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Morning Briefing

Retail Sales, India & S&P 500 Earnings

Check out the accompanying chart collection.

Executive Summary: As investors position portfolios for lower interest rates, Eric takes the pulse of goods producers, which stand to benefit from a lower-interest-rate environment more than services providers. … Melissa travels to India, where Prime Minister Modi just won a third term but without broad support. Does he have enough support to pull off planned reforms and meet ambitious economic goals? That's unclear. It will take substantial fiscal support for the Indian economy to sustain its soaring GDP growth trajectory. … Many S&P 500 Financials firms have already reported Q2 earnings; Joe says their aggregate y/y revenues growth was impressive, but their bottom-line growth not so much—though earnings did beat estimates.

US Economy: Green Shoots for Goods Producers. The services-providing sector is driving the US economy, but green shoots in the good-producing sector likely boosted Q2's real GDP growth. Financing conditions are likely to ease in the coming months provided that the Fed begins to cut interest rates, as we now expect. That should help rate-sensitive goods-producing industries like manufacturing and construction recover from their rolling recessions. Meanwhile, rising real personal incomes continue to fuel the US consumers' spending on both goods and services.

Here's more on the latest goods sales data and what they mean for the corporate profit and economic growth outlooks:

(1) *Business sales*. Nominal and real manufacturing and trade sales have remained relatively flat over the past two years through May and April, respectively, at record-high levels (*Fig. 1*). This series includes only goods, not services. Over this same period, the ISM's M-PMI remained weak (*Fig. 2*). Sales by retailers (up 0.2% m/m) and merchant wholesalers (0.4% m/m) both increased in May, while manufacturers' sales fell 0.7% m/m.

June's real manufacturing and trade sales were boosted by deflating producer prices for goods excluding food and energy. The manufacturing and trade sales series does not include the sale of any services and thus has remained largely unchanged at record highs for the past two years.

(2) *Margins.* In the past, nominal manufacturing and trade sales was highly correlated with both S&P 500 companies' quarterly aggregate revenues and weekly forward revenues, which both continue rising to record highs as the economy has been increasingly driven by services (*Fig. 3*).

While moderating inflation will slow S&P 500 revenues growth, we expect companies' bottom lines to be boosted by expanding profit margins (*Fig. 4*). We see S&P 500 forward profit margins widening from 12.0% in Q1 to 14.6% by the end of 2026. (FYI: Forward revenues and earnings are the time-weighted average of industry analysts' consensus estimates for the current year and following one; forward margins are calculated from forward revenues and earnings.)

(3) *Inventories.* Manufacturing and trade inventories rose 0.5% m/m in May, driven by retailers and wholesalers. That will provide a temporary boost to GDP growth; but more importantly signals rising expectations for future sales. Real retail and manufacturing inventories have generally been rising to new all-time highs since November 2022 (*Fig. 5*). During the 2022 and 2023 rolling recession in the goods sector, some of that was involuntary. Now we expect that improving goods sales will cause voluntary inventory building over the rest of 2024 and in 2025.

(4) *Retail sales*. June's retail and food services sales beat expectations of a nominal decrease, remaining unchanged from the prior month and up 2.3% y/y. Falling goods prices in June's CPI boosted real retail sales to a 0.3% m/m gain (*Fig. 6*).

Nominal nonstore retail sales, mostly online commerce, jumped 1.9% m/m while auto sales weighed on the overall index, falling 2.0% m/m (*Fig. 7*). Autos' decline was a one-off aberration stemming from a cyber-attack on car dealerships, which prevented sales. Excluding autos, nominal retail sales rose 0.4%; the retail sales control group, which is used to calculate consumer spending in GDP, rose 0.9%!

Our Earned Income Proxy for private industry wages and salaries hit a new record high last month (*Fig. 8*). As consumers' purchasing power rises, so does their spending, boosting manufacturing and trade sales. Personal savings rates remain low, below 4% as of May, as there is little need to save incomes with asset prices continuing to hit new highs and more Baby Boomers spending their retirement nest eggs (*Fig. 9*).

(5) *GDP.* The Atlanta Fed's *GDPNow* tracking model shows Q2's real GDP rising 2.5% (saar), an upward revision from 2.0% following the retail sales data (*Fig. 10*). The model now forecasts real personal consumption expenditures growth of 2.1% in Q2, up from the previously expected 1.6%.

The economy is on track for its eighth straight quarter of real growth for the US and an increase from Q1's 1.4% (saar) reading. There's no recession indicated in the data, and not one in our current outlook either.

India I: Modi Will Endure. On June 4, Prime Minister Narendra Modi secured a third term in office, but his party's alliance narrowly missed a majority. A coalition government therefore has emerged, with Modi's Bharatiya Janata Party (BJP) and its National Democratic Alliance (NDA) commanding only 43.4% of parliamentary seats, the Indian National Developmental Inclusive Alliance (INDIA) holding 40.6%, and other parties occupying the remaining 15.9%.

Modi's campaign manifesto, "Modi's Guarantee," emphasizes robust economic growth, but the Prime Minister will likely face challenges in enacting substantial reforms. While "Modi 3.0" promises continuity in key areas, its effectiveness will depend on managing the complexities of coalition governance.

The critical question is whether the Modi administration retains sufficient control to implement reforms necessary for the economy to stay on track to double within the next decade, targeting potential growth around 7%. Melissa and I believe this scenario is plausible but not guaranteed.

Here's more on their policy proposals:

(1) *Economic aspirations*. In her initial press briefing post-election, Finance Minister Nirmala Sitharaman reaffirmed the government's commitment to ongoing reforms aimed at transforming India into a developed nation by 2047. A central goal is to double India's global manufacturing share from 5% in 2030 to 10% by mid-century.

(2) *Infrastructure investments*. The Modi 3.0 administration is anticipated to maintain its focus on major infrastructure projects, including enhancements to roads, airports, ports, and advancements in solar power.

(3) *Strategic alliances*. The coalition is likely to uphold its policy of strategic autonomy while

strengthening ties with the US, India's key strategic partner.

(4) *Security priorities*. China will remain central to India's security agenda. A key issue in recent Sino-Indian *disputes* is the Sino-Indian frontier. The US has acknowledged Arunachal Pradesh as part of India, while China considers the region part of southern Tibet.

(5) *Reform challenges*. Modi's ambitious *reforms* in land, labor, and production—including digital infrastructure—are likely to face significant obstacles within coalition politics. Companies in India already struggle to acquire land, and restrictive labor laws complicate hiring and firing processes.

Over the weekend, Reuters *reported* that Modi's program to privatize a substantial portion of India's sprawling $600 billion state sector, announced in 2021, now faces increased resistance.

India II: Modi's Economic Momentum. As Finance Minister Nirmala Sitharaman prepares to unveil the Indian government's annual budget on July 23, the nation faces a dichotomy of soaring economic growth and stark socioeconomic challenges. Amid impressive real GDP growth of nearly 8% y/y and a surging stock market, income inequality has deepened in India and high unemployment has persisted.

India's stock market is in the midst of a historic bull run (*Fig. 11*). The India MSCI now accounts for more than 19% of the Emerging Markets MSCI, and its share has been steadily growing; conversely, China's 22.8% slice of the pie has been steadily diminishing, according to Bloomberg *data*.

For the Indian economy to sustain this growth trajectory, substantial fiscal support will be crucial. The government will need to equip its labor force with technological skills and stimulate the economy while simultaneously mitigating inflationary pressures.

Consider the economic trajectory:

(1) *Gangbusters growth.* India's real GDP rose 7.5% y/y during Q1-2024 (on a globally comparable basis as standardized by Refinitiv) (*Fig. 12*). GDP is anticipated to decelerate in 2024, according to the World Bank's latest *projections*.

(2) *Industrial production*. India's industrial output outpaced expectations in May, increasing 4.6% y/y (*Fig. 13*). The mining and electricity sectors were key contributors.

(3) *Elevated inflation*. India's CPI rose to 5.1% y/y in June, up from 4.8% in May, primarily due to a sharp increase in food prices (*Fig. 14*). Inflation may decline on an annual basis in July since it was so strong a year prior, but food inflation is likely to continue rising. Reserve Bank of India Governor Shaktikanta Das recently said that India needs a clear and unambiguous focus and commitment to lower inflation to its 4.0% goal, *reported* Reuters.

(4) *Youthful demographics.* India's economic growth prospects hinge on its ability to harness its demographic advantages, including one of the youngest populations, averaging 29 years old, with a substantial working-age cohort.

(5) *Skills mismatch*. Despite these advantages, India's labor market suffers from a large *skills mismatch*. The disconnect between available skills and job requirements has led to one of the highest youth unemployment rates in the world. The technology sector in particular will require over 1 million engineers with advanced skills in artificial intelligence and other emerging fields in the coming years, Bloomberg has *reported*.

Financials: Good Start to Q2 Earnings Season. The S&P 500 Financials sector's price index closed Monday at a record high that represents a ytd gain of 14.1%. Financials is the third best ytd performer of the S&P 500 sectors but trails the S&P 500's 18.1% ytd gain (*Fig. 15*). Also closing higher on Monday was the Real Estate sector, which improved to a 0.1% gain ytd. Now, all 11 S&P 500 sectors are higher ytd; the fact that the Fed looks likely to cut rates in September no doubt has helped (see Eric discussing this in Monday's weekly *webcast*).

(1) *Financials dominates early Q2 reporting companies.* The Q2-2024 earnings reporting season—which encompasses companies with fiscal quarters ending from May to July—is just over 7% done as of midday Tuesday; 36 companies in six of the 11 S&P 500 sectors have already crossed their quarterly reporting finish line.

It's still early in the season, though, as just 16 of those 36 reporters to date has a June fiscal quarter. And of the 16 with June-quarter results already reported, 13 are in the S&P 500 Financials sector. For the Financials sector, the Q2 reporting season is now 18% complete.

Consumer Staples' earnings season is also 18% complete, but just one of its seven reporting firms has a June fiscal quarter.

(2) *S&P 500 Q2 earnings results to date.* The 36 reporting companies in the S&P 500 to

date have an earnings surprise of 4.1% and y/y earnings growth of 11.1%. Among them, 31 (86%) bested earnings expectations. While just 61% of the 36 companies grew earnings y/y in Q2, we expect that percentage to improve markedly as S&P 500 firms begin reporting en masse next week.

(3) *S&P 500 Q2 revenue results so far.* Looking at their aggregate revenues, the 36 Q2 reporters have bested forecasts by 0.8% and recorded y/y growth of 6.5%. However, only 21 of the 36 companies (58%) beat consensus revenues forecasts to the upside as 29 (81%) reported positive y/y revenues growth. We expect the percentage of companies beating revenues forecasts also to improve as more companies report.

(4) *Weak earnings growth for Financials, but revenues are broadly stronger.* Thirteen of the 71 companies in the S&P 500 Financials' sector have reported Q2-2024 results through midday Tuesday. The sector's aggregate earnings surprise is 4.5%, as all 13 firms beat forecasts. However, their aggregate earnings has risen only 5.8% y/y, reflecting higher credit card provisions in response to consumers' shouldering more credit card debt, according to a July 16 *WSJ* article. Just eight of the 13 companies showed improving earnings y/y.

Revenues for the Financials are the big surprise so far in Q2. They exceeded their aggregate forecast by 1.8%, with 10 of these 13 firms recording a positive revenues surprise. Strong investment banking activity has helped to accelerate their revenues growth rate to 10.0% y/y, as all 13 firms showed y/y growth. That's an impressive performance considering the Fed's still restrictive monetary policy (for now).

Calendars

US: Wed: Industrial Production 0.4%; Capacity Utilization 78.6%; Housing Starts & Building Permits 1.310mu/1.390mu; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production; Beige Book; Barkin; Waller. **Thurs:** Leading Indicators -0.3%; Initial Claims 229k; Philadelphia Fed Manufacturing Index 2.7; Logan; Daly; Bowman. (FXStreet estimates)

Global: Wed: Eurozone Headline & Core CPI 0.2%m/m/2.5%y/y & 0.3%m/m/2.9%y/y; UK Headline & Core CPI 1.9%/3.5%y/y; UK PPI Input & Output Prices 0.1%/0.1%; Germany Buba Monthly Report. **Thurs:** ECB Interest Rate Decision & Deposit Facility Rate 4.25%/3.75%; UK Average Earning Index Including Bonus 5.7%; UK Claimant Count

Change 23.4k; UK Unemployment Rate 4.4%; UK Gfk Consumer Confidence -12; Eurogroup Meetings; Germany Buba Monthly Report; Lagarde. (FXStreet estimates)

US Economic Indicators

Retail Sales (*link*): Retail sales in June was stronger than expected, and there was an upward revision to May sales. *Total retail sales* showed no change, stronger than the expected 0.3% decline, while May's 0.1% uptick was revised higher to show a 0.3% gain. Meanwhile, sales in the *control group*—which excludes autos, gasoline, building materials, and food services—was much stronger than expected, increasing 0.8%, quadruple the 0.2% expected gain. This measure correlates closely with the consumer spending component of GDP. Of the *13 nominal retail sales categories*, 10 rose in June, while three fell. Here's a snapshot of the 13 categories' *June sales performance versus that of a year ago*: non-store retailers (1.9% m/m & 8.9% y/y), building materials & garden equipment (1.4 & -0.9), health & personal care stores (0.9 & 0.7), clothing & accessories stores (0.6 & 4.3), furniture & home furnishings (0.6 & -4.0), electronics & appliance stores (0.4 & 2.7), general merchandise stores (0.4 & 3.3), food services & drinking places (0.3 & 4.4), miscellaneous store retailers (0.3 & 2.8), food & beverage stores (0.1 & 1.9), sporting goods & hobby stores (-0.1% & -3.4), motor vehicles & parts (-2.0 & -2.2), and gasoline stations (-3.0 & -0.4).

Business Sales & Inventories (*link*): Both nominal and real business sales remain in record-high territory, barely budging in recent months. *Nominal business sales* showed no change in May, after a 0.2% increase and a 0.2% decrease the prior two months. Nominal sales are within 0.8% of June 2022's record high. *Real business sales* ticked down 0.1% in both April and March, after inching up 0.3% in February, and are within 1.3% of December's record reading.

NAHB Housing Market Index (*link*): Builder sentiment in July fell for the third straight month, after not posting a decline since November, as high mortgage rates, along with elevated rates for construction and development loans, continued to depress building sentiment. The *housing market index (HMI)* fell 1 point in July and 9 points during the three months through July, to 42—the lowest reading since December 2023. Two of the three HMI components posted declines over the three-month period, *current* sales (-10 points to 47) and *traffic of prospective buyers* (-7 to 28), while *future sales* ticked up a point to 48 in July after falling the prior three months by 15 points to 47. (Any reading below 50 is considered negative.) The July survey indicates that 31% of builders reduced home prices to stimulate sales during the month—up from 29% in June and 25% in May—however, the average price cut remained at 6% for the 13th straight month. In July, 61% of homebuilders used sales incentives, the highest since the 62% at the start of this year. “While home inventory is increasing, total market inventory remains lean at a 4.4 months’ supply, indicating a long-run need for more home construction,” notes Robert Dietz, NAHB’s chief economist.

Import Prices (*link*): June import prices showed no change, as lower energy prices offset a rebound in food prices. *Import prices’* flat reading followed a 0.2% decline in May, after gains of 1.0% in April and 0.6% in March. Import prices were 1.6% above a year ago last month, the highest since the end of 2022, and up from the -6.1% bottom last June. *Import fuel* prices sank 1.0% in June, after solid gains the prior few months, as crude petroleum and natural gas prices both declined, while the cost of imported food prices rose 0.7% after a 1.6% drop in May. Core import prices, which exclude fuels and food, were flat in June after a 0.1% downtick in May and rose 0.6% y/y. *Nonpetroleum* prices increased 0.2% in June, after falling 0.3% in May—which was the first decline since last October—after increasing 0.7% in April, which was the largest monthly increase since March 2022’s 1.2% advance. Excluding petroleum, import prices increased 1.0% last month, the highest since December 2022.

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