November 21, 2017

Economics Group

Special Commentary

Eugenio J. Alemán, Senior Economist
eugenio.j.aleman@wellsfargo.com • (704) 410-3273
Shannon Seery, Economic Analyst
shannon.seery@wellsfargo.com • (704) 410-1681

2017 Holiday Sales Outlook

Executive Summary

Our forecast for holiday sales this year is for an increase of 4.0 percent on a seasonally adjusted basis compared to only 3.0 percent for last year. Although income measures have not been supportive of stronger consumption this year, consumers have shunned this fact and continued consuming. The most important reason for this continuous improvement, other than the low unemployment rate and the relatively strong increase in employment of late, has been the strong improvement in consumer confidence since last November.

Therefore, we believe that the increase in consumer confidence will be enough to carry the consumer forward this year and contribute to make this holiday sales season better than what we saw last year.

Consumer Confidence Likely to Spur Holiday Consumption

More than eight years into the current economic expansion, consumers appear confident enough in the present and future state of the economy that they may be willing to continue to drive economic growth forward (Figure 1). The Consumer Confidence Index currently sits at its highest level since December 2000, with the Expectations Index at elevated levels compared to the previous holiday season. At the start of the previous holiday season, consumer expectations were negative on a year-over-year basis, suggesting little optimism about the economy. Since November of last year, the Expectations Index has registered elevated gains, leading us to believe that the consumer is upbeat about the future. Similarly, consumers view their present position at its highest level since July 2001, highlighting the conviction individuals have with their current economic position. Improved expectations coupled with a persistently high Present Situation Index point to an optimistic outlook for consumer demand this holiday season.

The Consumer Confidence Index currently sits at its highest level since December 2000.

Figure 1

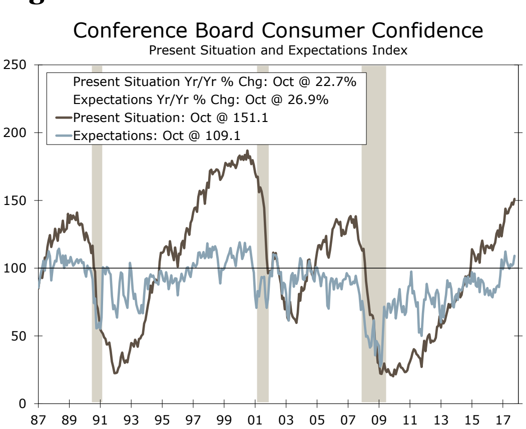
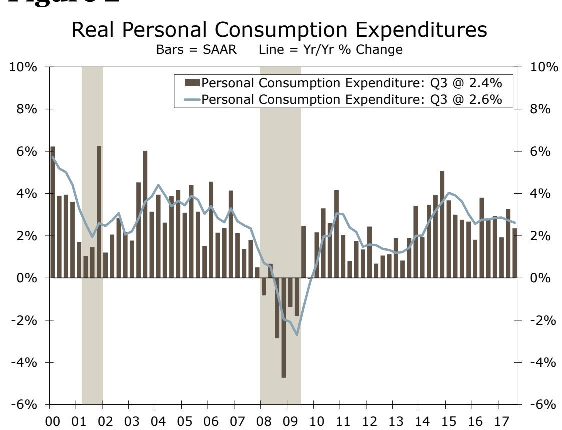


Figure 2



Source: The Conference Board, U.S. Department of Commerce and Wells Fargo Securities

Consumption habits of consumers have slowed relative to prior periods.

Although the Consumer Confidence Index continues to edge higher into the holiday season, consumption habits of consumers have slowed relative to prior periods. The slowdown in personal consumption is consistent with what normally happens this late in an economic cycle. We have seen a downshift from growth rates of close to 4 percent per year for real personal consumption expenditures (PCE) in early 2015, to about 2.8 percent in 2016 and roughly 2.5 percent currently (Figure 2). Our outlook suggests that demand will pick up in the fourth quarter, bringing personal consumption to a trend-like growth rate of 2.7 percent for the year. Although the trend of real PCE points to a weakened consumer, we believe that elevated confidence will likely translate to an increase in spending this holiday season.

Furthermore, while we suggest consumer confidence will translate to increased holiday spending, there are some mitigating circumstances that have affected consumption lately. Some of which have to do with the recent hurricane season, when we saw a very strong recovery in durable goods consumption as Americans affected by the natural disasters replaced their automobiles. This behavior was reflected in September and October retail sales numbers. This has also been reflected in non-revolving credit, which mostly consists of automobile and student loans.

However, growth in all three sectors of PCE, durable goods, non-durables, and services consumption has slowed during the year, an increasingly likely circumstance as the economic cycle ages (Figure 3). The recent slowdown in durable goods consumption may be partially due to a slight increase in interest rates. As the Fed continues to raise its benchmark rate, we anticipate slight weakness in durable goods consumption moving forward, an expected outcome of policy normalization joined with late-cycle expansion. The pace of growth in non-durable goods consumption has weakened over the past year as well, and some of this slowdown could reflect the slight increases in inflation. Inflationary pressures likely will continue to weigh on non-durable demand, but it is expected that holiday spending will push non-durable goods consumption higher over the next few months. Growth in the consumption of services remains stable at about 2.3 percent to 2.5 percent, and we expect continued modest growth within the sector. We do not anticipate that recent weakness will have a marked effect on holiday spending this year. However, we do see moderation in consumer spending growth throughout our forecast horizon.

Looking toward the monthly consumption figures, all three sectors of consumption surged in September. Going back to 1980, we have not found a stronger month for all three components of nominal PCE, likely suggesting some coming strength in overall consumer demand. Similarly, strong retail sales in October suggest solid momentum for spending headed into the fourth quarter. The control group portion of sales, which excludes autos, food, gasoline and building supplies and feeds directly into the calculation of GDP, printed a relatively strong rate of growth in October to start the fourth quarter of the year. High gains in the control group of sales for October may point to increased spending this holiday season.

Figure 3

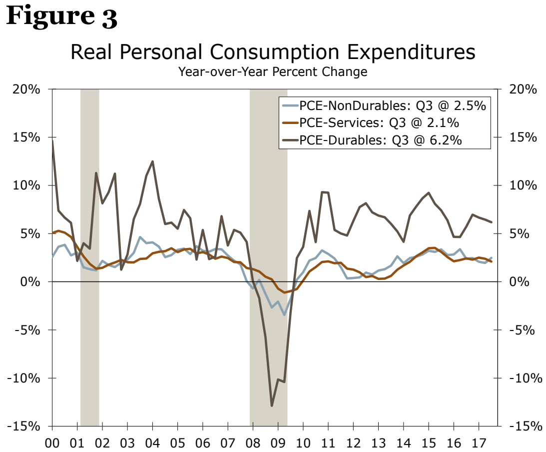
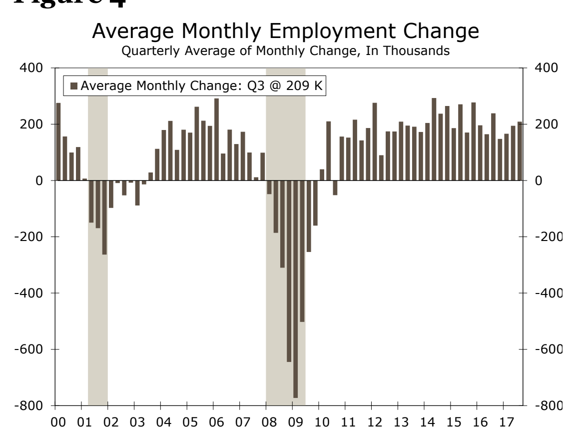


Figure 4



Source: U.S. Department of Commerce, U.S. Department of Labor and Wells Fargo Securities

Tight Labor Market Entices Demand

As the U.S. economic expansion extends further into its ninth year, employment measures continue to improve. With the unemployment rate at just 4.1 percent, we are in the midst of the tightest labor market since December 2000. Nonfarm payrolls have averaged roughly 169,000 jobs over the past 10 months, compared to about 192,000 jobs for the same period in 2016 (Figure 4). Such slowing is consistent with a tight labor market approaching full employment. Meanwhile, average hourly earnings have slowed slightly, to 2.4 percent from a 2.7 percent year-ago pace at this time last year. That said, we do expect average hourly earnings to firm in coming months due to continued strength of the labor market.

The job opening rate, which measures the number of opened positions relative to the employment base, currently sits at a record high of 4.0 percent. This means that the demand for workers continues to strengthen as total employment continues to rise. Such demand should be enticing for seasonal employment, as we anticipate work to be relatively easy to find for seasonal workers.

We anticipate work to be relatively easy to find for seasonal workers.

All these data point to a labor market that remains supportive of a relatively strong holiday sales season. However, there are some indicators that are not so holiday-sales-friendly this year, compared to what was happening at the end of last year. Case in point is the important slowdown in real incomes, which could weigh on holiday sales this year.

The Risk to Consumption: Weak Income Growth, Higher Confidence

In principle, the weak growth in personal income remains a potential risk going into the holiday sales season. However, given the strong consumer confidence numbers over the past year and a lower saving rate plus some improvement in borrowing, it does not seem that this income weakness will have an effect over holiday sales. Having said this, it is important to take this risk seriously, in case consumer confidence expectations fall short as we move into the new year.

Figure 5

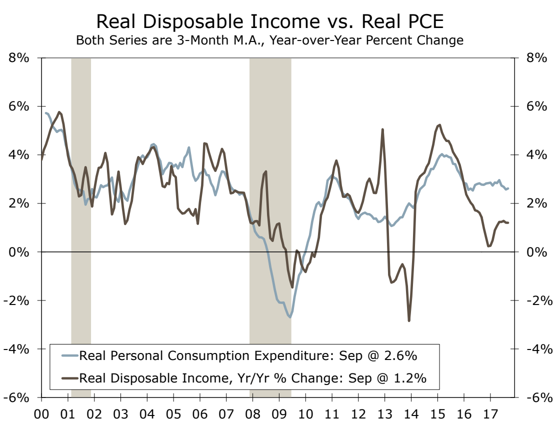
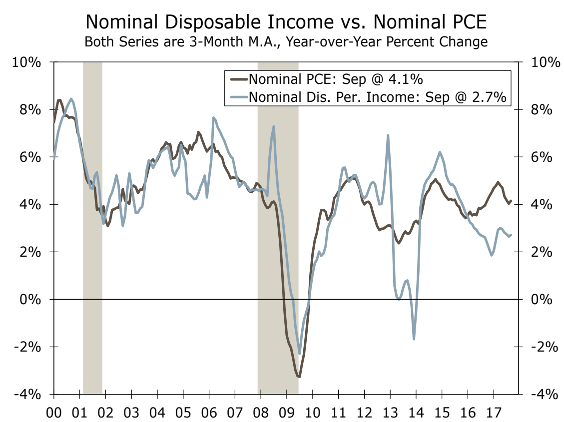


Figure 6



Source: U.S. Department of Commerce and Wells Fargo Securities

Although we see the holiday sales season as better this year than in 2016 for the aforementioned reasons, we also see weakness ahead for PCE if we do not see some improvement in income measures. Such improvements could come either from higher wages and salaries, or lower taxes or a combination of both. In fact, our forecast calls for a stronger growth in disposable personal income next year due to the impact of the tax reform. We have assessed this increase in disposable personal income on the second quarter of 2018. However, after that, we have a slowdown in the growth rate of disposable personal income and this is expected to drive the growth rate of PCE lower for the last year of our forecast (2019).

We are forecasting that holiday sales will increase 4.0 percent this year.

Holiday Sales Should Be Better than Last Year's[1]

Our forecast for holiday sales this year is better than what we had seen last year. We are forecasting that holiday sales will increase 4.0 percent this year compared to last year in nominal terms, and on a seasonally-adjusted basis (Figure 7). Holiday sales last year increased by 3.0 percent on a seasonally-adjusted basis. In non-seasonally adjusted terms, holiday sales were up 3.6 percent last year compared to 2015 and the National Retail Federation (NRF) is expecting holiday sales to increase between 3.6 percent and 4.0 percent in 2017 on a non-adjusted basis.[2]

Figure 7

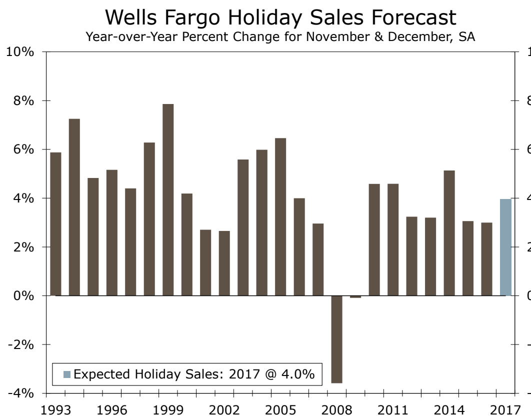
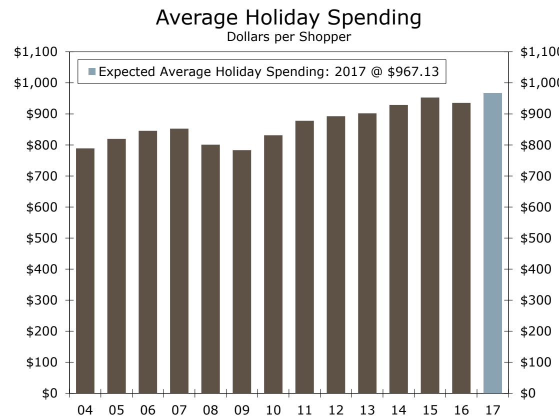


Figure 8



Source: National Retail Federation, U.S. Department of Commerce and Wells Fargo Securities

According to the NRF media release, American consumers are planning to spend, on average, $967.13 during the holiday season this year, which is up 3.4 percent from what the survey indicated they were planning to spend last year, which was $935.58, on average (Figure 8).[3] Last year's survey on average spending during the holiday season indicated a decline of 1.8 percent versus the 2015 holiday season. Thus, this year's survey result of a 3.4 percent increase versus last year's decline is an important improvement on average spending by American consumers. This development is probably driven by the strong improvement in consumer confidence since the end of last year, as consumers feel more optimistic regarding the future of the U.S. economy and are acting upon this conviction.

We are estimating overall retail sales to increase 4.3 percent compared to 2016.

Conclusion: Upside Risk for Holiday Sales

Together with higher holiday sales for this coming season, we are also forecasting higher overall retail sales for the year compared to what we saw last year. In 2016, overall retail sales increased by a scant 3.0 percent versus 2015. However, this year, we are estimating overall retail sales to increase 4.3 percent compared to 2016. We believe this increase will be driven by still relatively strong sales of automobiles, which were helped in September and October by the effects of the hurricanes that hit Florida and Texas, as well as building material & garden equipment & supplies dealers sales, furniture & home furniture store sales, general merchandise sales and non-store retailer sales. Another sector that saw sales increase considerably during the year was gasoline stations. However, much of the increase in gasoline sales was also due to the hurricane season as gasoline prices increased considerably during the year.

---

[1] We follow the National Retail Federation's (NRF) definition for holiday sales, which are November and December retail and food services sales minus automobile sales, gasoline sales and food services sales. However, our forecast uses seasonally adjusted sales versus the NRF forecast, which uses non-seasonally adjusted sales.

[2] See "NRF Forecast Holiday Sales to Increase Between 3.6 and 4 Percent", https://nrf.com/media/press-releases/nrf-forecasts-holiday-sales-increase-between-36-and-4-percent.

[3] See "NRF Consumer Survey Points to Busy Holiday Season, Backs Up Economic Forecast and Import Numbers", https://nrf.com/media/press-releases/nrf-consumer-survey-points-busy-holiday-season-backs-economic-forecast-and.

While we have a 4.0 percent growth projection for holiday sales this season, and 4.3 percent for overall retail and food services sales for the year as a whole, we need to point out that there is the potential for sales to be a bit higher than what we are forecasting in lieu of the still strong performance of the Consumer Confidence Index. Although we pointed out in this report that income has not accompanied the growth rate in consumption during the year, Americans seem to be reacting more to their feeling regarding the future of the U.S. economy, than to what the actual income numbers are suggesting.

Improved confidence in the future has brought down the saving rate at the same time as Americans have continued to borrow to complement income growth. These additions have helped keep the growth rate of PCE on a stronger path than the path established by personal and disposable income. Furthermore, if Americans believe they will pay lower taxes next year due to tax reform making its rounds through the U.S. Congress, then we may see an upward surprise during this holiday season. That is, we see risks for holiday sales to be tilted to the upside.

Wells Fargo Securities Economics Group

Diane Schumaker-Krieg	Global Head of Research, Economics & Strategy	(704) 410-1801 (212) 214-5070	diane.schumaker@wellsfargo.com
John E. Silvia, Ph.D.	Chief Economist	(704) 410-3275	john.silvia@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Currency Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Eugenio J. Alemán, Ph.D.	Senior Economist	(704) 410-3273	eugenio.j.aleman@wellsfargo.com
Azhar Iqbal	Econometrician	(704) 410-3270	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Eric Viloria, CFA	Currency Strategist	(212) 214-5637	eric.viloria@wellsfargo.com
Sarah House	Economist	(704) 410-3282	sarah.house@wellsfargo.com
Michael A. Brown	Economist	(704) 410-3278	michael.a.brown@wellsfargo.com
Jamie Feik	Economist	(704) 410-3291	jamie.feik@wellsfargo.com
Erik Nelson	Currency Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economic Analyst	(704) 410-3156	michael.d.pugliese@wellsfargo.com
E. Harry Pershing	Economic Analyst	(704) 410-3034	edward.h.pershing@wellsfargo.com
Hank Carmichael	Economic Analyst	(704) 410-3059	john.h.carmichael@wellsfargo.com
Ariana Vaisey	Economic Analyst	(704) 410-1309	ariana.b.vaisey@wellsfargo.com
Abigail Kinnaman	Economic Analyst	(704) 410-1570	abigail.kinnaman@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

WELLS FARGO SECURITIES