

MONDAY REPORT ON RETAILERS

The CCI as a Barometer of Consumer Spending

By Richard Jenkins, Ph.D., Vice President and Director of the TNS Consumer Confidence Index

With the United States sliding into or already in a recession, there is much talk about whether Canada will resist the pull of our closest neighbour and avoid a significant downturn. According to many published reports, Canada's balanced budgets, low unemployment and other strong economic fundamentals, will help to insulate us from the worst of the mess south of the border. Those with investments in the stock market, though, have undoubtedly noticed that the credit problems in the U.S. have far-reaching implications.

There is no question, however, that confidence or its antithesis, fear, can play a significant role in blunting or flaming the impact of a downturn. Consumer spending is the engine in a modern economy and, while we expect spending to decline when one's personal situation is negative (ie. when one has lost his/her job), spending can also erode out of fear of losing one's job.

Our barometer of consumer sentiment in Canada and in other Western economies is the Consumer Confidence Index. Conducted each month, the survey provides a monthly tracking of consumers' evaluation of the present and future state of the economy. Since it is independent from, though clearly related to, official indicators, it taps the underlying currents of public opinion.

In the U.S., the Consumer Confidence Index as tracked by the U.S. Conference Board fell from 111.9 in July to 89.9 in January, a precipitous decline of 21 per cent. No one looking at the trend, which seems to have continuing negative momentum, would expect consumer spending to rebound.

What then can we say about Canadians? Is confidence here fragile? Are Canadians starting to send signals that will translate into lower retail spending? The evidence is mixed, in part, because of the overall strength of the Canadian economy.

Over the past three plus years that TNS has conducted the Consumer Confidence Index in Canada, the overall trend has been positive when it comes to short-term evaluations of the economy. The Present Situation Index, which captures evaluations of the overall state of the economy and the employment situation, rose from 103.9 in July of 2004 to reach a high of 122.8 in November of last year, just before the depth of the U.S. crisis was starting to become apparent.

As bad news started to come in about the state of the U.S. economy (particularly the sub-prime news), Canadians reacted with a drop in their overall level of confidence. The drop has not been sustained, however, as the Index is now sitting at 118.7. Looking at the state of the current economy, those who think the economy is presently very good outnumber those who think it is very

bad by a four to one margin (12% compared to 3%). Canadians think the economy is strong and this should continue to drive consumer spending.

A good indicator of confidence is an assessment of whether it is a good time to make a major purchase, which is reflected in the Buy Index. If this is a good time to buy a big-ticket item, the implication is that one does not need that money to pay for an employment disruption or rising costs for essentials. Over the past two years, the Buy Index has fluctuated but largely stayed within the same range. Although not as many people think this is a good time to make a major purchase as did so in 2004, when low interest rates seem to have driven a very positive consumer outlook, 39 per cent of Canadians think that now is a very good or somewhat good time to make a major purchase. The appetite for spending has not yet been dampened by the rash of mostly U.S. negative news.

The one potential area of concern is Canadians' assessment of the future. The Expectations Index, which measures consumers' estimation of the economy, household income and employment in six months, declined for the third consecutive month in February. The index value is now 97.9 (down from 98.5 in January). This is the lowest level the Index has reached since the fallout from Katrina in the fall of 2005.

In fact, pessimists outnumber optimists when it comes to the future state of the economy. While 19 per cent think the economy will be better in six months, 27 per cent think it will be worse. Since the economy seems to be performing so well in people's minds, an expectation of some deterioration may not be too worrisome.

Retailers can be cautiously optimistic based on the current state of opinion and the implications for their business. Despite the considerable bad news about the economy south of the 49th parallel, Canadians have largely maintained a positive outlook. Confidence has declined but not fallen precipitously.

The Canadian economy must, however, deal with a range of significant economic risks that flow from a recessionary economy in the U.S., as well as the high Canadian dollar with its negative implications for our country's manufacturing and tourism industries. How these two sectors respond may determine how the barometer of consumer sentiment changes over the next six months to a year. If the news is bad, then consumers could be driven by fear and rein in their spending, which would spell trouble for the retail sector.

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