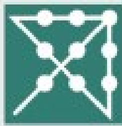

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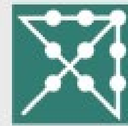

September 18, 2024

Morning Briefing

On Consumers, The Eurozone & S&P 500 Share Count

Check out the accompanying chart collection.

Executive Summary: August's rise in retail sales surprised many a hard-lander. We weren't surprised given our strong outlook for consumer spending, based on the growing labor market and rising real wages. Consumer credit doesn't threaten a balance sheet recession, Eric explains, and dissaving isn't worrying. We see more risk of an overheating economy as the Fed lowers rates than an anemic one requiring monetary support. … Also: Melissa explains the comprehensive plan to jumpstart economic growth in Europe, courtesy of former ECB chief Mario Draghi. … And: Joe shares data on share counts, falling more slowly amid elevated valuations as companies spend more on AI, less on share repurchasing.

US Consumer: Still Shopping, Not Dropping. August's retail sales beat the consensus expectation for a decline, rising instead. Many assumed that falling gas prices meant that nominal spending would fall. We've been expecting consumer spending to remain strong based on labor market growth and real wage growth trends.

We've heard a number of concerns regarding how much longer the consumer can shop without dropping. According to the die-hard hard-landers, pandemic-era savings are exhausted, a declining personal savings rate is fueling the final innings of spending, the labor market is on the brink, and high-net-worth households are distorting the data.

We're not so gloomy. Consumer spending looks likely to continue going strong in our outlook. Consider the following:

(1) *Earned income proxy*. Americans are working more and earning more. Nonfarm payroll employment rose just 0.1% m/m in August, but average weekly hours increased 0.3%. So aggregate weekly hours rose 0.4% (*Fig. 1*).

Combined with August's 0.4% m/m rise in average hourly earnings, our Earned Income Proxy (EIP) for private-industry wages and salaries in personal income increased 0.8% to a

record high last month (*Fig. 2*). We expect the PCED inflation rate rose 0.2% m/m or less in August, so real incomes rose at least 0.5%. That suggested to us that consumer spending increased last month, even after strong spending in July.

(2) *Wage growth*. Real average hourly earnings (AHE) continue to rise (*Fig. 3*). For low-wage (production and nonsupervisory) workers, real AHE rose to a new record high in July (*Fig. 4*). Their wage gains have been beating the rate of inflation for over a year.

Collective bargaining has helped swaths of workers increase their wages in the past several months and quarters (*Fig. 5*). Resultant pressure on corporate margins might be something for stock pickers to keep an eye on. Broadly speaking, however, unit labor costs have been suppressed to multi-year lows thanks to strong productivity growth (*Fig. 6*).

(3) *Retail sales*. As long as US consumers are earning, they are spending. Retail sales rose 0.1% m/m in August, while the consensus expected a 0.2% drop (*Fig. 7*). Core retail sales (excluding autos, gasoline, building materials, and food services) rose 0.4% m/m, suggesting that the underlying consumption trend remains strong (*Fig. 8*). Falling gas prices are essentially a form of stimulus to consumers (what they don't spend on gas, they'll spend on other things). A 0.24% decline in goods prices has further boosted real purchasing power (*Fig. 9* and *Fig. 10*). July's spending was revised higher as well, from 1.0% to 1.1% m/m. Online sales boosted this month's sales while auto sales surged in July after being hampered by a cyber-attack the prior month.

The New York Fed's quarterly household spending survey was released on Monday. It showed nominal household spending increased from 4.6% y/y in April to 5.0% in August. The increase in spending was broad-based across education levels and income groups.

We aren't blind to the fact that the cost of essentials has skyrocketed since the pandemic, causing some households to struggle to make ends meet. But in our opinion, concerns about a K-shaped economy (rosy for the wealthy, grim for lower-income households) are not supported by the data.

Better-than-expected retail sales boosted the Atlanta Fed's *GDPNow* model's Q3 real GDP growth forecast from 2.5% to 3.0% (*Fig. 11*). Personal consumption expenditures are estimated to rise 3.7% this quarter—hardly recessionary. While some components of retail sales are not included in GDP personal consumption expenditures (PCE) on goods (i.e., used car sales, building materials, food services, etc.), these series are highly correlated. Real core retail sales likely increased to another record high in August, suggesting another

record high for goods PCE during Q3 (*Fig. 12*).

(4) *Consumption per household*. Our preferred measure for the health of the consumer is personal consumption expenditures per household. This series rose to a record high of $148,100 per household (saar) in July (*Fig. 13*). Real personal consumption expenditures per household rose to a record $120,200 (saar) in July (*Fig. 14*).

Some complain that these data represent a mean, rather than a median. Therefore, wealthy households' consumption must be distorting the data. But in our opinion, that's unlikely to affect personal consumption per household very much. The rich can only eat so much.

In any case, median income as measured by the Census Bureau rose 4.0% y/y in 2023. We believe this data series faultily understates income growth, having showed Americans' standard of living has largely stagnated over the past 25 years despite record GDP growth, wage growth, and consumption growth. The Census Bureau data are derived from survey-based micro data on money income. The Census Bureau specifically gathers this data to report on income inequality and excludes fringe benefits, Medicare, Medicaid, the Earned Income Tax Credit, interest income, rental income, and dividend income. And yet this series still rose meaningfully last year.

(5) *Consumer credit in context*. Consumer credit rose $25.5 billion m/m during July, the most since November 2022. Revolving credit jumped $10.6 billion in July following a small decline in June (*Fig. 15*). There's no consumer credit bubble looming, however. Consumer credit outstanding represents less than a quarter of disposable personal income, well below its pre-pandemic percentage (*Fig. 16*).

(6) *Delinquencies*. There are fair worries that rising credit card delinquencies signal consumer weakness, especially with student loan payments primed to start up again (*Fig. 17*).

However, delinquencies on the biggest source of borrowing—mortgages—have plummeted. So just 3.3% of total household debt is delinquent as of Q2, down from 4.7% in Q4-2019 (*Fig. 18*). That makes sense, as credit card debt makes up just 6.4% of total household debt, whereas mortgages represent 70.3% (*Fig. 19*). While credit card delinquencies are rising, they are mostly among borrowers under the age of 25 and with less education. We do not discount that these cohorts are struggling. However, they represent a relatively small slice of overall consumption. Is it surprising that some are delinquent on their credit cards when many cards charge APRs of 30% and the cost of living has risen substantially?

(7) *Savings*. The personal savings rate fell to 2.9% in July (*Fig. 20*). The immediate claim by hard-landers was that dissaving has fueled consumption, and therefore spending will peter out soon. In our opinion, lower savings rates are a result of: 1) Baby Boomers retiring early and spending without incomes (negative savings), and 2) record asset prices (e.g., stocks, homes, etc.) suppressing the need to save and boosting consumption via the very positive wealth effect (*Fig. 21*).

To put a bow on the state of the consumer—things look pretty good to us. The labor market is growing, real wage growth is outpacing inflation thanks to productivity gains, and incomes and net wealth are sources of spending rather than credit. There are pockets of concern, as well as decelerations in some of these positive trends. However, with the Fed gearing up for a large easing cycle, we see greater risk of an overheating economy than a recession.

Eurozone I: Mario's Mega-State Ambitions. Mario Draghi—the former European Central Bank chief famous for his "whatever it takes" defense of the euro—has returned to center stage to push Eurozone governance toward a more unified state. During a December 2023 *speech*, he criticized the EU's fragmented model, arguing that it must evolve to foster economic growth. He cited the exodus of growing startups to the US as an example of the limited market potential in Europe.

Though lacking an official title, Draghi was enlisted by European Commission President Ursula von der Leyen to tackle structural issues. His 400-page September 2023 *report*, *The Future of European Competitiveness,* outlines Draghi's ambitious plan to boost innovation, energy, and infrastructure via centralized joint borrowing. His vision calls for deeper EU integration and a more centralized fiscal strategy, proposing annual EU investments of €750-€800 billion in digital innovation, green energy, and infrastructure through collective borrowing. He would emphasize tech sector reforms, important to productivity growth. He pointed to the stark contrast between the size of tech giants in Europe and the US; Europe hasn't produced a firm valued over €100 billion in the last half-century, as a September 16 *WSJ* article *discusses*.

Neither right- nor left-wing factions can contest that, but the remedy for the EU's diminishing global competitiveness remains a matter of debate. One critic of Draghi's centralized fiscal approach is German Chancellor Olaf Scholz, who warns that financial risk-sharing among the countries could undermine their fiscal discipline. Other EU leaders have voiced concerns about Draghi's policies potentially infringing on national sovereignty, apprehensive that increased centralization could erode individual countries' autonomy.

Nonetheless, Draghi has strong advocates in pro-EU French President Emmanuel Macron and the progressive Spanish Prime Minister Pedro Sánchez. Their voices have become more pronounced amid shifting EU power dynamics as Germany's economic influence wanes.

In his report, Draghi proposes horizontal EU policies aimed at bridging the skills gap, fostering innovative technology development, supporting productive investments, and boosting market competitiveness. These goals would be achieved via the creation of a Competitiveness Coordination Framework (CCF), helmed by a "Vice-President for Simplification" to streamline EU integration efforts. The CCF would work toward "deeper integration based on 'concentric circles', including enhanced cooperation or coalitions of the willing, where action at the EU level is hindered or blocked by existing procedures."

Might Draghi himself aspire to be the CCF's Simplification czar? Does anyone really draft a 400-page policy report without a personal agenda? Draghi is here to help.

Eurozone II: Made in Europe (TBD). Mario Draghi's competitiveness report draws inspiration from the Biden administration's Inflation Reduction Act (IRA) and China's "Made in China 2025" strategy. Both emphasize state-led strategic direction and state-led funding for domestic industries deemed to be critically important, particularly technology.

Draghi's vision pushes for centralized strategic planning, centralized procurement, and centralized public funding for key sectors across the EU. The report repeatedly underscores the need for "centralized" efforts, using the word 63 times, with terms like "harmonise" and "consolidation" also frequently appearing. His aim? Integrate and consolidate EU efforts to strengthen competitiveness and steer investment toward vital industries through "joint undertakings" (a.k.a. a larger EU governance body).

Here's a rephrased summary of just a few of the vertical industry-specific policies described in Draghi's report:

(1) *Energy*. EU strategy would be unified on energy security, joint EU gas procurement, and harmonized EU financial support. Centralized regulation and a collective public insurance system would mitigate market volatility. A "true Energy Union" with central governance is a key goal.

(2) *Computing and AI*. Investment in EU-wide AI and computing infrastructure would be prioritized, with ten key AI sectors targeted for development, including automotive and

energy. Standardized EU cloud rules are recommended.

(3) *Semiconductors*. A coordinated semiconductor budget and public-private partnerships would enhance EU leadership in advanced chip production.

(4) *Clean technologies*. Streamlined EU funding access and new financing schemes would support green tech, with a focus on supply-chain monitoring and R&D.

(5) *Automotive*. Electric vehicles and autonomous driving innovation would be better coordinated, with a focus on collaboration in the sector.

(6) *Defense*. Improved demand aggregation for defense assets and EU-level funding would strengthen the defense supply chain across member countries.

Strategy: AI Investment Crowding out Share Repurchasing. Artificial intelligence (AI) spending decisions are Topic #1 in corporate boardrooms across America. With stock prices and valuations at or near record highs, managements are opting to allocate more cash to AI investments and less to buying back their companies' highly appreciated shares. Even Warren Buffett has stopped buying shares of Berkshire Hathaway, according to a September 13 *WSJ* *article*. Furthermore, we're expecting only a gradual decline in the federal funds rate this rate-cut cycle, so debt-funded acquisitions may not become less expensive very quickly. Companies may opt to use their richly valued shares as currency in acquisitions instead of cash.

We're not surprised to report that the S&P 500's aggregate basic shares outstanding declined q/q at rate lower than 0.1% for a third straight quarter in Q2-2024 (*Fig. 22*). That's down substantially from an average 0.3% decline in the five quarters preceding that.

A company's share count rises when more shares are issued to pay stock dividends, as currency to fund acquisitions, and when an employee's stock option compensation is converted to shares. Counts fall when companies use excess cash to buy them back. That's important because a steadily falling share count boosts EPS over time.

Here's Joe's look at the aggregate count of basic shares outstanding over time for the S&P 500 and its 11 sectors (see also our *S&P 500 Shares Outstanding (sectors)* report):

(1) *Share count still declining, but at a slower rate*. The S&P 500's share count fell in Q2-2024 for an eighth straight quarter. Eight of the 11 sectors had declining share counts,

unchanged from Q1's count. Share counts rose for the Real Estate and Utilities sectors, as is typical since they typically issue stock as dividends in lieu of cash payments.

Other notable sector trends: Consumer Staples' share count declined for a 15th straight quarter, the most of any sector, followed by Financials (14 quarters), Industrials (13), Consumer Discretionary (12), Health Care (12), and Communication Services (8). Real Estate's share count rose for a 39th straight quarter. Also, Financials' count dropped 0.6% q/q in Q2, the fastest quarterly rate of decline in 10 quarters. On the flip side, the share count for Consumer Discretionary and Industrials declined at their slowest rates in 12 quarters. Energy's q/q share count gain was the highest in 10 quarters and its second in the past three quarters.

(2) *Share counts mostly down since 2009.* Since Q1-2009, the S&P 500's share count has dropped 2.8% (*Fig. 23*). Consumer Staples led the declines among the sectors, down 19.5%, ahead of Industrials (-16.8), Information Technology (-14.9), Health Care (-6.0), and Consumer Discretionary (-3.5). The Financials sector's share count is up 0.8% since Q1-2009, but that reflects years of share issuance after the Great Financial Crisis to shore up banks' balances sheets; since Q2-2011, Financials' share count has dropped 21.3%.

Calendars

US: Wed: Fed Interest Rate Decision 5.25%; FOMC Economic Projections; Housing Starts & Building Permits 1.31mu/1.41mu; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production. **Thurs:** Leading Indicators -0.3%; Jobless Claims 232k; Philadelphia Fed Manufacturing Index -0.6; Existing Home Sales 3.89mu; Fed's Balance Sheet. (FXStreet estimates)

Global: Wed: Eurozone Headline & Core CPI 0.2%m/m/2.2%y/y & 0.3%m/m/2.8%y/y; UK Headline & Core CPI 2.2%/3.3%y/y; UK PPI Input & Output -0.3%/0.0%; Nagel; McCaul. **Thurs:** BoE Interest Rate Decision 5.00%; UK Gfk Consumer Confidence -13; BoJ Interest Rate Decision 0.25%; Japan CPI 2.8%y/y; Schnabel; Nagel; Balz. (FXStreet estimates)

US Economic Indicators

Retail Sales (*link*): Retail sales beat estimates, though sales were still subdued. *Total retail*

sales edged up only 0.1% in August, stronger than the 0.2% decline expected, while July sales were revised upward slightly to 1.1% from the 1.0% initial increase. Meanwhile, sales excluding autos and gas edged up 0.2%, a tick below the expected gain of 0.3%, while sales in the *control group*—which excludes autos, gasoline, building materials, and food services—rose 0.3%, in line with expectations. This measure correlates closely with the consumer spending component of GDP. Of the *13 nominal retail sales categories*, five rose in August, while seven fell, and sales at food services & drinking places was unchanged. Here's a snapshot of the 13 categories' *August sales performance versus that of a year ago*: miscellaneous store retailers (1.7% m/m & 10.7% y/y), non-store retailers (1.4 & 7.8), health & personal care stores (0.7 & 3.5), sporting goods & hobby stores (0.3 & -3.6), building materials & garden equipment (0.1 & -0.1), food services & drinking places (0.0 & 2.7), motor vehicles & parts (-0.1 & 1.3), general merchandise stores (-0.3 & 2.1), food & beverage stores (-0.7 & 1.6), clothing & accessories stores (-0.7 & 1.0), furniture & home furnishings (-0.7 & -0.7), electronics & appliance stores (-1.1 & 1.9), and gasoline stations (-1.2 & -6.8).

Business Sales & Inventories (*link*): Both nominal and real business sales have been in a volatile flat trends around record highs, though both moved up during their latest reporting months. *Nominal business sales* jumped 1.1% in July after no change in June, to a new record high—0.2% above its previous record high posted in June 2022. Meanwhile, *real business sales* rose 0.4% in June, climbing within 0.1% of December 2023's record high.

Industrial Production (*link*): Industrial production in August rebounded from July's hurricane-related drop, which was the first decline since April—dragged down by the plunge in auto production in July. *Headline* production rebounded 0.8% in August from July's downwardly revised decline of 0.9% (first reported at -0.6%). *By industry, manufacturing production* rebounded 0.9% last month after contracting 0.7% in July—weaker than the initial estimate of a 0.3% downtick—led by a 9.8% surge in motor vehicle output following July's 8.9% plunge. *Excluding autos*, industrial production climbed 0.3%. *Durable goods manufacturing* jumped 2.1% from July's 1.5% slump, as the large jump in autos led August's gain, though there were increases of more than 1.0% in output for primary metals (3.2%), electrical equipment, appliances, and components (2.0), and aerospace and miscellaneous transportation equipment (1.2). The only decline in the durable goods components was recorded for miscellaneous durable manufacturing (-0.9). Meanwhile, *nondurable goods manufacturing production* fell for the first time in four months, dipping 0.2%, led by declines in output for petroleum & coal (-2.3%), apparel & leather (-1.6), and printing & support (-1.4). *Utilities* output was flat, while *mining* output rose 0.8% from July's 0.4% shortfall. *By market group, consumer goods* output rose 0.7%, following July's 1.1%

decline, largely due to the 10.5% jump in automotive products, while *business equipment* production rebounded 1.4% in August, led by a 6.6% jump in transit equipment output. Production of defense & space equipment (0.5%) and industrial equipment (0.4) rose fractionally last month, while information processing (-0.6) equipment posted a decline.

Capacity Utilization (*link*): The *headline* capacity utilization rate rose to 78.0% in August after falling from 78.2% in both May and June to 77.4% in July. August's rate is 1.7ppts below its long-run (1972-2023) average. The *manufacturing* utilization rate rose to 77.2% in August after falling the prior two months, from 77.5% in May to 76.6% in July—with August's rate 1.1ppts below its long-run average. The utilization rate for mining climbed from 89.2% to 90.0% in August—a rate 3.5ppts above its long-run average—while the utilities' rate fell to 70.5% last month, well below its long-run average.

NAHB Housing Market Index (*link*): Builder sentiment increased in September after falling the prior four months. The *housing market index (HMI)* edged up 2 points to 41 in September after a four-month slide of 12 points (to 39 in August from 51 in April)—which was the lowest reading since December 2023. All three HMI components posted gains in September: sales expectations (+4 points to 53), traffic of prospective buyers (+2 to 27), and current sales (+1 to 45). (Any reading below 50 is considered negative.) The September survey indicates that the share of builders cutting prices fell for the first time since April, down a percentage point to 32%, while the average price reduction (5%) slipped below 6% for the first time since July 2022. In addition, the percentage of builders using sales incentives fell to 61% this month from 64% last month.

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