May 26, 2016 | Andrew J. Nelson, Chief U.S. Economist

WHERE WE ARE: Focus on Consumers and the Retail Sector

I'm drafting this newsletter from Las Vegas, where the biggest retail real estate conference of the year, ICSC's RECon is wrapping up, so it's only appropriate that I focus this issue on consumers and the retail sector. I'd like to highlight two notable themes that have been in the news recently.

First, **consumers overall are quite strong and have largely recovered from the recession**, as I explained in a recent blog**.** By just about every key measure, consumers are in better shape now than they were in 2008 at the height of the last cycle: Household debt burdens are down, while their wealth is back at record levels thanks to recovery in the housing and equity markets. In fact, new home prices just this week reached a record level ($321,000) nationally, though existing home prices still have a bit more to go to reach their prior peak. Consumers are also back at work, thanks to the record number of jobs in the economy (now 4% above the prior peak) and unemployment essentially at the "full employment rate" of 5%. Add it all up and consumers are confident and out spending money, which is great for the economy, as consumption constitutes more than two-thirds of our GDP.

But you'd never know it from reading the financial press a couple of weeks back, as one department store after another reported weak April sales. To many analysts, this suggested that the anemic Q1 GDP growth was continuing into Q2, triggering a sell off on Wall Street. Then the Commerce Department reported that **retail sales actually had jumped 1.3% last month**, their biggest monthly rise in a year. Why the disconnect? Because **consumers are spending less in department stores**. Aren't you? More of their budgets are going toward services and other items not typically sold in department stores. Meanwhile, e-commerce is shifting more sales from physical to online retailers. Finally, big-box retailers are capturing a greater share of in-store sales. All of which means, **department stores are now a less reliable indicator of consumer strength**. Even the best, most innovative department stores (and their landlords) are likely to suffer as consumer spending shifts away from their stores.

The second consumer trend is that **despite the broad recovery, many households have not shared fully in the economic growth**. In this skewed recovery, wages are still stubbornly flat for a majority of Americans, while highly educated knowledge workers earn an ever-greater share of total compensation. A key reason: limited growth in high-paying blue collar and service jobs, as I highlighted in my "chart of the week" in my last newsletter**.** This has helped to create the retail sector's so-called **"bar-bell" recovery**, in which luxury retailers catering to the affluent are thriving, and discounters and dollar stores that appeal to less affluent households are surging, while retailers in the middle are getting squeezed. All of which means, more challenges at the nation's malls and shopping centers, with fewer department store anchors to draw in shoppers and more empty spaces to fill.

Related insights may be found here:

Retail Sales Gain Is Fueled By Web (WSJ)

How Online Shopping Is Cannibalising Mall Stores (Business of Fashion)

MORE QUICK HITS FROM RECENT ECONOMIC NEWS

Oil back at $50/barrel (at least for a few minutes). **Prices are now almost double their lows reached in February**, capping three-month bull run. And in what must be a first, economists are applauding this rise. Why? At this level, prices are high enough to allow producers to keep pumping (if not exploring) but low enough to boost consumer spending. That's the theory, anyway. **The gaining strength in commodity markets also could well tip the scales to a Fed hike this summer**, in July if not June.

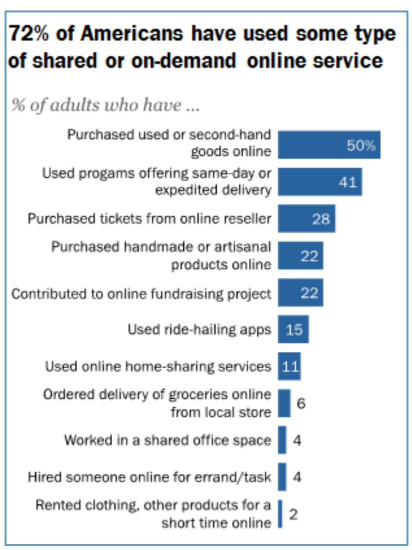
Overall manufacturing weakness masks relative strength for domestic-focused factories. Exporters continue to be held back by the surging dollar (down 2% in 2016 but up 18% over the past two years on a trade-weighted basis) and the slowing global economy (global GDP growth slowed from 3.4% in 2014 to 3.1% in 2015, and 2016 looks to be similar). But firms focused on the U.S. are doing better.

Housing markets continue to improve. Earlier this week the Commerce Department reported that **sales of new homes surged to their highest level in eight years, while prices reached an all-time high**. While these figures are for new homes only, the much broader existing home resale market also continues to gain (if more moderately) – a positive for consumers and the economy – but not millennials seeking to buy their first home. In a sad reflection on our economy (or perhaps our coddled young adults), millennials are now more likely to live with their parents than a romantic partner.

Finally, the U.S. economy seems to be shaking off its yearly winter hibernation, with Q2 GDP almost certain to be much stronger than in Q2. Makes you wonder how much of these winter downturns are the result of statistical adjustments as opposed to real economic weakness given their annual reliable return.

CHART OF THE WEEK

Term this "no, we're not a gig economy" or "the digital divide grows larger": It may come as a shock to urban professionals (and readers of this newsletter), but the vast majority of Americans have never used services like Uber or Airbnb. Almost 90% don't even know the term "gig economy." Yet, most Americans have at least made online purchases – a huge increase in just the past few years – so perhaps we can assume the use of gig services is destined to be adopted over time.



Source: Pew Research Center

OTHER WORTHWHILE READS

ECONOMIC NEWS AND VIEWS

Trillions in Debt—but for Now, No Reason to Worry (WSJ)
If current trends persist through the end of the year, U.S. households will owe as much as they did at the peak of borrowing in 2008 . . . But for all the hand-wringing, a near-term debt crisis is unlikely. Lower interest rates mean debt payments are far lower than they were before the crisis. In the U.S., household debt compared with the overall economy is way down. And overseas, loans can easily be rolled over.

Fewer Americans Choose to Move to New Pastures (The New York Times)
"Economists have become increasingly worried that a slide in job turnover and relocation rates is undermining the economy's dynamism, damping productivity and wages while making it more difficult for sidelined workers to find their way back into the labor force."

THE ECONOMY AND THE ELECTION

American Anger: It's Not the Economy. It's the Other Party (The New York Times)
Americans are angry. That's the sentiment that many believe is driving the 2016 election. They are angry because the rich are getting richer, the average guy is struggling and the government in Washington hasn't done anything to stop the trend. But it may not be that simple . . . economic conditions and their overall sense of satisfaction with life do not suggest Americans are angry. Americans aren't annoyed by the economy; they're annoyed with one another."

Economists Disagree With Voters Who See U.S. Worse Off Today Than in 1960s (WSJ)
"Forecasters in The Wall Street Journal's monthly survey of business, academic and financial economists were asked to rate whether U.S. living standards were higher today or at various points in the past. Around 80% say those standards are higher today than during the 1990s or earlier . . .While many economists view the U.S. as not fully recovered from the recession that began in 2007 or the previous recession in 2001, that still leaves a 40-year disconnect compared to voters who see the U.S. in a half-century of decline."

Why a B-Minus Economy May Be Causing a Turbulent Election (The New York Times)
"The boring economy seems to be making this presidential race even more exciting. And uncertain . . . The quiet strength of the economy appears to be affecting the campaign. It's far easier for candidates to make economic policy messages resonate when the economy is roaring (Dole vs. Clinton, Bush vs. Kerry). Or when the economy is in the doldrums (Bush vs. Clinton). But when it's middling?"

PROPERTY MARKETS

Digital Weapon (My blog on Knowledge Leader)
The growing ubiquity of mobile devices that is laying waste to retailing. Standard features on most smartphones now include an alarm clock, radio, thermometer, dictionary, mp3 player, calculator, address book and scheduler—not to mention the apps for streaming music, videos, and movies—all of which replace physical products formerly sold in stores. This trend presents challenges to retails – both online and in physical stores, while also slowing GDP.

Foreclosure Starts Lowest Since 2000
"The delinquency rate of 4.77 percent has returned to typical pre-recession levels and is lower than the historical average of 5.4 percent for the time period from 1979 to the first quarter of 2016."