

Weekly Economic Commentary



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Highlights

Will warmer weather keep consumers and business spending?

Total spending on home heating this winter looks like the winter of 2008–09

Gasoline dominates consumer spending on energy-related goods and services

Economic Calendar

Monday, March 19 NAHB Housing Survey <i>Mar</i>	Thursday, March 22 Initial Claims wk 3/17
Tuesday, March 20 Building Permits <i>Feb</i>	Leading Indicators <i>Feb</i>
Housing Starts <i>Feb</i>	Friday, March 23 New Home Sales <i>Feb</i>
Wednesday, March 21 Existing Home Sales <i>Feb</i>	

Warmer Weather to the Rescue?

Housing is the dominant theme on this week's economic and policy calendar. Reports on homebuilder sentiment for March as well as housing starts, building permits, new home sales and existing home sales for February will compete for the market's attention this week. Much warmer-than-usual weather during the first two months of 2012 will likely boost housing-related data. Outside of housing, very few economic reports are due out in the United States this week.

The Federal Reserve (Fed) will be active this week, as Fed Chairman Ben Bernanke and several of his colleagues on the Federal Open Market Committee (FOMC) make public appearances. Housing has been a key talking point for the Fed in recent months as policymakers mull over another round of monetary policy stimulus. On balance, there are more monetary policy doves (FOMC members favoring easier policy) than hawks (FOMC members who favor tighter policy) on the docket this week.

Overseas this week, there are several debt auctions in Europe, and several emerging market central banks (Thailand, Taiwan and Columbia) meet to set rates. This week may bring the release of the Chinese PMI data for March amid ongoing fears of a hard landing in China.

Warmer Weather Means Less Consumer Spending to Heat Homes, but not Enough to Fully Offset Rise in Gasoline Prices

In our March 5, 2012, *Weekly Economic Commentary*, we discussed the impact that the much warmer (and drier) than usual weather in the first two months of 2012 may have on the economic data in the coming weeks and months. In that report, we noted that warmer weather during the winter months tends to lower household and business expenditures for heating fuels (heating oil, natural gas, electricity, propane, etc.) freeing up more spending power for discretionary purchases. With gasoline prices rising rapidly (prices have moved up by more than 60 cents per gallon to near \$3.90 per gallon since the beginning of 2012), is the warmer weather enough to offset the rapid rise in gasoline prices and keep consumers and businesses spending?

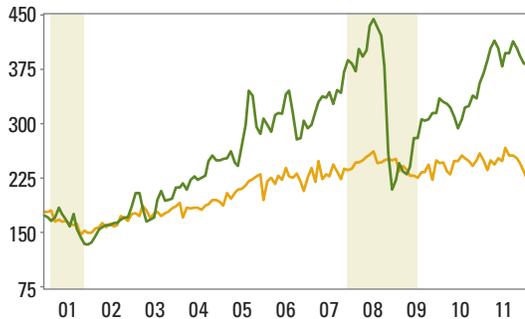
In October 2011, the United States Department of Energy (DOE) forecast that the average household would spend 5% more to heat their homes over the winter heating season (October through March of 2011–12) than they



1 We Are Spending Less on Heating Our Homes This Winter, but We Spend Nearly Twice as Much on Gasoline Than We Do on Heating Our Homes

Personal Consumption Expenditures

- Gasoline and Other Motor Fuel, Seasonally Adjusted Annual Return, Bil. \$
- Home Heating Products, Seasonally Adjusted Annual Return, Bil. \$

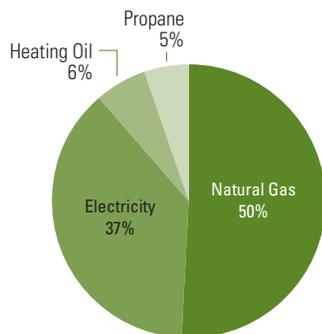


Source: Haver Analytics 03/19/12

(Shaded areas indicate a recession)

The use of particular fuels for space heating varies widely across the United States. While natural gas heats 50% of homes nationwide, heating oil is particularly important to the Northeast and electricity is most widely used in the South.

2 Percentage of Households That Use Each Fuel for Heat



Source: Haver Analytics 03/19/12

did in the winter of 2010–11. In early March 2012, the DOE revised that forecast sharply lower, and it now expects that the average household will spend 6% less on heating their homes this winter than they did last winter. On balance, total spending on home heating this winter is likely to be little changed from what Americans spent in the winter of 2008-09 to heat their homes. While this will provide some cushion to higher gasoline prices, it cannot offset all of the impact of higher gasoline prices simply because consumers spend 75% more on gasoline (\$381 billion in January 2012) than they do on natural gas, heating oil, electricity and propane (\$220 billion).

The expenditure per household for natural gas—50% of households use natural gas to heat their homes—is now expected to be \$629. This is 15% below what was expected in October and 13% below last winter. About 37% of all households use electricity to heat their homes. The DOE now expects the average household to spend \$911 this winter on electricity to heat their homes, down from \$956 expected in October 2011, and 5% less than last winter’s expenditure. Just 6% of households use heating oil to heat their homes, although 80% of households in the Northeast use heating oil. The average expenditure per household on home heating oil is expected to be 11% lower than the forecast made in October and 3% lower than last year. Only about 5% of households use propane to heat their homes, and costs there are dropping sharply as well. Back in October 2011, the DOE expected that households in the Midwest (where the highest percentage of home owners use propane to heat their homes) to spend \$1,880 this winter. Now, the DOE expects these households to spend just \$1,658 this winter, 12% less than in October and 9% less than last winter.

3 The Warmer Weather This Winter Has Led to a Drop in Household Expenditures on Home Heating

Fuel	Spending Per Household (Winter 2011–2012)	Spending Per Household (Winter 2010–2011)	\$ Difference vs. Last Winter	% Difference vs. Last Winter
Natural Gas	\$629	\$724	-\$95	-13%\$
Electricity	\$911	\$956	-\$46	-5%\$
Heating Oil	\$2238	\$2298	-\$60	-3%\$
Propane	\$1658	\$1816	-\$158	-9%\$

Source: U.S. Department of Energy 03/16/12

This data reflects the average spending per household across the United States. Each household’s consumption is different and varies widely by region, household, number of people in the house, age and type of home, etc.



4 Detail of Consumer Energy Spending and Prices

	Spending in January 2012	% of Total Consumer Energy Spending in January 2012	Price Today	Price in July 2008
Gasoline	\$381 Billion	63%	\$3.88 / gallon	\$4.17 / gallon
Electricity	\$154 Billion	25%	\$79 / MWH	\$100 / MWH
Natural Gas	\$44 Billion	7%	\$2.30 BCF	\$13.35 BCF
Heating Oil	\$21 Billion	3%	\$3.27 / gallon	\$4.01 / gallon
Total	\$608 Billion	100%		

Source: U.S. Bureau of Economic Analysis 03/16/12

Energy Spending As a Percent of Total Spending Has Moved Up Over the Past Two Years, but Remains at a Low Level...for Now

Detailed data on consumer spending in January 2012 from the monthly report on personal income and spending help to provide a broader perspective on what consumers spend on energy-related goods and services. In January 2012, consumers spent an annualized \$608 billion on energy goods and services (gasoline, home heating oil, propane, electricity, natural gas, etc.). [Table 4](#) details how that \$608 billion was spent.

The data on spending is adjusted for seasonality, so it takes into account the fact that people spend more on heating oil and natural gas in January than they do in June. However, the data also accounts for the fact that consumers do more driving in June than in January. Seasonally adjusting data allows us to compare month-to-month changes in datasets and also allows us to compare spending in one month to spending in a different month on an “apples-to-apples” basis.

5 Consumer Spending on Energy Goods and Services

	Early 2000s Lows	July 2008 Peak	Late 2008 Lows	January 2012
Total Consumer Spending on Energy Goods and Services	\$286 Billion	\$713 Billion	\$466 Billion	\$608 Billion
Consumer Energy Spending As a Percent of Total Spending	4.0%	7.0%	4.8%	5.6%
Consumer Energy Spending As a Percent of Income	3.2%	5.7%	3.8%	4.6%

Source: U.S. Bureau of Economic Analysis 03/16/12

Gasoline Dominates Consumer Spending on Energy-Related Goods and Services

Out of context, \$608 billion appears to be a great deal of money, but when compared to total personal spending (\$10.9 trillion in January 2012), personal income (\$13.2 trillion) and gross domestic product (\$15.3 trillion), consumer spending on energy and energy services is relatively small. On balance, 5.6% of consumer spending and around 4.6% of personal incomes were spent on energy and energy services in January 2012 [[Table 5](#)]. While low, these readings have moved steadily higher over the past three years, as prices of energy climbed from their Great Recession lows. For example, at the peak of energy prices in July 2008, consumers spent \$713 billion on energy goods and services, representing 7% of total personal spending and 5.7% of personal incomes. In the worst of the Great Recession in late 2008, spending on energy goods and services sunk to \$466 billion (4.8% of spending and 3.8% of incomes).

Higher energy costs impact businesses as well, although the data on what businesses spend on energy-related goods and services is not as detailed as the consumer spending data. On balance, energy costs account for between 5% and 10% of overall business costs. By comparison, labor costs are roughly 70% of business costs. The most noticeable impact on businesses from higher energy prices is on shipping and transportation costs. Businesses will try to pass these higher transport and shipping costs onto the end user (typically, the consumer), and if they are unable to pass on these costs, businesses’ profit margins (which are near record highs) could suffer, which would slow corporate profit growth. We will learn more about the impact of rising energy prices on corporations’ profitability as they report their results for the first quarter of 2012 beginning in early to mid-April.



6 Total Consumer Spending on Energy (Percent of Total Consumer Spending)



Source: Haver Analytics 03/19/12

(Shaded areas indicate a recession)

The average U.S. household is expected to pay about \$629 to heat with natural gas this winter, down 13% from last winter and the lowest projected gas heating expense since \$599 for the 2002-03 winter.

Since December 2008, spending on energy goods and services has moved from 4.8% of total consumer spending to 5.6% of spending, but still shy of the 7.0% of spending hit in mid-2008. Even that elevated reading was dwarfed by the near 10% of spending on energy goods and services relative to total spending seen in the late 1970s and early 1980s. Still, it is how far and how fast energy spending rises that matters most, and by those metrics the recent rise in consumer spending on energy goods and services is still muted. For example, in 1973, consumer spending on energy goods and services accounted for around 6% of total spending. After two oil embargoes (1973 and 1979), consumer energy spending accounted for nearly 10% of spending by 1980. This rising share of energy spending acted as a tax on the economy during the mid-to-late 1970s, slowing consumer spending and the overall economy, contributing to three recessions (1973–75, 1980 and 1981–82).

Energy spending as a percent of total spending troughed in the early 2000s at around 4.0%, and by mid-2008 had nearly doubled to 7%. In our view, the surge from around 5% in late 2006 to the aforementioned peak in mid-2008 (7%) was a key factor in causing the onset of the Great Recession in late 2007. In short, the move higher in energy prices and spending in the last 36 months or so has probably not been sharp enough or rapid enough to derail the economic recovery by itself. However, should consumer energy prices (gasoline, heating oil, electricity) move sharply higher in the coming months, and income gains reverse course and stagnate, the recovery would be in jeopardy. We will continue to monitor this important metric closely, and report back in future editions of the *Weekly Economic Commentary*. ■

LPL Financial Research 2012 Forecasts

- GDP 2%*
- Federal Funds Rate 0%^
- Private Payrolls +200K/mo.†

Please see our *2012 Outlook* for more details on LPL Financial Research forecasts.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

* Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

^ Federal Funds Rate is the interest rate at which depository institutions actively trade balances held at the Federal Reserve, called federal funds, with each other, usually overnight, on an uncollateralized basis.

† Private Sector – the total nonfarm payroll accounts for approximately 80% of the workers who produce the entire gross domestic product of the United States. The nonfarm payroll statistic is reported monthly, on the first Friday of the month, and is used to assist government policy makers and economists determine the current state of the economy and predict future levels of economic activity. It doesn't include:

- general government employees
- private household employees
- employees of nonprofit organizations that provide assistance to individuals
- farm employees



The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Stock investing involves risk including loss of principal.

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

International investing involves special risks, such as currency fluctuation and political instability, and may not be suitable for all investors.

Chinese Purchasing Managers Index: The PMI includes a package of indices to measure manufacturing sector performance. A reading above 50 percent indicates economic expansion, while that below 50 percent indicates contraction.

The Beige Book is a commonly used name for the Fed report called the Summary of Commentary on Current Economic Conditions by Federal Reserve District. It is published just before the FOMC meeting on interest rates and is used to inform the members on changes in the economy since the last meeting.

The Federal Open Market Committee (FOMC), a committee within the Federal Reserve System, is charged under the United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasury securities).

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