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**Economics Group**

**Retail Sales Surge in June**

Retail sales rose a solid 0.4% in June, despite a huge 2.8% drop in sales at gasoline stations. Control group sales rose an even stronger 0.7%, suggesting real personal consumption rose solidly in Q2.

**Falling Gasoline Prices Boost Consumer Spending Power**

Retail sales rose 0.4% in June, while sales ex-autos rose 0.4%. Both were revised down for the prior month 0.1 percentage point. Control group sales, which are a good proxy for personal consumption expenditures within the GDP report, rose 0.7%, the strongest gain since March. This suggests substantial upside to our forecast of 3.4% annualized growth in Q2 PCE, as well as our headline GDP forecast of 1.8%.

The strength in consumer spending is a relief following last year’s year-end stock market turbulence, which cut into consumer confidence and triggered an apparent 2.0% plunge in December retail sales. The retail sales data are often revised considerably and December’s weakness and March’s 1.8% spike look highly suspicious. We suspect the government data are having trouble adjusting to the shift to online purchases. The 3.8% year-over-year rise in core retail sales more likely reflects the underlying momentum.

Headline sales rose 0.4% all three months of the second quarter, and core retail sales rose 0.5%, 0.6% and 0.7% in April, May and June, respectively. The second quarter’s stability is encouraging, as smaller tax refunds were expected to hold down spending. While tax refunds did decline, solid job and income growth appear to have more than made up any shortfall.

Falling gasoline prices shaved some strength off overall retail sales. Sales at gasoline stations fell 2.8%, as gasoline prices—as tracked by AAA—fell nearly 4%. Sales at electronics stores also fell 0.2%, but the savings from lower gasoline prices set off broad based gains elsewhere. Ten of the other 11 broad retail categories rose in June, with the other—sporting goods—unchanged.

Retail sales of motor vehicles and parts rose 0.7% in June following a similar gain the prior month. The strength is a nice surprise. Earlier reported manufacturer sales had shown motor vehicle sales losing momentum in June. Moreover, fleet sale, which show up in business data fixed investment, have reportedly been strong, benefitting from more generous depreciation. The drop in manufacturer sales is likely an effort to curb dealer inventories.

Home improvement center sales rebounded in June but fell sharply for the quarter as a whole. Unusually rainy weather depressed sales in April (-1.0%) and May (-1.5%), setting the stage for a rebound. Sales at general merchandise stores rose a modest 0.2% and are up just 2.3% year-over-year. Department stores fell 1.1% in June and are down 5.4% over the past year. Restaurants were the prime beneficiary of falling gasoline prices. Sales at eating and drinking places jumped 0.9% in June and are solidly up year-over-year.

The only downside to June’s better retail sales data is they raise questions about whether the Fed will follow change its intentions to cut the federal funds rate later this month. We doubt it. The Fed’s decision to cut rates is based more on where they see the economy headed than where it has been.

Source: U.S. Department of Commerce and Wells Fargo Securities