ECONOMIC UPDATE

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September Retail Sales: Special Factors Push Headline Sales Sharply Higher

- Retail sales rose by 1.6 percent in September after falling by 0.1 percent in August (originally reported down 0.2 percent).
- Retail sales excluding autos rose by 1.0 percent after rising by 0.5 percent in August (originally reported up 0.2 percent).
- Control retail sales (sales excluding motor vehicles, gasoline, restaurants, and building materials) rose by 0.4 percent in September.

Total retail sales were up 1.6 percent in September, the largest monthly increase since March 2015, while ex-auto sales were up 1.0 percent and control retail sales were up 0.4 percent. Our forecast anticipated larger increases in total and control retail sales, 2.5 percent and 0.8 percent, respectively, while our forecast for ex-auto sales was on the mark. We'll toss in our usual caveat about the general unreliability of the initial estimate of retail sales in any given month but, as the data now stand, the sizeable gain in total retail sales in September was largely a function of factors related to Hurricanes Harvey and Irma, with gasoline, motor vehicle, grocery, and building materials sales all up big. Allowing for these one-off gains fading from the data, the underlying story on retail sales remains pretty much the same – growth in consumer spending remains healthy but the absence of pricing power on the part of retailers means that growth will be understated unless one properly accounts for falling core goods prices.

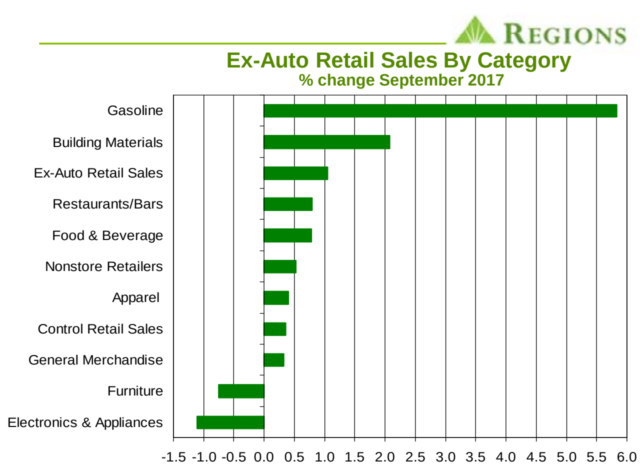
The biggest source of our miss on our forecast for total retail sales was revenue at motor vehicle dealers. The initial estimate of a 3.6 percent increase was well shy of our forecast, which was based not only on the 15 percent jump in unit motor vehicle sales but also the tilt in the mix of sales that even more heavily favored higher-priced SUVs/light trucks. Still, today's CPI report shows vehicle prices, both automobiles and SUVs/light trucks, unexpectedly fell in September. As such, even if the initial estimate of September sales revenue at motor vehicles dealers is revised higher as we expect, it will likely still fall short of our forecast. Sales at gasoline stations were up 5.8 percent in September, reflecting the post-hurricane spike in retail gasoline prices. But, given that the spike in prices seen after the hurricanes has largely reversed, gasoline sales will likely be down sharply in the October retail sales data. Sales at building materials stores were up 2.1 percent, also reflecting the effects of the hurricanes, and the 1.0 percent jump in grocery store sales also reflects the effects of the hurricanes, particularly as prices for food purchased in stores were flat in September, per the CPI data.

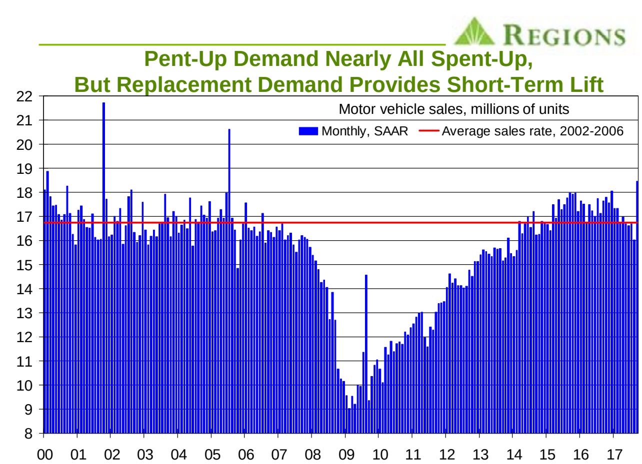
Control retail sales, a direct input into the GDP data on consumer spending, were up 0.4 percent in September, well shy of our forecast. One reason is that sales at nonstore retailers, which includes but is not limited to online sales, were up just 0.5 percent following a decline of 0.4 percent in August. We had anticipated a larger rebound from that decline in August (originally reported as a 1.1 percent decline), but given the pattern of upward revisions in this category, largely due to online sales being reported with a two-month lag, we fully expect the initial September estimate to be revised higher over coming months.

Notable soft spots in control sales are the 0.4 percent decline in sales at furniture stores and the 1.1 percent decline in sales at electronics and appliance stores. Apparently the release of the newest and latest (but not the priciest, which will come in November) iPhones did not do much for sales in this latter category, but again we would not be surprised to see upward revisions here as well over coming months. Sales at apparel stores were up 0.4 percent and sales at general merchandise stores were up 0.3 percent.

To the extent hurricane related effects pushed retail sales higher in September, those effects will reverse over coming months, thus making retail sales look weaker than will actually be the case. For instance, we've already seen a material reversal of the post-hurricane spike in retail gasoline prices. As for motor vehicle sales, most accounts attribute the jump in unit sales in September to replacement demand that was highly concentrated in Texas, with little such demand evident in Florida in September. As such, it could be that unit sales in October will be strong, though not as strong as in September, but the broader point is that unit sales will ultimately settle back to a lower trend rate.

Sorting out the high degree of hurricane related noise leaves the narrative of U.S. consumers largely unchanged. Continued job and income growth and low interest rates are supportive, but price effects continue to mask the underlying strength in consumer spending.





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