Daniel Alpert Managing Partner • dalpert@westwoodcapital.com • +1-212-953-6448

Retail Sales as the Echoes of a Pre-Crisis Habit:
Consumer Behavior in the Post-Crisis United States

There's something happenin' here;
What it is ain't exactly clear.
-- Steven Stills, Buffalo Springfield

Highlights

- One can hardly be blamed for viewing retail sales data as directly linked to the overall health of the U.S. economy. It would stand to reason that a more rapid escalation in sales bodes well for an economy desperately trying to achieve "escape velocity" from the worst crisis it has experienced in over 70 years.

- But now, after observing three definable cycles of post-panic fluctuations in the rates change of retail sales, we have come to the following conclusion: ***Expansion and contraction of retail sales in the post-panic U.S. economy has been predominantly the result of fluctuations in the use and repayment of consumer credit facilities, not the normal recovery patterns expected following a garden-variety recession These activities principally represent the overall recent patterns of consumer saving, punctuated by periodic dis-saving as credit facilities free up, are employed again, and then must be paid down anew.***

- As we have written previously, sustainable growth in final demand in the U.S. can only be generated through an increase in the number of people with jobs and/or the wages earned by those employed. A material decline in the number of people employed (especially with only meager changes in hour's worked and hourly wages) is not consistent with an improvement in final demand.

- In this report, we examine the relationship between the monthly rates of change in outstanding consumer credit and retail sales volumes during both post-panic and pre-panic periods. Please see the chart on page 3 of this report for a graphic illustration of the results of our examination.

- Growth in retail sales that is driven by the old habit of drawing on consumer credit – without the wage growth necessary to pay down the credit card bills with they come in – is limited growth indeed. With the current micro-cycle apparently repeating its predecessors, there is ample reason to believe that retail sales will slump again. Timing-wise, that could turn out to be a very unwelcome Christmas present (or at least mean that consumers and retailers will break up with each other by Valentine's Day).

- More disappointing is that it will be difficult to rely upon the retail sales component of the all-important consumer economy to drive a recovery in 2011. The consumer may be seen from time-to-time as being "back" – but at best she is coming and going until other economic fundamentals offer her a sustainable deal.

Overview

One can hardly be blamed for viewing retail sales data as directly linked to the overall health of the U.S. economy. After all – with consumer spending constituting over 70% of total economic activity – it would stand to reason that a more rapid escalation in sales bodes well for an economy desperately trying to achieve "escape velocity" from the worst crisis it has experienced in over 70 years.
In truth, a gainfully employed, well paid and confident consumer is exactly what we need in order to emerge from the present malaise. Growing consumption in an economy that is well producing (and, hopefully, not consuming much more than it produces overall), is the lynchpin of real prosperity. And real prosperity is what we sorely lacked during the nearly decade-long, unprecedented, explosion of credit that passed for sustainable economic well-being.

As we attempt to gauge the level and trajectory of recovery, it is tempting to try to latch onto monthly retail sales data as evidence of movement in one direction or another. The almost steadily improving rates of growth in retail sales from July through October of this year (0.46%, 0.86%, 0.71% and 1.23%) would tend to support the notion that the economic worm has turned. We are, however, not so sure.

Since Q2 2009 we have been watching, and periodically commenting upon, the relationship between the rates of change in retail sales and consumer credit. We have wanted to publish our data before, but waited a few "micro-cycles" to see if our observations would continue to be sustained. But now, with three definable cycles of post-panic increases and setbacks in the rates change of retail sales, its time to explain our point of view more fully:

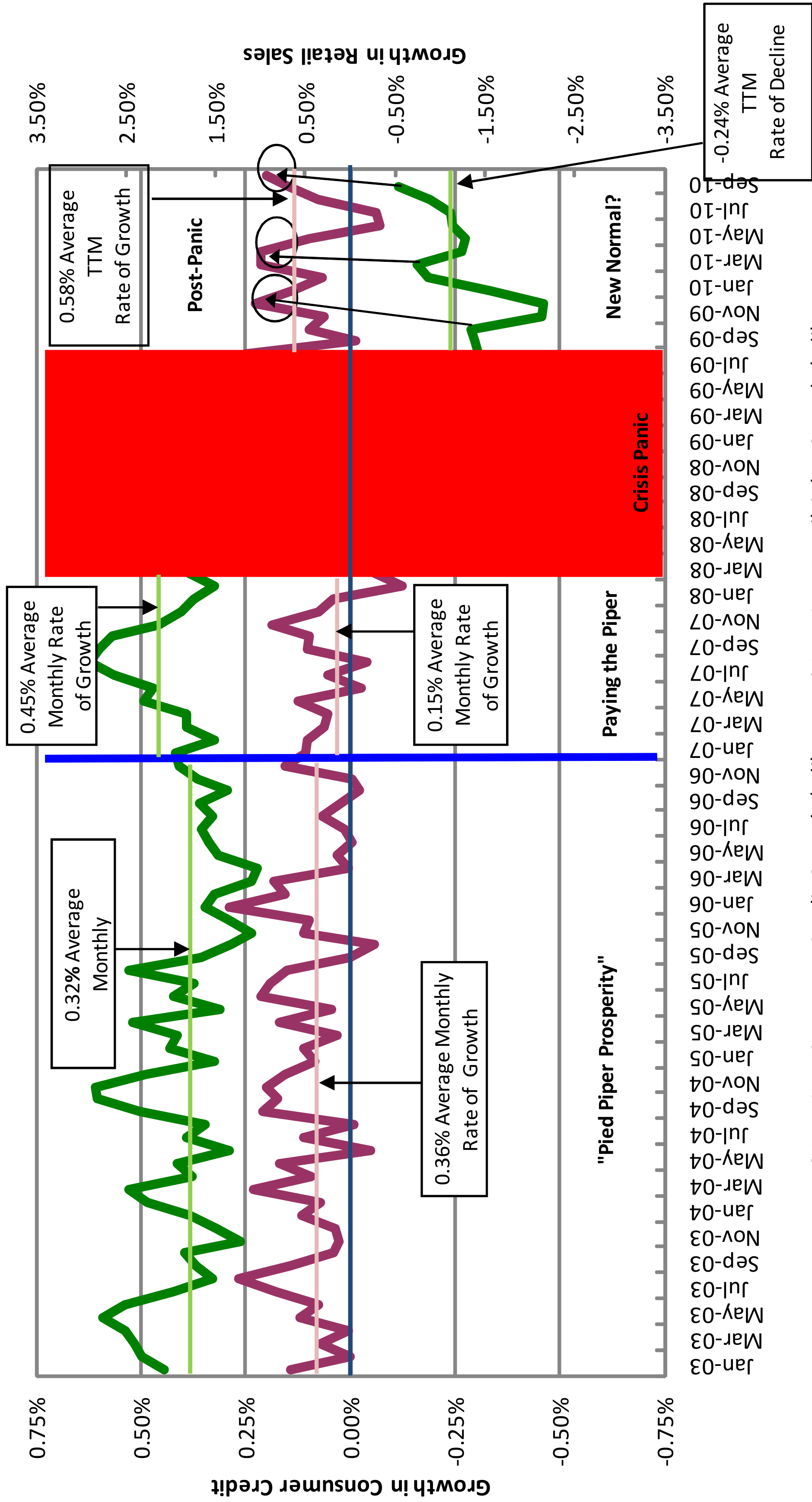
Expansion and contraction of retail sales in the post-panic U.S. economy has been predominantly the result of fluctuations in the use and repayment of consumer credit facilities (revolving credit for the most part), not the normal recovery patterns expected following a garden variety recession.

Since the panic stage of the financial crisis ebbed, we have experienced three mini-expansions in the growth rate of retail sales, which have coincided with slowing rates of consumer credit repayment (or, in some months, such as this past September, expansion of consumer credit). ***These activities principally represent the overall recent patterns of consumer saving, punctuated by periodic dis-saving as credit facilities free up, are employed again, and then must be paid down anew.***

With underemployment mired in the high double digits, and little evidence of wage growth, it is hardly surprising that sustained growth in consumption is proving illusive. As we have written previously, final demand in the U.S. can only be generated through an increase in the number of people with jobs and/or the wages earned by those employed. A material decline in the number of people employed (especially with only meager changes in hour's worked and hourly wages) is not consistent with an improvement in final demand.

There's a Hole in My Khakis

Following the panic, which saw over a year of net declines in retail sales and a rapid acceleration in the rate of repayment of consumer debt, pent up consumer demand – the normal result of deferred consumption – led to a positive rate of retail sales growth by mid-2009. In our research on this topic, and in the related graph on page 3, we utilize a three-month moving average rate of change for both retail sales and consumer credit (seasonally adjusted) to dampen inter-month fluctuations in both statistics and identify trend activity.



Three Month Moving Average Growth in Consumer Credit Outstanding & Retail (Seasonally Adjusted)
Growth in Consumer Credit
Growth in Retail Sales
0.75%
0.50%
0.25%
0.00%
-0.25%
-0.50%
-0.75%
3.50%
2.50%
1.50%
0.50%
-0.50%
-1.50%
-2.50%
-3.50%
Jan-03
Mar-03
May-03
Jul-03
Sep-03
Nov-03
Jan-04
Mar-04
May-04
Jul-04
Sep-04
Nov-04
Jan-05
Mar-05
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Nov-08
Jan-09
Mar-09
May-09
Jul-09
Sep-09
Nov-09
Jan-10
Mar-10
May-10
Jul-10
Sep-10
0.32% Average Monthly
0.36% Average Monthly Rate of Growth
"Pied Piper Prosperity"
0.45% Average Monthly Rate of Growth
0.15% Average Monthly Rate of Growth
Paying the Piper
Crisis Panic
0.58% Average TTM Rate of Growth
Post-Panic
New Normal?
-0.24% Average TTM Rate of Decline
3 Mo. Avg. Consumer Credit Growth (adj)
3 Mo. Avg. Retail Sales Growth (adj)

Pent-up demand occurs for fairly obvious reasons, including wear and tear (hence the above reference to khakis), replacement of durables, adoption of technologies that became available during a recession, and the psychological need to indulge in deferred "little luxuries" after a period of real or perceived deprivation.

Without any material improvement in consumer incomes (and, in our opinion, significant downward pressure on net disposable incomes with continued inflation in healthcare and education costs, despite near-deflation in other sectors), growth in retail sales has seen a natural ceiling in the form of fixed or declining availability of consumer credit. Consumer credit includes both revolving and installment credit, referenced in this report – but was historically and substantially enhanced by, now severely constrained (if not eliminated), home equity and conventional residential lending.

Post-Panic Deferred Demand Echoes

One of the significant characteristics of the Great Recession is the geographically near-simultaneous crash in U.S. consumption in the fall of 2008. During that crash, the 3 month average change in retail sales bottomed out at around negative 3% and remained negative for one year. When sales growth turned positive, however, it did so for only a few months, before declining to zero once more.

This behavior pattern (retail sales declines and renewed growth) has repeated itself three times over the past fourteen months, on a three month rolling average basis. We call these events Post-Panic Deferred Demand Echoes

And each time, the increase in sales has coincided with a progressively greater slowing in the rate of consumer debt repayment to finance renewed consumption. Please see the diagram on page __ for an illustration of these very regular Deferred Demand Echoes.

To a certain extent, attributing cause to the above-described consumer behavior involves proving a negative. Since it would appear that there are no other economic inputs that would support the recent waves of increased retail sales – and since credit card usage is at the front line of retail consumption – there appears to us to be no other variable to attribute it to other than the rather obvious fluctuations in consumer credit usage.

But to make to point completely, we looked back into recent history to assess how the relationship between consumer credit and retail sales growth in, theoretically at least, "happier times."

Pied Piper Prosperity

During the four year period from January 2003 through December 2006, America was making up for lost production by incurring massive amounts of debt at every level – households, consumers, businesses, commercial property, financial institutions and the government. During the total bacchanalia of borrowing (2000 through 2008), total outstanding debt in the U.S more than doubled to over $52 trillion. Consumers were major participants, borrowing to a peak level of $11.2 trillion against their homes (from $5.4 trillion at the decade's start), and incurring consumer revolving and installment debt that topped out at $2.6 trillion (up from $1.4 trillion).

Despite the fact that most other indicia of economic well being – wage and GDP growth, job formation and the balance of trade – were sluggish, at best, during the bubble period, Americans were living high on the (borrowed) hog.

Lenders lent, and consumers obediently borrowed and bought. As shown on the graph on page __, retail sales fairly well marched along to the tune of the Pied Piper of consumer lending (and, of course, of home mortgage lending). Retail sales grew at an average of 0.36% per month and consumer credit grew at an average of 0.32% per month from 2003 through 2006.

But this period of "Pied Piper Prosperity" – in the absence of disposable income growth – could only last as long as the debt accumulated could still be serviced by bigger and bigger chunks of Americans' stagnant incomes. Eventually, we were destined to hit a wall as our consumption was drastically exceeding our ability to produce.

Eventually came in 2007 and the end is clearly visible in the two indices that are the subject of this report. During the fifteen month period from January 2007 through March 2008, consumer credit growth and retail sales growth disconnected as a greater proportion of increasing borrowings were applied to supplement debt service on amounts already borrowed, rather than on new spending. During this period immediately before the panic, consumer credit exploded at rate of 0.45% per month, while retail sales growth fell to only 0.15% per month. It was time to pay the piper.

Conclusion

Growth in retail sales that is driven by the old habit of drawing on consumer credit – without the wage growth necessary to pay down the credit card bills with they come in – is limited growth indeed. With the current micro-cycle apparently repeating its predecessors, there is ample reason to believe that retail sales will slump again. Timing-wise, that could turn out to be a very unwelcome Christmas present (or at least mean that consumers and retailers will break up with each other by Valentine's Day).

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Daniel Alpert is a Managing Partner and Founder of the New York-based investment bank Westwood Capital, LLC, and its affiliates. He is a frequent commentator on the housing and credit crises on the CNBC, Bloomberg and FoxBusiness networks, as well as in leading newspapers, periodicals and websites.