US Consumers: A Roar Before Retreat?

- Consumption is tracking an impressive rebound of about 3.5% in Q2…
- ...but it is likely a transitory burst of activity financed by a lower saving rate…
- ...while weakening income growth points to softer consumption over H2
- Q2 GDP tracking is soft despite solid consumption growth…
- ...as Trump's trade policies are hammering investment…
- ...which begs the question what happens if consumption growth falls apart
- Core PCE inflation is stabilizing but showing no signs of rebounding

United States, Personal Income / Consumption, % m/m, May:
Actual: 0.5 / 0.4
Consensus: 0.3 / 0.5
Scotia: 0.3 / 0.4
Prior: 0.5 / 0.6 (Revised from 0.5 / 0.3)

United States, PCE / core PCE deflators, y/y % change, May:
Actual: 1.5 / 1.6
Consensus: 1.5 / 1.5
Scotia: 1.4 / 1.5
Prior: 1.6 / 1.6 (Revised from 1.5 / 1.6)

- **Now that's a rebound! For now, which is a very strong qualifier in this case.** US consumer spending is charging ahead in Q2 and this amounts to a powerful rebound from transitory weakness during Q1. The problem lies in evidence this might not be durable into H2 at the same time that investment in the US economy is tanking because of Trump's confidence-sapping trade policies. **With GDP growth tracking softly in Q2, the question then reverts to what happens over H2 if consumer spending softens again as investment weakness persists in the face of substantial risks to global trade.** These issues matter much more than the latest inflation prints that have garnered more of the recent attention.
- **Consumption growth is tracking 3 ½% in Q2 at a q/q seasonally adjusted and annualized rate.** That's a strong rebound from just 0.9% Q1 growth after yesterday's Q1 GDP revisions and in turn follows growth of 2 ½% in Q4. Just one quarter of softness played an out-sized role in dampening the understanding of financial markets toward consumer dynamics when in reality the softness was likely transitory and driven by considerations such as abnormally harsh weather effects compared to seasonal norms.
- The saving rate was stable in May at 6.1% (chart 1). The correction lower occurred earlier. The saving rate hit 7.4% in December of last year and held at 6.8% and then 7.1% in the subsequent two months. Headline confidence effects spiked it higher, but then the saving rate corrected lower from March onward as pent-up demand was unleashed. **The very legitimate question here lies in whether this burst of pent-up activity points to durable consumption gains over the back half of the year in the face of sundry domestic and external risks.**

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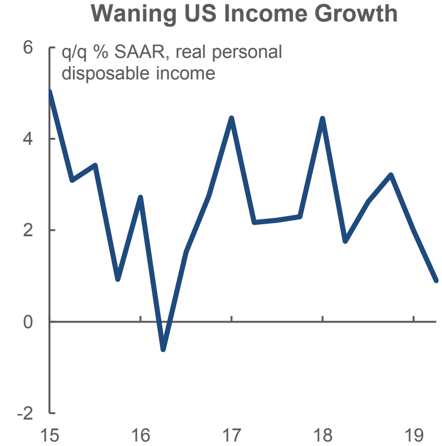
US Personal Saving Rate

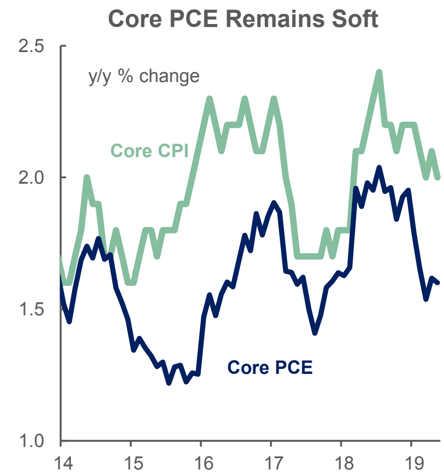
Sources: Scotiabank Economics, Bureau of Economic Analysis.

Waning US Income Growth



Sources: Scotiabank Economics, Statistics Canada, BEA.

- **One way of addressing this risk is to look at income growth (chart 2).** It's not just one month of soft nonfarm payrolls that is disconcerting, pending next Friday's report for June. Income growth is not impressive. In inflation-adjusted terms, personal disposable income was up by 3.2% q/q at a seasonally adjusted and annualized rate in Q4. Since then, income growth has ebbed to 2% in Q1 and just under 1% in Q2. Q2 income growth is the weakest in three years. **Further gains in consumption would be more likely to be driven by erosion of the saving rate rather than income growth and that requires confidence to improve and/or easier lending terms. It's difficult to see such confidence effects transpiring.**
- Core inflation held in at 1.6% y/y. **Basically core PCE inflation has been trending around 1.5–1.6% y/y for the past four months which indicates a trough but no upward progress.** There isn't really evidence that transitory factors are shaking out versus persistent sub-2% readings. At the margin, this is not materially informative to Fed policy risks which shifts the focus to the G20, Monday's ISM and how big the downside risk may be, and next Friday's nonfarm payrolls.



Sources: Scotiabank Economics, Bloomberg.

- On the blend of consumption and investment implications to GDP growth, **the Atlanta Fed's updated 'nowcast' for Q2 GDP growth shifted down to 1.5% from 1.9% previously** on the back of this morning's updates (here). I'm getting 3.5% annualized consumption growth and they're estimate is similar, but the offset is a worse than expected investment picture in the lesser watched figures from the BEA this morning. **Simply put, investment in the US economy is tanking.** Gross domestic private investment in the GDP accounts is tracking a drop of almost 5% by their estimate. **If Q2 consumption gains fade while investment is tanking on Trump's trade tactics, then guess where the risk lies for H2 GDP...**
- **Tying it all together, what does this mean to the Fed?** They should look through solid consumption in Q2 and be cautious toward future consumption growth while raising alarms on the investment picture. At the same time, years of undershooting inflation persist in 2019, let alone any signs of an approaching overshoot. The crosscurrents in the tracking dynamics to US growth and inflation support easing with further risks to be informed by the G20 and next week's ISM and nonfarm gauges that may inform market risks surrounding the conditional timing of possible easing.