Consumer Metrics Institute Members News

March 19, 2013: Looking Back and Projecting Forward

(Web page version is here)

When we last looked back at our data for US consumer behavior for the end of 2012, we included comments on two phenomena directly visible in our data**:**

-- On a day-by-day basis we could see that the initially promising "Black Friday" retail sales had not been sustained throughout the balance of the holiday season. In retrospect the promising early sales merely pulled deeply discounted transactions forward from the traditional heart of the holiday season. At that time we suspected that households were being cautious in their spending (especially those requiring short-term revolving credit, e.g. credit cards) as tax hikes loomed at the first of the new year -- hikes that we calculated would further decrease real disposable income by upwards of 2% (roughly $130 billion annually, or the equivalent of 10% of durable goods spending) and remove 1% of growth from the already stalled GDP;

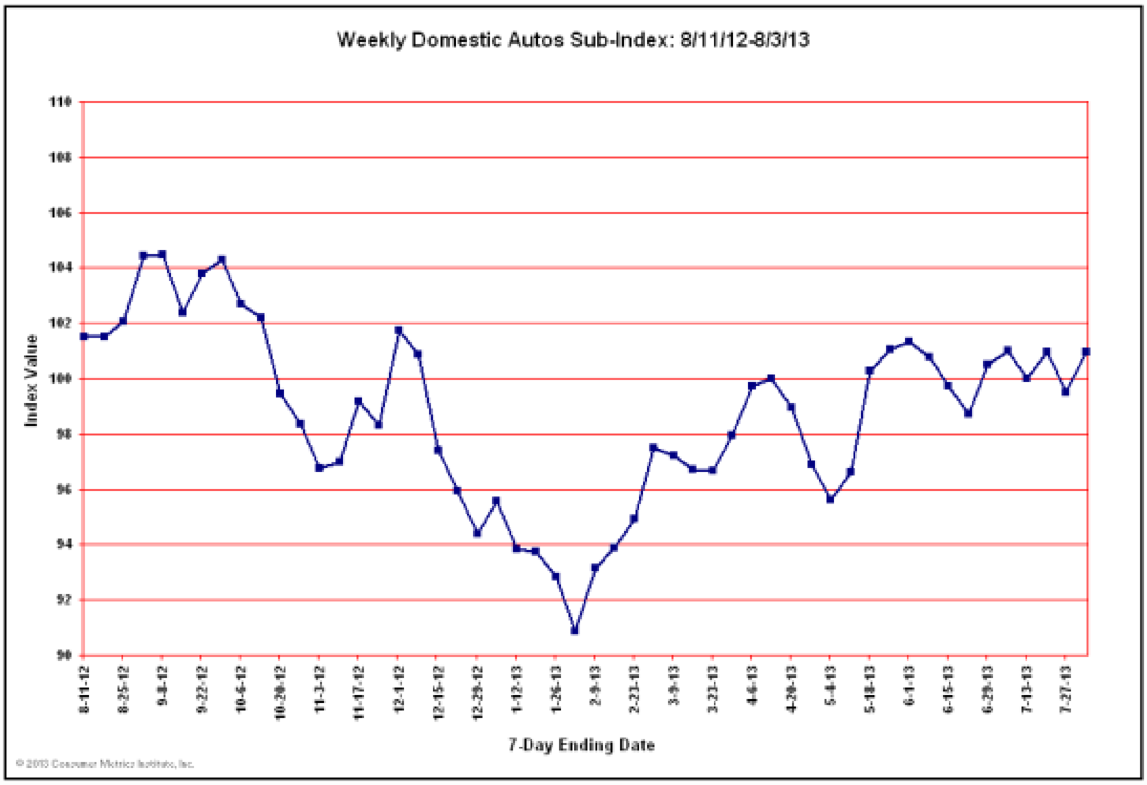
-- And we were surprised that the (now long forgotten) significant ***drop*** in gasoline prices during the fourth quarter had not spurred any measurable upturn in durable goods spending. We reminded readers that each penny of change in gasoline prices alters non-discretionary spending by U.S. consumers and businesses by an annualized $1.3 billion, and that by that time we should have been seeing some evidence of the $50 billion or so (annualized) in newly available discretionary funds being spent. In a similar situation in late 2008 we did see a dramatic surge in discretionary expenditures as gasoline prices dropped -- a surge that the mainstream media first noticed as retail "green shoots" a full quarter later during the spring of 2009. In late 2012, however, our data reminded us on a day-to-day basis that no such similar upturn was happening.

In an effort to understand the paucity of discretionary spending, we speculated then that the (since reversed) late 2012 fall in gas prices was "too-little/too-late" for consumer holiday budgets already strapped by declining real household disposable income -- although in retrospect perhaps we should have given households more credit for being smart enough to know that sharply falling pre-election energy prices were too good to be true. We might also have guessed that by 2012 consumers have become deeply skeptical about the longer term trajectory of the economy, and far less likely than they were in 2008 to quickly spend any new-found windfall.

(We should also note that we have recently suggested that the subsequent $.50 per gallon rise in gasoline prices has plausibly sucked an additional $65 billion in annualized discretionary spending out of the economy relative to the already stalled 4Q-2012 -- the equivalent of 4.6% of consumer durable goods spending, and possibly causing an additional 0.5% decline in GDP growth. But some might argue that this is simply projecting the flip-side analog of a spending pattern change that clearly didn't materialize when gas prices were dropping -- i.e., consumers may have become acclimated to the gasoline price roller coaster and don't alter spending materially as a consequence of gasoline price fluctuations. Although some of that is likely, we also suspect that households battered by 5 years of stagnant or declining real disposable household income -- and "deeply skeptical about the longer term trajectory of the economy" -- react asymmetrically to the roller coaster ride by stashing away occasional windfalls and increasing frugality when feeling renewed pain at the gas pump. Increased household savings rates during

4Q-2012 -- up about $132 billion annualized, or roughly 1% of GDP -- and our charts below give some credit to our asymmetric suspicions.)

We are now over two and a half months into 2013, and what can we conclude about the consumer portion of the economy during the first quarter? The answer from our data is clear**:** at least the households that we monitor remain reluctant to spend on durable goods. This can be easily seen in the following chart of weekly consumer interest in domestic auto brands over the trailing year (where an index level of 100 represents no change in year-over-year consumer demand)**:**



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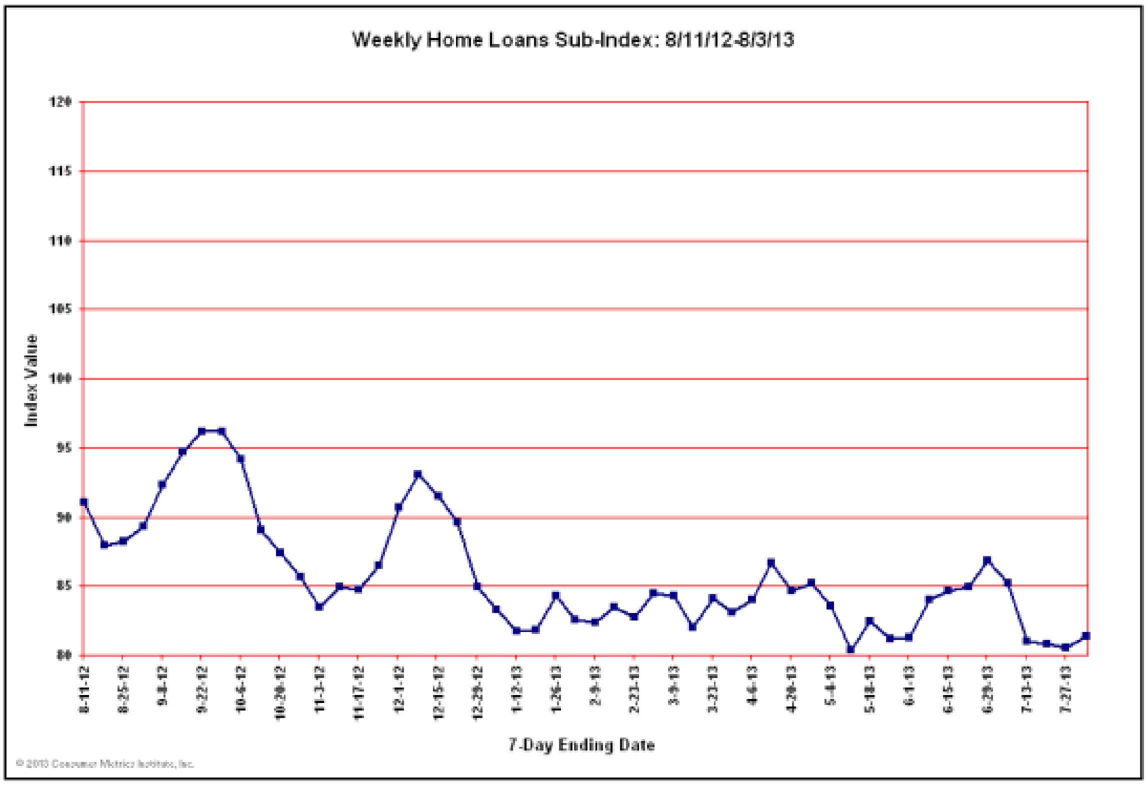
And automobiles are not the only products experiencing consumer reluctance. As an additional example our data indicates that firming housing prices and increasing housing starts may be a delayed and overly optimistic reaction to last spring's sharp upturn in consumer interest in residential real estate -- and a reaction that may ultimately be viewed as premature in light of more recently fading consumer interest in new loans for the acquisition of new homes**:**



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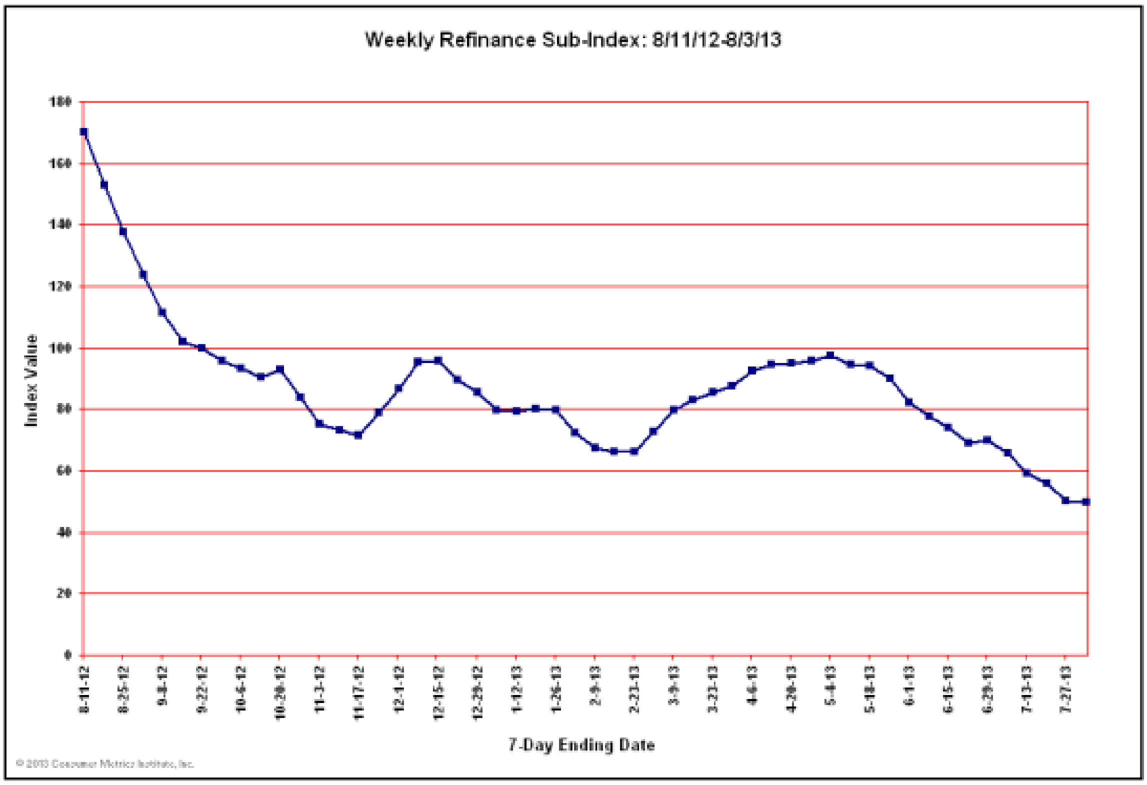
Of equally fundamental interest to us has been the binge in home refinancing over the past several years. In an era of stagnant (if not decreasing) real household disposable income, we have tried to understand the funding sources that have sustained consumer spending. One of those critical sources has been home mortgage refinancing, which has added hundreds (or many hundreds) of monthly disposable dollars to those households fortunate enough to have been in a position to refinance. In aggregate we have estimated that refinancing activity has freed up over $50 billion in annualized household cash (or about 4% of annual US durable goods expenditures).

Fortunately for those lucky households, that $50 billion per year is a recurring reduction in non-discretionary monthly outlays. And for the consumer economy as a whole the resulting transfer of spending from non-discretionary to discretionary (and from the purely financial portion of the economy to the more conventional consumer portion of the economy) has been growing dramatically over the past several years. But that growth has now run its course as most households with refinancing eligibility have clearly already done so**:**



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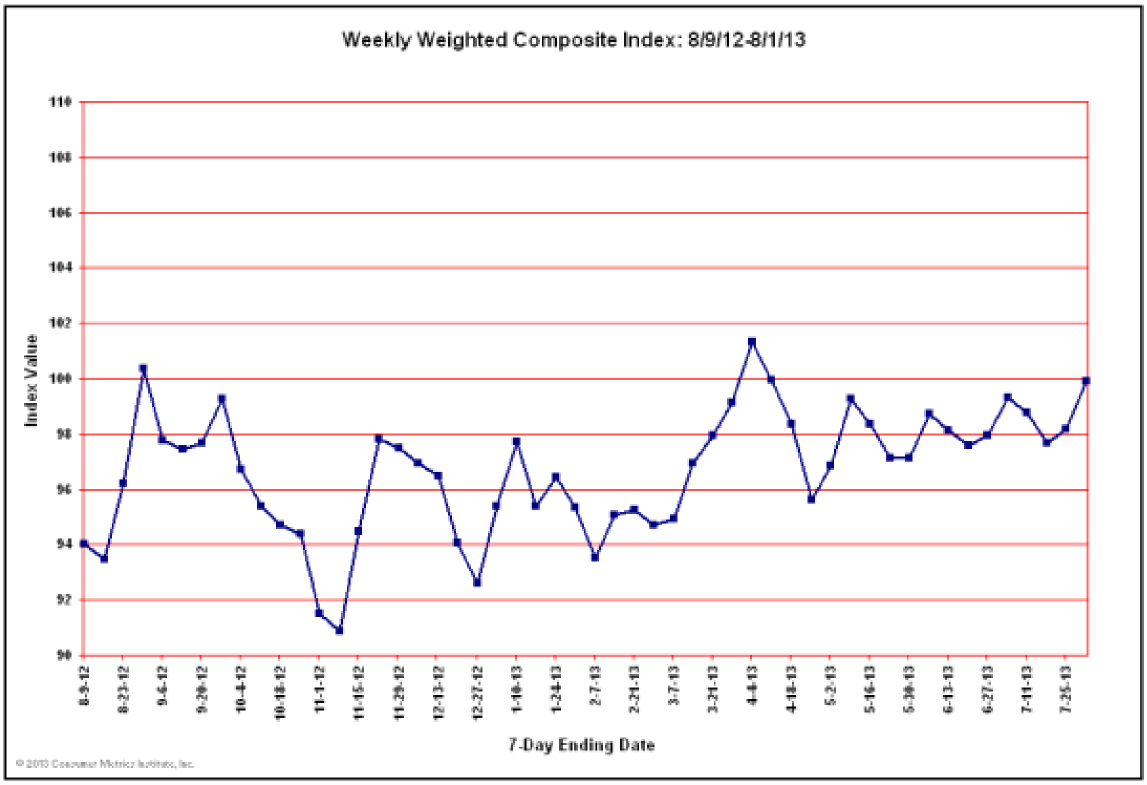
The bottom line for economic growth is that refinancing (plus non-performing mortgages, whether strategic or otherwise) have transferred cash flow streams from the non-discretionary financial sector to more traditional discretionary spending on consumer goods and services. Those transferred cash flow streams have initially shown up as growth in consumer spending -- growth that has now likely run its course.

Taking a broader look at the consumer economy, our "Weighted Composite Index" shows a similar weakness that began in the third quarter of 2012 and has persisted since**:**



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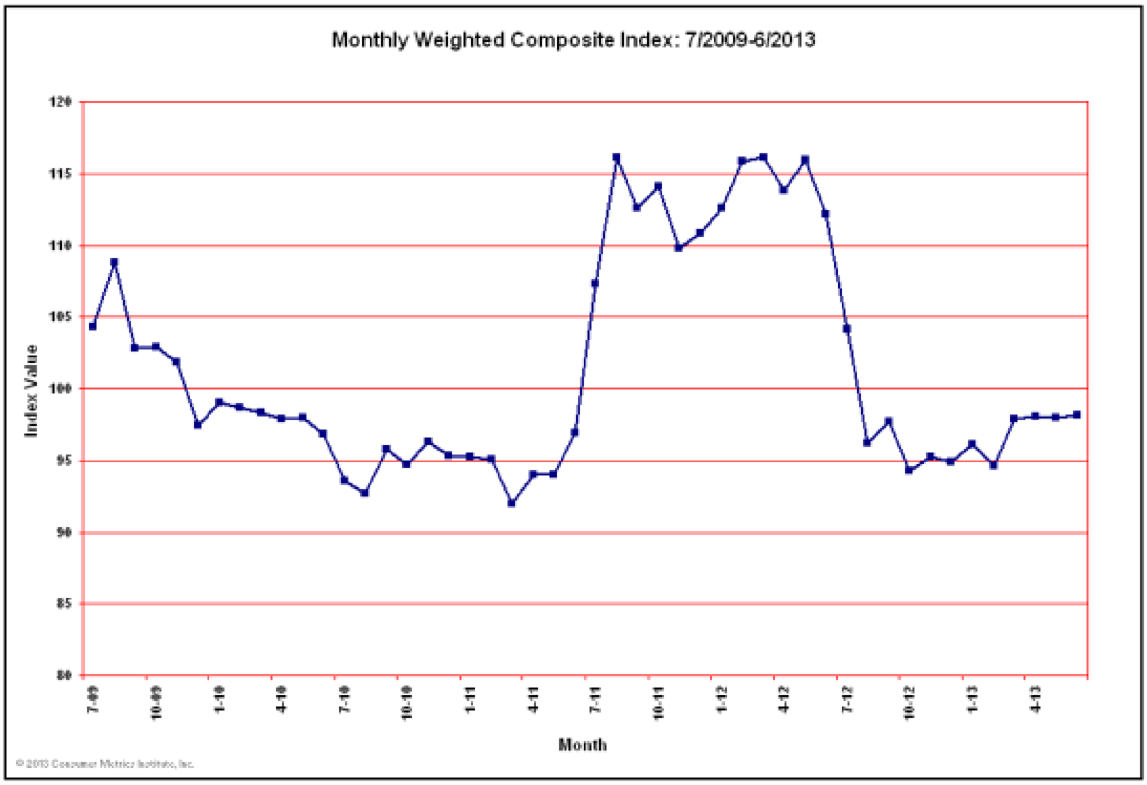
Looking at that same index over a longer time span brings into focus the one-year spurt of consumer activity that commenced during the summer of 2011 but has faded over the past 9 months**:**



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The shape and timing of the above one-year spurt should not be a surprise, especially to people who recognize the headwinds faced by the economy as a result of the re-normalization of the FICA tax rates. In fact it is hard to account for that one-year spurt without invoking to some extent the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010" (TRUIRJCA-2010). That stimulus package was passed in December 2010 and it included a temporary 2% reduction in the FICA tax rate (which just lapsed, effective January 2013).

The re-normalization of the FICA tax rates will remove upwards of 2% from disposable household income -- roughly $130 billion annually, or the equivalent of 10% of durable goods spending (and 1% of GDP). It follows then that the corresponding initial reduction in FICA tax rates in early 2011 had the reverse effect, adding $130 billion in annual disposable household income and boosting discretionary spending by a similar amount. And there are two "take-aways" from the timing and shape of the spurt in the above chart**:**

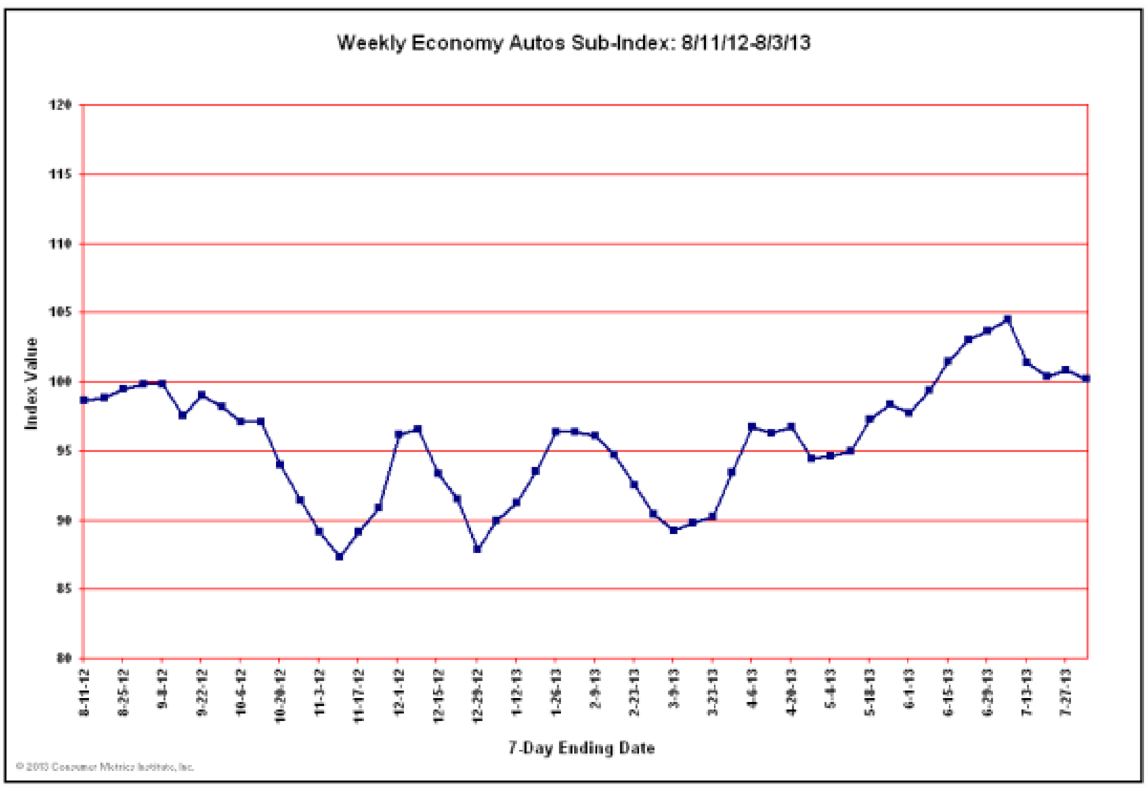
-- First, there was a roughly six-month lag between implementation of a tax reduction and the subsequent increased spending. Households initially absorbed the benefits of the tax cut (increasing the 1Q-2011 savings rate by an annualized $50 billion) for about six months before acclimating to the windfall and changing their spending behavior.

-- And secondly a growth-rate mathematical reality**:** when looking at GDP growth (or viewing year-over-year data as in the chart above), the effective lifespan of the growth-rate boost from a simple consumer rate-change stimulus can obviously be only one year. After that first year the tax cut is no longer contributing to year-over-year growth (or year-over-year changes in spending) and has become part of the new baseline spending pattern -- i.e., there are no compounding or productivity gains from the stimulus that will contribute to ongoing growth.

The shape and timing of the one-year spurt are a smoking gun for TRUIRJCA-2010 being the source of the spending binge. It also does not bode well for the coming summer when the inverted image of that spurt (from the January 2013 hike in the FICA tax rate) should begin to show up in the above chart. With apologies to Bette Davis**:** Fasten your seatbelts. It's going to be a bumpy summer.

Updated Charts

Below are some charts that expand on the themes presented above. First, a look at the automotive lull in more detail -- starting with the Economy models**:**



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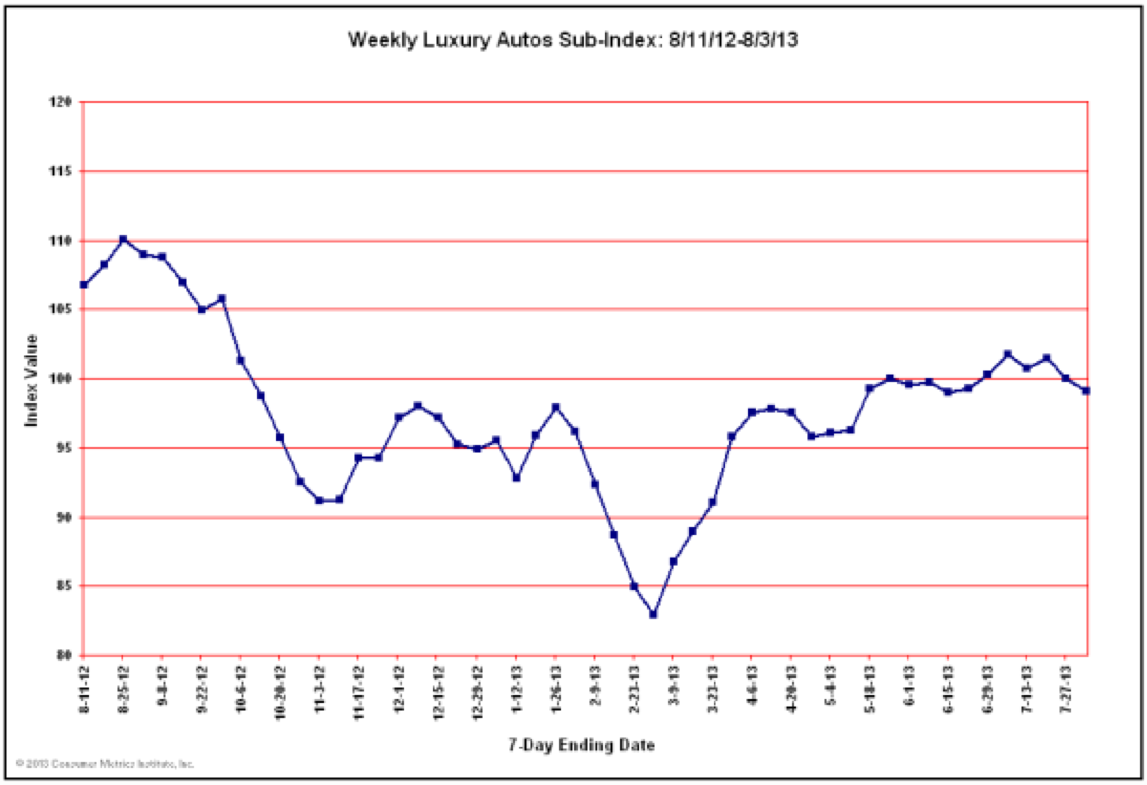
From the above it is clear that consumers are hurting broadly, and not just shifting buying patterns to less costly cars. But consumer interest in Luxury brands is also taking a hit**:**



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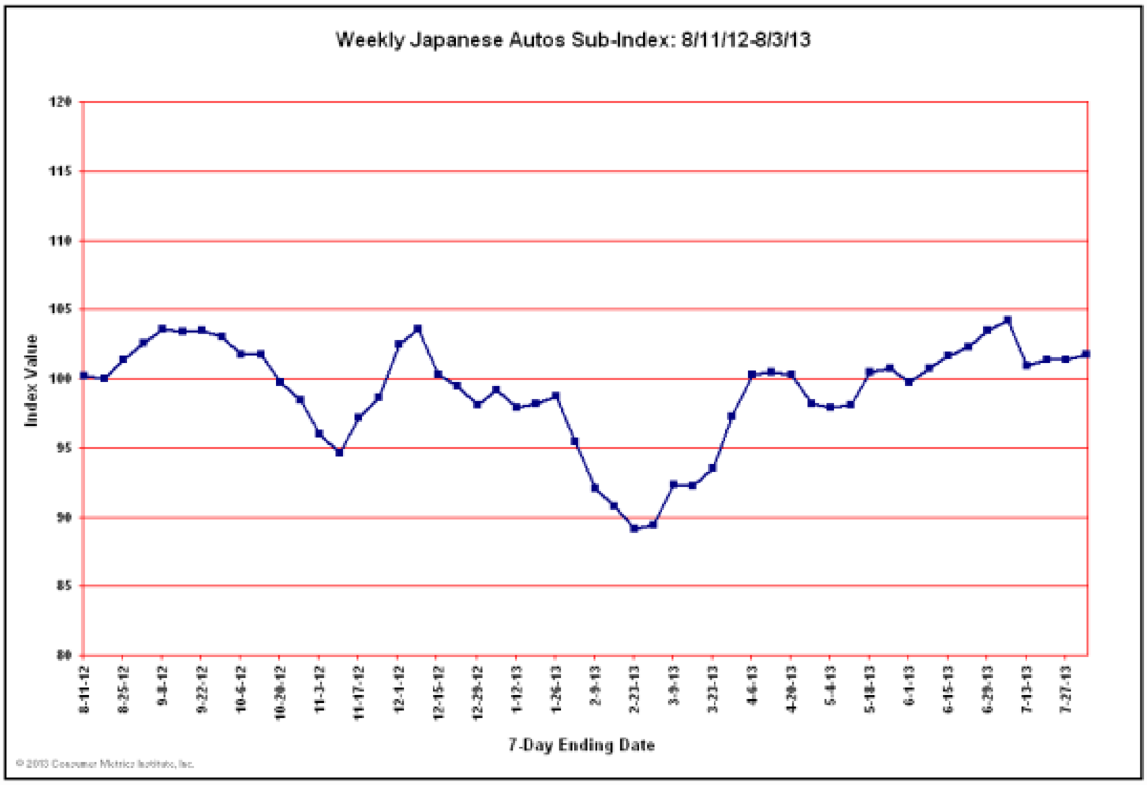
Historically the Luxury brands have weathered economic downturns better than any other category, but this time around the lull in interest is broadly shared by all segments of the market -- including the traditional Japanese brands**:**



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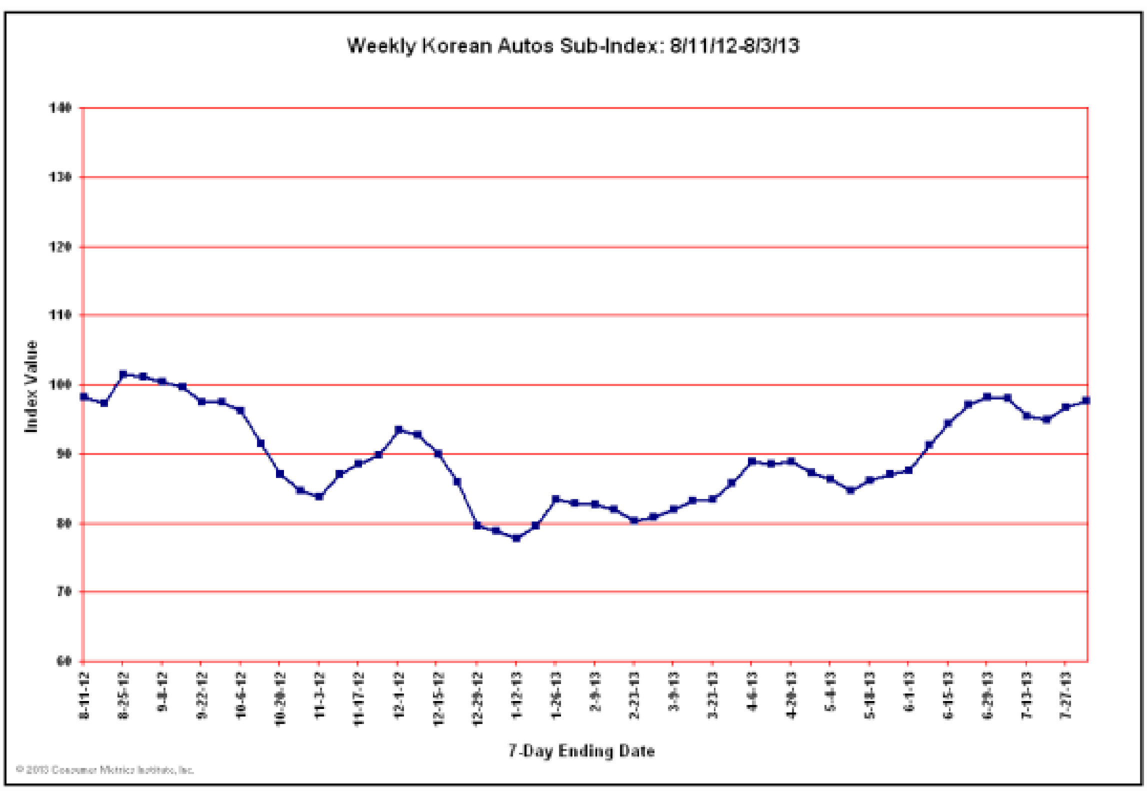
And the more recently ascendant Korean nameplates**:**



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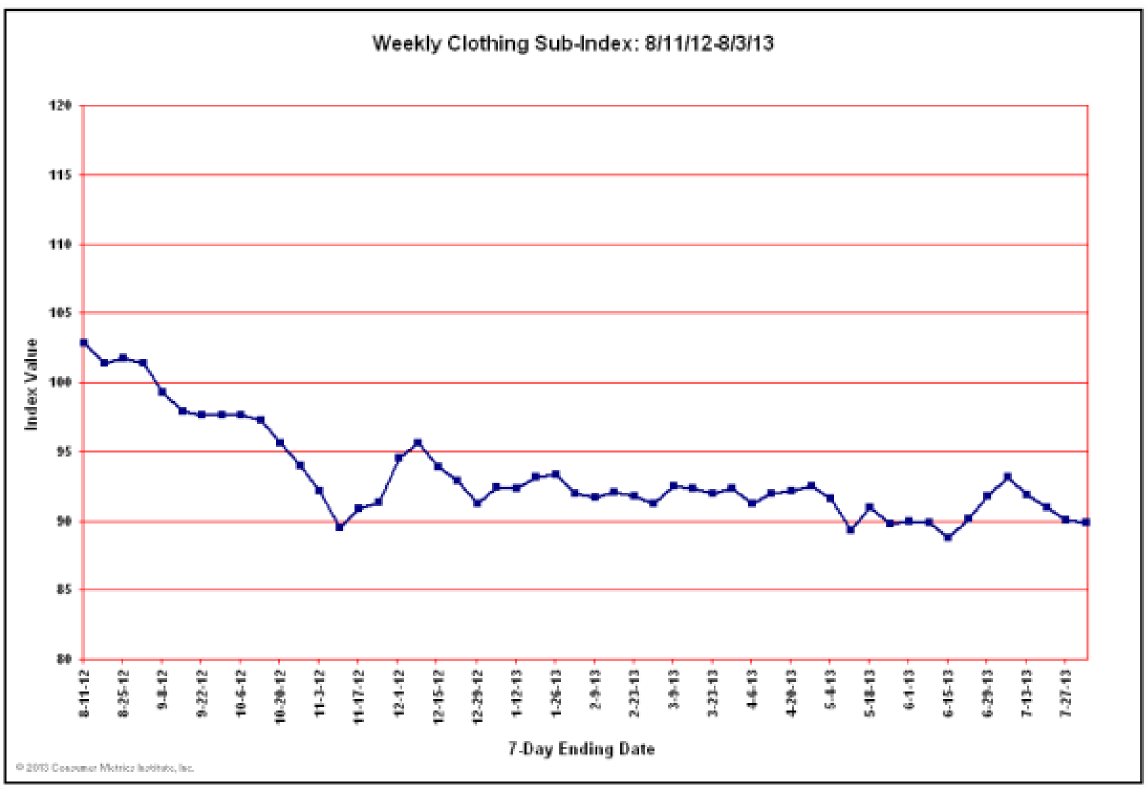
The above chart is in some ways startling, since it is an extreme reversal of the multi-year trend in consumer interest in Korean manufactured autos. We had previously speculated that the rise in the Korean brands represented a generational transition driven by demographics -- i.e., the Boomer loyalty to Japanese brands was being overwhelmed as Generations "X" and "Y" (plus their successors, the "Millennials") opt for favorably priced Korean brands as their starter "new" vehicles. The above chart, however, hints at some level of saturation in the Korean auto marketplace that demographics alone cannot explain.

We have also seen a drop-off over the past six months in a number of products, including Apparel -- which seems to have benefited greatly from the TRUIRJCA-2010 one-year spending spurt described above**:**



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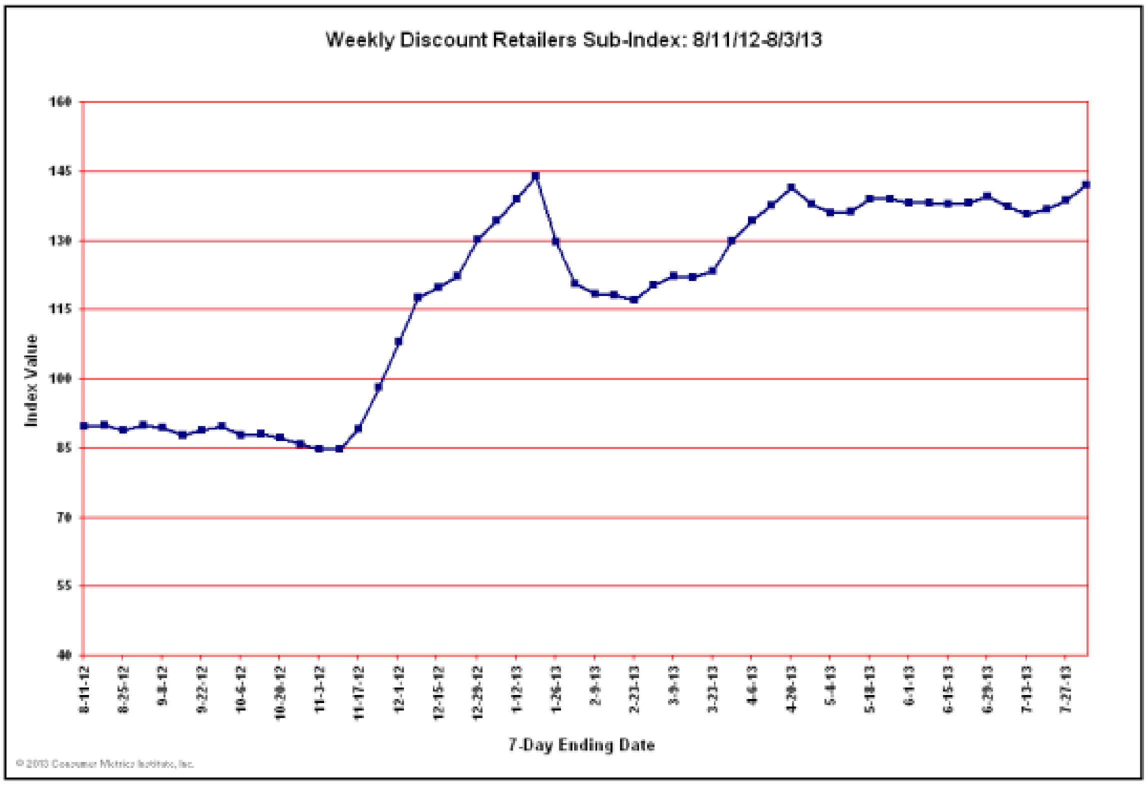
But the most interesting data comes from the retailers themselves. We think that Walmart's February concern about vanishing customers is simply an extension of the overall trend, although our data indicates that Walmart may be better off (and perhaps better informed) than some of their peers. First the Discount Retailers, of which Walmart is a key component**:**



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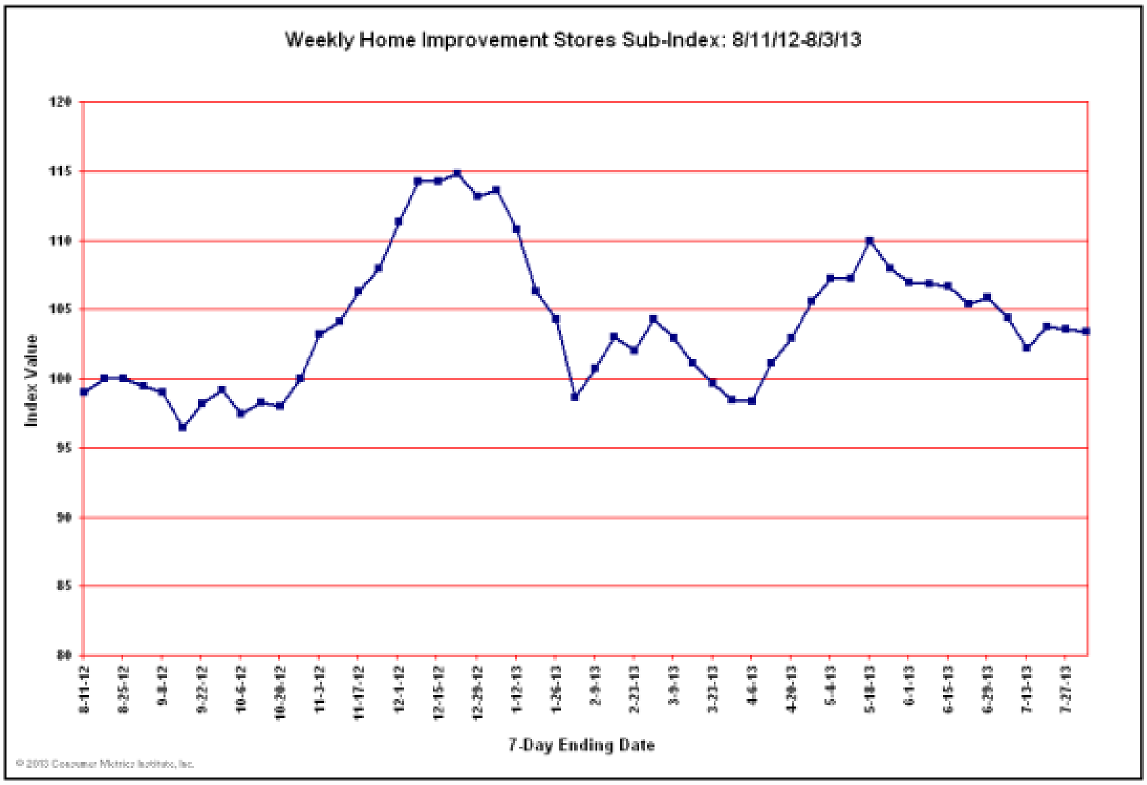
The fall-off into February is every bit as spectacular as the Walmart executives would indicate, but at least the Discount retailers had experienced some market share gain leading up to February (and are still showing year-over-year gains). And the Home Improvement segment has also shown some notable softness of late, although they saw the most clearly defined holiday bump of all the retail categories**:**



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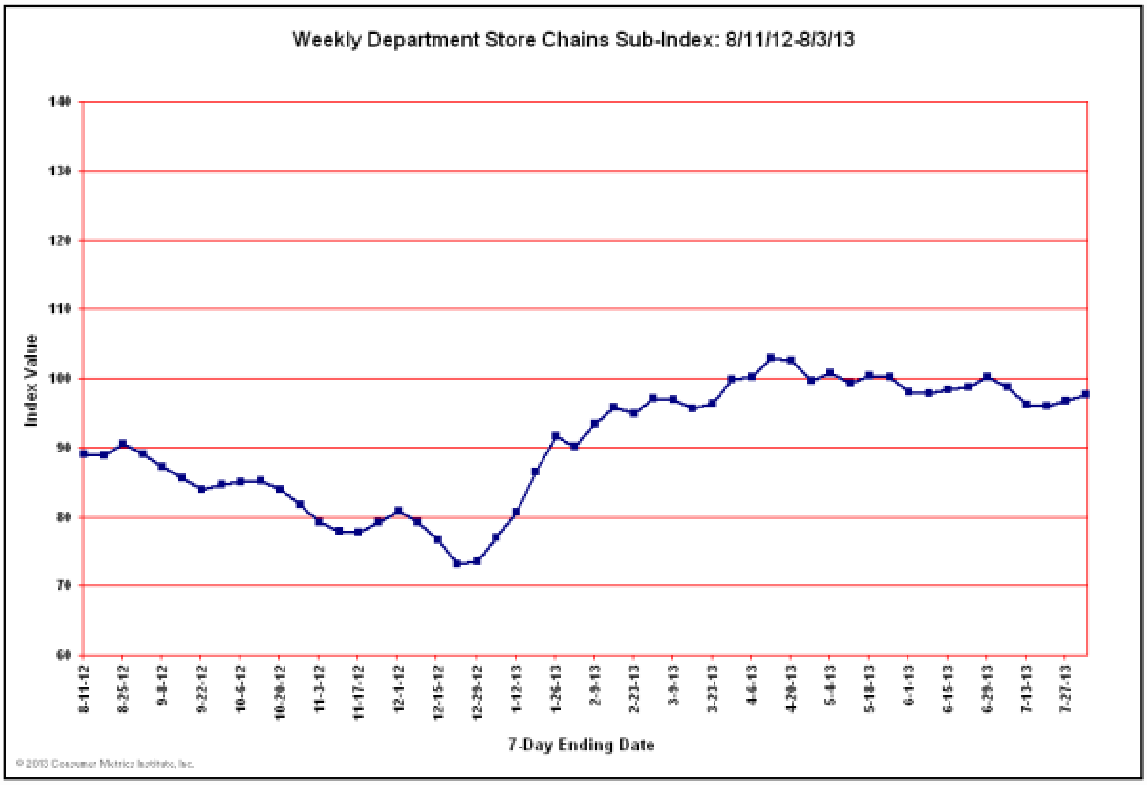
The major conventional Department Store Chains have remained extremely soft, although in some regards that is still an improvement over the holiday season**:**



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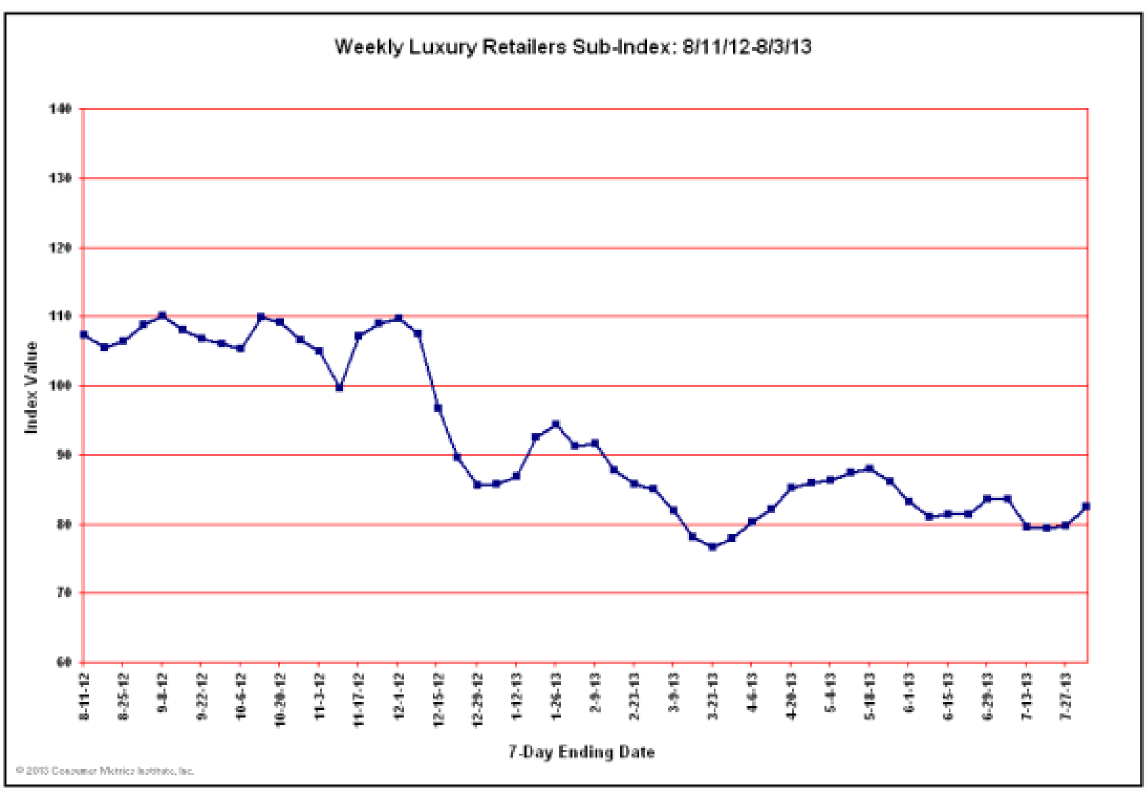
But the most interesting of the retail group are the traditional "Luxury" chains**:**



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Not unlike the Luxury Autos, the Luxury Retailers have historically been particularly resilient when faced with economic downturns. This time around the pain -- or economic cynicism -- seems to be universal.