ECONOMIC UPDATE

REGIONS

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September Retail Sales: Autos Drive Headline Lower, Strength Is In The Core

- Retail sales fell by 0.1 percent in September after a 0.2 percent gain in August (matches the initial estimate).
- Retail sales excluding autos rose by 0.4 percent, following a 0.1 percent increase in August (matches the initial estimate).
- Core retail sales (excluding vehicles, gasoline and building materials) rose by 0.5 percent in September.

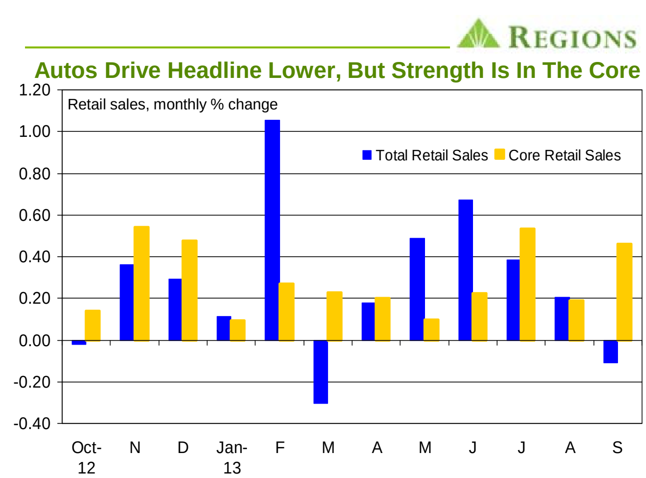
Belying a weak headline, the September retail sales report shows a strong finish to Q3 for consumer spending. Total retail sales fell by 0.1 percent in September, largely due to a calendar quirk that pushed auto sales over the Labor Day weekend into August. With the BEA already having reported a 5.1 percent decline in unit auto sales, the September retail sales data show a 2.4 percent decline in the dollar volume of sales at motor vehicle dealers. Stripping out autos, retail sales rose by 0.4 percent, while control (or, core) retail sales were up by 0.5 percent. This is the most relevant number here, as control sales are a direct input into the BEA's measure of consumer spending on goods in the GDP data. For Q3 as a whole, control sales rose at an annualized rate of 4.1 percent before accounting for inflation but, given how tame inflation has been, this will translate into a solid gain in real consumer spending on goods. And, it is also worth noting that, after accounting for the large swings in the August and September data, unit motor vehicle sales also posted a gain for Q3 as a whole. We expect real consumer spending to have risen by better than 2.0 percent, annualized, in Q3.

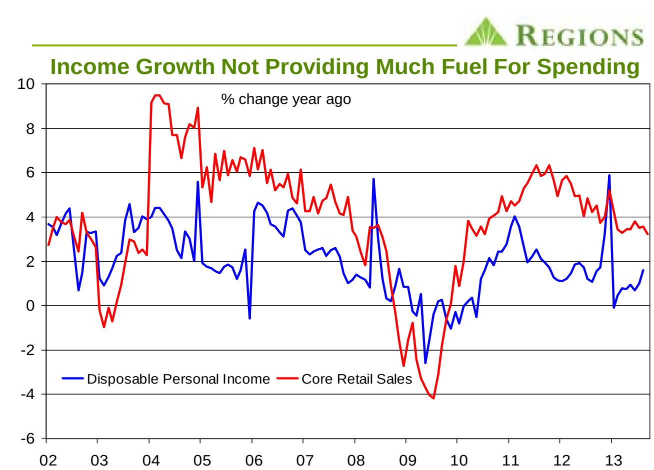
The full impact of Apple's new iPhone5 is not apparent in the September retail sales data. Sales at electronics/appliance stores posted a 0.7 percent gain, while sales at nonstore retailers rose by 0.4 percent. This latter category includes, but is not limited to, sales by online retailers, and this series comes with a lag so the September data are not yet available. As such, it will not be until we have the October retail sales report that we have a better sense of how the rollout of the iPhone5 impacted retail sales.

Elsewhere in the September retail sales data, sales were up at furniture stores (0.2 percent), grocery stores (0.9 percent), building materials stores (0.1 percent), and restaurants (0.9 percent), among others. Sales were down at department stores (0.9) percent and apparel stores (0.5 percent). Sales at gasoline stations were flat during September, as lower pump prices were offset by higher volume (and likely some seasonal adjustment effects). Retail gasoline prices fell further in October, so while gasoline sales will post a decline in the October retail sales data lower pump prices will have freed up cash for consumers to spend elsewhere.

How consumers actually used this extra cash remains to be seen. There is, of course, a considerable degree of uncertainty as to whether consumers were in a spending mood in October given the theatrics coming out of Washington. The higher frequency indicators of consumer confidence/sentiment fell sharply during October, which has led many analysts to scale down expectations for consumer spending during the month. While the first rule of retail may be "the customer is always right" the first rule of analyzing consumer spending is "what matters is what consumers do not what they say." Past episodes of the fiscal follies have led to declines in consumer confidence that in the end did not translate into lower sales. And, to the extent that government workers placed on furlough in October may have held down their spending, that they will have received back pay for their time off means any such restraint in October will likely be made up for in November.

While this suggests the government shutdown will have little impact on consumer spending for Q4 as a whole, the bigger issue is the underlying trend in job growth, and in turn income growth. The pace of monthly job gains has eased a bit over recent months and growth in disposable income remains modest. With consumers remaining disciplined as to the use of credit to facilitate spending, growth in consumer spending is more closely aligned with growth in labor earnings than had been the case in the years leading up to the Great Recession. It will take further improvement in labor market conditions to kick income growth, and in turn consumer spending growth, into a higher gear. This will come, but at an uneven pace over the near term, which means we are likely to see consumer spending post the same sort of uneven performance going forward as has been the case in recent months.





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