

# Consumer Metrics Institute Members News

## August 15, 2011: Daily Growth Index Surge Continues; But Why?

We have been inundated with requests for explanations as to why our indexes have suddenly and spectacularly reversed course after bottoming at the end of May. We need to remind those readers that we are only passively measuring on-line consumer behavior, and then only with regards to their demand for discretionary durable goods. We do not conduct surveys, so we are left with only the nuances of those behaviors in any attempts to understand the "why" of any major course changes.

But that said, clearly something of note is happening. Let's first look to the main-stream media's usual suspects: the recent widely reported government reports on consumer credit and retail sales.

### Consumer Credit

-- First we have the Federal Reserve's most recent G.19 report on total consumer credit. The headline stated that in June consumer credit "increased at an annual rate of 7-3/4 percent." This is exactly the kind of signal we might be hoping for as an explanation of new-found consumer spending. So, we offer the actual non-seasonally-adjusted year-over-year numbers from that G.19 report for your consideration (in billions of dollars, and excluding home loans):

Credit Type	June 2010	June 2011
Total	2387.5	2427.4
Commercial banks	1133.7	1074.8
Finance companies	527.2	501.3
Credit unions	225.8	220.6
Federal government	222.6	370.1
Savings institutions	80.6	86.8
Nonfinancial business	52.8	53.1
Pools of securitized assets	144.8	120.7

The year-over-year numbers tell a story somewhat different from the headline "7-3/4 percent." The actual nominal year-over-year change in total consumer credit (excluding home loans) was an increase of \$40 billion, a less-than-inspiring +1.67%. But the details are even more dismal, with the total outstanding credit from "Commercial banks," "Finance companies" and "Credit unions" actually contracting by \$90 billion. An additional \$24 billion evaporated from outstanding "Pools of securitized assets." The categories "Savings institutions" and "Nonfinancial business" loans did increase some, but by a modest aggregate of \$6.5 billion. So where did the vast bulk of the increases come from? The "Federal Government," according to the G.19 tables -- which accounted for a \$147.5 billion dollar expansion of the total consumer credit, increasing 66% year-over-year.

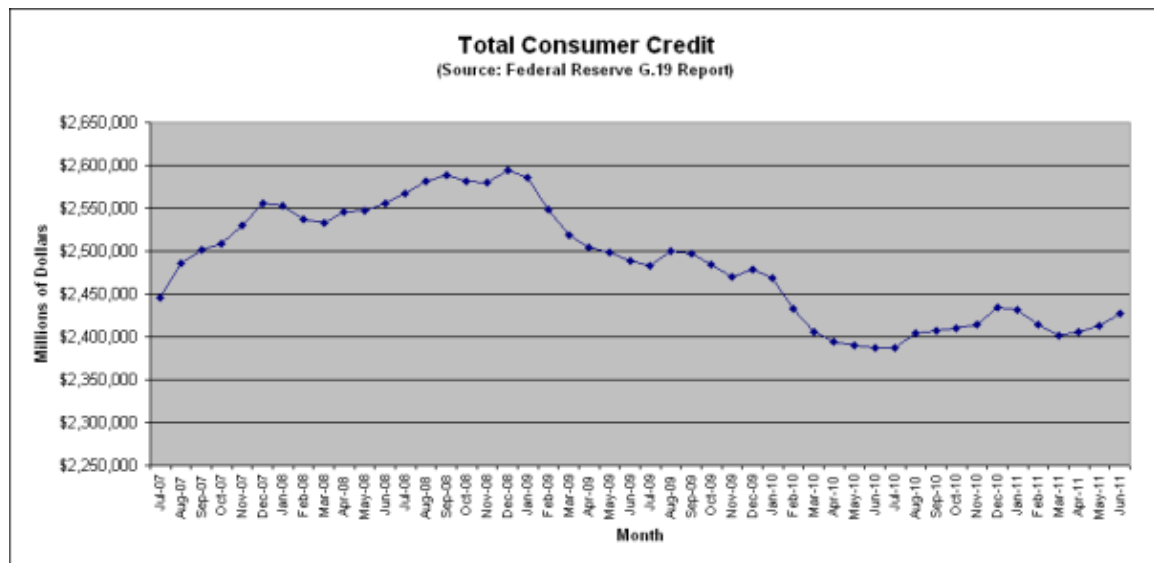
We have mentioned before that it is likely that the vast bulk of that increase was coming from student loans. While it might be nice to think that student loans were replacing unemployment checks, even that assumption doesn't pass credibility tests when you look further back in that series. Since 2008 that line item has grown by nearly 250%. That kind of growth in total outstanding student loans over a three year period simply doesn't pass the "smell test," given that Federal Student Loans have been a staple of higher education since the passage of Title IV of the Higher Education Act of 1965 -- nearly a half century ago.

We suspect that the incredible "growth" in student loans since 2008 was at least partly an artifact of the Higher Education Opportunity Act of 2008, which had caused a massive migration of student loans to the Direct Loan programs that were captured by this report in ways that the prior loans were not. Further clouding the issues surrounding student loans was the implementation of FAS 166/167 accounting rules, which caused financial institutions to re-categorize loans from "Pools for securitized assets" into other line-items between 2009 and 2010. Given all of the above it is hard to assign any real credibility to the reported changes in long term G.19 line-item composition.

*(By the way, if anyone can find any hint of the impact of a couple trillion dollars in QE monies in the G.19 report, please let us know. They certainly didn't make it to the "Main Street" credit part of the rabbit hole.)*

So where did the "7-3/4 percent" headline come from? Probably not from a massive expansion of real "end-user" consumer credit. It is almost certainly the result of seasonal adjustments, the annualization of a single monthly data point (thereby extrapolating a single month's movement into a year-long trend) and the migration of student loans into accounts that the Federal Reserve is finally able to definitively measure.

-- Furthermore, it is also important to keep the consumer credit data in a long term perspective:



The new nominal numbers have not reached the recent highs from last December, let alone July of 2007, the starting point for the chart. In fact, a similar multi-quarter up-tick can be seen in the

above chart during the last half of 2010 -- before deteriorating again during the first quarter of 2011. We would prefer to have any of these movements play out over longer time periods before announcing that consumer deleveraging is finally completely behind us.

-- And, by the way, all of the above data is reported in nominal terms (i.e., they don't factor-in inflation). Simply using the Bureau of Labor Statistic's (BLS) CPI-U for the same twelve month period (+3.6%) as a deflater, we find that the reported year-over-year "growth" of 1.67% is actually a "real" contraction of -1.86%. In other words, despite the headlines "real" consumer credit shrank year-over-year by nearly 2%.

## **Retail Sales**

-- Meanwhile the Census Bureau of the U.S. Department of Commerce reported in their Monthly Retail Trade Survey that retail trade sales were "8.9 percent (+/- 0.7%) above last year." Those numbers were nominal (again, unadjusted for inflation). Contributing significantly to this rise were gasoline sales, which rose 23.6% year-over-year. Grocery store sales were reportedly up 8.2% year-over-year, motor vehicle sales increased 8.3% and apparel sales grew by 7.7%.

Interestingly, the BLS inflation rate for gasoline over the same twelve months was 35.6% -- meaning that at face value the quantity of gasoline consumed actually contracted 8.8% (representing a possible, but not plausible, change in driving habits). Otherwise, the reported increases in retail sales were significantly greater than the BLS inflation figures for the same types of goods: 3.6% overall and for groceries, 3.9% for motor vehicles and 1.9% for apparel -- indicating that (per the BLS inflation data) the sales increases are real and in the neighborhood of 5%, net of inflation.

And although it is tempting to bash the BLS's CPI reports, independent data from the "Billion Prices Project" at MIT generally supports the BLS inflation figures. We like the "Billion Prices Project" in large part because it uses data collection methodologies not unlike the techniques that we use here at the Consumer Metrics Institute.

So where did the money for this reported growth in spending come from?

Evidently not from an organic growth in incomes: over the same twelve month period, the Bureau of Economic Analysis (BEA) reports that aggregate real disposable income in the U.S. increased only 1.14% (with real *per-capita* disposable income increasing a miserable 0.33%). Another plausible source of funds would be from changes in personal savings rates, but those only dropped from 5.8% of disposable income to 5.4%. Although the savings rate is down a little, it still can't explain any meaningful increase in retail sales.

In short, something is askew when we look at year-over-year real retail data in conjunction with comparable year-over-year disposable income, credit, and savings data -- the inputs and outputs simply don't add up.

We have consistently held that the methodologies used in the the Census Bureau's Monthly Retail Trade Survey suffer from a number of biases that impact the quality of their data during times of dynamic change in the economy. The survey is a "*mail-out/mail-back survey of about 12,000 retail businesses ... supplemented by estimates for nonemployers, new employers, and missed employers*" and further augmented by seasonal adjustments and a birth-and-death model that they admit contains "*about a 9 month delay.*" Any such methodology contains an inherent "survivor

bias" in the samples that overstates numbers during contractions and understates them during periods of growth. In essence, for the next 9 months the "same store sales for stores open at least a year" metric will either assume that "missed employers" (e.g., Borders) are performing as before or they (and their lost sales) will simply be dropped from the 12,000 sampled businesses. For a glaring example of this phenomena in action we need look no further than the recent GDP revisions from the BEA -- where the prior extreme ups and downs had been significantly under-reported.

Given the fact that the numbers just don't "compute," we are faced with several possibilities:

-- Some of the data from the BEA, BLS, Census Bureau and/or the Federal Reserve is simply wrong, particularly at times of dynamic change in the economy;

-- The data sets are from such diverse sources that they can't be related to each other in any reasonable way;

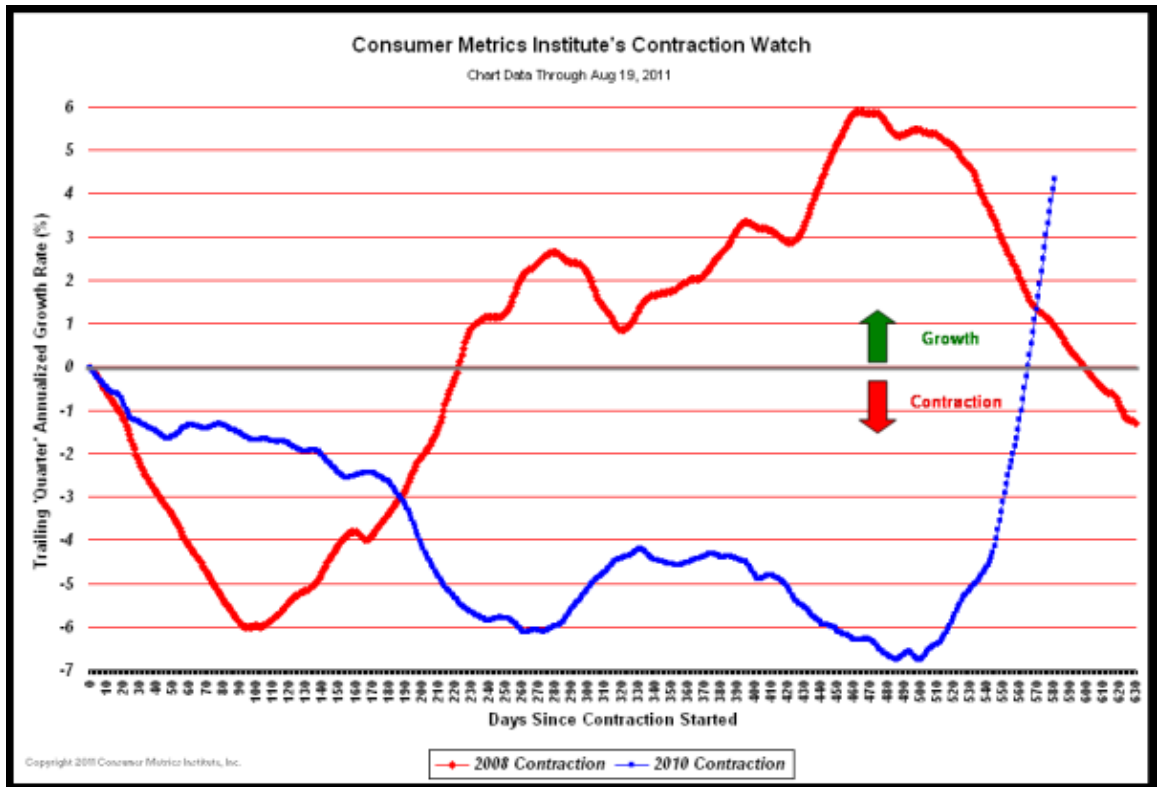
-- Or, the government has managed to completely miss something significant that has been happening over the past year.

None of these options bode well for the quality of Mr. Bernanke's data when he is making critical policy decisions.

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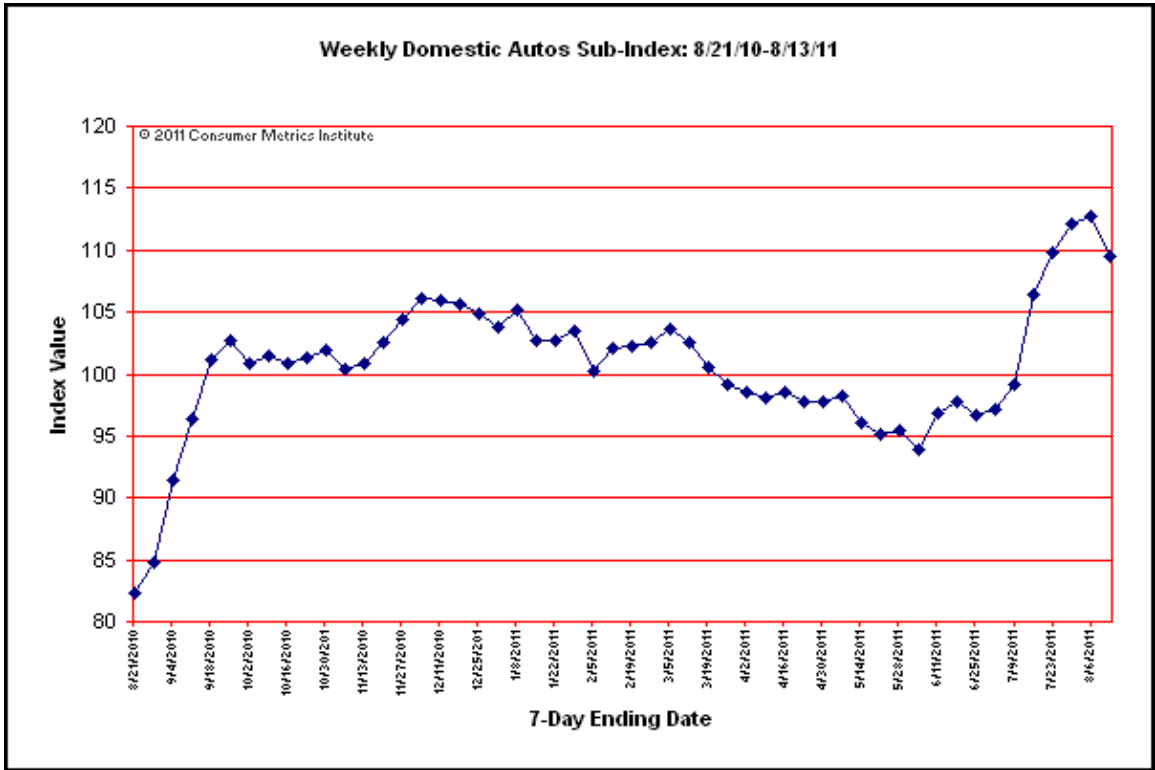
## **Our Data**

In any event, compared to our essentially "real-time" data, the government reports are ancient history. The rise in our Daily Growth Index from its lows at the end of May have been both spectacular and unprecedented:

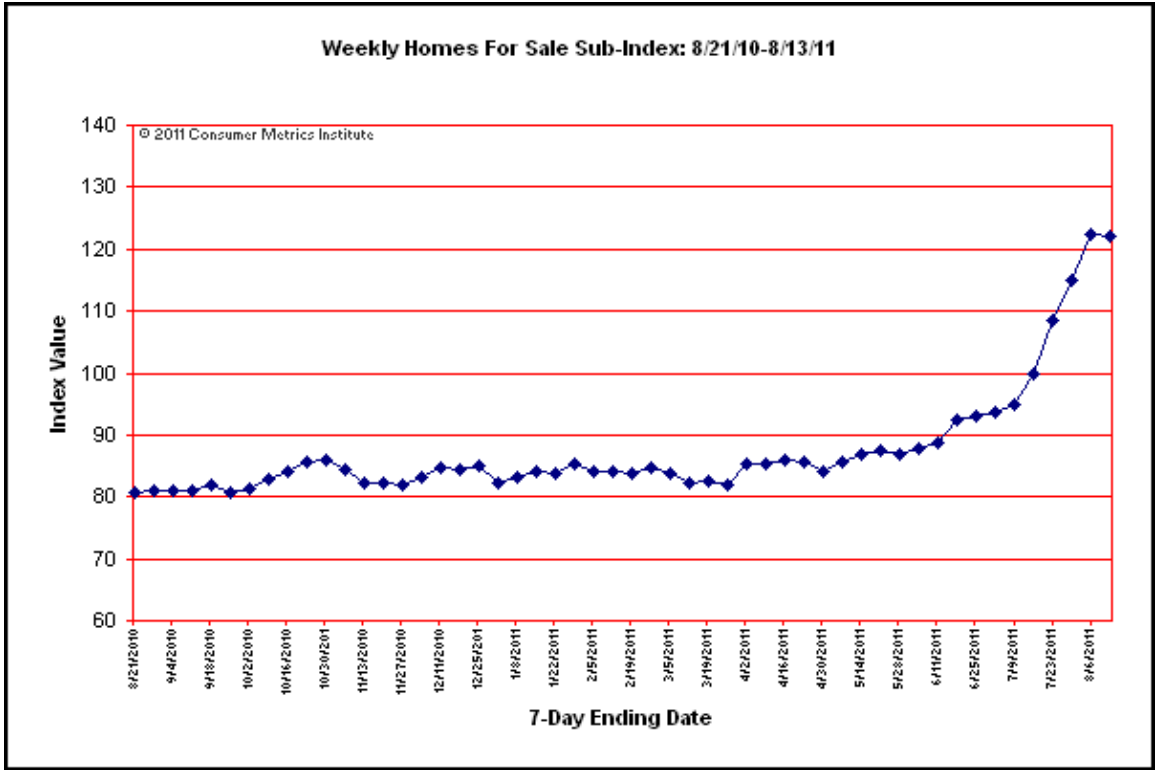


The above chart follows the course of our Daily Growth Index (actually just a 91-day moving average of the Weighted Composite Index, converted from the base 100 index to a +/- percentage) during its contraction phase -- from when that index first went into contraction (on January 15, 2010) to when it broke again above zero (on August 3, 2011), a span of 566 days. The chart also shows what the Daily Growth Index was doing during the consumer contraction that occurred within the formally defined "Great Recession" of 2008-2009. The progress of each event was recorded as a track of Daily Growth Index values commencing on the left margin on the date that the index first went into contraction.

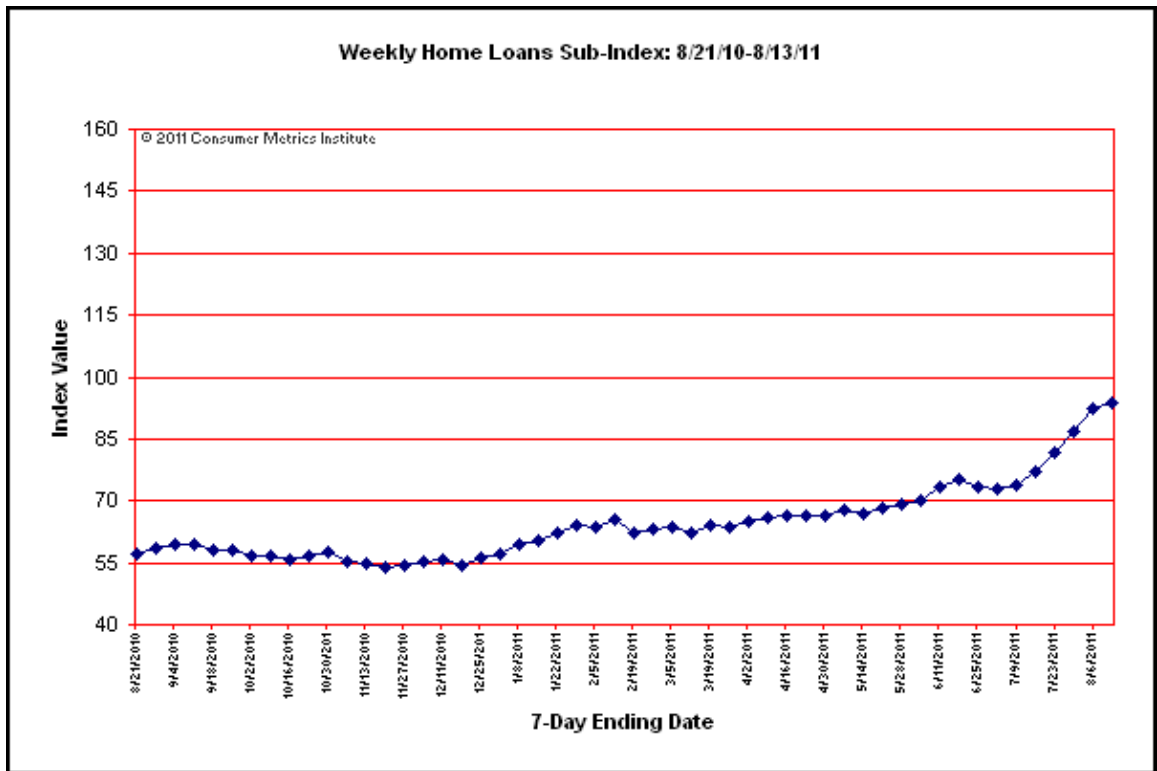
We have seen the improvements across a wide range (but not all) of the consumer demand categories that we monitor. Notable recent improvements include those in Domestic Autos:



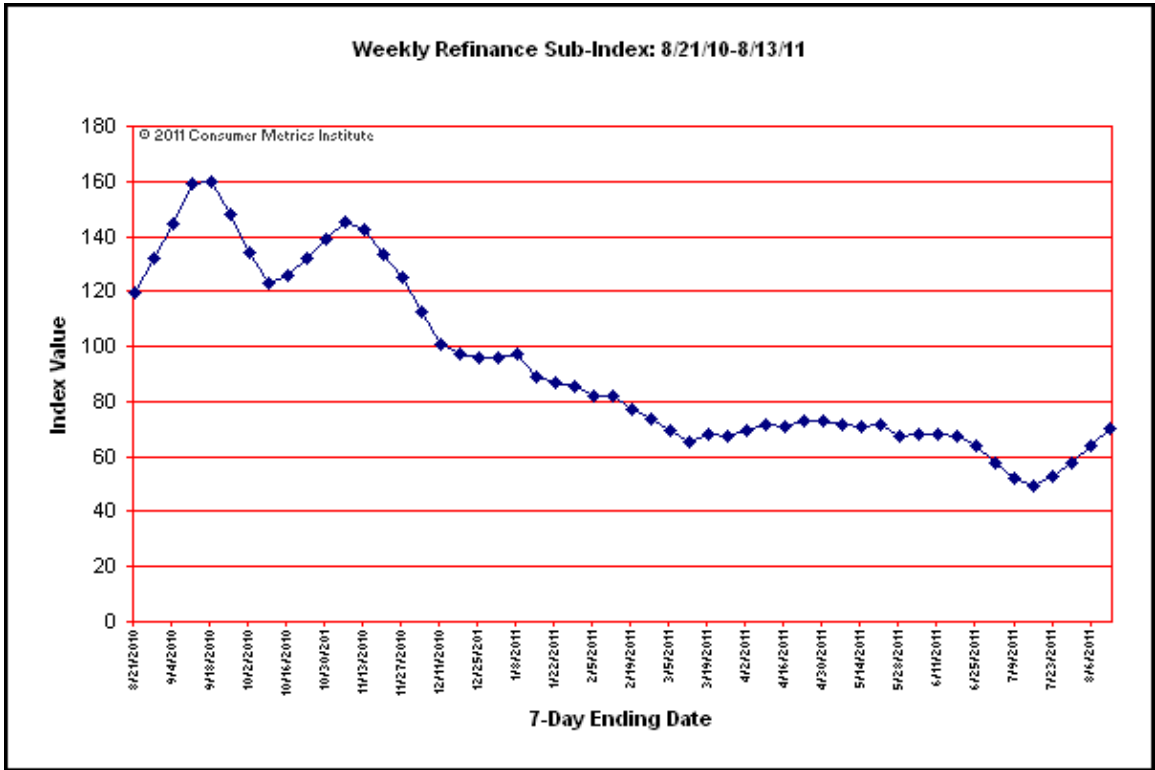
And nearly all areas related to Housing have seen recent year-over-year surges, beginning with consumer demand for listing services:



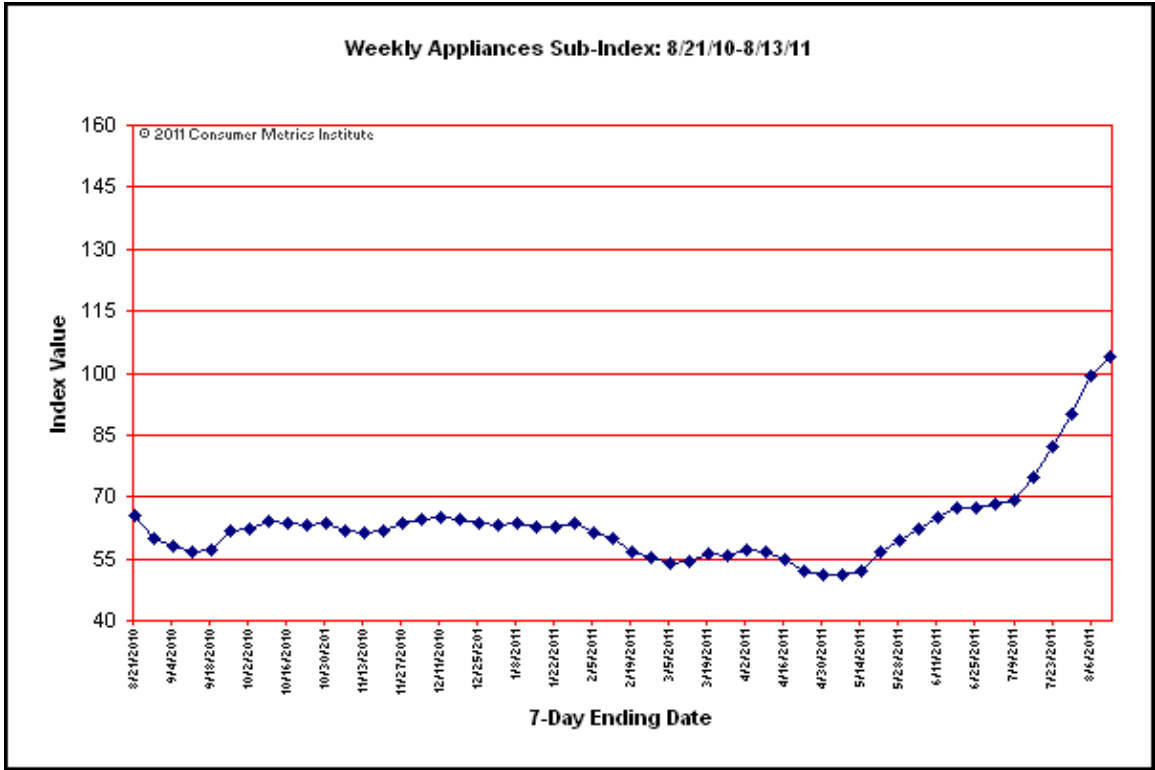
The increases in demand for listings could be a sign of either wishful thinking or desperation, but it has been mirrored (with a slight lag) by an increase in demand for new loan services:



This up-tick in new loans can be contrasted with the continued year-over-year contraction in demand for refinancing, although even that has turned up slightly over the past month:

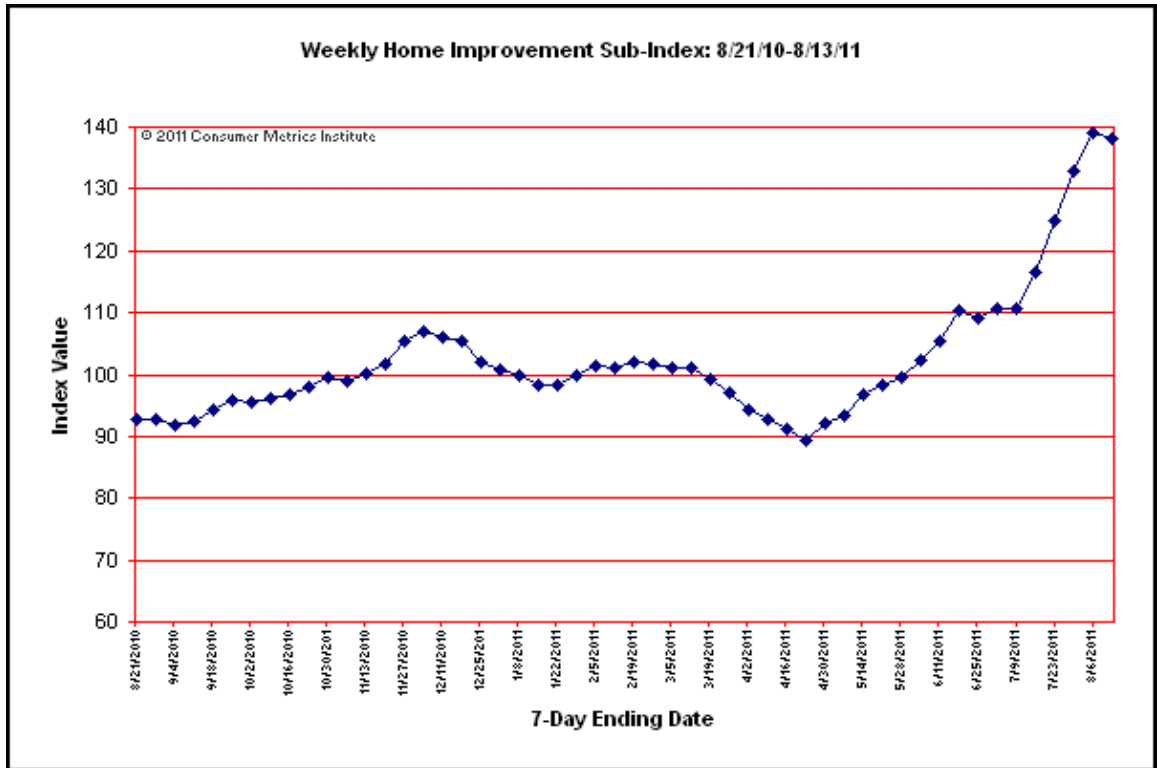


A sure sign of fresh activity in the housing arena can also be found in the closely related Home Improvement areas, including major appliances:

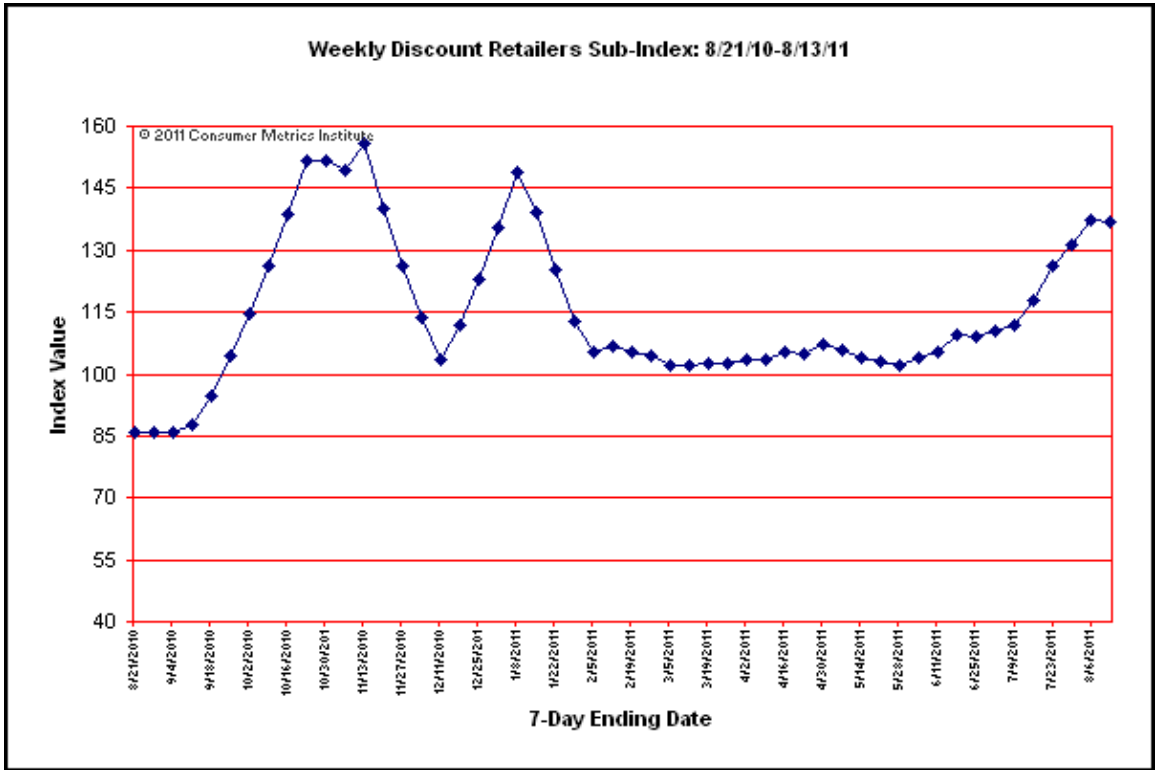




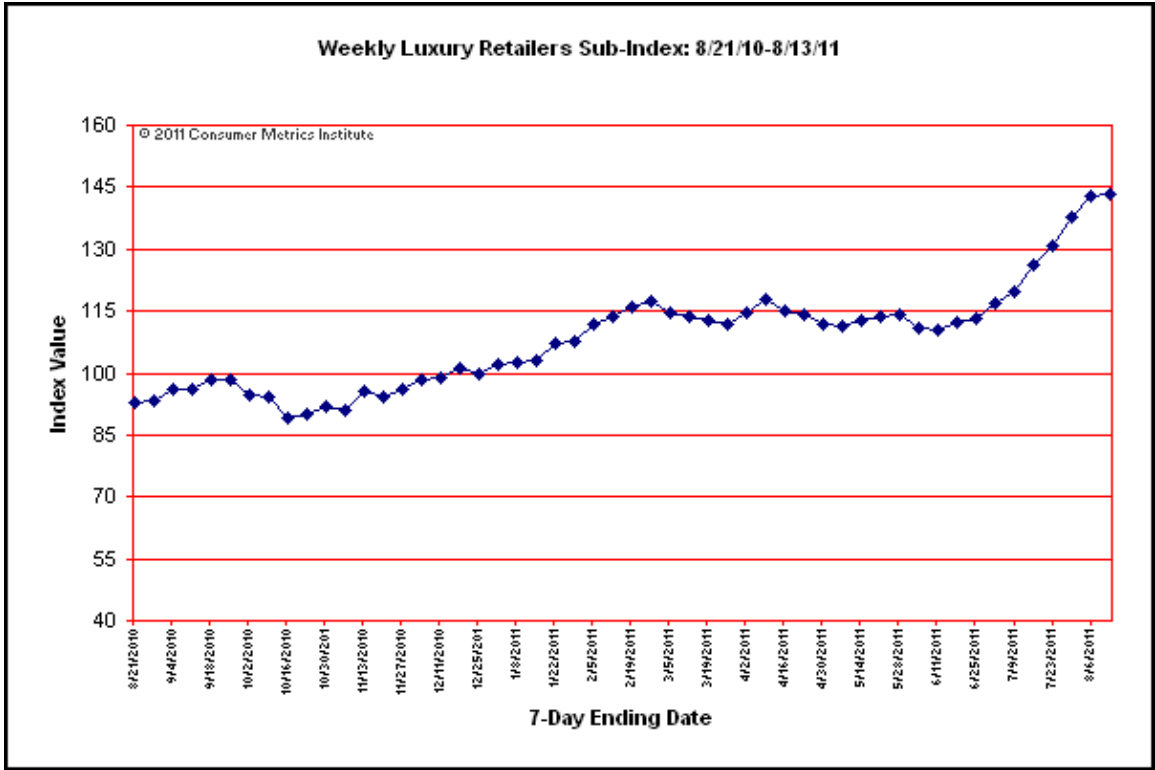
and other home-improvement material:



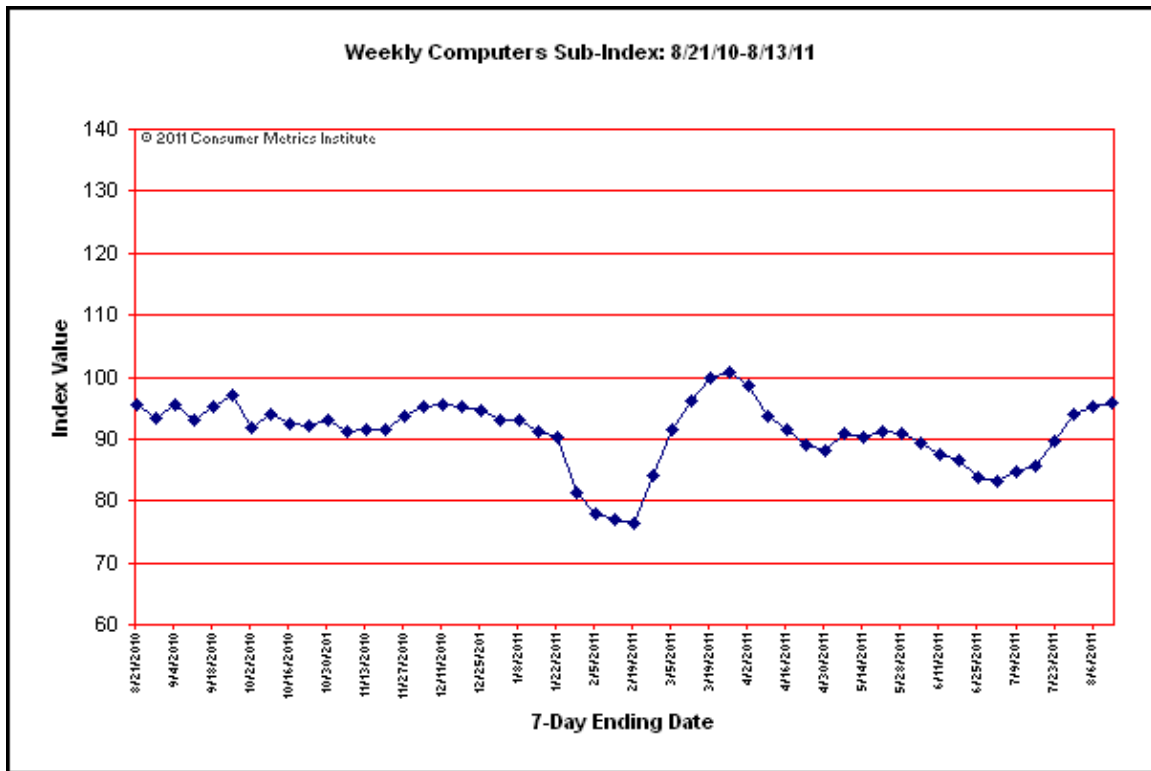
Both ends of the retail spectrum show similar bounces. The discounting retailers are now back in territories last seen during the prior holiday season:



And luxury goods buyers are showing the same pattern after spending somewhat more freely than their discount store brethren for the past several quarters:

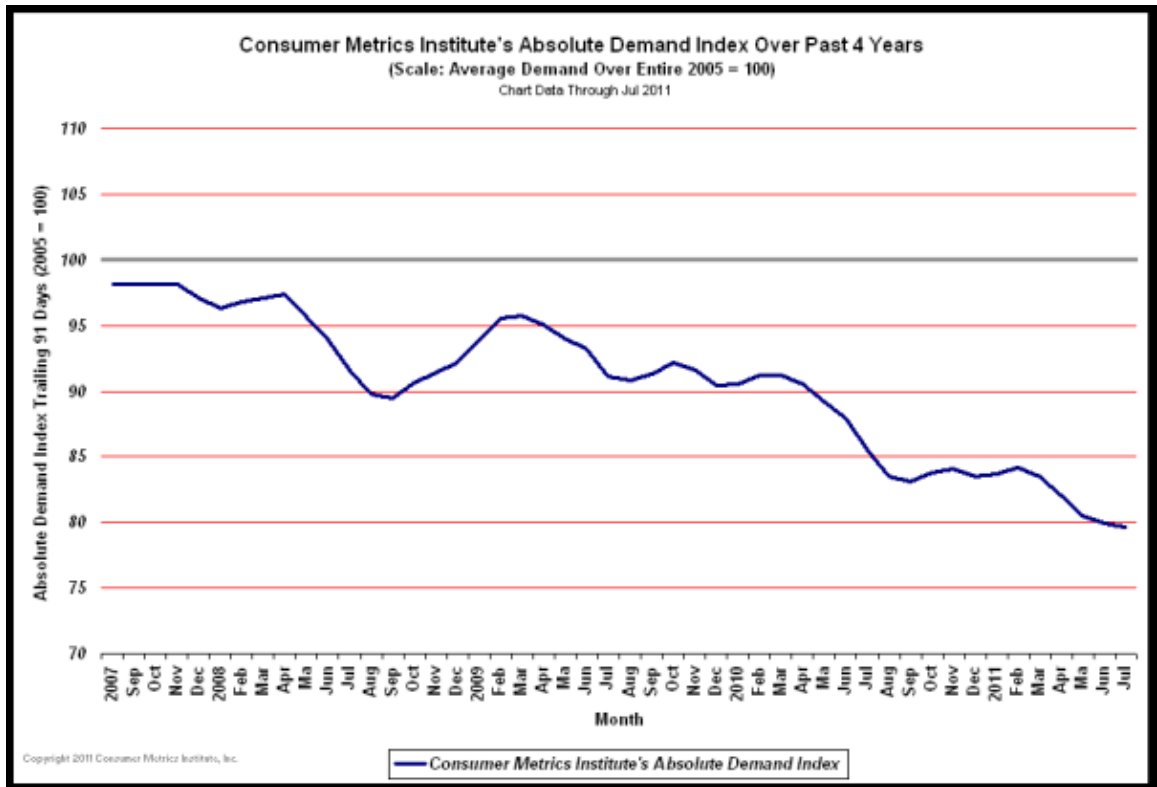


And lest we leave the impression that the improvements have been universal, there are some segments (such as computers) which have not yet shown clear signs of a "sea change":



And lastly, it is important to keep all of this in perspective. It is *very important to remember* that our Daily Growth Index measures year-over-year changes in consumer demand for on-line discretionary durable goods. In other words, *the indexes measure the slope of the demand curve, not the actual demand itself*. When the indexes first cross into neutral territory (a reading of 0 for the Daily Growth Index and 100 for the Weighted Composite Index) it only means that the actual "absolute" on-line demand is no longer getting worse -- i.e., it has just reached rock bottom.

We have previously used the analogy that our indexes measure the slope that a car is experiencing when driving on mountain roads in a fog. Our "car" started down a slope on January 15, 2010. It reached the greatest downward grade on the road over 16 months later in late May 2011. And on August 3, 2011 our "car" reached the bottom of the slope and the forward tilt leveled off. The economic topology we have experienced can be perhaps best visualized from our new "Absolute Demand Index" chart, where the leveling off had just begun to be visible in the July 2011 data:



## Why?

So, back to the bottom line: what is going on here?

The mechanics of the rapid rise in our Daily Growth Index (and its precursor Weighted Composite Index) are at least partly related to the weightings of the housing sector components in the historical NIPA tables from the BEA, especially in years when housing was still an important part of the economy. Any year-over-year improvements in the housing arena will therefore produce significant gains in our weighted indexes. Furthermore, the housing sector was so moribund at this time last year that any signs of life will be a vast improvement.

In that perspective the recent improvements in housing have only transformed it from a *vegetative* state to one where it is merely *comatose*.

It is also important to remember that the measurements that we have are weeks (if not months or a full quarter) ahead of the kinds of data on closings that are widely reported in the main-stream press. Thus the up-trend that we first noticed at the very beginning of July will not show up in most other housing data sources until the end of the third quarter.

But why has there suddenly been an upswing in interest in housing? We can only speculate, but among the many plausible causes are:

-- The U.S. debt ceiling debate caused dire warnings in the media about near-term interest rate

increases. S&P followed suit with a credit downgrade that should have rate implications in a (truly un-manipulated) debt market place. Those dire warnings, if not at least premature, have generally re-enforced the feeling that mortgage rates have only one direction to go: up. Whether that will prove true or not, the mass psyche assumes that now is the time to snatch up bargain priced residential real-estate.

-- The housing bubble actually burst a half decade ago. Since then a full quarter of a generation of young adults has progressed to the stage of household formation. That cohort was too young to get materially harmed by the housing debacle, and they are entering the housing market with pristine credit ratings (thanks to keeping their student loans current) and the desire to take advantage of historically low mortgage rates and housing prices.

-- For the non-housing sectors, we think it is critical to fully understand the impact that gasoline prices have had on discretionary expenditures. Gas prices are down, and most people are reminded of that fact at least once a week at the gas pump. The larger impact of that moderation is that popular fears of run-away inflation have subsided. By early July it became clear that the doomsday projections for summer-driving season gas prices were not going to materialize, and the needs for obsessive frugality subsided. This particular scenario best explains the extreme reversal seen in our demand data between spring and early July.

-- Some have suggested the flip side to the above argument: that increasing frugality among an increasingly distressed populace is driving them onto the web in search of the bargains needed to make ends meet. We freely admit that there are potential biases in our data caused by our use of on-line shopping data, and this could be yet another -- since our algorithms to remove the long term market share shift of commerce from brick-and-mortar to the web are not sensitive to short term spikes of that nature. If this scenario is true, then circumstances for "Main Street" Americans materially worsened in the second quarter.

-- And finally, the reluctance of the banking sector to aggressively pursue new foreclosures ("*what will we do with even more empty houses?*") has led to extended periods of "rent free living" for a growing portion of the cohort of consumers most harmed by the housing crisis. The numbers relating to strategic defaults are murky, but our own "back of the envelope" calculations indicate that as much as \$100 billion per year in consumer cash is being freed up. The implications of this amount of free cash for both retail sales and the bottom lines of those same banks has probably been greatly under-appreciated.

Our bottom line has always been that the U.S. economy is comprised of roughly 100 million household "loose cannons" that will do whatever they think is in their own best interests. Perhaps better than the geniuses inside the beltway.