US retail sales confirm 3Q soft patch is over

A strong performance from retail sales coupled with surging spending on travel and leisure suggests that the economy is re-accelerating after the recent Covid-related slowdown. This should help cement expectations for a November 3rd QE taper announcement from the Federal Reserve

Shopping mall in New York City

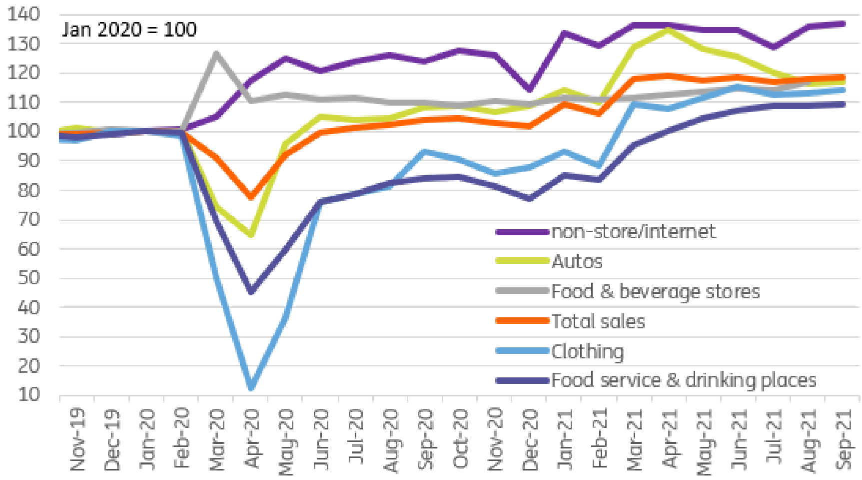
18.7% Gain in retail sales from pre-pandemic levels

Spending surprise

US retail sales numbers for September offer further encouragement that the Covid-related slowdown in activity in July and early August has given way to a more positive macro environment now that case numbers are falling sharply.

Headline sales rose 0.7% month-on-month versus expectations of a 0.2% drop and there were upward revisions worth 0.2 percentage points. We were certainly on the more pessimistic end of expectations given unit auto sales slowed from an annualized 13.06mn rate in August to 12.18mn in September due to the semi-conductor chip shortage that has blighted the industry. Yet somehow the value of motor vehicle and parts sales rose 0.5%. Either prices are surging far faster than as measured by CPI or there are some data problems.

US retail sales levels versus January 2020



Source: Macrobond, ING

There were mixed performances elsewhere with sporting goods surging 3.7% MoM and general merchandise gaining 2% and gasoline station sales rising 1.8%, but electronics fell 0.9% and health and personal care dropped 1.4%. Nonetheless, the control group, which excludes the volatile autos, food and building materials components and historically is better correlated to broader consumer spending trends, rose 0.8% versus expectations of a 0.5% gain. As such it does indeed look as though we are seeing the economy re-accelerate.

Rising incomes and wealth to fuel spending

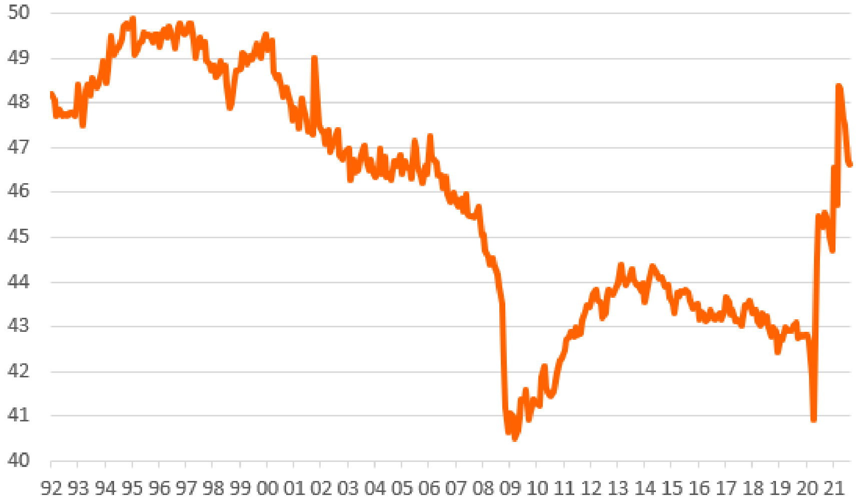
Consumer finances remain in good shape with incomes picking up thanks to rising employment and wages. The really encouraging news is that this is more than offsetting the ending of unemployment benefits and with firms desperate to hire workers and wages being bid higher this looks set to continue.

Meanwhile, the Federal Reserve flow of funds data showed that households have seen their wealth surge $26tn since the end of 2019 with $3.5tn of that increase in liquid cash, checking and time savings deposits. With some of this likely to be spent in coming quarters we wouldn't bet against consumer spending being a really strong growth driver next year.

Spending on services will grow even faster

That said, we wouldn't be surprised to see retail sales underperform broader spending over the next 12 months. Remember that retail sales is largely expenditure on physical things rather than services and as the chart below shows, services are now the dominant spending category. Even if we see some falls in retail sales, broader consumer spending can still rise substantially given a greater number of options on which to spend money.

Retail sales as a proportion of total consumer spending (%)



Source: Macrobond, ING

Recent high frequency numbers show that hotel, air travel and restaurant dining has increased substantially through mid-September into October. Together with today's retail sales number this points to a firm consumer spending figure and fits with our story that after a 3Q soft patch the economy is re-accelerating as we head to year end. This reinforces the message that there is no need for the Fed to delay on "normalising" monetary policy with the QE taper decision set for November 3rd.

Author

James Knightley
Chief International Economist
james.knightley@ing.com

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