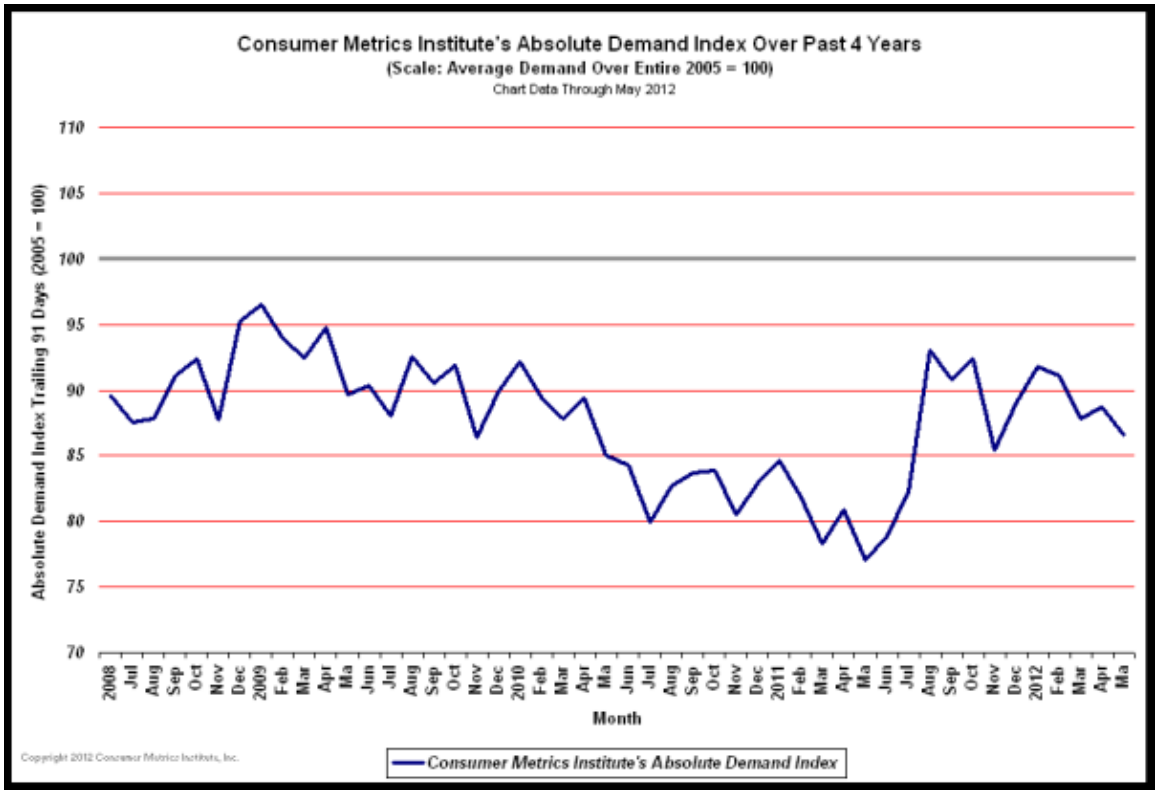
Consumer Metrics Institute Members News

May 9, 2012: Chart Updates and Commentary

We are now approaching the first anniversary of the on-line consumer behavior shift that our year-over-year charts have been reflecting since very late second-quarter 2011. The shift can be clearly seen in a number of our longer term charts, but the best perspective is provided in the chart of our Absolute Demand Index for the past 4 years**:**



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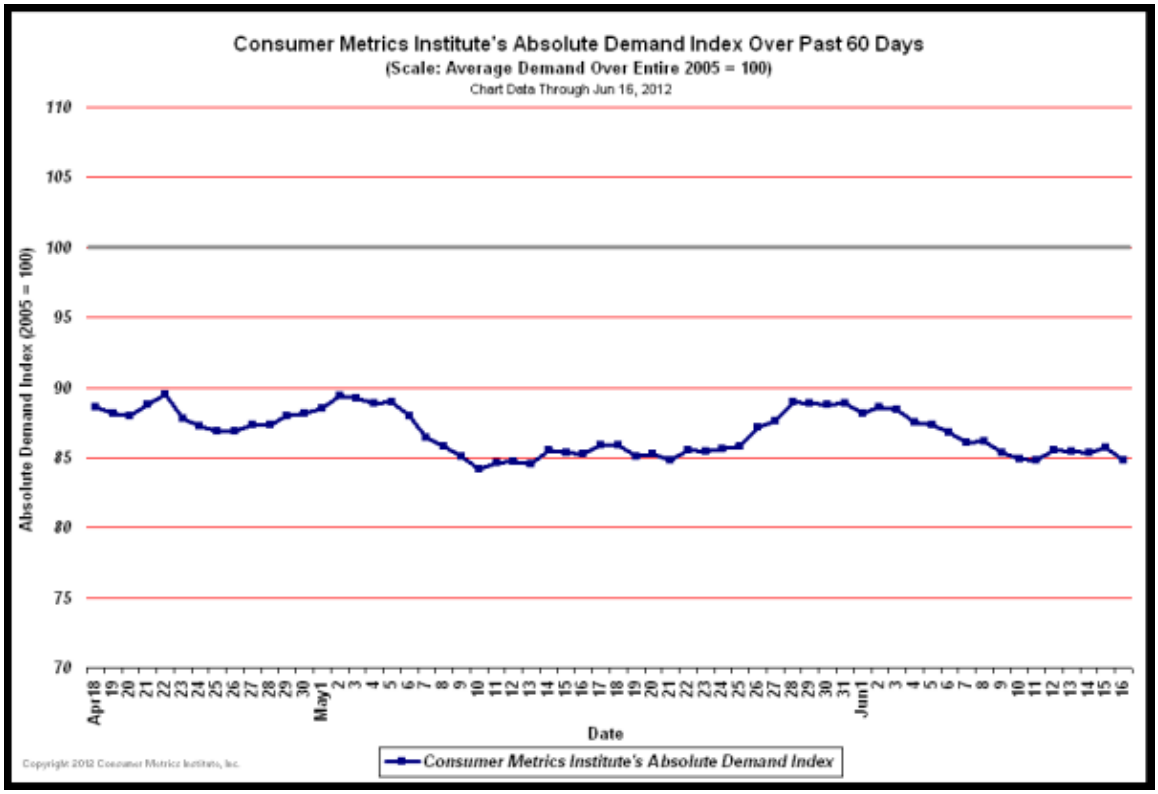
Something clearly happened to the consumer spending patterns that we measure late in the second quarter of 2011. In a span of a couple of months our Absolute Demand Index recovered from truly abysmal levels to something more reminiscent of the second half of 2009 -- and it has more-or-less plateaued at that level now for the better part of a year. The critical perspective point is that the "plateau" level straddles the 90 line in our chart, meaning that the levels are at about 90% of the average level of our base-line "pre-recession" year of 2005 -- a level that has persisted even to the most recent days**:**



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We have struggled in a number of our newsletters to fully understand a simple question**:** where did the money for the late 2Q-2011 spending splurge come from? Given that real per-capita disposable income contracted over that time span, the likely other sources for the money funding the late 2Q-2011 upturn included**:**

-- Gasoline prices at the pump declined by nearly $.75 per gallon between the middle of May 2011 and the middle of December 2011. Since roughly 140 **billion** gallons of gasoline are consumed by U.S. drivers each year, this price decline increased annualized discretionary cash available to U.S. households by slightly over $100 **billion**, not exactly chump change and over 8% of the aggregate annualized consumer spending on discretionary durable goods. It is notable that gasoline prices bottomed in mid-December and that most of the $.75 decline reversed during 1Q-2012.

-- We continue to believe that "strategic defaults" and the vastly extended time-frames for involuntary foreclosures has pumped much more money into the consumer discretionary sector than is commonly realized. If there are approximately 4.5 million "non-performing" pre-eviction mortgage loans in the U.S., simple arithmetic (assuming an average pre-default payment of $1,500 per month) indicates that $81 billion per year is currently available for discretionary expenditures that was not available prior to the "mortgage crisis." This represents about 6% of the aggregate annualized consumer spending on discretionary durable goods. Some sources suggest that the 4.5 million number could well double over the course of the next two years, bringing the freed-up consumer cash to over $150 billion per year. This would provide a 1% upward bias in the raw GDP numbers -- since the flip side of the defaulted cash flows is not fully reflected in the gross domestic "product" numbers.

-- Only one category of loans reported in the Federal Reserve's G.19 report has increased

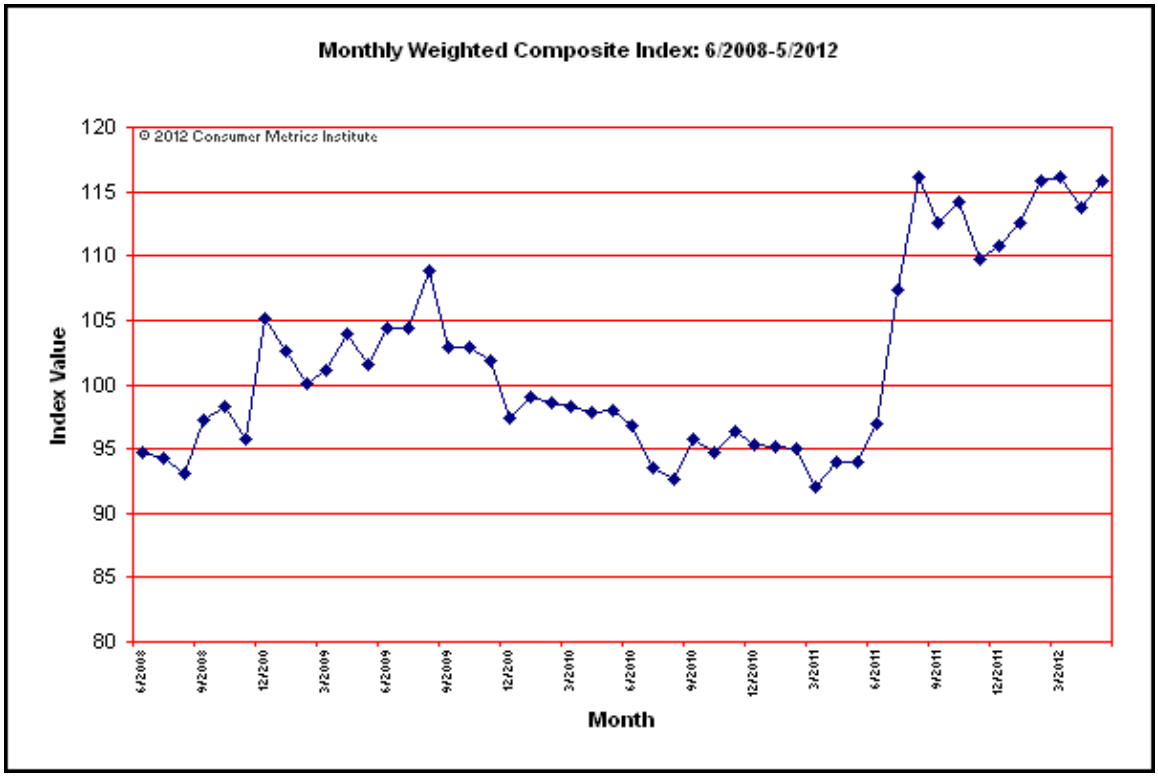
dramatically both during and since the "Great Recession": student loans. We suspect that many students are staying in school (or returning to school) for what are actually "economic reasons" (i.e., lack of employment opportunities). We further suspect that a significant number of expiring unemployment benefits have defacto morphed into extended student loans. Whatever else students may do, they spend money and access their non-dis-chargeable loans -- resulting in a year-over-year increase in student loans of a staggering $105 billion.

-- Savings rates that soared at the onset of the "Great Recession" have recently plummeted. We believe that extended crises cause sequential changes in consumer behavior, and this particular event is no exception. Consumers who initially deleveraged or raised "rainy day" funds have likely already reached their goals. Those needing to change their lifestyles have already come to terms with their new lots in life. But at some point in time, unrelenting frugality simply becomes unbearably tedious. Whether you consider it increased comfort with (or acclimation to) distressed circumstances or simply "frugality fatigue," it doesn't require a fundamental change in household economics for consumers to eventually increase/revert their spending into the neighborhood of the pre-crises norm. Nor does it take anything more than returning pessimism to cause that spending to shrink once again.

-- We also believe that the 100 million or so U.S. households are to some extent economic "loose-cannons" doing whatever makes the most sense for them. And they are not idiots. They will adapt to new life-styles and/or new coping strategies during protracted economic downturns. One of the coping techniques may have been increased searching for bargains on the internet (a behavior change that could shift commerce to the web faster than our proprietary market-share normalization metrics can accommodate). They will also "game" the economic system in whatever ways their consciences allow (e.g.: the previously mentioned mortgage defaults and income-augmenting student loans, plus early "retirements" and the increased gaming of disability rules to optimize social "safety net" transfer payments). If consumers continue to be hammered by the economy, we risk far more than financial Japan-ization -- we also risk a serious Mediterranean-ization of entitlement mentalities and strategies.

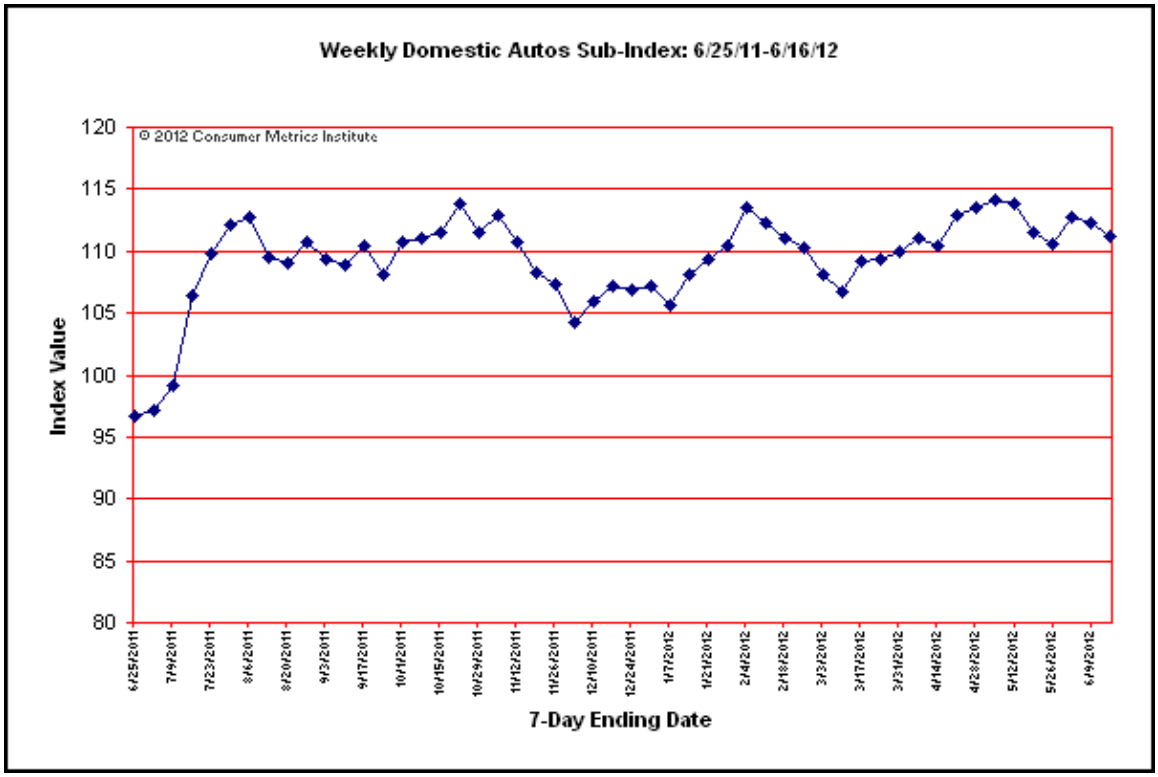
Updated Charts

The consequence of the late 2Q-2011 surge in consumer on-line demand for discretionary goods is that the raw values of our year-over-year metrics look outstanding when compared to dismal prior year numbers:

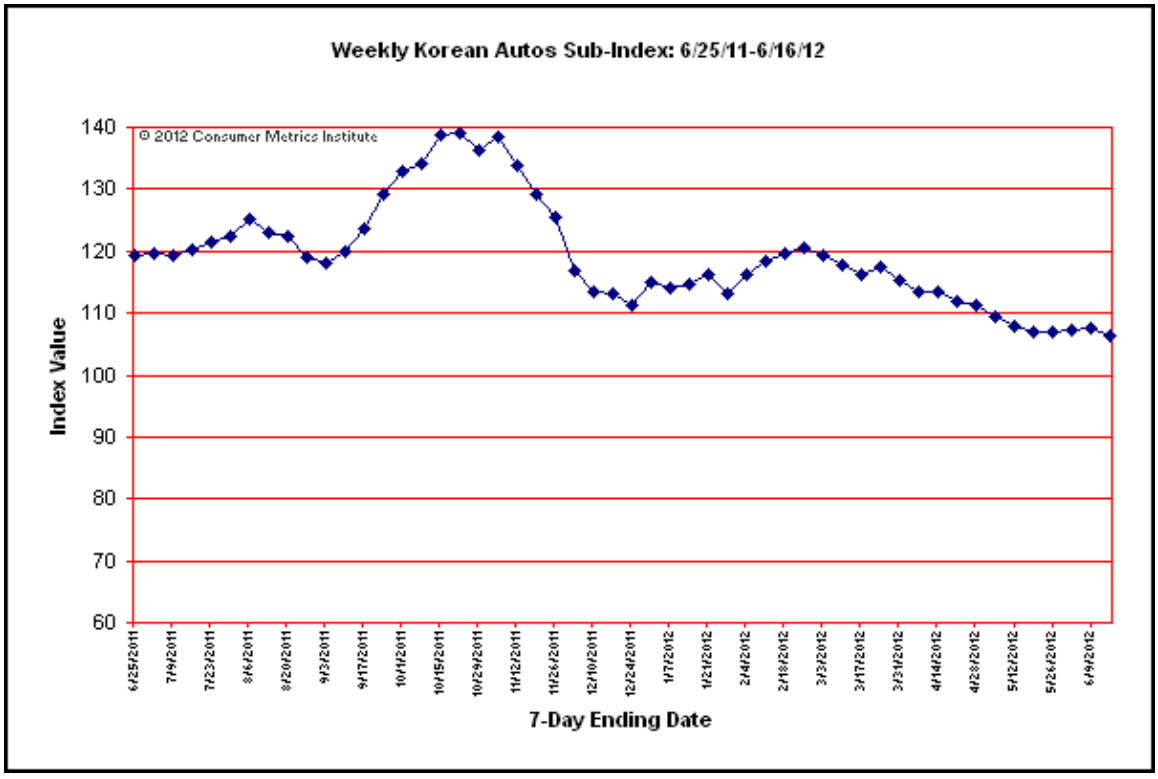


That said, the extremely favorable year-over-year comparisons cannot fully account for all of the upward movement -- leaving somewhere between 5% and 10% as residual year-over-year growth that requires some explanation (e.g., gasoline prices, strategic defaults and student loans). Collectively, those three previously mentioned sources could have accounted for a national cookie jar containing $285 billion annually in spendable cash -- as much as 20% of annualized consumer durable goods expenditures ($1,375 billion annualized, per the BEA's 1Q-2012 estimate). While some of that cash was needed to offset a continued shrinking of real per-capita disposable income, some certainly found its way into spending patterns -- especially since personal savings rates were dropping over the same time spans.

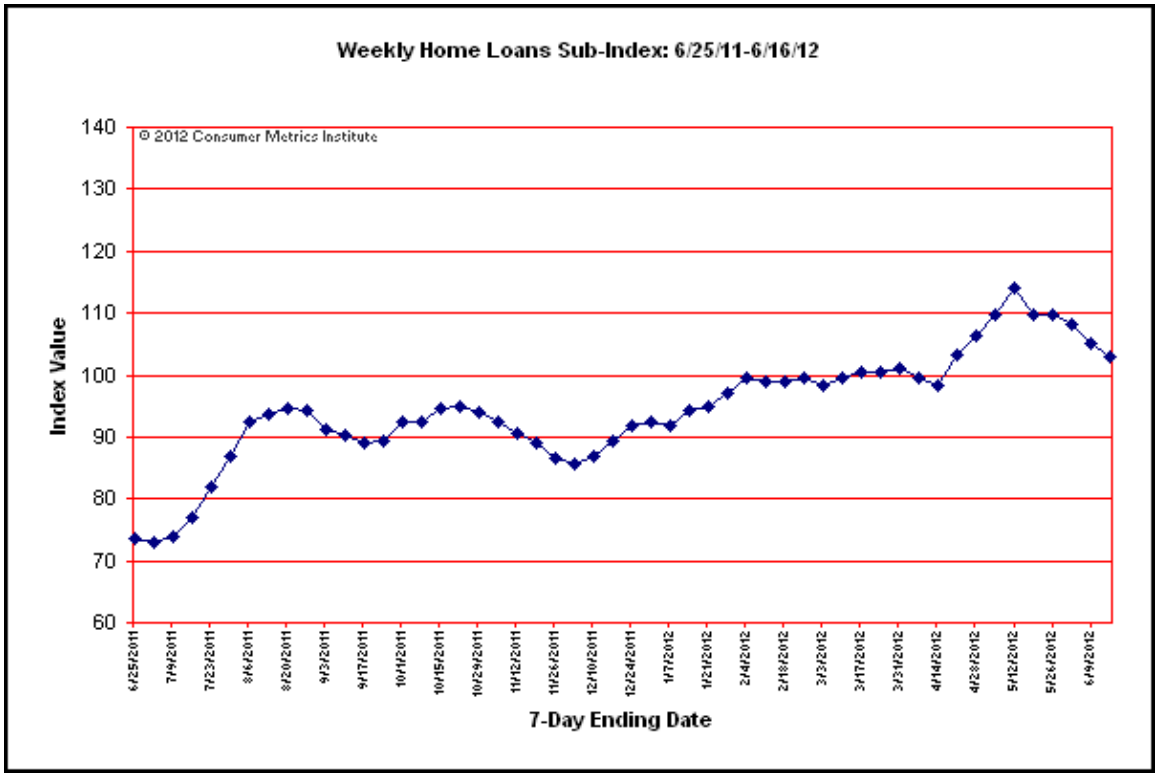
Essentially all of our charts have shown favorable year-over-year comparisons during the past year. One of the charts having interesting patterns during that time is the graph of Domestic Autos**:**



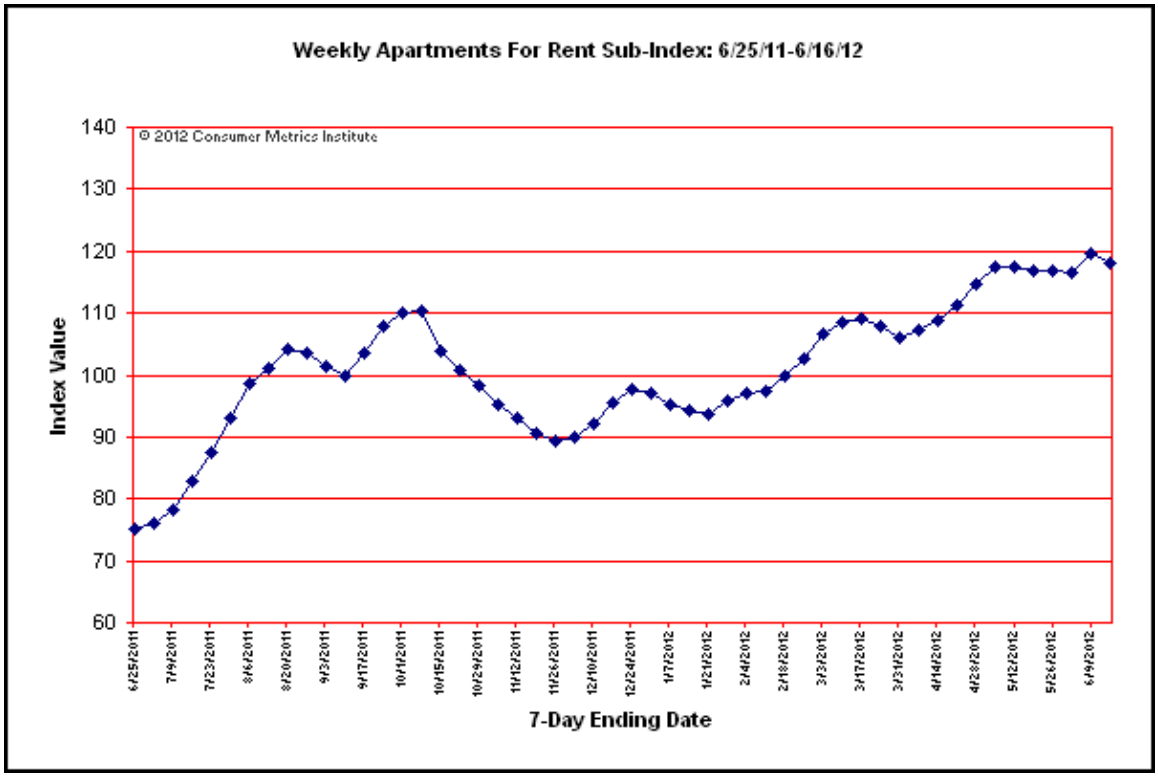
A significant portion of this gain in Domestic Auto demand has come at the expense of decreasing the (still substantial) year-over-year growth in the Korean badges, possibly as a result of the maturation of generation "Y" & "Z" market preferences**:**



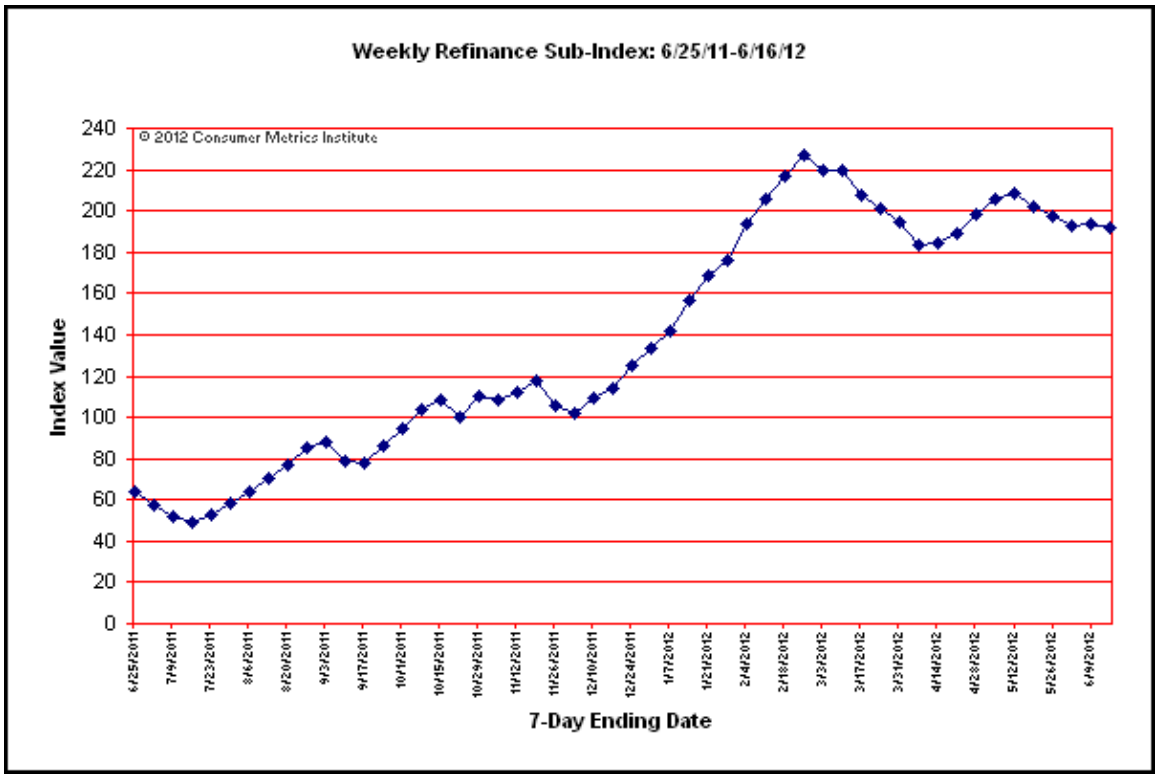
But our Housing industry indices have crawled back into respectability -- and here the effect is truly one of highly favorable comparisons against historically pathetic prior-year numbers**:**



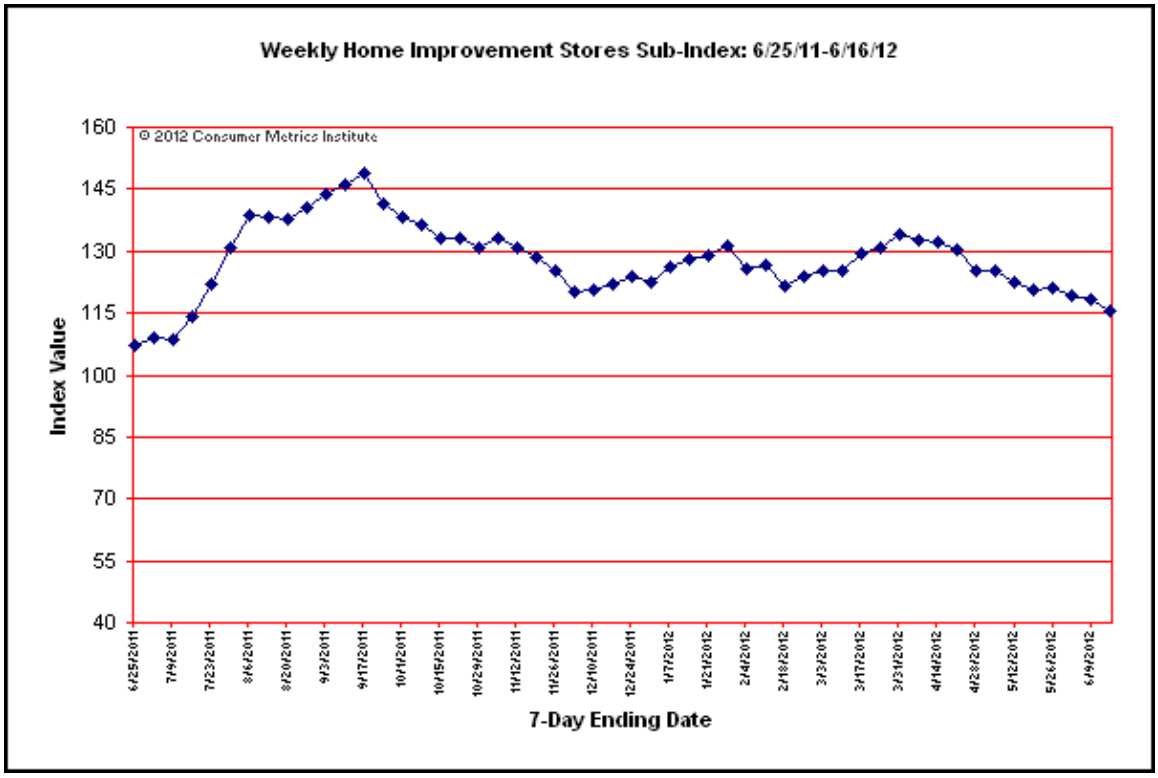
The dismal state of most real-estate markets continues to dramatically benefit rental housing -- with growth levels exceeding those of home loans**:**



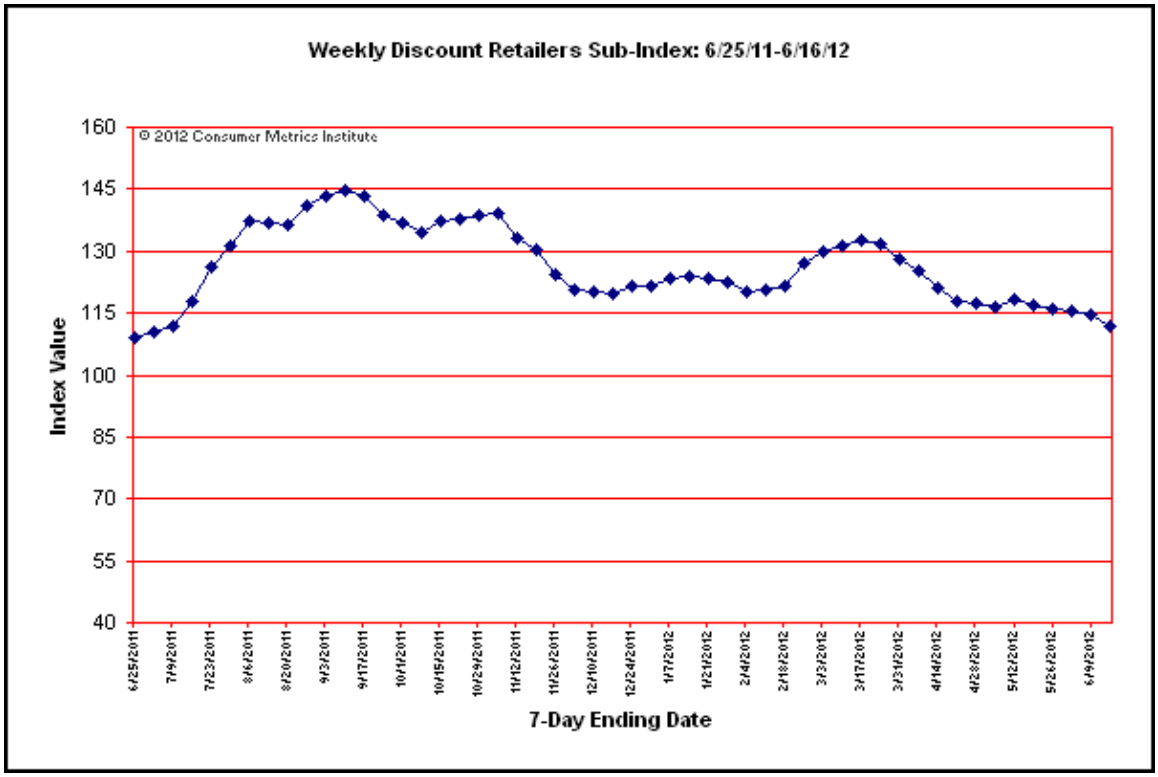
Meanwhile, late last year we had concluded that nearly anyone with both untarnished credit and favorable current loan-to-value ratios had likely already re-financed. That reading was clearly premature, as persistent low rates have continued to draw a new waves of activity**:**



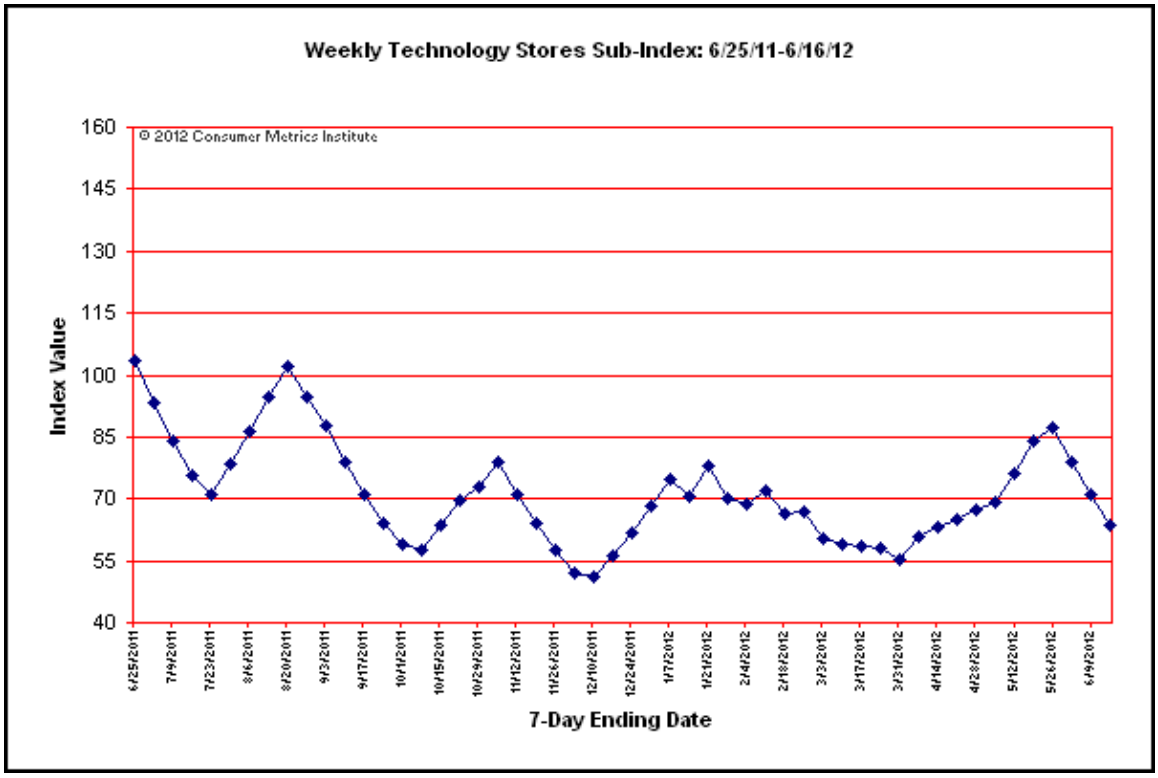
Retailers have generally also benefited from the upturn, with Home Improvement Stores showing strong year-over-year demand**:**



And discounting general retailers reflecting essentially the same pattern**:**



But not all retailers are feeling the same levels of consumer love, with the Technology outlets suffering from serious consumer apathy between brief activity spikes tied to new product releases**:**



For some time we have thought that the timing of price movements at the gasoline pump was the single most plausibly correlated cause for the late 2Q-2011 upturn in discretionary spending. As we approach the anniversary of whatever benefit that year-ago price drop provided -- and as the benefits of that price drop have now reversed -- we should see our year-over-year comparisons begin to return to more normal territory. But our real message is that the favorable year-over-year comparisons need to be kept in perspective, especially in the perspective provided by our Absolute Demand Index shown in the top two graphs of this newsletter.
