



Is Consumer Spending Signaling a Recession?

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Have consumers stopped spending?

Consumer spending comprises 71% of GDP, so even a small decline in spending can wipe out growth in other parts of the economy, sending overall GDP growth into negative territory.

Gauging consumer spending in real-time is tricky business. We turned to Craig Johnson, CEO of [Customer Growth Partners](#), a consulting firm based in New Canaan, Conn. Johnson's focus is on macro trends in consumer behavior for corporate clients, while identifying and overcoming the statistical and institutional biases in reported data.

"Clearly the economy has softened," says Johnson, adding that "two parts of the economy – financial services and housing– have receded." The single biggest factor in the 0.6% decline in fourth quarter GDP was a dramatic cutback in inventories, reducing GDP growth by 1.5%. The decline in residential construction contributed another 1.25%. Without these two burdens, GDP would have grown 3.3%, which Johnson characterizes as "okay, but clearly not a disaster."

"January and February got us a little further into the ditch," notes Johnson. He believes the Q1 GDP number will be low, an increase of somewhere between 0.6% and 2.0%, but does not expect a negative number.

"The consumer is still rocking along, but at a more cautionary pace" Johnson says.

And he explains why.

Don't Believe What You Read

"A lot of conventional wisdom is wrong when it comes to the reported data for consumer spending," he says.

Johnson is highly critical of public and private databases that have failed to keep pace with the changing landscape of retail spending. The primary source of consumer data is the Department of Commerce, which collects data directly from retailers, based on their industry classification (SIC code). Data collection for the



largest retailers (Sears, Lowe's, Home Depot, Wal-Mart, etc.) is fairly comprehensive, and their survey randomly selects mid-tier and smaller firms.

The biggest problems are definitions of categories and data collection periods, which Johnson says are "stuck in the last century." Reporting of e-commerce data lags by a month, although technology should enable faster reporting of this data than that of in-store sales. The result is reported holiday sales in December leave out the 7% of revenue from the on-line channel, which is the fastest growing segment, up from 6% of sales in 2006 and 5.5% in 2005.

January sales were purportedly the worst in history, but Johnson says this data can be highly misleading. A good portion of technology sales, such as iPods, iPhones, and iTunes downloads is not counted in the Commerce Department's retail statistics. Apple Retail is a \$5 billion company with revenues growing at 50%. But this revenue "drops out of consumer spending altogether," and shows up in the GDP in durable goods, Johnson says. He is confident this is not an isolated example.

A related problem affects Amazon, the nation's 15th biggest retailer, whose revenue is classified by analysts in technology indexes instead of retail indexes.

Johnson also notes that eBay's revenue, representing the consumer-to-consumer channel, is "all but ignored" in industry statistics. "There is a whole new channel of consumer-to-consumer commerce that is not being tracked," says Johnson.

Barter and cash sales (such as those paid to a housecleaning or lawn care service) do not show up but, unlike e-commerce and eBay revenue, this is not a new problem.

The National Retail Federation picks up data from the Commerce Department and propagates the errors.

Data gleaned from consumer sentiment surveys holds little value for Johnson. "Consumers consistently underestimate their actual spending," says Johnson, who has 20 years of data to back up this claim. He notes that the only reliable metric is an inverse relationship to the price of gasoline – as fuel prices go up, consumer sentiment goes down, and vice versa. "I am a big believer in what is actually happening in stores, not what consumers say they are going to do," says Johnson.

Trends in Retailing



Johnson has tracked a steady decline in department store sales, which have seen their market share of general merchandise sales shrink from 35% to 15% over the last 15 years. This market share has been picked up by the big box retailers like Wal-Mart and Costco. Johnson expects this trend to continue, and the effect can be detected on a monthly basis (adjusted seasonally).

“Macy’s, Sears, and J.C. Penney are bleeding market share,” says Johnson, adding that “even higher end venues like Nordstrom’s and Saks are seeing flat growth.” Johnson’s index of “value” retailers has gained 7% year-to-date, with the mid-tier retailer index losing 7.5%.

Changes in shopping habits – primarily among women – are behind this migration. “Women used to shop on a recreational basis,” Johnson says, “but now they visit malls on the holidays and the occasional weekend.” With 72% to 78% of women in the workforce (depending on age), they do not have the time to spend shopping at malls. “When you include the parking, the all-in transaction time is just too much of a hassle,” he says.

“Department stores don’t reflect how women want to shop,” Johnson says. “When you add in the price factor, they can get what they want at a discount store. Only when they want unique or designer merchandise do they go to a store like Neiman Marcus.”

The Effect of the Falling Dollar

The dollar’s fall has had a small net negative impact on consumer spending. “Psychologically, consumers pull back,” Johnson says, although he is quick to add that recent surges in energy prices have a greater impact on buyer behavior. The prices of some imported consumer goods are moving up, but these are mostly in the luxury categories. The dollar’s decline, along with energy prices and ethanol growth has contributed to food price increases more than in the last several years.

Tourism is offsetting these increases. “When I go to the stores in SoHo [in New York], I am sometimes the only one speaking English,” notes Johnson, adding that foreigners are still seeking bargains in the depressed U.S. dollar, even now in a low tourist season.

If you look at households as a business, a key indicator is their debt service ratio (the percentage of income used to pay principal and interest on mortgage and other debt). After having risen for many years, it peaked in the fourth quarter of 2006 at just over 14%, and has receded since then. From a cash flow perspective, the majority of households have gotten healthier in the last year. “This fact is not widely known,” Johnson says, because it is overshadowed by



news of foreclosures and the troubles of consumers caught in the sub-prime crisis.

Tracking the Health of the Economy

To gauge the health of the economy, Johnson pays little attention to the same store “comp” sales that are closely tracked on Wall Street. These are heavily influenced by retail promotional tactics and store openings and closings.

He is also skeptical of data based on reported earnings relative to analyst forecasts, because he believes management is prone to manage analysts’ expectations to enhance their stock performance.

Instead, Johnson monitors the growth in operating margin and cash flow from operations for the 10-12 largest retailers, tracking this on a year-to-year basis. In fact, Johnson suggests that the best single proxy for the overall economy is Wal-Mart’s total sales, which represents approximately 9% of the consumer economy. “Half of American families shop there a couple of times a month,” Johnson notes.

Wal-Mart just reported 8% growth worldwide and 5.8% growth in the US for the month of February. Considering that one-third of Wal-Mart’s revenue is from slow-growth groceries, he is optimistic about the path of the economy. “Once heating bills get digested and paid off, I expect to see improved growth in the economy,” notes Johnson.

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