MONTHLY

Economic Review

September 2023

Jack Kleinhenz, Ph.D., CBE
Chief Economist
National Retail Federation

The data for this report is released on a rolling schedule. The presented numbers are current as of publication and are subject to revision.

SYNOPSIS | Economy is expanding but momentum is slowing

The U.S. economy continues to expand but recent data is signaling a slowdown in its momentum. This theme was evident in second-quarter real gross domestic product, which the Bureau of Economic Analysis has revised downward to a 2.1% annual growth rate from the prior estimate of 2.4% because of downward revisions to inventories, business investments and net exports. The BEA has also provided the first look at real gross domestic income for the second quarter. In theory, GDI and GDP should provide nearly identical growth, but GDI grew at a modest 0.5% annual rate after falling 1.8% in the first quarter. That left the average of GDP and GDI increasing 1.3% in the second quarter. While GDP conceptually measures the value of everything produced, GDI measures the value of everything earned during production, including wages, rent, interest and corporate profits. The GDI data adds to the argument that the economy is slowing but not halting.

Housing remains a major weak spot, beleaguered by high mortgage rates and limited availability of homes for sale. Residential investment was one of the few areas of weakness in revised second-quarter GDP, having slid at a 3.6% annualized pace and subtracting 0.14% from GDP growth over the previous quarter. Residential construction activity started to drop off almost immediately in response to the Federal Reserve's acceleration in interest rate hikes last year and has now declined for nine consecutive quarters.

Disposable personal income (income after taxes) was up 7.2% year over year in July, which was unchanged from June and remained the slowest growth so far this year. Wages and salaries expanded only 0.4% in July, down from 0.6% growth in June.

SYNOPSIS | Economy is expanding but momentum is slowing

Growth in consumer spending outpaced income growth in July. Personal spending increased 0.8% month over month after rising 0.6% in June while July's overall consumer spending was up 6.4% year over year. Retail sales surprised to the upside in July, thanks to a midsummer boost from Amazon's Prime Day, special deal days offered by other retailers and entertainment-related events. The 3.8% year-over-year increase in retail sales as calculated by NRF was partially lifted by a low base of comparison last year. Spending growth is not expected to remain at this pace given still-high inflation, high interest rates, a depletion of excess savings combined with the expiration of the student loan moratorium. And with spending outpacing income, the savings rate dipped from 4.3% in June to 3.5% in July, suggesting that consumers are digging into their finances to support household spending.

While consumers are still spending, the composition of their spending continues to favor services over retail goods and even then, there was less momentum going into the third quarter. According to the Quarterly Services Survey released by the Census Bureau, spending on services expanded 1.6% from the first quarter to the second on a seasonally adjusted basis, but that was down from a 3% gain in the first quarter.

Consumer confidence took a bit of a hit in August as high prices and interest rates weighed on shoppers' decisions. The Conference Board's Consumer Confidence Index fell to 106.1 from July's 114 as consumers said they were less optimistic about future business activity and prospects for employment and income gains. Likewise, the University of Michigan Consumer Sentiment Index showed less optimism, dropping from 71.6 in July – the best reading since October 2021 – to 69.5 in August. Those readings are likely to fall further as the labor market subsides in the months ahead. However, as pointed out in the past, low confidence readings do not always translate into a drop in household spending.

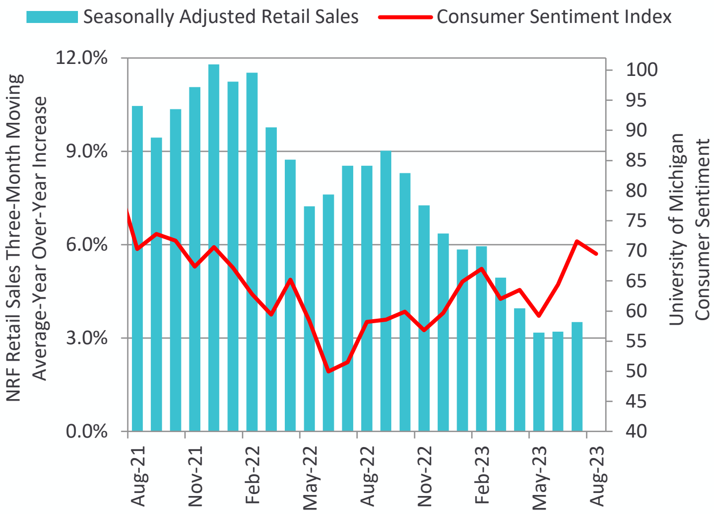
Progress has been made on combating inflation, but higher prices remain. The Personal Consumption Expenditures Price Index – the Fed's preferred measure of inflation – was up 0.2% month-over-month in July for the second month in a row. Year-over-year, PCE was up 3.3% compared with 3% in June. Excluding the volatile food and energy components, core PCE was up 4.2% year over year, compared with 4.1% in June.

Job growth has been decelerating. Nonfarm payrolls gained 187,000 jobs in August, which was up from 157,000 in July but far below the average monthly gain of 271,000 over the past year. The unemployment rate jumped 0.3 points to 3.8% in August as more people entered the labor market looking for jobs.

Earlier this year, NRF forecast that 2023 retail sales – excluding automobile dealers, gasoline stations and restaurants to focus on core retail – would increase between 4% and 6% over 2022. We noted that spending would likely be tempered as access to credit became more expensive and job growth slowed through the year. Tighter financial conditions were an imminent risk, and it was too early to know the true effect of interest rate hikes on the base of the economy. Since then, fresh data shows that aggregate economic activity has held up, but the economy has been slowed by the Fed's interest rate increases and resulting higher borrowing costs. At this juncture, there is a good chance that sales will end up in the lower range of the forecast, if not lower. The end of rate hikes may be near, but much will depend on the course of inflation. The Fed's battle to contain inflation is ongoing, and elevated rates will continue to affect consumer attitudes and spending behavior.

SALES AND SENTIMENT

Retail sales for July showcased the resilience of U.S. consumers. In contrast, consumer sentiment retreated in August, offsetting some of the gains made during the past several months.

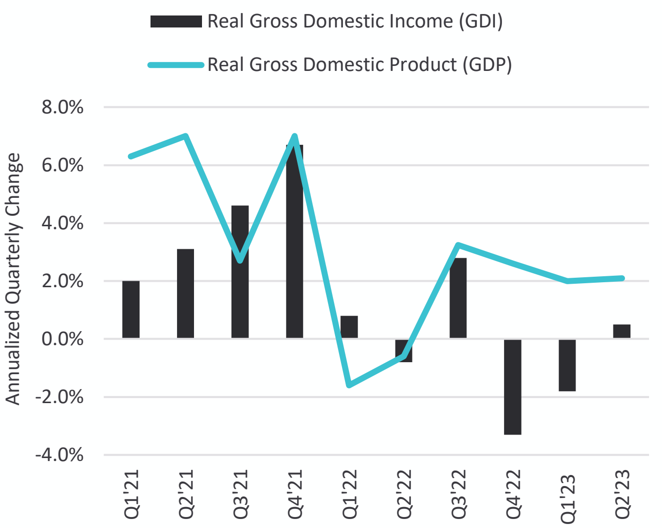


REAL GDP & UNEMPLOYMENT

Real GDP growth in the second quarter was revised lower to a 2.1% annual rate from the prior estimate of 2.4%. Incoming data for the third quarter shows signs of moderation.

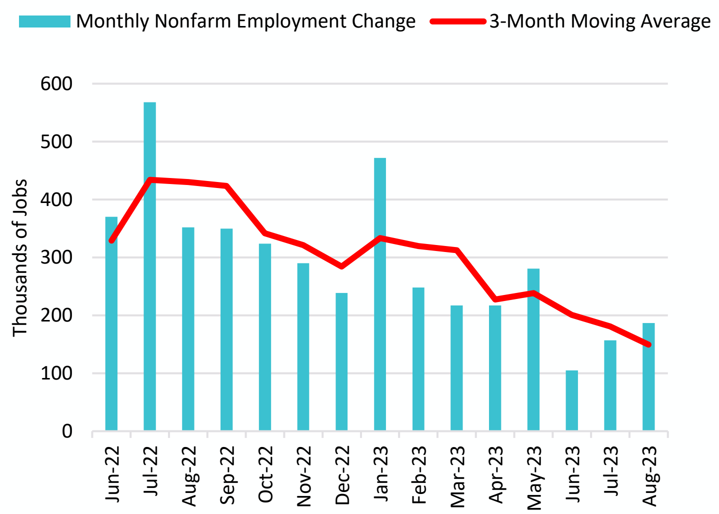
REAL FINAL SALES & GDP

Real Gross Domestic Income increased at a modest 0.5% annualized rate in the second quarter after falling 1.8% in the first quarter – an improvement but still a signal of underlying weakness.



EMPLOYMENT

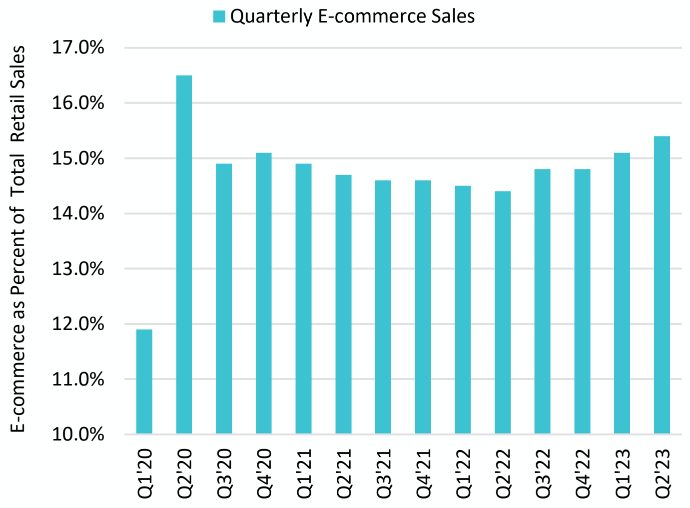
The U.S. labor market added 187,000 jobs in August, which was higher than both June and July. The average gain for the past three months moderated from 181,000 in July to 150,000.



NRF National Retail Federation

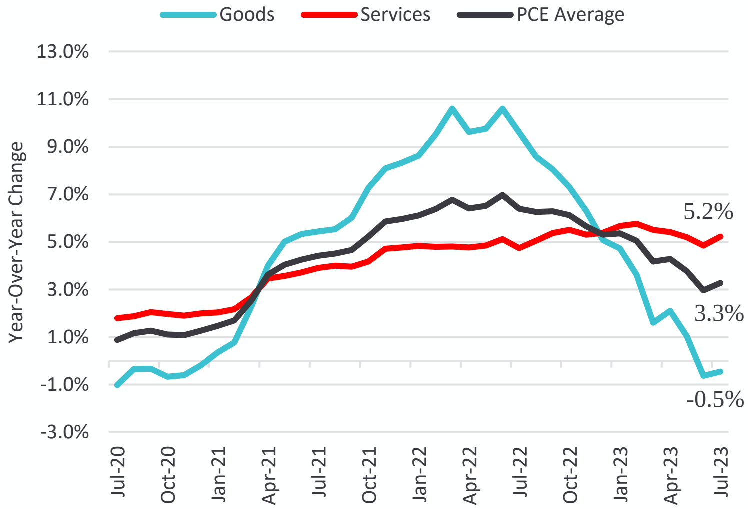
ECOMMERCE SALES

U.S. consumers are maintaining a strong desire to spend online. Internet retail sales accounted for 15.4% of total sales in the second quarter.



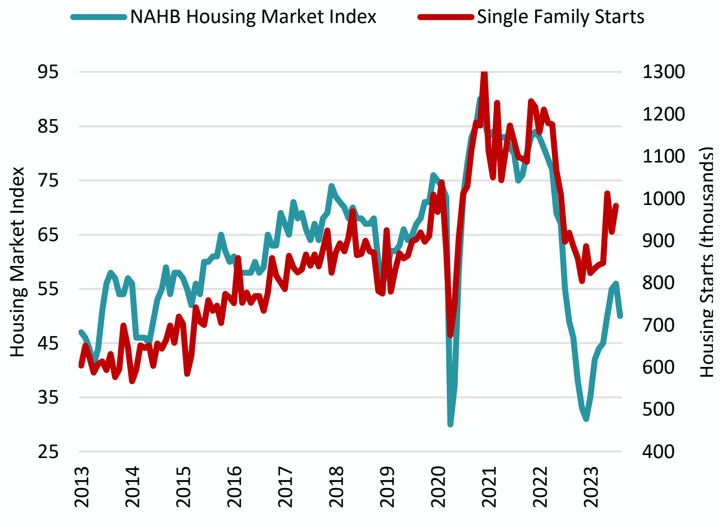
PERSONAL CONSUMPTION

The Personal Consumption Expenditures Price Index – the Fed's preferred measure of inflation – picked up in July. As expected, it will be a bumpy ride back to a normal inflation pace.



HOUSING MARKET

The National Association of Home Builders Housing Market Index fell to a barely expansionary 50 in August. Higher mortgage rates are likely to cause demand to drop off in the coming months.



CONSUMER SPENDING

Consumer spending continues to shift from goods to services, but July spending was boosted by special deal days offered by multiple retailers and entertainment-related events.

NRF National Retail Federation