

FINANCIAL FAQs

CAUTIOUS CONSUMERS THIS WEEK

December's retail sales rose 6.3 percent over December 2004, but this week shows little else to cause optimism for 2006. The wholesale Producer Price Index rose 0.9 percent for finished goods, 5.4 percent for all of 2005, the largest rise since 1990 (just prior to the last recession).

And although the unemployment rate fell to 4.9 percent, 250,000 more workers left the work force, indicating that we are far from a fully-employed economy. If the total number of discouraged were added back into the work force the unemployment rate would be above 7 percent, according to Barron's.

It is perhaps why consumer credit is actually shrinking. October and November outstanding consumer debt fell a total of \$9 billion, the largest ever decline in 15 years, according to CBS Marketwatch. This was attributed to a drastic falloff in auto sales, but credit card debt also shrank, indicating that higher interest rates are causing consumers to think twice about financing their purchases with credit.

This is just what the Federal Reserve Governors intended with their 13 interest rate hikes since last summer. Their fear is if consumers continue to pile up debt, then no "soft landing" of the economy is possible. I.e., over indebted consumers could cause a much more severe downturn when this business cycle runs its course, which is inevitable. At least no one has yet found a cure for the cycles of boom and bust that characterize capitalist, free market economies.

PRODUCER PRICE INDEX—December's wholesale inflation indicator (PPI) rose a huge 0.9 percent, but its core index was up just 0.1 percent without food and energy included. Its core rate for all of 2005 has declined to 1.7 percent, vs. 2.3 percent in 2004. The question is whether high energy prices will be passed on to retail (CPI) prices, due out this week. The 2.3 percent fall in so-called crude-goods prices was good news in that respect. So while crude goods have risen 22.1 percent in a year, intermediate goods' prices rose 8.4 percent and finished goods 5.4 percent in 12 months, respectively, which seems to indicate that producers are able to pass on very little of their material costs to consumers.

RETAIL SALES—Rose 0.7 percent in December, indicating still healthy consumer spending. The question is how much more consumers will borrow, since incomes are not keeping up with spending. Pundits characterized consumers as "cautious", in part because Wal-Mart posted weak same-store sales numbers of just 2.2 percent in 12 months.

There have been 10 such boom-bust cycles since World War II, according to the National Bureau of Economic Research (at NBER.org) with recessions averaging 10 months, and recoveries (from end of last recession to beginning of next one) averaging 57 months. This recovery is already long of tooth—50 months old—which is why economists are cautious about the outlook for 2006.

Fed officials, as well as Mortgage Bankers have remained optimistic about 2006, in part because interest rates could plateau while economic growth continues to create 2 million new jobs per year as in 2005. The Mortgage Bankers Association predicts that housing sales and real property prices (adjusted for inflation) will decline about 5 percent in 2006, indicating that higher inflation may be taking a bite out of property sales. Household

income has not kept up with inflation since 2000, which leaves less disposable income (i.e., after taxes) to spend.

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