ECONOMIC UPDATE

REGIONS

October 15, 2012

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September Retail Sales: Consumers Dial Up A Strong Third Quarter

- Retail sales rose by 1.1 percent in September after a 1.2 percent increase in August (originally reported as a 0.9 percent gain).
- Retail sales excluding autos rose by 1.1 percent, after a revised gain of 1.0 percent decline in August (originally reported as up 0.8 percent).
- Core retail sales (excluding vehicles, gasoline and building materials) rose by 0.9 percent in September.

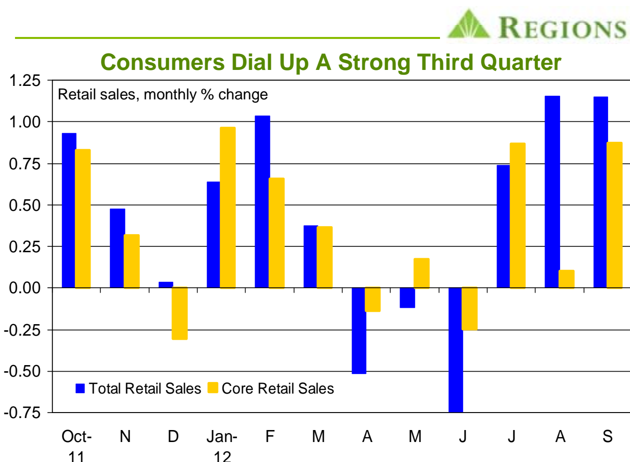
Okay, fine, we realize no one actually dials a phone these days, but somehow "consumers tap an icon in their list of contacts" just doesn't have the same ring, um, ringtone as our headline. In any event, the release of the IPhone 5 contributed to a strong gain in retail sales in September, which was also helped along by higher vehicle sales and higher gasoline prices. Still, September's gains were broad-based, while previously released estimates for sales in July and August were revised higher, both headline sales and core sales. The latter is of more significance, as core retail sales are a direct input into the BEA's measure of consumer spending on goods.

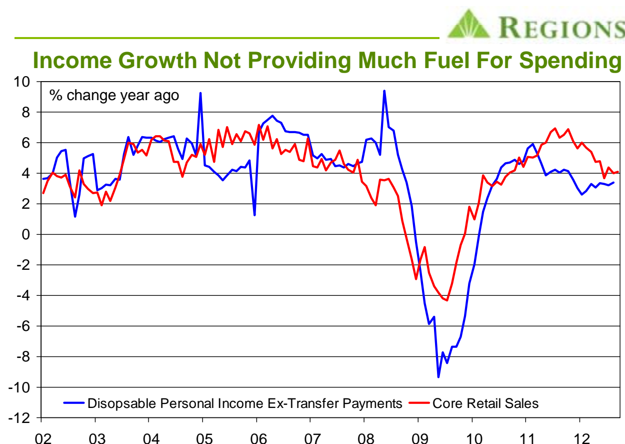
To be sure, there are clearly some price related effects in the data, in addition to gasoline sales the reported 1.0 percent gain in grocery store sales also likely reflects price increases related to the drought that has gripped much of the nation. Still, even with what should be another sizeable increase in retail prices, whether measured by the CPI or the PCE, we should still emerge with decent gains in real consumer spending for September. Along with the upward revisions to the data for July and August, our expectations for 2.0 percent growth (annualized) in real consumer spending for Q3 now looks a little light, so there is an upside risk to our forecast for 2.0 percent real GDP growth for Q3.

Sales at electronics stores rose by 4.5 percent during September, thanks to the release of the IPhone 5. The other component of the retail sales data that would have been impacted by the IPhone 5 is nonstore retailers, which includes but is not limited to on-line merchants, but the detail within this component is lagged by a month. It is, however, more than reasonable to expect that the 1.8 percent gain in sales amongst nonstore retailers was mainly driven by on-line sales. Still, even with these gains, we had expected a bit more of a lift from the release of the IPhone 5, but this could be a matter of timing, as the release date was fairly late in the month (September 21). It could be that the October retail data will also get a boost from IPhone 5 sales (maybe by then us IPhone users will be able to "do that thing" where we can transfer playlists by touching phones).

Still, despite what looks to have been a strong third quarter in terms of consumer spending, there are reasons to be concerned. As the second chart below shows, the over-the-year pace of growth in core retail sales has been steadily decelerating. Income growth remains mediocre in large part because the pace of growth in wage and salary earnings remains so, reflecting the considerable degree of slack that remains in the labor market. Recent months have seen the personal saving rate fall below 4 percent so consumers have, up to a point, been dipping in to savings to finance current spending. What was an increase in the level of revolving consumer credit, i.e., credit card debt, in the most recent month of data could be a sign that higher food and gasoline prices are taking a mounting toll on consumers and discretionary purchases have increasingly been made with credit. Outside of vehicle sales, where credit is flowing somewhat freely, it will remain to be seen the extent to which this continues to be the case. Moreover, while consumers may not seem terribly stressed by the pending fiscal cliff, they could be in for a rude surprise in early 2013 if, as we expect, Social Security withholding rates revert back to their normal 6.2 percent from the current 4.2 percent. This will be a significant hit to disposable income felt more acutely amongst lower-to-middle income households, and will have an adverse impact on discretionary spending.

Thus, at least in the near term, we don't expect the pace of growth in real consumer spending seen in Q3 to be sustained, particularly absent meaningful improvement in the rates of job and earnings growth. We do have a more positive outlook once we get into the second half of 2013, when we expect overall growth to accelerate, leading in turn to better job and income growth, while we will be even further along in the household deleveraging process. Until then, however, we expect more restrained growth in consumer spending than seen in Q3.





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