



Capital
Markets

US Economics

RBC Capital Markets LLC

Michael Reid
+1-212-437-2434
michael.reid@rbccm.com

February 14, 2025

Quick Reid: Retail sales decline exposes the burden of inflation

While the decline in January retail sales reflects some payback for the strong holiday season, it is also reflective of the k-shape emerging in the consumer economy. The headline contraction was widely expected, but the sizable fall in the control group suggests consumption growth will be weaker than expected in Q1. In fact, we are still thinking about the consumer credit data released last week by the Federal Reserve Board. Consumer credit outstanding – that includes auto loans, credit cards, student loans, etc. but excludes debt backed by real estate (i.e., mortgages, HELOCs, etc.) – increased by \$40.8 billion in December. That represents the largest m/m increase in series history. About half of that increase came from a rise in revolving credit – typically what we consider to be credit card spending. And in the context of retail sales, that increase suggests 5% of spending was fueled by debt. Importantly, it gives us a view on the sustainability of growth – and this trajectory is not encouraging. In the last 25 years, the contribution of credit to retail sales has been around 1.5%, and December's surge was more than three times the average. This will dynamic represents one of the biggest risks to our consumption forecast in 2025.

Inflation is a central theme in the US growth divide

We think that the story of exceptional US growth masks a divided picture beneath the surface and US inflation is a key component of that divide. US Consumer confidence has been exceptionally weak relative to pre-pandemic levels and revolving credit utilization is moving higher at a time when the US has been touted as the global “golden child” of post-pandemic growth stories. A key part of the “K-shaped” recovery story is the fact that inflation has hit lower and middle-income households harder compared to higher income households. Indeed, US inflation has been sticky, making little progress over the last year in its path towards the Fed's target. What the CPI data does not convey, however, is just how burdensome above-target inflation has been on various groups along the income spectrum. We looked at the data and found that higher inflation for essentials hits lower income households harder since they devote a greater share of their consumer basket to nondiscretionary spend. We estimate that when headline inflation peaked at 9.1% in June 2022, it felt more like 10% inflation for those at the bottom of the income scale, while the top earners felt a lower inflation burden of 8%.

Lower income households have less choice in the face of above-target inflation

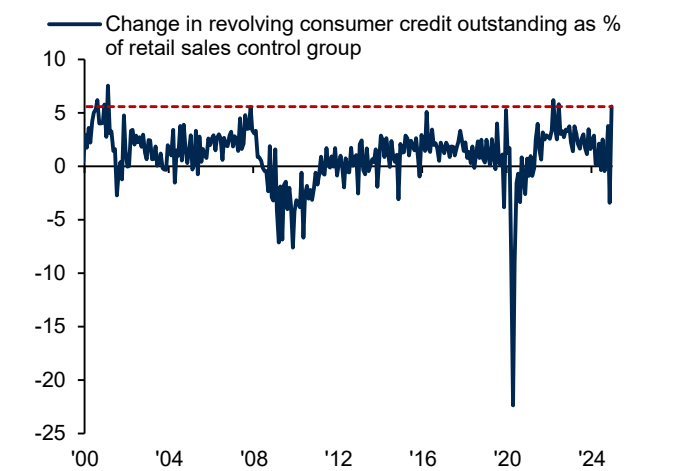
We constructed a re-weighted CPI basket based on average annual expenditure shares from the Consumer Expenditure Survey. This exercise tells us that even recently, December's 2.9% inflation rate felt like inflation above 3% for America's lowest earners. Since 2019, the lowest income earners' consumer baskets reported price growth of ~25%. For middle and lower-middle income earners, it was 23-24% and for the highest earners in the US, prices increased 22%. While this dispersion is not jaw-dropping, an important theme here is the disparity of choice. America's lowest earners allocate most of their income to essentials – they cannot hide from higher grocery prices and rent. At the same time, the highest earners devote a greater share of their spending basket to discretionary consumption like restaurants (which can easily be scaled back in the face of inflation), recreation and hobbies (tennis lessons can be canceled), and travel. Additionally, high income households devote, on average, more than 20% of their income to savings and pension contributions, meaning they are more insulated and can tap into these reserves during periods of higher price growth. Meanwhile, lower-income households have less cushion. The difference in housing costs has been the most pronounced, and this is especially concerning because shelter is still driving the bulk of price growth. Low-income renters have seen their rents rise 45% since 2019 in contrast to the highest-earning homeowners who reported 35% price-growth. Middle-income homeowners reported ~30% growth and appear to be more insulated than renters, as many locked into ultra-low mortgage rates during the pandemic.

Why does this matter?

Higher income earners have been able to continue to spend on discretionary goods and services despite higher prices, as this group has benefited from robust growth in non-labor income (i.e., dividend and rental income). Meanwhile, lower and middle-income households, have largely spent their excess savings and remain reliant on wage income. Going forward, this disparity will

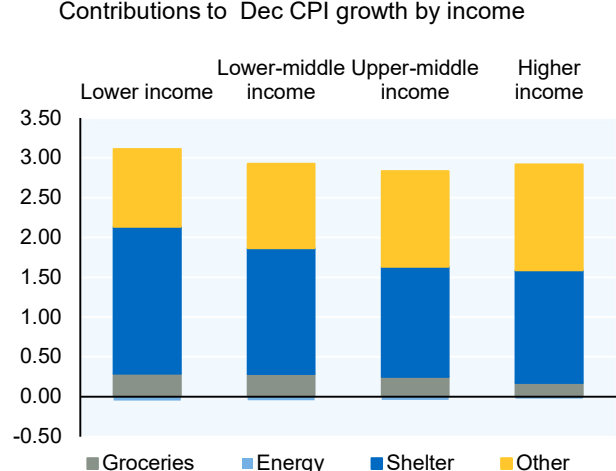
continue to be a key story that may become more pronounced in a high-rate environment as low-income earners turn to debt to sustain their spending.

Dec retail sales control strength was fueled by debt



Source: Haver, Federal Reserve Board, US Census, RBCCM US Economics.

Housing costs weigh on lower-income households*



Source: Haver, US Census, RBCCM US Economics.

* Lower Income (30K-<50K)
Lower-Middle Income (50K- <100K)
Upper-Middle Income (100-<150K)
Higher Income (150K+)

Disclaimer

This communication has been prepared by RBC Capital Markets ("RBCCM") sales personnel for institutional clients and your information only and is not a research report prepared by the RBCCM Research Department. Unless otherwise specified, the views expressed herein are the author's and may differ from the views of RBCCM's Research Department and from the views of others within RBCCM. The information in the body of this communication is intended to provide general company and/or market commentary, is not intended to provide a sufficient basis for an investment decision and should not be considered a research report. This material may include references to recently published research notes and reports by RBCCM's Research Department. Complete research notes and reports, including important conflicts disclosures, are available at www.rbcinsight.com. You should assume that trading desks at RBCCM or its affiliates makes markets and/or hold positions and may have conducted underwriting or other investment banking work in any of the securities referenced herein. Information contained herein has been compiled by RBCCM from sources believed to be reliable, but no representation or warranty, express or implied, is made as to its accuracy, completeness, or correctness. Every province in Canada, state in the US, and most countries throughout the world have their own laws regulating the types of securities and other investment products which may be offered to their residents, as well as the process for doing so. As a result, the securities discussed in this communication may not be eligible for sale in some jurisdictions. To the full extent permitted by law neither RBCCM nor any of its affiliates or any other person accepts any liability whatsoever for any direct, or indirect or consequential loss or damage arising from any use of the information contained herein. No matter contained in this communication may be reproduced or copied by any means without the prior consent of RBCCM.

RBC Capital Markets is the global brand name for the capital markets business of Royal Bank of Canada and its affiliates. United States: This communication has been approved by RBC Capital Markets, LLC (member FINRA, NYSE, SIPC), which is a US registered broker-dealer and Michael Reid, which accepts responsibility for this communication and its dissemination in the United States. Any US recipient of this communication that is not a registered broker-dealer or a bank acting in a broker or dealer capacity and that wishes further information regarding, or to effect any transaction in, any of the securities discussed in this communication, should contact and place orders with RBC Capital Markets, LLC.

IMPORTANT DISCLOSURE: THIS COMMUNICATION HAS BEEN GENERATED BY AN EMPLOYEE OF RBCCM AND IS BEING CONVEYED TO YOU AS A COMMENTARY ON ECONOMIC, POLITICAL OR MARKET CONDITIONS (FOR PURPOSES OF 17 CFR §§1.71(a)-(c) AND 23.605).

This communication is not a research report or a product of RBCCM's Research Department. Canada: RBC Dominion Securities Inc. (member IIROC and CIPF). France: RBC Paris Branch, RBC Capital Markets (Europe) GmbH Paris Branch are regulated by the Autorité de Contrôle Prudentiel et de Résolution and the Autorité des Marchés Financiers. Germany: This publication has been approved by RBC Capital Markets (Europe) GmbH, which is a company authorized by BaFin. United Kingdom: This publication has been approved by RBC Europe Limited, which is authorized by the Prudential Regulation Authority ("PRA") and regulated by the Financial Conduct Authority and PRA. Hong Kong: Royal Bank of Canada, Hong Kong (regulated by HKMA and SFC). Australia: Royal Bank of Canada, Sydney Branch (regulated by the Australian Securities & Investments Commission and the Australian Prudential Regulation Authority; AFSL 246521; ABN 86 076 940 880). This document is distributed only to persons who satisfy the definition of wholesale client for the purposes of the Corporations Act 2001 and not intended for distribution to retail clients. Japan: Securities business (as defined under the Financial Instruments and Exchange Law) in Japan will be carried out by RBC Capital Markets (Japan) Ltd. in compliance with all applicable laws and regulations. RBC Capital Markets (Japan) Ltd. is a Financial Instrument Dealer registered with the Kanto Financial Bureau (Kinsho #203) and a member of Japan Securities Dealers Association ("JSDA") and the Financial Futures Association of Japan ("FFAJ"). Banking business (as defined under the Banking Law) in Japan will be carried out by Royal Bank of Canada, Tokyo Branch in compliance with applicable laws and regulations. Singapore: Royal Bank of Canada, Singapore Branch (regulated by the Monetary Authority of Singapore).

This material has been prepared and distributed by RBC Capital Markets for informational and marketing purposes only and should not be construed as an opinion as to whether you should enter into any over-the-counter derivative transaction (including, but not limited to, an interest rate swap, FX swap, FX forward, etc.) ("OTC Derivative Transaction") or engage in any related trading strategy. It is important that you (or anyone exercising discretion on your behalf) understand the risk of loss prior to entry into each transaction, regardless of any prior experience in financial transactions. OTC Derivative transactions are subject to a variety of risks and the materials available at <https://www.rbccm.com/en/legal/dodd-frank-disclosures.page> are provided for your benefit to understand factors to consider when entering into such transactions. The disclosures have been developed as market standard disclosures and cover a wide array of products and instruments and generally describe the material characteristics, materials risks and typical material incentives and conflicts of interest that may arise in OTC Derivative transactions. You should read carefully any transaction-specific disclosures, economic terms and such other information contained in any documentation or provided to you in relation to the transaction.

There is no assurance that the transaction will provide you with a positive or anticipated return, that any such returns will be consistent with past performance, or such transaction will achieve your desired hedging objectives. You must carefully review each transaction's particular structure, including any terms incorporated by reference, in consultation with your own legal, financial, tax or accounting advisors. We are not providing you with legal, financial, tax, accounting, or other advice in connection with any transaction.

This disclosure is provided to you on behalf of the Royal Bank of Canada and certain of its branches, subsidiaries, and affiliates (each an "RBC Group Company" and collectively, the "RBC Group"). This disclosure is being provided as the contents of this communication may contain an "investment recommendation", as defined by the Market Abuse Regulation EU No 596/2014 ("MAR"). Please therefore be aware of the important disclosures outlined below.

Unless otherwise stated, this communication was completed and first disseminated at the date and time provided on the timestamp of the communication, as applicable. However, it is possible that it may have first been disseminated at an earlier date. If you would like further information on dissemination times, please contact us.

This is a marketing communication and the views on the communication expressed herein are of the individual only (the sender's name and job title appears on the communication). They do not necessarily correspond to, and may differ from, the views of any other individual or entity within the RBC Group.

Further, as a marketing communication, this has not been prepared in accordance with legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of dissemination.

All sources of information in this communication are reliable, but where there is any doubt as to reliability of a particular source, this is clearly indicated.

Unless otherwise indicated, the information in this communication was based on the individual's own view formed as a result of information available in the market. A summary of any basis of valuation or methodology and the underlying assumptions used to either: (i) evaluate the financial instrument or issuer referred to in this communication or (ii) to set a price target for a financial instrument, as well as an indication and a summary of any changes in the valuation, methodology or underlying assumptions can be made available upon request.

Where the communication includes or implies a recommendation to "buy", "sell" or "hold" or other form of recommendation, this must be understood as being a temporary and short-term recommendation, which relates only to the time period immediately following the time the communication was sent, unless otherwise indicated.

All statements and opinions contained in this communication are made as at the date and time of its dissemination and are not held out as being applicable at any point thereafter. There is no intention to update this communication in the future.

The relevant date and time for any price of financial instruments referenced in this communication are as at the date of dissemination, unless otherwise indicated.

Please note, this communication may provide views which differ from previous recommendations made by the same individual in respect of the same financial instrument or issuer in the last 12 months. Information and details regarding previous recommendations in relation to the financial instruments or issuer referred to in this communication can be located at <https://www.rbccm.com/en/legal/sales-note-disclosures-under-the-market-abuse-regime.page>.

The person(s) responsible for the production of this communication declare(s) that, as far as they are aware, there are no relationships or circumstances (including conflicts of interest) that may in any way impair the objectivity of this recommendation, and that where any such relationship, conflict or circumstance exists concerning any financial instrument or issuer to which this recommendation directly or indirectly relates, this has been declared below. This statement applies equally to any persons closely associated with him or her. However, it is possible that persons making communications in relation to a financial instrument may have a holding in that instrument. Further details may be provided on request. The RBC Group has controls in place to manage the risks related to such. An outline of the general approach taken in relation to conflicts of interest, including details as to our procedures in place to identify, manage and control conflicts of interest is available at <https://www.rbccm.com/assets/rbccm/docs/legal/information-on-the-rbccm-conflicts-management-policy.pdf>.

An RBC Group Company and/or the RBC Group may in relation to relevant securities have a net long or short financial interest in excess of 0.5% of the total issued share capital of the entities mentioned in the investment recommendation. Information relating to this is available upon request from your relationship manager.

An RBC Group Company: (i) may be a market maker in respect of the securities of the company which is the subject of this communication, (ii) may have managed or co-managed a public offering for the issuer which is the subject of this communication in the past 12 months, (iii) may be party to an agreement with the issuer that is the subject of this communication relating to the provision of services of investment firms, and (iv) may be party to an agreement with the issuer that is the subject of this communication relating to the production of this communication. As noted above, we have in place procedures to manage conflicts appropriately. Further information in respect of the details mentioned in this paragraph are available on request. [View investment recommendation](#).

This content relies on tracking technologies to monitor, understand, and improve our electronic communication and your online experience, to customize marketing, and to track your usage of RBC content, websites, and services. Tracking technology may identify when you visit specific RBC content and may be shared with third parties involved in customizing RBC marketing on RBC or digital channels. RBC does not sell your information to third parties, nor do we track your interaction with a third-party website. For more information, see our privacy policy at <http://www.rbc.com/privacysecurity/ca/index.html>.

® Registered trademark of Royal Bank of Canada. Used under license.

© 2025. All rights reserved.