TD Bank Financial Group

TD Economics

Special Report

July 16, 2008

U.S. HOUSEHOLDS LOOK TO BE SAVING THEIR STIMULUS CHECKS

One of the main inputs into the near-term outlook for the U.S. economy is the impact on economic growth of the $117 billion in fiscal stimulus checks sent to U.S. households through the second and third quarters of this year. Last month we updated our Quarterly Economic Forecast with an assumption that largely due to the fiscal stimulus, economic growth in the second quarter of the year would come in at a rate of 1.4% annualized - led by growth in consumer spending growth of 2.1%. While we will not know the final impact of the stimulus until we get the first estimate of second quarter GDP growth at the end of this month, we can use some quick metrics to make a rough estimate as to how close we were to reaching our initial forecast of consumer spending with the advanced reading on June retail sales.

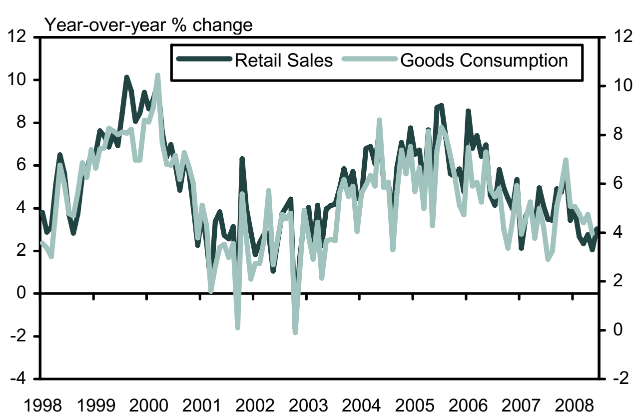
As of the final week of June, 95 million checks had been sent to U.S. households, totaling $78.3 billion. As a result of the fiscal stimulus, nominal disposable income in the second quarter likely rose by close to 20% (annualized) – an increase too big not to have some impact on consumer spending. Personal consumption expenditure is split up between spending on goods (both durable and non-durable) and services. Spending on services makes up 60% of consumption, non-durable goods 30% and durable-goods 10%. U.S. retail sales are an input into the calculation of goods consumption and in combination with data on services spending in April and May we can use the retail sales data to make an estimate of personal consumption growth in the second quarter.

Total nominal retail sales expanded by 3.9% (annualized) in the second quarter, thanks in large part to higher-gaso-

HIGHLIGHTS

- **With the advanced reading on U.S. retail sales out yesterday we get our first glimpse at how successful the fiscal stimulus checks to U.S. households have been in stimulating consumer spending.**
- **Nominal retail sales came in below expectations in June and were revised down for May. For the quarter retail sales were up 3.8% at an annual rate.**
- **With PCE goods inflation running close to 4% (thanks in large part to higher gasoline prices) in real terms retail sales were likely very close to flat in the quarter, putting downside risk to our forecast for PCE growth.**
- **It appears that spending growth is slowing even in spite of the stimulus checks, implying that households may be in fact saving more of their checks than previously thought.**

RETAIL SALES & GOODS CONSUMPTION



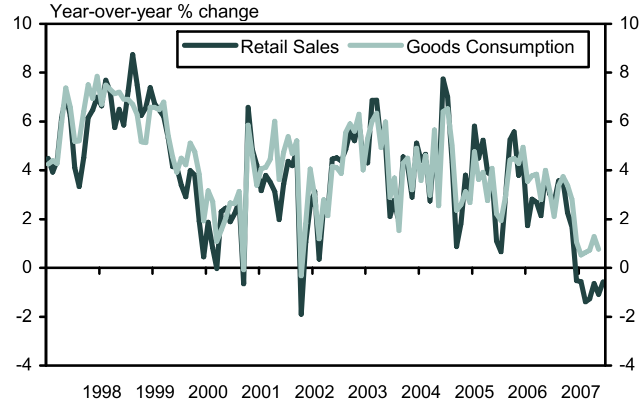
Source: BEA & Census Bureau / Haver

line prices. Excluding sales at gasoline stations, retail sales were up 0.8% in the quarter – implying that after filling up their gas tanks, households spent little else of their economic stimulus checks on goods. CPI in the second quarter expanded by close to 5% and PCE goods inflation was likely not far behind, implying that in real terms retail sales growth was likely very close to flat in the quarter and quite possibly negative.

While we still do not know how much of the stimulus households spent on the much larger category of services in June, if spending on goods was flat or even optimistically increased by 1% in the quarter, services spending would have to increase by between 7% and 15% annualized in June in order to reach our forecast of 2.1% growth in the second quarter. This kind of growth has not occurred in one month in several years and at this point in the cycle is a near impossibility. In all likelihood we will not reach our forecast of 2.1% personal consumption growth in the second quarter, putting some downside risk to our real GDP forecast of 1.4%.

There are three possible reasons why our forecast may have missed the mark in the second quarter with different implication for the longer term forecast: 1) we were overly optimistic in our assumptions of pre-stimulus growth, 2) households intended to spend less of their rebates than we expected them to 3) households intend to spend the checks but did not do so immediately so the higher spending has not shown up yet. In the first two cases, the impact on future economic growth is unchanged but in the third case there may be some upside to our forecast for growth in the third quarter. It is too early to be definitive but our sense is growth in the second and third quarter will be a bit softer than we had previously forecast.

REAL RETAIL SALES & GOODS CONSUMPTION*



*Deflated by PCE goods deflator
Source: BEA & Census Bureau / Haver Analytics

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