

# Weekly Economic Commentary

March 7, 2011

## Economy Appears to be Accelerating as it Absorbs Higher Energy Prices

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#### Highlights

- This week is relatively quiet for economic data and events
- Rising gasoline prices are likely to impact the February retail sales report
- Strong February jobs report highlights a strong week for U.S. economic data

#### Economic Calendar

**Monday, March 7**  
Consumer Credit  
*December*

**Wednesday, March 9**  
Wholesale Inventories  
*January*

**Thursday, March 10**  
Trade Balance  
*January*

Initial Claims  
*wk 03/05*

Treasury Statement  
*February*

**Friday, March 11**  
Retail Sales  
*January*

U of Mich Consumer  
Sentiment *March*

Business Inventories  
*January*

A relatively quiet period for economic data and events this week in the United States should allow financial market participants to focus on the troubling rise in energy prices that has accompanied the ongoing political unrest in the Middle East. Outside the United States, a full slate of economic data in China and a scattering of central bank policy meetings will compete for the market's attention. Finally, markets will continue to mull over the February employment report (released on Friday, March 4), which revealed that the U.S. labor market may have finally turned the corner. Aside from the monthly jobs report, the other economic data released last week was equally strong, suggesting that the economy was accelerating (not decelerating as it was in 2007-2008) as it began to absorb the higher consumer energy prices.

## Rising Gasoline Prices to Impact Consumer Spending in February and Beyond

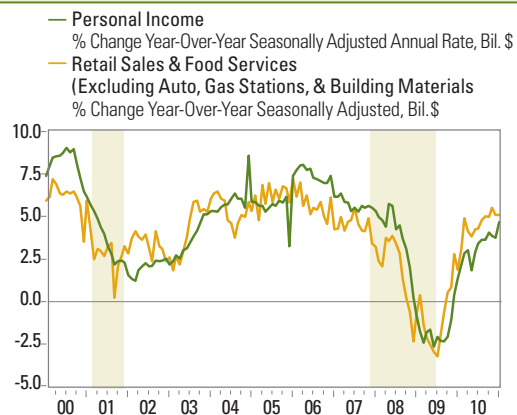
Aside from the regular weekly readings on retail sales, mortgage applications and initial claims for unemployment insurance, the only potentially market-moving economic report due out in the United States this week is the U.S. government's retail sales report (issued by the Commerce Department) for February. The nation's retailers reported their sales last week and results again exceeded expectations despite higher energy prices. The government's monthly retail sales report this week extends beyond chain store retailers and includes sales at auto dealers, gasoline service stations, restaurants, grocery stores, sporting goods stores, electronic, furniture and appliance stores.

The broadest measure of consumer spending is the monthly report on personal consumption expenditures. This report includes all consumer purchases captured in the retail sales report, and also consumer spending on services—haircuts, dry cleaning, healthcare, public transportation, airfares, utilities, hotels, theme parks, legal fees, insurance, childcare, entertainment, college tuition, etc.—which together accounts for 70% of consumer spending. Consumer spending, in turn, accounts for about two-thirds of gross domestic product. Spending on services is, for the most part, not captured in the retail sales report due out this week. The February personal consumption data is due out in late March. [\[Chart 1\]](#)

Although most of the rise in gasoline prices occurred in the latter half of February, gasoline service station sales are likely to have a big impact on



## 1 Retail Sales, Personal Income Growth Are Both Muted Relative to the Mid-2000s



Source: BEA, CEN/H/Haver 03/07/11  
(Shaded areas indicate recession)

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overall retail sales in February. In addition, vehicle manufacturers already reported their February sales (the strongest in three years), so the market is likely to focus on “core” retail sales (sales excluding gasoline, auto dealers and building supply stores) to get the best reading on the underlying health of the consumer in February. Core retail sales is at an all-time high (surpassing its 2007 peak in early 2010), and was up 5.1% year-over-year in January 2011. By comparison, core retail sales growth averaged about 6.0% in the mid-2000s recovery.

The solid but not spectacular gains in retail sales in recent months are being driven by:

- Personal income is up 4.7% year-over-year in January 2011 (income growth averaged 6% during the mid-2000s recovery)
- Ongoing repair of consumer balance sheets (monthly debt payments relative to incomes are below their long-term average)
- Higher consumer net worth (flat housing prices and a 100% gain in equity prices over the past two years)

On the downside, rising consumer energy prices, the lack of mortgage equity withdrawal (home equity loans were a sizeable source of spending power for homeowners in the mid-2000s), and a subdued labor market recovery are restraining consumer activity. On balance, we expect modest gains in consumer spending in 2011, stronger than 2010, though below the long-term average for this point in the economic cycle.

## Strong February Jobs Report Caps off a Strong Week for Economic Data

As previously noted, last week’s batch of economic data (mainly for January and February) was almost universally strong. Personal income, personal spending, vehicle sales, the Beige Book, the ISM reports on manufacturing and nonmanufacturing, weekly initial claims for unemployment insurance, and chain store sales all matched or exceeded expectations. In general, last week’s data followed the pattern observed at the start of 2011 which saw severe weather in January dampen economic activity that gave way to more normal weather in February, boosting economic activity.

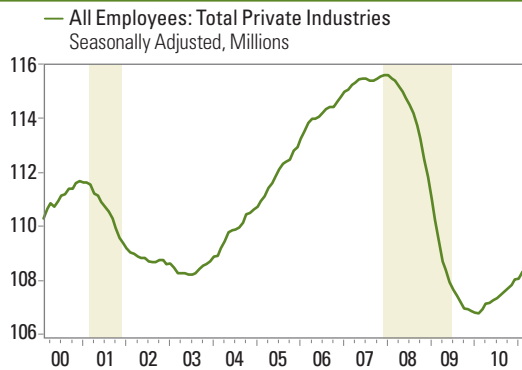
The strong February jobs report capped off the week. On balance, the data suggest that the U.S. economy was gathering momentum in early February 2011, and was probably in a better position to absorb the rise in consumer energy prices than it was in 2007-2008, when oil prices rose from \$50 to \$150 per barrel, and gasoline prices moved from around \$2.00 per gallon to over \$4.00 per gallon between early 2007 and mid-2008.

The private sector added 222,000 jobs in February, a snapback from the meager 68,000 jobs added in January. Severe winter weather had a big impact on the job count in January, and market participants are likely to average the payroll job count in January and February to get a better sense of the underlying health of the labor market. At 145,000, the average job gain in the first two months of 2011 is an improvement over where we



At 145,000, the average job gain in the first two months of 2011 is an improvement over where we were six months ago, but is probably not yet robust enough to convince the Fed that the labor market is completely healed.

**2 At the Current Pace of Job Creation, it Will Take Another Three Years to Recoup All the Jobs Lost in the Great Recession**



Source: Bureau of Labor Statistics/Haver Analytics 03/07/11  
(Shaded areas indicate recession)

were six months ago, but is probably not yet robust enough to convince the Fed that the labor market is completely healed. There were solid job gains in manufacturing, construction, transportation, and leisure. State and local governments shed another 30,000 jobs in February and have lost 400,000 since the end of the recession. [Chart 2]

We remind readers that the monthly jobs report is made up of two surveys, the establishment survey and the household survey. The establishment survey generates the payroll job count data previously mentioned, while the household survey produces the unemployment rate. The unemployment rate is calculated by dividing the number of unemployed persons by the total number of people in the labor force. In February, the number of unemployed persons fell by 190,000 to 13.7 million and has declined by 1.4 million in the past three months. This is consistent with the drop in initial filings for unemployment benefits over the past three months. The labor force increased by 60,000 in February to 153.2 million, so the unemployment rate (13.7 million/153.2 million) fell from 9.0% in January to 8.9% in February.

While a promising sign, the strong February jobs report by no means signals an “all clear” for the labor market. The economy shed 8.8 million private sector jobs between January 2008 and February 2010, and has added just 1.5 million jobs back since early 2010. At the pace of job creation seen in February (222,000) it would take another 33 months (nearly three years) to recoup all the jobs lost in the Great Recession. For more on the February jobs report, please see this week’s *Weekly Market Commentary*.

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The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings.

The ISM index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

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