



## Retail Takes a Breath: Sectoral Rotations and a Softer Q4 Outlook

### Retail Sales Hit a Flat Spot...

- ▲ **Retail sales rose 0.2%**, softer than expectations and essentially flat given the Census Bureau's  $\pm 0.4\%$  confidence interval.
- ▲ **August's +0.6% gain was unrevised**, preserving a strong summer handoff.
- ▲ **September's sectoral shifts** showed **goods categories cooling** while service-oriented and necessity-driven categories strengthened.
- ▲ Control-group sales fell **0.1%** but still rose **6.3% annual rate during Q3**.
- ▲ The unwind of summer EV-driven auto demand began earlier than expected. The EV tax credit expired at the end of September, suggesting supply constraints or early pull-forward effects were behind the drop.
- ▲ Nonstore sales' 0.7% decline may stem partly from **seasonal adjustment issues tied to unusually large August online promotions** that seasonal factors failed to fully capture.
- ▲ The K-shaped consumer remains firmly in place: high-income households continue to spend, while middle- and lower-income households face rising costs for key necessities, weaker job fundamentals and tighter credit.

### ...As Momentum Rolls into Services

U.S. retail sales rose **0.2%** in September, undershooting expectations and marking a meaningful slowdown after a stronger summer. The gain sits entirely inside the Census Bureau's  $\pm 0.4\%$  confidence interval, effectively yielding a flat print.

The report—delayed by the 43-day federal shutdown—follows July and August strength that was

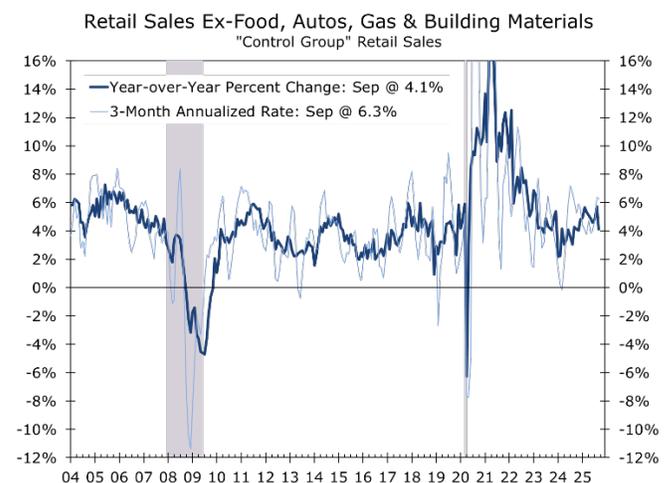
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amplified by a rush to purchase electric vehicles ahead of the expiring federal tax credit. Curiously, motor vehicle sales softened **0.3%** in September even though the credit expired at month-end, suggesting that the best models were sold ahead of the deadline and that the pull-forward was more front-loaded.

### *September's soft headline gain masks a shift away from goods to steadier service spending.*

The defining feature of September's report is the sectoral rotation that is becoming more pronounced as the cycle matures. Goods categories that surged earlier in Q3 softened across the board: electronics ( $-0.5\%$ ), clothing ( $-0.7\%$ ), sporting goods ( $-2.5\%$ ), and nonstore retail ( $-0.7\%$ ). Yet all remain positive year-over-year, indicating that part of the decline reflects payback for prior strength rather than an outright deterioration. **The weakness in nonstore sales was likely amplified by residual seasonality created when a wider group of online retailers aligned their promotions with Amazon's expanded Prime Day**—an effect not yet fully reflected by seasonal-adjustment.



Source: Census Bureau



In contrast, service-oriented and necessity-based categories showed ongoing strength. **Food services (restaurants and bars) rose 0.7%**, health & personal care 1.1%, and miscellaneous retailers 2.9%. **Gasoline station sales rose 2.0%, though they remain negative year-to-year due to lower fuel prices.** This rotation away from discretionary goods and toward services and necessities mirrors classic late-cycle behavior, with households becoming more selective but still engaged.

***Control-group softness adds mild downside risk to early Q4 GDP tracking.***

Momentum indicators reinforce this shift, with most retail categories posting softer readings in September. Nonstore retail shows the same pattern: weak sequential momentum despite a 6.0% year-over-year gain. **Food services remains the most dependable pillar**, maintaining three-month momentum near 6.2% and 6.7% year-over-year growth.

The weakness in **control-group sales**, which fell **0.1%**, introduces nuance without changing the underlying Q3 story. Core retail sales, which provide a good approximation of the goods portion of personal consumption expenditures, rose at a 6.3% annual rate. Personal consumption is tracking a 0.4% nominal gain for the month and a **0.2% real increase**, consistent with real consumer spending rising at **around a 3.2% annualized in Q3**. That aligns closely with our latest Q3 real GDP tracking estimate at 3.7%.

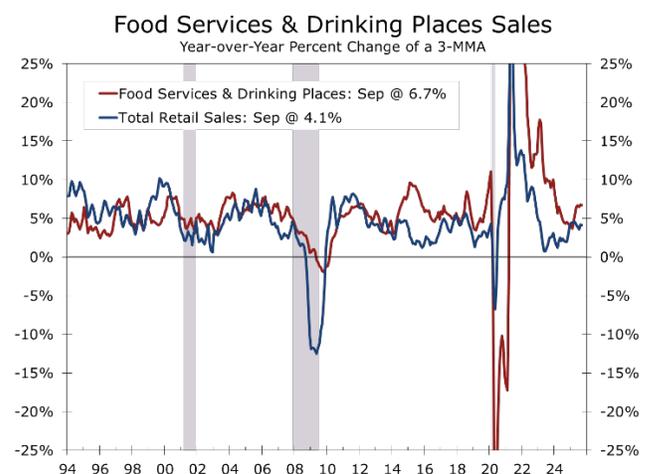
The outlook for the quarter increasingly hinges on the labor market. Unemployment has climbed to **4.4%**, a four-year high, and hiring has become more uneven—pressure that is now showing up in September’s discretionary spending. These dynamics strengthen the market’s case for a **December rate cut**. While policymakers have framed their concerns around labor-market softening, the retail data confirm that weaker job growth is beginning to curb spending. The marginal cooling in goods dovetails with market volatility, softer sentiment, and an increasingly bifurcated consumer landscape.

September’s weaker auto sales imply a smaller October pullback than earlier feared. We continue to expect **real consumer spending to slow to a 1.7% annualized pace in Q4**, though underlying demand remains firmer than the headline suggests. High-frequency indicators are solid, and strong household wealth—particularly among older and higher-income households—is set to support a holiday spending.

Taken together, the September retail report signals normalization rather than deterioration: **a resilient but more selective consumer adjusting to a cooling labor market**, fading incentives, and tighter financial conditions. Momentum is easing, the ceiling is lower, and the floor is thinning as the expansion matures.



Source: Census Bureau



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