisions to GDP history of the last several years, which are due for release in late July.

Nominal Retail Sales. Today's (February 15th) January 2011 retail sales report -- issued by the Census Bureau -- indicated a statistically-insignificant, seasonally-adjusted monthly gain of 0.34% (up 0.12% net of revisions) +/- 0.6% (95% confidence interval), versus a revised 0.52% December gain (previously an increase of 0.61%).

On a year-to-year basis, January 2011 retail sales were reported up by 7.76% from January 2010, versus a revised year-to-year December 2010 gain of 7.65% (previously 7.93%). Annual changes still have been unstable due to year-ago comparisons ranging from a severe trough in activity to last year's cash-for-clunkers stimulus effects.

At the same time, the Census Bureau still plays games with the monthly seasonal factors and revisions to year-ago data. Continuing at work in retail sales reporting are ongoing major distortions from basically the same concurrent seasonal-factor adjustment problems (unprecedented business-cycle effects overwhelming the traditional seasonal patterns of activity, see [Commentary No. 349](#)) and sampling issues (companies out business that no longer are reporting, but still are being counted) with sales or employees on payrolls.

Real Retail Sales. With the now-estimated monthly gains in December 2010 and January 2011 retail sales at 0.5% and 0.3%, respectively, and with the monthly gains in the December CPI-U at 0.5% and in January expected at 0.3%, real retail sales appear to have flattened out. Such will be reviewed in Thursday's (February 17th) *Commentary*, when the actual January CPI and any seasonal-adjustment revision to the December CPI are published.

Core Retail Sales. Assuming that the bulk of non-seasonal variability in food and gasoline sales is in pricing, instead of demand, "core" retail sales -- consistent with the Federal Reserve's predilection for ignoring food and energy prices when "core" inflation is lower than full inflation -- are estimated using two approaches:

Version I: January 2011 versus December 2010 seasonally-adjusted retail sales -- net of total grocery store and gasoline station revenues -- was flat at 0.0% (0.04%) versus official aggregate gain of 0.3%.

Version II: January 2011 versus December 2010 seasonally-adjusted retail sales -- net of the monthly change in revenues for grocery stores and gas stations -- was flat at 0.0% (0.03%) versus the aggregate gain of 0.3%.

Week Ahead. Given the unfolding reality of an intensifying double-dip recession and more-serious inflation problems than generally are anticipated by the financial markets, risks to reporting will tend towards higher-than-expected inflation and weaker-than-expected economic reporting in the months ahead. Increasingly, previously unreported economic weakness should show up in prior-period revisions.

Residential Construction (January 2011). Due for release on Wednesday, February 16th, January housing starts likely will continue to weaken, with any upside surprise unlikely to be of no statistical significance.

Industrial Production (January 2011). Due for release on Wednesday, February 16th, January industrial production -- aside from the continued effects of unseasonably bad weather spiking utility usage -- should be down for the month, again, likely weaker than consensus forecasts.

Producer Price Index -- PPI (January 2011). Due for release on Wednesday, February 16th, the January 2011 PPI should tend to be on the upside of expectations, although the series is irregularly volatile.

Consumer Price Index -- CPI (January 2011). Due for release on Thursday, February 17th, the January 2011 CPI once again should reflect not only higher gasoline prices, but also upside inflation pressures from other dollar-denominated commodity prices spiked by the Federal Reserve's U.S. dollar-debasement policy, as well as from some spreading oil-price impact into the broad "core" economy. Odds favor a possible upside reporting surprise versus the consensus estimate, which is for a 0.3% monthly gain per Briefing.com.

The monthly numbers also will undergo the annual seasonal-adjustment revisions, which can shift around inflation patterns of the last year.

Not-seasonally-adjusted, year-to-year inflation would increase or decrease in the January 2011 reporting, dependent on the reported seasonally-adjusted monthly change, versus the 0.17% adjusted monthly gain seen in January 2010. I use the adjusted change here, since that is how consensus expectations are expressed. To approximate the annual inflation rate for January 2011, the difference in January's headline monthly change (or forecast of same) versus the year-ago monthly change should be added to or subtracted directly from December 2010's reported annual inflation rate of 1.50%. A monthly increase of 0.3%, for example, would yield a year-to-year January 2011 inflation rate of about 1.6%.