Research @ Citi Podcast, Episode 6: U.S. Consumer — What's in the Cart?

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Guest: Paul Lejuez, Head of Consumer Discretionary, Citi Research

Transcript:

Lucy Baldwin (00:02)

Welcome to the Research @ Citi Podcast. I'm Lucy Baldwin, Global Head of Research at Citi. In each podcast episode, we bring you our thought-leading views and analysis across asset classes, sectors, and economies from around the globe. Now, let me hand you over to our host today.

Rob Rowe (00:22)

Hi everyone, and welcome to our Research @ Citi podcast. My name is Rob Rowe. I am the U.S. Regional Director of Research at Citi. And we're going to be talking all about the consumer today and about retail. This is a very important topic as we approach potential Fed cuts, as we're seeing and observing what's going on in the labor market, what's going on in consumption, which is a very, very, as you know, integral part of the U.S. economy. And so the State of the Union, when it comes to the consumer, is awfully important. With us on the podcast today is Paul Lejuez, our head analyst of Consumer Discretionary. Welcome, Paul.

Paul Lejuez (01:01)

Thanks, Rob, and thanks for having me.

Rob Rowe (01:04)

Let me start off with first question about how retail earnings have looked among your coverage. And now that you're through that first quarter earnings, what did you learn about the state of the consumer? What are companies saying and how did that compare to what the market expected?

Paul Lejuez (01:20)

The first quarter earnings period was a very interesting one. There was significant nervousness going into the first quarter earnings. And I think because the holiday period was actually very strong, and there was some concerns in the market that the first quarter was going to show that the consumer was taking a step back, that there was going to be a lull. And what we heard from the companies in the retail landscape was that the consumer was kind of holding steady. There were pretty consistent trends that companies saw during holiday. And again, holiday was very good. Wasn't very promotional, certainly wasn't as promotional as most companies expected. And generally speaking, sales trends were very strong. And so to get through the first quarter earnings period in a spot where consumer looked very similar to how they looked in the fourth quarter was generally viewed as a positive by the market. Like I said, there were many concerns about a pullback. And if we look at the stock reactions coming out of the first quarter earnings period, it also paints a picture of more upside surprises than downside surprises. It was certainly a very volatile period. We saw more stock moves of 10% or more within our coverage universe than we had seen in any quarter over the past year. And there were more up moves of 10% than down moves of 10% plus. So really more upside surprises than downside. And again, it all just comes back to the consumer holding in a little bit better than what the market was anticipating.

Rob Rowe (03:10)

So that was the first quarter. And, you know, how is it, I know that you use a lot of, you know, what we call high frequency data to help gauge how things are progressing. I know you're using a lot of credit card data as well. As you look at the rest of the year now, how is that progressing and more specifically, are there sort of stand-out categories where you're seeing consumption or not seeing consumption?

Paul Lejuez (03:37)

Yeah, it's a great question. So, you know, similar to what I was saying about the companies and what they saw in the first quarter versus the fourth, as we look at the credit card data that we follow, really all the data that we follow, it also shows pretty consistent results as well. Just yesterday, we published our credit card report that captured all of June. You know, we use, we follow 17 subsectors that we track using Citi's credit card data. And what we found was that the overall month of June in those 17 subsectors that we track, spending was down 6.3% in the month of June. That compares to May down 6.2%, and it compares to April of also down 6.2%. So remarkable consistency, really, as we look over the past several months. But of course, there's always going to be differences in certain categories versus others. Some are doing better, some are doing worse.

And when we look at June overall versus the month of May, we saw the greatest acceleration — so better results — in categories like jewelry, dollar stores, and home improvement. And on the other side of the spectrum, we saw more of a deceleration, weaker results, in categories like athletic footwear, yoga and active wear, and home furnishings. So there's always some differences on categories. When we look at, we also track foot traffic data using Placer traffic data that we have access to. And when we look at that data, the month of June overall was actually very strong. Traffic was up 8.4% as we measure it. And that's the strongest rate of growth that we've seen over the past 12 months and that compared to April and May both up in the mid single digit range. So June, 8.4% versus both May and April up mid single digits. So the data that we track — as we look quarter to date, trying to get a feel for what's happening out there — is also a picture of consistency and on the traffic side, actually picking up a little bit.

Rob Rowe (06:01)

So we've seen a little bit of a decline in consumption or like in purchases, you're saying down 6.2% down 6% consistently, but we're actually seeing an increase in traffic. So is traffic correlated necessarily with forward higher consumption?

Paul Lejuez (06:17)

Yeah, it's a great question. You know, the credit card data that we track — you know, the down six-three, the down six-two — what we look at more than look at that on an absolute basis is we look at it relative to itself because there are always going to be dynamics that might influence the absolute level of the credit data that we have access to. And so we pay much more attention to the direction than the absolute. When we look at the traffic data, the traffic data works via cell phone. The way Placer traffic data works is that they're tracking people moving in and out of stores. And so that's probably a little bit more of an indicator of footfall and how people are moving around and whether or not they're going to stores at an increased rate or decreased rate. So those two things won't always line up perfectly because again, the Citi credit card data is just a subset and certain subsectors that we track, but we pay attention to it more directionally, which is why we look at that down six-three, down six-two, over the last couple of months and look at that as a pretty consistent trend.

Rob Rowe (07:36)

I mean, because I know that I'll go in and shop a lot. I sometimes don't buy anything. *[Laughs]*

Paul Lejuez (07:42)

Yeah. That's a problem a lot of retailers have. *[Laughs]*

Rob Rowe (07:47)

But in terms of, you mentioned those subcategories, and it's just funny to me, because it sounds like jewelry is a high price item, and dollar stores is probably a cheaper item, and you're seeing surges in both. Everything you're suggesting to me, and I ask that because is there any trends among the subcategories that would suggest to you that people are either saving or they're actually more expansive?

Paul Lejuez (08:15)

Yeah, I think I think when we look at, you know, the numbers that I was referencing, again, speak to the change and direction. When we look at the absolute increases and decreases, we actually saw the largest positive absolute results on the off price retailer side and the dollar stores showed the strongest results on an absolute basis. So you know, on one hand, we look at the changes just because, you know, we like to know, how certain subsectors are doing better or worse than they were the prior month. But on an absolute basis, it probably paints a picture of a consumer that's a little bit more gravitating towards value. So the off price retailers certainly represent value. Dollar stores are known for value as well. So I would say that the value proposition is certainly one that the consumer is paying attention to and gravitating towards for the retailers that offer value.

Rob Rowe (09:25)

And when you look at these numbers, Paul, I mean, is there any seasonal component to this, or is this more of a structural change?

Paul Lejuez (09:34)

Well, we're always looking year over year when we're measuring anything in retail because of how seasonal it can be.

Rob Rowe (09:41)

It can be.

Paul Lejuez (09:42)

Yeah. I mean, obviously, you know, holiday period is always going to be a peak period, but we're always comparing holiday to the holiday before, and any month, any quarter's worth of data we're always thinking more on a year over year basis because of that seasonality.

Rob Rowe (09:59)

And Paul, let's switch a little bit to the job and wage picture within the consumer sector — what gives a sense of the consumer income statement, right? But can you also touch on the consumer balance sheet and wealth creation we've seen over the past several years?

Paul Lejuez (10:21)

Yeah. Yeah, sure. I mean, consumer income statement, consumer balance sheet, two very important topics. If we think about the income statement, and the employment picture, over the past several years, we've seen a very healthy employment picture and very strong wage growth. And of course, all eyes are, all eyes are on what are we seeing today. And more recently, we've seen a bit more of a rising unemployment rate, we're a little over 4% now — still low, but versus a low of 3.4%, somewhere in that range. And, you know, it's as we speak to our internal Citi economists, you know, there's a view that there's a concern of a weakening in the employment picture. Wage growth, strong at around 3.9% year over year. But there's also a thought that has been slowing and that it would slow further. Hours worked have been, I think, generally moving sideways. But when we look at the overall employment/wage picture, we're certainly coming from a place of strength, and now we're starting to see a little bit more of a slowdown. The question is, just how much of a slowdown we will see, and that's something we're obviously paying a lot of attention to.

The balance sheet and overall consumer wealth creation is a really interesting topic, we think, and it's important consideration because what we've seen over the past several years has really been unprecedented. And when we talk about consumer wealth or household wealth or household assets, we kind of use those terms somewhat interchangeably. There are primarily two things that are the drivers of, you know, call it, you know, household wealth. It's the stock market and it's home prices. And just to paint the picture, you know, of what's been going on there, prior to 2019, we had never seen any year of household assets grow more than $10 trillion. And then in 2019, we actually saw gains of over $12 trillion. Then in 2020, we saw household assets grow over $14 trillion. And then in 2021, it was over $20 trillion. This is each individual year growth in household assets of that amount. That's not a cumulative amount that I was talking about. We had a little bit of a blip in 2022. We were down about $4 trillion, but 2023 came right back and more than made up for that, and we saw $12 trillion approximately of household asset growth. And this year, we're running up in the $6–$7 trillion range.

So the bottom line is there has just been significant wealth creation. And so the consumer balance sheet has just been really so strong for the past several years and getting stronger all the time. But there is, you know, there is a difference between what the higher or upper middle income folks might be seeing versus the lower income demographics. And a lot of that wealth that's being created, again, stock market and home prices, a lot of that wealth has been concentrated with the higher and upper middle income demographics, and that creates some discrepancies in terms of, you know, the retailers that serve those demographics versus those that serve some of the lower income demographics, might be experiencing slightly different trends.

Rob Rowe (14:06)

And so Paul, do you see that playing out in consumption? Because I know that our economists would tell us that the savings rate overall has been declining. So people have been using, and I guess the suspicion is that as the savings rate declines, we'll probably see less consumption, or, you may see a slowdown. And certainly what you're suggesting is, we're seeing a little bit of more slowdown, we're seeing more of a value play. When you look at the overall consumer, how do you break it down? Are the upper income folks driving that consumption or you know, are lower income folks driving that consumption, and how does that play out in your space?

Paul Lejuez (14:43)

There are certainly a lot of different dynamics, and, you know, as much as we like to talk about, you know, the “U.S. consumer”, you know, there really isn't a “U.S. consumer”, that it's made up of many different, you know, income cohorts, and there are differences in spending trends. The upper income folks have performed very well, and, you know, they're traveling, they're spending on services. They are very much seeing strong spending patterns. And I think that's been the case for, you know, the past several years. On the lower income side, you know, there's been more pressure. There's been pressure from inflation starting back in early 2022 when food and energy prices started to really soar, cause the shift in how consumers are spending. Now, they have they were employed, they had wage growth, and so they did have the power to spend. But with some of the inflation that we saw in food and energy, we saw a shift and how they were spending. It was much more towards food and consumables and much less on discretionary and big ticket items. And again, thankfully, a healthy job and wage picture, and a healthy consumer balance sheet — which, by the way, included a lot of savings built up over the pandemic period — it really allowed them, the consumer, to hold up during that period of high inflation.

You know, in 2024, you know, we're looking at the inflation picture and seeing things calm down a little bit. Food, inflation has been running more flat to up low single digits. We really haven't seen deflation in many places. So the last few years of higher prices hasn't necessarily hasn't reversed, but they've been stable. On the general merchandise sides, I think more discretionary categories, we've actually seen some deflation across categories like electronics, home, some apparel. So generally speaking, there's a bit of mixed picture in terms of how the upper income consumers have been reacting in spending versus how the lower income consumer really has had to shift some of their spending again away from discretionary and big ticket and more towards food and consumables just given the inflation that we've seen in the market over the past couple of years.

Rob Rowe (17:19)

And Paul, yeah, maybe we continue on the topic of inflation. There's an economist who used to be here at Citi used to say if you don't pay attention to headline inflation, then you probably don't eat or drive a car. But how is it looking for food prices? How much of a strain do you think is putting on the consumer here?

Paul Lejuez (17:38)

Yeah. It certainly has been a big point of strain over the past several years. And again, starting back in 2022, we really started to see food prices tick up to something we hadn't seen in a really long time. And we're finally starting to see less inflation. Seems kind of flattish to up low single digit, at least on the food side. And that's great that we're not seeing big increases anymore. Having said that, we're not seeing deflation in food. Every once in a while, we'll see certain categories where there are big retailers out there that will invest in price. You'll see some year of year declines in certain categories for short periods of time. But generally, as we think about food category overall across the board, we're running flat to up low single digits and that would be supported by, you would hear several of the large retailers, food retailers, talk about inflation in that range. I think everybody would like to see some declines, just in terms of the health of the consumer, we'd love to see more dollars get freed up, you know, not have to spend as much on some of those essential food items that would free up more dollars to spend on discretionary. We haven’t really seen that at this point because we're not in a deflationary environment. We're really more running flattish.

Rob Rowe (19:13)

And Paul, if you were to put this all together right now, what would you say or how would you define the health of the consumer for the rest of the year and maybe into 2025?

Paul Lejuez (19:22)

So yeah, it's a great question. And, you know, we think it's a very important one as we think about the economy in general, the health of the consumer, the health of our retail stocks that we cover, you know, we're trying to figure out what direction the consumer is going. And in terms of putting it all together, some of the things that we talked about, can we look at the U.S. consumer income statement and balance sheet both to sort of get a picture of what's going on? To help measure and forecast the consumer's income statement, we use our household available cash flow model. And what that model does — and the acronym, we call it the HAC model — the HAC model estimates the major disposable income inputs of the consumer income statement, like wages and employment, and it subtracts out a lot of the major non discretionary expenses, like food and energy and shelter, to help estimate how much money the consumer has left to spend on discretionary items, which, you know, it's a very important topic for the majority of the retailers in our coverage universes: How much is the consumer going to be able to spend on discretionary items? And so this household available cash flow model, this HAC model, tries to approximate the amount of money households will have left for discretionary purchases after spending on all those non discretionary items and savings. And it quantifies the estimated level of discretionary spending power consumers will have in the coming quarters by using Citi’s forecasts, our economists’ forecasts, for some of the key inputs.

And just to sum it all up, as we look at what the household available cash flow will show, will be, we're looking out to the third quarter of ‘24. We're actually looking for an increase in household available cash flow of about 3.4%. But then that slows to about 0.7% in the fourth quarter of ‘24. It slows further into the first quarter of ‘25 to pretty flat, up, maybe 0.1%. And then it starts to pick up a little bit in the second quarter of ‘25 up 1.5%. And so what that paints a picture of is, I would say, kind of a bit of a roller coaster in terms of what we're expecting, in terms of the consumer, and that year over year change to the spending power that the consumer has. Again, third quarter running up in the three-plus percent range, but then dipping down to sub-1% in the fourth quarter of ‘24 and into the first quarter of ‘25, before starting to back up again towards the second half of 2025. And again, this is very much based on our Citi economists’ forecasts, those are a very key input to this model that we use. But again, it does paint the picture of what we would say is a bit of a consumer roller coaster that we're likely to be on over the next several quarters and into 2025.

Rob Rowe (22:57)

It also suggests, Paul, some strength in — still some short-term strength — in the consumer. Paul, thank you so much for all of your insights here. It's been very insightful to me, you know, even individually as a consumer, to hear all the trends that are going on and also, how this could possibly affect the economy and inflation. Thanks again for being on our podcast.

Paul Lejuez (23:25)

Thank you. Thanks for having me.

Lucy Baldwin (23:27)

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