

The US Consumer Keeps Powering Ahead

- Retail sales were a bit stronger than expected on headline...
- ...mostly due to autos that may have been distorted
- Still, Q3 consumption is tracking strongly again
- The Fed shouldn't capitulate to market pricing for rate cuts...
- ...on the back of CPI and also improved trade sentiment

US retail sales, headline/ex-autos, m/m % change, SA:

Actual: 0.4 / 0.0

Scotia: 0.1 / 0.1

Consensus: 0.2 / 0.1

Prior: 0.7 / 1.0

Growth in retail spending growth slowed, but the overall quarter is still tracking strongly. That spending held in at all is, on its own, a solid plus after such a strong prior month. When combined with strength in CPI, perhaps positive trade developments and the bond market reversal, strength in how these figures point to Q3 GDP prospects is added evidence the Fed isn't likely to capitulate to market pricing

Headline sales beat expectations with a 0.4% m/m rise. That was all due to the autos component, however, as other measures of sales were not as robust. Sales ex-autos were flat and ex-autos and gas increased only 0.1%.

The retail sales control group (RSCG) was up 0.3% m/m and in-line with a thinner consensus. This is the measure that matters by way of how the overall figures feed into consumption within the GDP accounts.

Quarterly growth in the RSCG is 7.3% q/q at a seasonally adjusted and annualized rate in Q3. That's on par with the 7.9% growth in Q2.

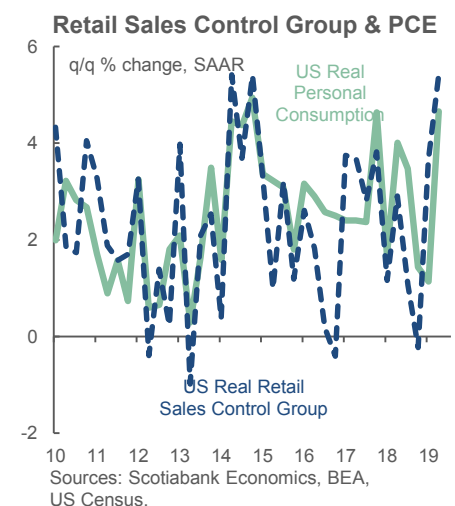
While it's imperfect to do so, simply deflating this growth using headline CPI translates into 3.9% annualized growth in Q3 versus 4.6% in Q2. This approach is imperfect because CPI doesn't speak directly to retail prices. In fact, the hottest categories in yesterday's upside surprise to US CPI were not related to retail sales (e.g. health insurance, housing costs etc). That only means that properly deflated retail sales growth would probably be even stronger in Q3.

One can therefore suggest that inflation-adjusted retail sales growth in Q3 was probably at least on par with Q2 growth. By extension, the same might be true for broad consumption growth, albeit at a cooler pace upon incorporation of services spending. Still, it doesn't take much to get total consumption growth up to tracking around 3 ½% compared to 4.7% in Q2. The accompanying chart shows the rough correlations between growth in the inflation-adjusted retail sales control group and total consumption up to Q2. As this strength persists in the RSCG, so will broad consumption.

The bottom line conclusion is therefore that the incredible strength in consumer spending during Q2 looks to be followed by continued strength in Q3 at only a somewhat softer pace.

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There are, however, several cautions here.

- There were 5 glorious weekends in August and that often raises doubts about seasonal adjustments when it occurs;
- Labor day weekend fell at the end of August. Auto dealers count the whole weekend's sales in their monthly tallies reported by their association. That may have artificially biased spending higher.
- Across components, breadth was ok, but not great:
 - Autos and parts were up 1.8% m/m. I didn't get that from the association numbers that were up by under 1% for vehicles and the split in today's numbers between vehicles and parts is unavailable on the first pass. I would watch this category closely into the next round of revisions.
 - Building materials were up 1.4% m/m for a third straight strong gain. Was August in part driven by preparations for hurricane Dorian?
 - Health/personal care store sales were up 0.7% after two months of declines;
 - Sporting goods were up 0.9% after a large prior drop;
 - Gas stations fell 0.9% due to lower prices;
 - Clothing fell 0.9% presumably on volumes because apparel prices didn't fall like that;
 - Eating/drinking establishments fell 1.2% on less restaurant spending;
 - Food and beverage retailers fell 0.2%;
 - Electronics came in flat and furniture sales fell 0.5%

Why are we seeing such strength in consumption? While I'm surprised at how strong this is, the direction doesn't surprise me. Household finances are great with record low debt service burdens (payments to incomes), a high saving rate, elevated confidence etc. The so-called 'misery' index (inflation plus unemployment) is very low. **You can't tell so much by monitoring the daily flow of complaints, news stories and concerns about unequal outcomes, but the reality is that the US consumer sector's overall finances are in sparkling, early-cycle health.** Yes, early cycle. There is nothing late cycle whatsoever by way of the indicators of consumer finances that we're monitoring. Furthermore, they are getting automatic stabilizer benefits from lower borrowing costs through bond markets and through shorter term administered rates, plus lower gas prices. A vulnerability that persists lies toward an overly abrupt correction higher in bond yields.

Between CPI and now retail as well as mild trade optimism, I think Fed Chair Powell disappoints bond markets again next week. He may try to stick to "act as appropriate" language and condition everything like he did last week, but the press conference will have him pressed to update whether he thinks this is a mid-cycle adjustment or the start of a full-on easing cycle. I think the stronger risk is toward the former, like he did at the July press conference. A solid case can be made for how the US doesn't need rate cuts period and should keep its powder dry.

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