Resilient US retail sales suggests Fed decision will be a coin toss

Despite some better data of late, financial markets are gunning for a 50bp rate cut from the Fed tomorrow. We certainly agree there is a strong case for the Fed to move policy to neutral quickly and expect Chair Powell to make the case for a 50bp cut, but the issue is whether the other FOMC members are as certain. There will be large pockets of resistance

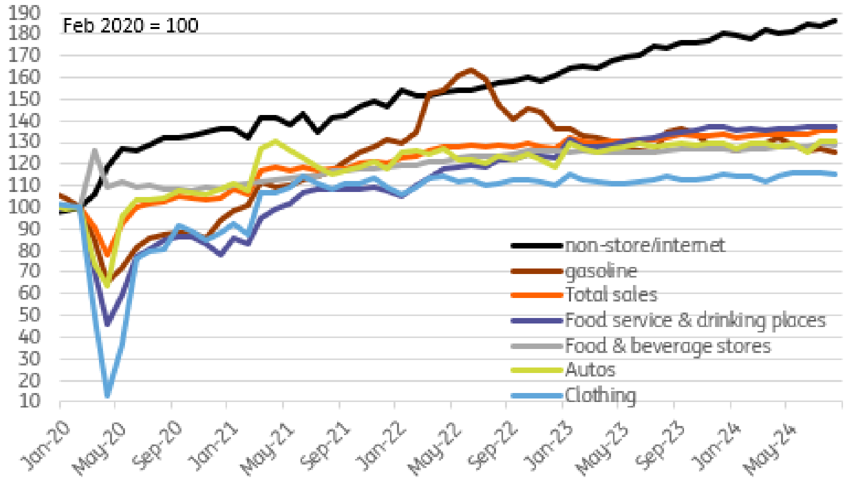
Mixed newsflow makes the Fed decision a close call

US retail sales in August were stronger than anticipated, rising by 0.1% month-on-month versus the -0.2% consensus, while July's growth rate was revised up to 1.1% from the initial 1% reported. The control group, which excludes volatile items and has a better tracking record for broader consumer spending, grew 0.3% as expected, but again there was a 0.1pp upward revision to July's growth rate – now 0.4%.

Industrial production was also stronger than anticipated in August, rising by 0.8% MoM versus the 0.2% consensus forecast. July's contraction is now reported as -0.9% versus -0.6% initially published, but we have come out ahead overall. Hurricane Beryl played a part in these swings, disrupting output in July in some key areas before recovering in August.

Overall, the trend is roughly flat, but that has been the case for the past two years. None of this screams economic weakness, but that isn't stopping the market gunning for a 50bp rate cut from the Fed tomorrow (42bp currently priced) on the rationale that if inflation fears are receding and job market worries are mounting, the Fed should get ahead of the situation and move policy to neutral as quickly as possible.

Retail sales levels – nominal index Feb 2020 = 100



Source: Macrobond, ING

High income households continue to drive spending growth

In terms of the consumer situation, we know the top 20% of households by income spend more than the entirety of the lowest 60% of households by income. The top 20% are in fantastic shape – inflation has been less of a constraint, property and equity market wealth has soared and high interest rates benefit them – receiving 5%+ on money markets versus perhaps paying 3.5% on a mortgage, if they have one. This group will continue to spend strongly.

However, it is a very different story for the lowest 60% by income with many more renters feeling the pain of sharp increases in housing costs in recent years while wealth gains have been far more modest, and soaring car loan and credit card borrowing costs have been painful.

The question for consumer spending is how long those higher-income households can offset a moderation in spending growth from lower-income households. If the jobs market is cooling as rapidly as some of the hiring data suggests and unemployment fears start to build, it may not be all that long.

As such, we fully buy into the argument for the Fed moving policy back to neutral swiftly and expect Fed Chair Jerome Powell to push the case for a 50bp cut tomorrow. However, the issue is whether the other FOMC members are as certain. An economy growing at 2.5-3% with low unemployment, inflation above target and equities at all-time highs suggests there will be large pockets of resistance, which makes the outcome tomorrow a coin toss.

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