

## Orlando's Outlook: Consumer spending remains positive in April

May 14, 2010

Largely on the strength of a surge in the sale of building materials and a steady rise in the sale of both autos and gasoline, the Commerce Department reported that nominal retail sales climbed for the seventh consecutive month in April by a stronger-than-expected 0.4%.

Importantly, already-robust March results were revised sharply higher, to a headline gain of 2.1%, matching the single strongest retail-sales month since January 2006.

To be sure, April's nominal retail sales were significantly weaker than March. This sequentially slower pace was likely due, in part, to the Easter calendar shift, as Easter was eight days earlier (April 4) this year than last, which pulled some sales forward into March.



**Philip J. Orlando**

As regular readers of this space well know, however, we fully recognize that Easter bounces back and forth each year, which is why we much prefer to look at the two-month March and April period as a whole—compared with like two-month results from a year ago—before rendering an opinion. On that basis, we conclude that consumer spending remains healthy, and its future pace is likely dependent on continued employment gains.

To that point, the good news is that last week's April employment report boasted a gain of 290,000 non-farm jobs, the strongest payroll report in four years.

Nominal retail sales in April rose by a stronger-than-expected 0.4%, compared with the consensus forecast for a more muted 0.2% gain last month. March headline retail sales were revised sharply higher, growing now at a robust 2.1%, compared with a previously reported 1.6% gain.

Core retail sales—which strip out volatile auto results—rose by an in-line 0.4% in April, while March's results were revised to a gain of 1.2%, double what had been previously reported.

Adjusted core retail sales—which strip out the results from both gasoline and auto sales—rose by 0.4% in April, which was a tick better than the consensus forecast. March was revised to a gain of 1.3%, compared with an originally-reported increase of 0.7%.

### Building materials could form a foundation

Digging into the detail, it's clear that building materials were the star performer, soaring by 6.9% in April, on top of a 7.8% surge in March. In our view, this is likely related to the recently expired April 30 deadline for the \$8,000 tax credit for first-time, low-income home buyers.

Other April highlights include gains of 0.5% for both autos and gasoline, compared with stronger March gains in these two categories of 6.7% and 1.0%, respectively.

But the rest of the retail picture in April was relatively bleak: department stores fell by 1.5% last month, versus a 1.3% gain in March; apparel dropped by 1.0% in April, compared with a 2.6% increase in March; furniture declined by 1.2% last month, versus a 2.1% gain in March; and general merchandise slipped by 0.4% in April, compared with a modest 0.6% increase in March.

These sharp sequential reversals, in our view, are probably due, at least in part, to the shift in the Easter calendar. Nonetheless, the bears have been quick to point out that in April, if we back out everything that was positive—namely building materials, autos and gas—then we're left with mostly negative contributors, which collectively account for a 0.2% monthly decline in headline sales, which would have been the first decline since July.

Clearly, then, with the Easter shift and the \$8,000 housing tax credit now behind us, all eyes will be on May's retail sales results, to glean whether more balanced category growth resumes.

### Confident consumer buoying GDP

Gross Domestic Product (GDP) grew by 5.6% in the fourth quarter of 2009 and by a preliminary 3.2% in the first quarter of 2010. Some of that strength was certainly attributable to consumer spending, which rose by 1.6% in the fourth quarter and by 3.6% in the first quarter. In fact, given the strong upside revision to March's retail sales results, that augurs well for an upside revision to first quarter GDP on May 27.

We continue to believe that this positive turn in consumer spending has legs. As we've detailed previously, the improvement over the past 15 months in both employment and housing have resulted in a sharp improvement in consumer confidence.

The Conference Board's consumer confidence index hit an all-time low at 25.3 in February 2009, and it has more than doubled to 57.9 in April 2010. The Thomson Reuters/University of Michigan index of consumer sentiment similarly rose from a 30-year low of 55.3 in November 2008 to a preliminary May 2010 reading of 73.3.

Bottom line, we have enjoyed a positive turn in retail sales during last year's important Back-to-School season, a surprisingly robust Christmas, and powerful Easter results.

### **Fundamentals good for continued retail therapy**

It appears as if the so-called "80/20 Rule" is in effect—the top 20% of America typically drives 80% of the consumer spending in this country. Higher-end consumers are beginning to feel better about themselves, so retail therapy is in full swing.

The reality is that there is enormous pent-up demand among consumers—particularly at the high end—who are sick of depriving themselves, in the face of an improving jobs picture, a strengthening economy and surging financial markets—up until three weeks ago, that is.

Since then, investors have been ignoring solid economic fundamentals—such as solid retail sales numbers—and have focused their attention instead on a variety of euro-centric concerns, resulting in a volatile 12% correction since the equity market's cycle peak on April 26.

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Views are as of May 14, 2010 and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security.

Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

The Consumer Confidence Index is based on a survey by the Conference Board that measures how optimistic or pessimistic consumers are with respect to the economy in the near future.

The Thomson Reuters/University of Michigan Consumer Sentiment Index is a measure of consumer confidence based on a monthly telephone survey by the University of Michigan that gathers information on consumer expectations regarding the overall economy.

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