



MORNING BRIEFING

May 21, 2019

US Consumers: Still Born To Shop?

See the [collection](#) of the individual charts linked below.

(1) The United States of Consumers. (2) Blaming the winter weather. (3) We are all minimalists now. (4) Soft patch for consumer spending? (5) Auto sales and gasoline usage may have peaked. (6) Home improvement sales likely to improve. (7) Consumer sentiment at new cyclical high in May. (8) Don't count on Millennials to buy your house. (9) Buddy, can you spare \$400 in an emergency?

US Consumers I: Less Urge To Splurge? Forecasting consumer spending is obviously one of the major inputs into the process of predicting both the trend and the cycle in GDP. The US is a consumer society. Americans consume a lot, both collectively and individually. In current dollars, personal consumption expenditures accounted for a near-record 68% of nominal GDP during Q1-2019, well above its record low of 59% during the first quarter of 1967 ([Fig. 1](#)). However, that uptrend is entirely attributable to health-care spending. Data available since 1960 show that consumption spending excluding health care has been relatively stable around 54% of GDP during most of that period ([Fig. 2](#)).

Recent consumer spending data have been disappointing. It was a brutal winter in many parts of the country right through April. The weather is always a good excuse during winter time, even though the data are seasonally adjusted.

More fundamental concerns about consumer spending focus on the minimalism of Millennials, high student debt burdens, and mounting signs of stress in the auto loan market, especially among subprime borrowers. Even Baby Boomers are turning into minimalists as they confront retirement and uncertainty about their health care needs.

On the other hand, consumer purchasing power is strong thanks to solid employment increases and real wage gains. Debbie and I think that consumers will continue to drive the US economic expansion for the foreseeable future. Consider the following:

(1) *Personal consumption*. Real GDP rose by a solid 3.2% (saar) during Q1. However, real consumer spending rose only 1.2% during the quarter. Consumer spending on durables fell 5.3% last quarter, the first decline since Q1-2018 and only the second since Q2-2011 ([Fig. 3](#)).

(2) *Retail sales*. Retail sales fell 0.2% m/m during April. On an inflation-adjusted basis, using the CPI for goods, it fell 0.6% during the month. The story is still downbeat when we look at the three-month percentage change in the three-month moving average of real retail sales in total through April, at 1.4% (saar) ([Fig. 4](#)). Core real retail sales (excluding autos, gasoline, building materials, and food services) showed a similar gain, at 1.5%.

The Bureau of Economic Analysis uses this core retail sales measure to estimate personal consumption expenditures (PCE) each month. PCEs on autos and gasoline are based on actual unit retail auto sales and gasoline usage. Building materials are included in residential construction.

(3) *Autos and gasoline.* The 12-month sum of motor vehicle sales was 17.1 million units during April, down from a cyclical peak of 17.7 million units during February 2016 ([Fig. 5](#)). The popularity of Uber, Lyft, and rental scooters may be starting to weigh on auto sales. Furthermore, credit conditions may be tightening as a result of the rising delinquency rate for auto loans, to 4.7% during Q1, the highest since Q4-2011 ([Fig. 6](#)).

While vehicle miles traveled remains on a slight uptrend in record-high territory, gasoline usage has been relatively flat since early 2017 ([Fig. 7](#)). Gasoline fuel efficiency in the US has been trending sharply higher since 2012 ([Fig. 8](#)).

(4) *Home improvement.* Retail sales of building materials and garden equipment is up 41% since January 2009 through April of this year. It's down 6% over the past three months, probably because the winter was so severe. The forward revenues of the S&P 500 Home Improvement industry (HD, LOW) continues to rise to record highs.

Industry analysts have been lowering their revenues growth estimates for this industry in recent weeks, most recently to 2.5% this year and 4.2% next year ([Fig. 9](#)). For earnings growth, they currently project 6.5% this year and 11.1% next year ([Fig. 10](#)).

US Consumer II: Purchasing Power & Personal Saving. Consumer spending is driven by consumer incomes, which are mostly determined by employment and wages. Every month, after the release of the Employment Situation report, Debbie and I calculate the Earned Income Proxy (EIP) for total wages and salaries. Not surprisingly, the growth rate of retail sales on a y/y basis tends to fluctuate around the growth rate of the EIP, which was a solid 5.0% during April ([Fig. 11](#)). This suggests that the weak 3.1% growth of retail sales during April should soon be moving higher.

If income continues to grow at a solid pace, as we expect, so should consumption, unless the personal saving rate moves higher. The latter has been in a relatively flat range around 7.0% since 2012 ([Fig. 12](#)).

US Consumers III: Confidence Factor. The Consumer Confidence Index has stalled in recent months through April, but remains near the cyclical high reached during October ([Fig. 13](#)). On the other hand, the Consumer Sentiment Index jumped to a new cyclical high during the first half of May, led by a big jump in its expectations component ([Fig. 14](#)).

So consumers have the purchasing power to shop. In other words, they have the means, but do they have the will? They should, given the strength in both the CCI and CSI.

US Consumers IV: Millennial Minimalists. Previously, Melissa and I have written about the minimalism of Millennials. They were born between 1981 and 1996. So they are 23-38 years old. There are 68 million of them. During the financial crisis of 2008, they were 12-27 years old. So, many of them were old enough to see that home prices don't always go up. That may have turned them off from buying homes in the suburbs.

Since they are getting married later, or not at all, they don't need homes in good school districts for the kids they don't have. Many of them prefer renting apartments in urban centers, where they don't need cars to get to work. Besides, many are saddled with large student loans, which is also delaying their ability to raise a family and buy cars and homes.

Our demographic theme was reflected in a 5/17 *WSJ* [article](#) titled "Millennial Home Buyers Might Never

Come Knocking.” It’s fairly depressing for those of us Baby Boomers who would like to trade down to smaller houses or apartments now that our kids are gone—the very same kids whose cohorts we were counting on to buy our homes when the time came but have opted not to do so.

The article observes that the homeownership rate among households headed by someone under 35 was 35.4% as of Q1, according to the Census Bureau, down from about 40% in 1999. It concludes: “It still seems likely that, as they age, many millennials will catch up with their predecessors and finally buy a place of their own. But when it comes to the housing market, the millennial buying wave may end up being little more than a ripple.” Leave the house to the kids in your will.

US Consumers V: \$400 Emergencies. Melissa and I are skeptical about a shocking statistic picked up by the media recently. A 5/17 CNBC [article](#) reported, “One-third of middle-income adults don’t have enough savings to cover an unexpected \$400 expense without selling something or borrowing money, Fed Governor Lael Brainard said at a conference in Washington D.C. earlier this month.”

Brainard spoke at the “Renewing the Promise of the Middle Class” 2019 Federal Reserve System Community Development Research Conference. Brainard mixed and matched several different surveys with different time periods in her 5/10 [speech](#) titled “Is the Middle Class within Reach for Middle-Income Families?” The result was a bit of a misleading mishmash. Consider the following:

(1) *Sneak peek.* Some of Brainard’s data were a sneak peek at the Federal Reserve Board’s Survey of Household Economics and Decision-making (SHED) to be released soon with 2018 data. The last one was issued on 5/22/2018 with data through 2017. The forthcoming SHED will deliver further insights on the financial resilience of households, particularly those with low and moderate incomes. Keep in mind that these data are based on surveys, which tend to be inaccurate.

(2) *Questioning the question.* Getting back to the SHED question in question, Brainard [presented](#) a chart that showed 65% of middle-income adults, defined as those earning between \$40,000 and \$99,000, would pay for an unexpected \$400 expense with savings, cash, or equivalent while 27% would borrow or sell something and just 6% would not be able to cover it as of 2018. We are not saying that 27% is an insignificant number, but 6% is a very small number.

Further, it isn’t clear whether the 27% who said they would borrow or sell something would do so because they don’t actually have the money to cover a \$400 emergency or they just don’t want to tap into their savings for whatever reason. According to another Fed data source noted by Brainard, the Distributional Financial Accounts, the average wealth of middle-income adults was \$340,000 as of Q4-2018 (including the equity in their homes). In fairness, that’s an average number, but it’s still a decent nest egg that would more than cover a \$400 emergency.

The problem for middle-income households may have more to do with liquidity than the ability to cover expenses with existing wealth. That could explain why three out of ten middle-income households carry a balance on their credit cards all or most of the time, according to Brainard’s discussion of the latest SHED data.

(3) *Outdated data.* Additionally, the CNBC article covered another startling stat that Brainard noted in her speech: Only one-quarter of middle-income households have liquid savings that would cover six months of expenses, the number of months commonly suggested for emergency fund coverage by personal finance advisors. However, these data are outdated, as sourced by Brainard from the 2016 Survey of Consumer Finances (SCF), the latest available up to now. It will be interesting to see if these data improved since then when the next SCF is released later this year now that the unemployment rate is at historical lows.

(4) *Historical reference*. Further, the SHED—with 2017 data—[revealed](#): “Over the past five years, as the economy has recovered, the fraction of families able to easily cover [a \$400] emergency expense has increased by about 9 percentage points.” Importantly, these later data from the original SHED summary cover all US households, while Brainard focused on middle-income families. Presumably, however, the top-income households would not have contributed to this increase, because they probably wouldn’t have had any trouble with covering a small emergency in the first place.

CALENDARS

US. Tues: Existing Home Sales 5.35mu, Evans, Rosengren. **Wed:** MBA Mortgage Applications, DOE Crude Oil Inventories, FOMC Meeting Minutes, Williams. (DailyFX estimates)

Global. Tues: Eurozone Consumer Confidence -7.7, Japan Trade Balance ¥229.5b, Japan Machine Tool Orders 0.0%/m/-3.5%/y/y, OECD Publishes Economic Outlook, RBA Minutes of May Policy Meeting, Lowe, Carney, Guindos. **Wed:** UK Headline & Core CPI 2.2%/1.8% y/y, Canada Retail Sales Total & Ex Auto 1.0%/0.8%, Draghi, Praet. (DailyFX estimates)

STRATEGY INDICATORS

S&P 500/400/600 Forward Earnings ([link](#)): LargeCap’s forward earnings rose w/w for a fifth straight week, but fell for the first time in five weeks for MidCap and SmallCap. LargeCap’s has risen during 11 of the past 14 weeks; MidCap’s in eight of the past 10 weeks; and SmallCap’s in six of the past eight weeks. LargeCap’s forward EPS is just 0.4% below its record high of \$175.48 in late October; MidCap’s is 1.3% below its mid-October high; and SmallCap’s is 6.5% below its mid-October high. At their bottoms, LargeCap’s forward EPS had been the most below its record high since June 2016, and MidCap’s was the lowest since May 2015. SmallCap’s had not been this far below since October 2010. The yearly change in forward earnings soared to cyclical highs during 2018 due to the boost from the Tax Cuts and Jobs Act, but tumbled as y/y comparisons became more difficult. But that may be ending soon too. In the latest week, the rate of change in LargeCap’s forward earnings fell to a 29-month low of 4.5% y/y from 5.1% y/y. That’s down from 23.2% in mid-September, which was the highest since January 2011 and compares to a six-year low of -1.8% in October 2015. MidCap’s y/y change dropped to a 30-month low of 4.2% from 5.8%, which compares to 24.1% in mid-September (the highest since April 2011) and a six-year low of -1.3% in December 2015. SmallCap’s dropped to a 40-month low of 1.6% from 2.6%, which is down from an eight-year high of 35.3% in early October and compares to a six-year low of 0.3% in December 2015. Analysts had been expecting double-digit percentage earnings growth in 2019, but those forecasts are down substantially since October. Here are the latest consensus earnings growth rates for 2018, 2019, and 2020: LargeCap (22.7%, 3.2%, 11.8%), MidCap (22.7, 2.2, 13.9), and SmallCap (22.4, 3.6, 18.9).

S&P 500/400/600 Valuation ([link](#)): Forward P/E ratios fell for a second week for all these indexes, but they remain well above their multi-year lows in late December. LargeCap’s weekly forward P/E edged down to 16.4 from 16.5, which compares to a 13-month high of 16.9 in early May and is up from a five-year low of 13.9 during December. That also compares to a 16-year high of 18.6 during January 2018—and of course is well below the tech-bubble record high of 25.7 in July 1999. Last week’s level remains above the post-Lehman-meltdown P/E of 9.3 in October 2008. MidCap’s forward P/E dropped 0.3pt to 15.4. That’s down from a seven-month high of 16.3 in early April, but up from 13.0 during December, which was the lowest reading since November 2011. MidCap’s P/E is down from a 15-year high of 19.2 in February 2017 and the record high of 20.6 in January 2002. However, MidCap’s P/E has been at or below LargeCap’s P/E for most of the time since August 2017—the first time that alignment has prevailed since 2009. SmallCap’s P/E weakened to 16.3 from 16.7, which is well above its seven-

year low of 13.6 during December. That's still well below its 51-week high of 20.2 in December 2017 (which wasn't much below the 15-year high of 20.5 in December 2016, when Energy's earnings were depressed). SmallCap's P/E was a tad below LargeCap's P/E for the first time in 16 weeks, after being below for much of December for the first time since 2003.

S&P 500 Sectors Quarterly Earnings Outlook ([link](#)): With the Q1 earnings season 92% complete, the blended Q1 estimate/actual surged in what has become the typical positive earnings surprise hook seen during the earnings seasons. Last week saw the S&P 500's blended Q1-2019 EPS forecast rise yet another 7 cents w/w to \$38.98. The \$38.98 estimate represents a forecasted pro forma earnings gain for Q1-2019 of 1.4%, up from a forecasted decline of 2.3% in early April and a forecasted gain of 5.3% at the end of Q4. Q1's gain is the 11th straight y/y rise, but down from 16.8% in Q4 and 28.4% in Q3 (which marked the peak of the current earnings cycle). Just six of the 11 sectors recorded positive y/y earnings growth in Q1-2019, with only one rising at a double-digit percentage rate. That compares to 10 positive during Q4, when seven rose at a double-percentage rate. Five sectors beat the S&P 500's Q1 growth rate, which compares to just four during Q4. Real Estate and Utilities are the only sectors to post better growth on a q/q basis during Q1. Here are the latest blended Q1-2019 earnings growth rates versus their Q4-2018 growth rates: Health Care (10.1% in Q1-2019 versus 13.3% in Q4-2018), Financials (8.1, 15.6), Industrials (6.8, 27.0), Consumer Discretionary (7.5, 18.1), Real Estate (6.3, 6.2), Consumer Staples (0.6, 4.6), Utilities (-0.5, -10.4), Information Technology (-1.9, 10.3), Communication Services (-9.9, 26.4), Materials (-13.4, 6.1), and Energy (-26.1, 81.4). On an ex-Energy basis, S&P 500 earnings rose 2.8% y/y in Q1, well below the 14.2% y/y gain in Q4 and the lowest ex-Energy growth rate since Q2-2016.

S&P 500 Q1 Earnings Season Monitor ([link](#)): With 92% of the S&P 500 companies finished reporting revenues and earnings for Q1-2019, the y/y growth rates in revenues and earnings have slowed substantially from Q4. The revenue surprise metrics have weakened substantially, but earnings continue to beat forecasts. Of the 459 companies in the S&P 500 that have reported through mid-day Monday, 76% exceeded industry analysts' earnings estimates. Collectively, the reporters have averaged a y/y earnings gain of 2.7%, and exceeded forecasts by an average of 6.6%. On the revenue side, just 57% of companies beat their Q1 sales estimates so far, with results coming in 0.2% above forecast and 5.1% higher than a year earlier. Earnings growth is trailing revenue growth for the first time since H1-2016. Q1 earnings growth results are positive y/y for 63% of companies, vs a higher 71% at the same point in Q4, and Q1 revenues have risen y/y for 67% vs a higher 75% during Q4. These figures are not likely to change markedly as the remaining Q1-2019 results are reported in the coming weeks. Looking at earnings during the same point in the Q4-2018 reporting period, a lower percentage of companies (70%) in the S&P 500 had beaten consensus earnings estimates by a lower 3.5%, but earnings were up a higher 14.4% y/y. With respect to revenues at this point in the Q4 season, a higher 61% had exceeded revenue forecasts by a higher 0.6%, and sales rose a greater 5.9% y/y. The results so far for Q1 indicate a slowdown in revenue and earnings growth from Q4, but that comes as no surprise to investors. Q1-2018 will mark the 11th straight quarter of positive y/y earnings growth and the 12th for revenue growth. Looking at the Q1 results ex-Financials and Real Estate, the earnings surprise improves to 6.8% from 6.6% and growth falls to 1.8% from 2.7%. The ex-Financials and Real Estate revenue surprise drops to 0.1% from the 0.2% rate with all sectors included, and revenue growth drops to 5.0% from 5.1%.

US ECONOMIC INDICATORS

Housing Starts & Building Permits ([link](#)): Some encouraging news for housing: April housing starts were stronger than expected, while March's loss was revised to a gain. In addition, confidence among homebuilders in May reached a seven-month high. Housing starts jumped 5.7% to 1.235mu (saar) in April, following a 1.7% increase in March (to 1.168mu) instead of a 0.3% decrease (to 1.138mu), as first

reported. Single-family starts climbed 7.8% during the two months ending April, to 854,000 units (saar), after wide swings the first two months of this year. Multi-family starts jumped 17.2% during the three months through April to 381,000 units (saar). Single-family starts are 4.3% below year-ago levels, while multi-family starts are 1.6% above. Building permits rose for the first time this year in April, up 0.6% to 1.296mu (saar), after falling 2.9% the first three months of the year. Single-family permits continue to trend lower, sinking 7.8% the past five months to 782,000 units (saar)—its lowest reading since November 2016. Meanwhile, multi-family permits rebounded 8.9% in April to 514,000 units (saar) after a three-month drop of 5.0%. Permits for single-family homes remain below a year ago, falling 9.4% y/y, as land and labor shortages, as well as rising materials' costs, continue to constrain builders' ability to build. Homes under construction sank to a seven-month low last month. Meanwhile, improvement in homebuilders' confidence continued to build in May. The National Association of Home Builders Housing Market Index (HMI) shows builder optimism climbing through the first five months of this year, to 66 this month from 56 in December. All three components are up over the five-month period: expected sales (72 from 61), current sales conditions (to 72 from 61), and buyer traffic (49 from 43).

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