



A Bold Forecast for Consumer Spending

By Robert Huebscher

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In a world where mainstream media has become overly fond of alliterative headlines, “frugality fatigue” has emerged to characterize the view that consumers have loosened their belts and begun to spend some money. That’s far from the consensus view, but if it proves to be correct it would be the clearest indication that the economy is recovering strongly.

One analyst who is convinced the days of rampant penny-pinching are behind us is Craig Johnson, with whom I spoke last week. Johnson runs Connecticut-based Consumer Growth Partners, a consulting and research firm focused on consumer service industries. His clients are among the largest retailers, investment firms and corporations, for whom he divines the key trends in consumer behavior.

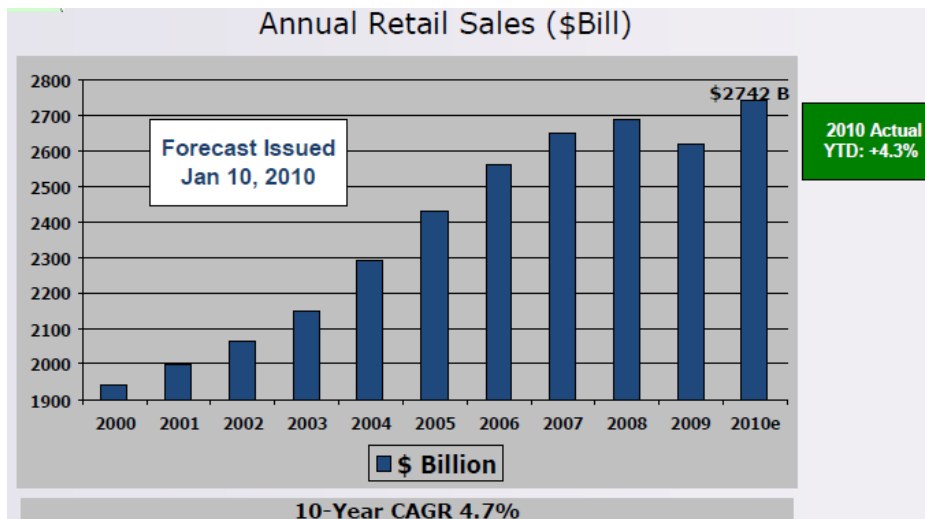
Over the last three years, the retail sector has been in a ditch. Retail sales slowed in the run-up to Lehman’s collapse in September of 2008, at which point they fell off a cliff, according to Johnson. No income bracket was spared, and everyone stopped spending, leading to a disastrous 2009 for retailers.

The nadir came that year, when retail sales declined 2.4% year-over-year, the first such decline since the oil crisis of the early 1970s. It wasn’t so much a question of frugality, Johnson said, but rather the byproduct of a deep recession.

Today, however, we are witnessing a “resurgence in retail,” Johnson said. In late 2009, Johnson predicted 4.6% growth in retail spending for 2010, and he now expects the final numbers to come in at between 4.7% and 4.8% – the strongest growth in years, he said.

Johnson’s anticipated growth in 2010 will be consistent with trends over the last decade, as can be seen from the data below:

Annual Retail Sales and Consumer Growth Partners 2010 Forecast: Total Sales Growth 4.6% YoY



Johnson said that consumers used the rigors of the recession to get themselves healthier. One of the statistics he looks at, calculated by the Fed, is the household debt service ratio, which measures the ratio of interest payments on debt to household income. This metric is down to 11.88%, the lowest since 1998. Despite over 9% unemployment, Johnson said, Americans are in “much healthier financial shape.”

“When they spend now, they are spending smartly and strategically, and they are spending out of cash flow,” he said.

Moreover, the savings rate went from 8.2% at the peak of the recession in May of 2009 to approximately 5%, and Johnson said it is now stabilizing at that level, which is near its historical norm.

Healthier household finances are fueling Johnson’s prediction that 2011 retail spending growth will be between 4% and 5% over last year’s numbers. “That will come from healthy spending,” he said, “not just charging up on plastic like during the bubble period of the mid-2000s.”

Consumers may still be using credit cards to accumulate rewards like airline miles, he said, but the numbers out of the Fed show that they are paying off their plastic each month.

Despite the high unemployment rate, nearly a million more Americans have jobs than a year ago. “For the 120 million US households,” he said, “gaining or holding a job makes for a much more bountiful holiday than losing a job.”

Holiday spending in 2010 looks like it will justify Johnson’s optimism. His is one of about 10 organizations that forecast retail sales, and his forecast of 4.5% growth over the prior year was the highest among that cohort, about twice the consensus. Johnson said he



expects the final number for 2010 holiday sales growth to be between 5% and 6% over 2009 levels, once the Department of Commerce releases its final December figures. November's numbers, which were all that were available when we spoke, were up about 8% over the prior holiday season.

Preliminary but disappointing holiday numbers were released last week by a group of approximately 28 retailers. Johnson said those represent only 10% to 12% of the retail industry, and he was confident that the final numbers from the Department of Commerce will be in line with his forecast.

Lessons learned by consumers during the recession – focusing on value – have endured, Johnson said, and that is true at both ends of the retail spectrum. He said that discount retailers like Target, Wal-Mart, and the Dollar Store, and [off-pricers](#) like T.J. Maxx are doing well. So are luxury retailers, like Tiffany and Cartier, which he said are posting “tremendous” results.

Even retailers in the middle of the spectrum, like Macy's and Kohl's, had great seasons, Johnson said. The retailers that are doing poorly are those that were already struggling under competitive pressures, such as Talbots, American Eagle and Sears, and Johnson said their problems predated this holiday season.

Over the longer term, Johnson expects healthy retail spending to lead the way to a stronger-than-expected economic recovery.

Consumer spending has been approximately 70% of GDP for the last decade, with retail spending representing between 43% and 45% of GDP. Consumer spending was just above 60% of GDP in 1970, and it rose to its current level over the next three decades, in part due to increased borrowing through vehicles such as home equity mortgages.

Johnson does not expect spending to change as a percentage of GDP. As long as we are bringing in 65% of our oil from overseas, he said, net exports will maintain its share of GDP. Although he expects the contributions from housing and construction to GDP to remain depressed for a while, he said that shortfall will be offset by increased government spending. “Unless something dramatically changes in those factors,” he said, “consumer spending is still going to be about 70% of GDP, plus or minus.”

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