February 14, 2019

Why You Should Fade US Retail Sales

United States, Retail Sales, % Change headline/ex-autos/ex-auto-gas, m/m, December:

Actual: -1.2 / -1.8 / -1.4

Scotia: 0.1 / 0.1 / na

Consensus: 0.1 / 0.0 / 0.4

Prior: 0.1 / 0.2 / 0.5 (revised from 0.2 / 0.2 / 0.5)

- **This was a miserable report, but don't use it to jump on the recession bandwagon despite headlines that invite you to go to that dark place by noting it was the largest monthly decline since 2009. There are several reasons to view it skeptically** and frankly I'm surprised that the Census Bureau didn't even flag any of the ones offered below. That may be testament to the combined effects of short memories and delayed data due to the government shutdown. Regardless, markets reacted with S&P futures turning south immediately afterward, the US 2 year yield dropping 3–4 bps, and the USD on a DXY basis depreciating.
- **Before turning to those reasons for caution when interpreting the figures, the report was bleak on all fronts.** We knew that headline sales would be challenged by gas prices and little change in auto sales, but the weakness in sales ex-autos and ex-gasoline (-1.4% m/m) is where the disappointment lies and that compounded the headline weakness. The drop in the retail sales control group—that excludes food services, autos, building materials and gas stations—is what will flow through to a weak report for total consumer spending during December on March 1st.
- **Breadth was poor as most categories fell.** Surprisingly, auto vehicles and parts were up 1% despite flat new vehicle sales as a combination of the rest of the drivers including prices and parts spared this component from the red ink elsewhere. Gas station sales fell 5.1% m/m which reflected the drop in gasoline prices and should be excluded. However, sales fell for furniture (-1.3% m/m), electronics (-0.1%), health and personal care items (-2%), clothing (-0.7%), sporting goods (-4.9%), general merchandise (-0.9%), eating/drinking establishments (-0.7%), and even non-store retailers (-3.9%).
- **Now, when underlying fundamentals driving consumer finances are sparkling, one should perhaps have cause to question why consumers pulled their heads back in their shells with such abruptness.** I don't see any such temptation through post-release market signals at least as of yet. Americans are saving 6% of their paycheques, so forget the pre-GFC period when the saving rate was at one-third its present level as a tapped out signal back then. Debt payments as a share of disposable income are trending around a record low. Wage growth is at a decade high. Households have been deleveraging. You get the picture. The drivers of US consumption are generally very robust.
- **Alternatively, what is presented below is an assessment of what may have driven the sudden weakness with the broad takeaway being that I'll wait to see more data before ringing any alarm bells. It's prudent to be cautious but also not to over-react.**

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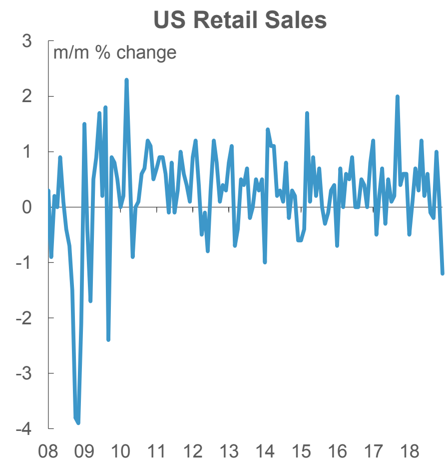
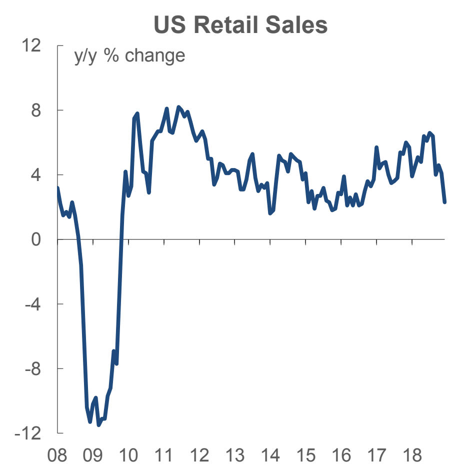


Sources: Scotiabank Economics, US Census Bureau.



Sources: Scotiabank Economics, US Census Bureau.

- **Weather:** December 8–10th saw the 3rd largest snowstorm in history for a month of December across much of the southeastern and eastern seaboard of the US. The storms hit the southern plains through the southeast and even included 10 inches of snow getting dumped in parts of Texas. One foot of snow fell through parts of the Carolinas and Virginia resulting in declarations of emergency and power outages (here). Another major storm disrupted travel along the eastern seaboard just days ahead of Christmas and again into peak shopping season. Blame Mother Nature.
- **The government shutdown**: This began on December 22nd and hence three days before Christmas right in the mad dash to fill stockings. It lasted until January 25th. The impact upon consumer spending could have been material through direct channels (ie: furloughed government workers not getting paid and uncertain about when their next paycheque will arrive) and indirectly through the confidence hit on many others dismayed toward the state of affairs in Washington and the market effects. Blame Trump.
- **Sampling:** this being the advance report and a delayed one at that, I suspect revision risk may be high into the next estimate for December. Retail sales can often be heavily revised. While the Census Bureau states that response rates were at or above normal levels for this release, data collection and processing were delayed by the shutdown. This may be pure conjecture, or it may be prudent caution toward a process that was delayed and resulting in an uncertain quality of the responses. Recall that the advance estimate is based upon a small subset of the total retail space. Even in normal times, the 90% confidence interval on this report is +/- 1.6 percentage points (here). In abnormal times when one might prudently question data collection and overall accuracy, the scope for sampling error could well be much higher even compared to what's normal.
- **Brought forward sales:** retail sales were up 7.3% q/q SAAR in Q2 and 4.3% in Q3. They ended up 1.8% in Q4. The moderating pattern fits the theory that the distributions related to the TCJA would put consumption on a sugar high temporarily and at the expense of later figures. We're in that patch now. That doesn't mean recession. That means brought forward momentum into a soft patch while core drivers like jobs and income gains remain strong and could well support a return to modest consumption growth. By way of comparison, I believe Canada's consumer story is a leading example of the US story in that Canada offered tax cuts to middle-income earners and a huge increase in child transfers amounting to thousands of dollars per child (tax free) that juiced consumption temporarily and then drove it into a soft patch among other drivers.
- **Stocks:** The S&P500 fell by about 20% from early October through to the low point in late December, with almost 16% of that 20% drop occurring from early December onward. Stocks have since rebounded into January and are presently only about 6% off the high in late September and early October. Is retail weakness a reflection of the stock market drop in a sudden negative wealth effect? Maybe, but I doubt it. Wealth effects usually require longer lived corrections and lagged effects, but the rebound in January may suggest stability in terms of this possible driver. The December meltdown was correlated with the shutdown and US-China effects and so be careful about double counting shutdown effects on confidence and the market effects, plus other considerations like tax loss selling especially in tech stocks, the story on Trump threatening to fire Powell and algo trading during thin holiday markets. If there was a sudden negative wealth effect on consumption, then expect it to stabilize to the extent to which stocks have improved this year.