Lavery Consulting Group

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The U.S. Consumer Is Not Dead

Later in this report, in the section forecasting indicator releases in the week ahead, retail sales and consumer sentiment are particularly germane. Our expectations on both barometers are stronger than the market consensus. Same-store sales y/y comparisons in February were the best since November 2007, just before the outset of the recession.

Consumer credit outstanding (CCO) broke a string of eleven consecutive declines and increased $5.0 billion in January. December was revised to a steeper decline of $4.6 billion, which had previously been estimated as a decline in CCO of $1.7 billion. Revolving credit (outstanding credit card balances) fell $1.7 billion in January, following a revised plunge of $9.4 billion in December. Non-revolving credit (auto credit, education loans, vacation loans, etc.) increased $6.6 billion in January, following an increase of $4.9 billion in December. This is the first time that non-revolving credit increased two months in a row, since December 2008 and January 2009. (Please note that CCO does not include auto leases, mortgage loans, or any loan secured by real estate, e.g. home equity loans.)

Despite the January increase in CCO, we believe the consumer will remain cautious. The CCO series is volatile, and we expect to see incremental consumer deleveraging. On a y/y basis, CCO declined 4.2% in January. This is barely above the 4.3% y/y declines registered in November and December, the steepest such drops since June 1944. The largest declines are in revolving credit, which continued to fall in January and is now down for 16 consecutive months. Revolving credit was off 9.60% y/y. Other than the December '09 9.61% y/y drop, January 2010 was the worst decline in fifty years, as far back as comparable data go. The story of the CCO declines is, however, not just one of consumer deleveraging. The banks have cut credit lines to many businesses, and pared credit card limits significantly.

Personal income (PI) disappointed in January, rising 0.1% m/m vs. expectations of a 0.4% rise. Nominal or current $ personal consumption expenditures (PCE), however, rose 0.5%, a touch stronger than expected. This was due substantially to gasoline station sales, owing to higher prices. Adjusting for inflation, real PCE increased 0.3% m/m. On a y/y basis, real PCE are up 1.4%. Over the last six months, however, real PCE has advanced at a 2.7% annualized rate, and at a 3.3% annual rate for the last three months through January. Furthermore, the financial obligations of households, measured as debt service plus car leases and rents, are the lowest share of after-tax income in roundly a decade. With an upturn in employment at hand, the U.S. consumer will be an important and positive cog in supporting the recovery.

Initial unemployment claims fell in the latest weekly data. The ADP report showed private sector jobs falling at the smallest pace since February 2008. Non-farm payroll employment fell by 36,000 in February, beating consensus expectations of a larger decline. The revisions to December and January combined lessened job losses in those months by 35,000. Weather hurt the non-farm payroll number. Construction jobs fell 64,000, considerably worse than the prior three month average decline of 43K. We believe payrolls would have grown in February, were it not for the heavy snowstorms. The household survey tells us that the number of workers "Not at Work Due to Weather", i.e., reported as missing at least some work because of weather during the February survey period, was nearly 1.12 million workers. This was the highest such reading for a February ever, and the largest weather related incidence since January 1996.

The February data leave us convinced of substantial employment gains in March and beyond. The indications include: the sixth consecutive monthly increase in hiring temporary workers, up 48,000 in February; the second consecutive month of increases in manufacturing employment, despite the weather; the household survey showed civilian employment, including the self-employed and new start-up businesses have added an average of nearly 170,000 workers per month for the last three months; Census related hiring is slated to increase in March; the non-manufacturing ISM has shown an improving employment component likely to be above 50.0 in its next reading; the breadth of industries showing increasing employment has improved markedly; business and professional services showed a 51,000 increase in February payrolls, atop a gain of 30K in January; the household survey revealed the first downtick in long-term unemployment; the Challenger report on layoff intentions for February were the smallest since July 2006. And, despite the weather issue, the unemployment rate remained at 9.7%.

The consumer will not be going it alone. The swing to intended accumulation of inventories is near at hand. This is a positive for capital spending. January factory orders rose 1.7%, following an upwardly revised advance of 1.5% in December. January factory orders are up 9.5% y/y, the strongest such comparison since April 2006. Export orders continue to rise.

Beyond our regular forecasts of the weekly forthcoming indicators, two informational releases on which to focus are Tuesday morning's report from the National Federation of Independent Business (NFIB) Optimism measure, and Thursday's noon release of the quarterly flow of funds data for 4Q:'09. The numbers to watch relate to the household sector's change in net worth vs. 3Q:'09.

Economic Indicators in the Week Ahead:

Wednesday, March 10 10:00a.m. January Wholesale Inventories
Wholesale inventories will likely be reported as rising 0.1% in January m/m, following a decline of 0.8% in December. The consensus sees a 0.2% rise in wholesale inventories. Automotive inventories likely rose 0.4% in January, following two months of decline. With a recovery in sales, we expect the inventory to sales ratio to fall to 1.11. This I/S ratio prevailed prior to the recession. We expect inventory building to strengthen in the months ahead, in keeping with the economic recovery.

Thursday, March 11 8:30a.m. January Merchandise Trade Balance
The January merchandise trade deficit likely worsened from $40.2 billion in December to $42.0 billion in January. The consensus sees a $41.0 billion trade deficit in January. We expect a January gain of close to 2.5% in exports. The export advance is supported by the upward move in export orders in the ISM survey, and the import increases we've seen in non-U.S purchasing manager surveys. Imports by the U.S., however, likely rose faster than our exports, due in part to food and petroleum imports, boosted higher by both volume and price increases.

Thursday, March 11 8:30a.m. Jobless Claims, Week Ending March 6
Initial unemployment claims in the week ending February 27 dropped by 29,000 from 498K to 469K. We anticipate a drop in claims of 23,000 in the week ending March 6 to 446K. The consensus sees claims coming in at 450K. Claims were bloated for several weeks by administrative problems in California and by recent snowstorms. Following the data reported March 4 for the week ending February 27 (469K), and our expectation of another decline in initial claims to 446K for the week ending March 6 (to be reported on March 11), we believe claims will then settle between 425K and 440K for several weeks. Continuing claims are reported with a one week lag, and the data for the week ending February 20 show a drop in continuing claims of 134,000 to 4.5 million. Even if continuing claims drop further in the week

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ending February 27, it would not be cause for euphoria about the condition of the labor markets. The number of recipients of federal extended and expanded benefits has continued an irregular rise, and stood at 5.687 million in the week ending February 13, a reflection of the high level of long-term unemployment (27 weeks or longer).

Friday, March 12 8:30a.m. February Retail sales

After an increase of 0.5% in January retail sales, we believe weather related distortions will restrain February retail sales to a 0.2% rise m/m. Gasoline station sales likely fell m/m due to declining retail gasoline prices. The consensus expects a 0.2% decline in overall retail sales. Auto sales will likely fall 1.0% m/m, related to Toyota recalls. Same-store sales reported by the major retailers in February were 3.9% higher y/y. In February 2009 same store sales were down 3.4% y/y. Preliminary total retail sales are 6% higher y/y. Comparisons, however, are very easy vs. depressed levels in February 2009. Both total and same-store sales have been increasing for six consecutive months on a y/y basis, following twelve successive months of y/y declines.

Friday, March 12 10:00a.m. March (P) Index of Consumer Sentiment

We see the Reuters/University of Michigan Index of Consumer Sentiment rising to 75.0 in the preliminary March reading, above the final February actual of 73.6. The consensus sees a slight gain in consumer sentiment to 73.9. The Tuesday March 9 release of the ABC News Consumer Comfort Index will be telling. Improved equity prices and a better than expected overall employment situation for February should help the Consumer Sentiment Index in early March. The RBC CASH (Consumer Attitudes and Spending by Households) Index increased 18.2 points to 58.2 in early March. The same series fell 18.9 points in February.

Friday, March 12 10:00a.m. January Business Sales & Inventories

January business inventories likely increased 0.2% m/m, following a 0.3% decline in December. Based on already reported data, manufacturing inventories rose 0.2% in January m/m. Given our forecast earlier in this report that wholesale inventories rose 0.1% in January, the likelihood of a 0.3% increase in retail inventories, and a 0.5% rise in business sales, the inventory to sales ratio will remain at 1.26 or nudge lower to 1.25. Either of these I/S ratios bode well for production, employment, income, and spending.

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