Cooling US consumer spending points to weakening inflation threat

US retail sales were softer than hoped in May and with April revised to show a contraction we are seeing more evidence of a cooling consumer spending story. With inflation pressures seemingly moderating and unemployment ticking higher a September Fed rate cut will be on the table for discussion

US retail sales for May were weaker than expected, indicating cooler consumer spending and the likelihood of Fed rate cuts starting in September

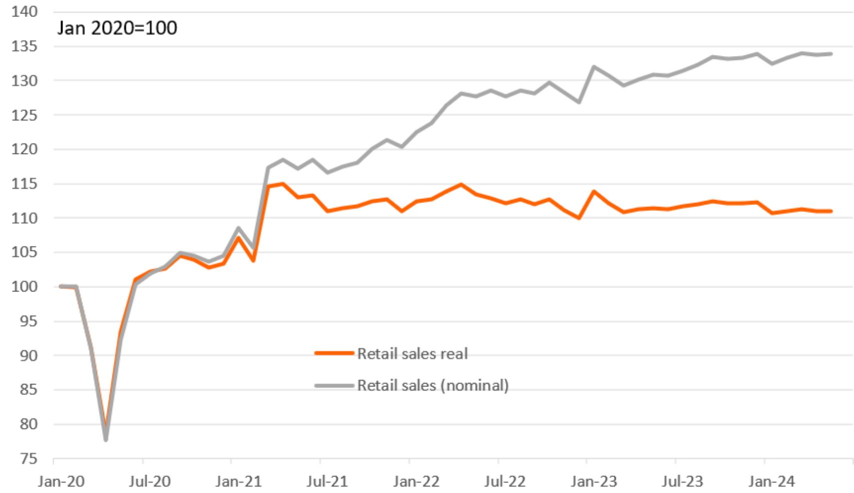
0.1% MoM increase in US retail sales

Lower than expected

Softer spending growth highlights intensifying consumer pressures

US retail sales for May are disappointing, rising 0.1% month-on-month versus the 0.3% consensus while April was revised to show a 0.2% contraction rather than the 0% outcome initially reported. We focus more on the "control group" which strips out volatile items such as autos, building supplies, food service and gasoline; therefore it better aligns with broader consumer spending trends as measured within the GDP report. It reported growth of 0.4% versus the 0.5% consensus while April was revised down to a -0.5% MoM contraction from the -0.3% MoM initially reported.

Retail sales levels in nominal and real terms



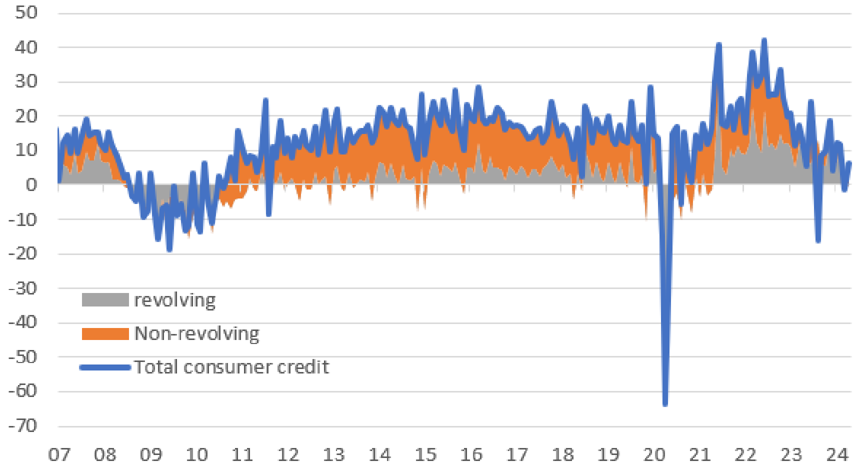
Source: Macrobond, ING

The details show a very mixed performance – sporting goods up 2.8%, clothing up 0.9%, non-store retailers up 0.8% and autos up 0.8%. However, eating and drinking out fell 0.4%, gasoline station sales fell 2.2% (lower gasoline prices) while furniture fell 1.1% and building materials declined 0.8%.

Constraints on spending will likely intensify

We expect consumer spending to continue cooling through this year as flat real household disposable incomes constrain spending power while the exhaustion of pandemic-era accrued savings means there are fewer resources from this pot to keep spending going. High consumer credit costs make borrowing to fund spending painfully expensive too, with net credit card lending actually contracting in April. Throw in declining consumer confidence readings and it all points to a consumer sector that is set to become more cautious, especially if unemployment continues to rise.

Consumer credit changes ($bn)



Source: Macrobond, ING

If we see more evidence of this consumer cooling, coupled with further rises in the unemployment rate and MoM core inflation prints tracking at 0.2% MoM or below then a September rate cut will clearly be on the table for discussion. Should the Federal Reserve pull the trigger then we doubt very much they would stop at one cut. We favour three cuts this year with the Fed funds target rate getting down to the 4% level in the second quarter of 2025.

0.9% MoM increase in industrial production

Higher than expected

Manufacturing bounce needs a rebound in orders to be sustained

US industrial production is much stronger than expected, rising 0.9% MoM versus the 0.3% consensus forecast. Manufacturing output rose 0.9% led by a 2.3% surge in machinery production. Utilities output increased 1.6%, which is a function of the weather while mining output increased 0.3%. Manufacturing payrolls and hours worked did increase in the month, hence expectations for a rise, but this outcome is more than anyone was forecasting. Nonetheless, in year-on-year terms output remains only 0.1% higher and for today's manufacturing output bounce to be sustained we need to see manufacturing orders rebound. Unfortunately, the ISM manufacturing report has shown a contraction in orders for the past two months with the May reading the weakest for 12 months. At the same time, the durable goods orders report is growing at perhaps a 1% annualised rate so far this year. This doesn't suggest we are about to break out of this flat trend anytime soon.

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