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More Clever Economic Indicators

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Rock fish, 401(k) withdrawals, shopping bags and snowflakes: When deciphering America's economic future, tea leaves come in many forms. To get a good read, Knowledge@Wharton asked a few professors, economists and company bosses in a range of industries what they saw in their cup of tea--which economic indicators they planned to watch during the final quarter of 2009, and what they are waiting to see in 2010 that would convince them the economy is turning around. On the macro side, from retail to real estate, finance to factories, the central theme of employment echoed again and again. Retailers linked it to consumer confidence, real estate watchers to office space, bankers to loan losses, and manufacturers to product demand.

Indeed, Wharton real estate professor Susan Wachter believes that high unemployment will persist through 2010, impacting the real estate market. Although the residential housing market is turning around, the commercial real estate market is the next shoe to drop, and that isn't going to turn around until employment does, she says. "Commercial is a lagging indicator, and it follows employment. Employment itself is a lagging indicator. Probably six months after we see employment improving we'll see commercial improving, and we don't see employment changing in 2010."

Steven Silverstein, for one, is preparing for a long haul. The CEO of Spencer Gifts, a mall retailer that targets the 18- to 24-year-old demographic, Silverstein says he's "adjusting to the new normal" of a cautious consumer. "The consumer has a different mindset now.... We're not going to see the revenue growth that we have been accustomed to in the past."

On a macro level, Silverstein is keeping an eye on inflation and employment--especially teen employment, since his stores appeal to young people. Store to store,he's looking more closely than ever at his margins, keeping inventories tight, focusing on efficiency and expenses, and getting costs out of the system. "Everybody realizes we have to tighten our belts a little bit."

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The number one economic indicator for Silverstein is consumer confidence. "I don't sell anything that people need. I only sell things that people have to have," Silverstein says of his store's offerings. "We're all about how the consumer is feeling and what's in his or her wallet." He remains optimistic that consumers will come back eventually. "They're resilient," he says. "Nobody likes to stay home forever. We might be pleasantly surprised in the fourth quarter."

Retailers aren't the only ones watching retail sales. Bankers are too. "Everyone's looking for that magic indicator," says Paul Merski, senior vice president and chief economist of Independent Community Bankers of America, an association of more than 5,000 community banks throughout the U.S. "The one thing I would look at is holiday retail sales. If that's down in the dumps, it's an indication that confidence hasn't returned and risk-taking hasn't returned. ... The strength of the economy is still tied very much to personal consumption spending."

Merski says he's also watching any indicator linked to jobs. "If you have roughly 10% of the workforce idle, that is a significant drag on consumer confidence ... and the capacity to spend." In addition, bank customers haven't been taking out enough loans. "Loan demand has decreased dramatically," says Merski, adding that the common refrain that credit is hard to get isn't really true. The fact is, banks would like to make loans--after all, loans mean income for a bank--but consumers and businesses are too nervous to borrow. "Both businesses and households are de-leveraging, repairing their balance sheets and not seeking as much credit," he says. "As a small business, if your sales are down and you're laying off workers, why would you need more credit?"

One of the biggest question marks in retail is how long consumers can hold off on spending the way they used to, says Wharton operations and information management professor Marshall Fisher. Last year, consumers "hunkered down massively when the economy tanked," and retailers were caught off guard. With holiday sales sluggish, inventories piled up, and retailers were forced to slash prices to unheard of lows to get merchandise out the door. Since then, consumer behavior has changed. Consumers are delaying purchases and trading down to lower-priced items. "It remains to be seen whether that will persist," Fisher says. "If you talk to people from Walmart, they'll say, 'These customers are ours for good. There's been a sea-change in how people think about consumption.' Talk to people from [luxury retailer] Tiffany, and they will say, 'The fundamentals of human behavior are invariant. People will go back.' I would say that's a big, big question mark."

Underlying that question mark is the issue of leverage, Fisher points out. Before the recession, "the buoyancy of the economy was driven by leverage." People borrowed, spent, took out money from home equity loans and spent again. Today, with unemployment rising and home prices stagnant, "consumers--instead of borrowing money--are paying down their debt," Fisher says. "Will that persist? If it does, then that has long-term implications."

More Savings Accounts for Children

Household insecurity is familiar to R. Michael Menzies, president and CEO of Easton Bank and Trust in Easton, Md. "We have one of the highest unemployment rates in all of Maryland," Menzies says. A wealthy retirement community, Easton has grown in the past few years due to in-migration and real estate activity. But the recession has cast a pall over that growth. Loan losses are at a record high as asset values have fallen and over-leveraged customers have lost their jobs, Menzies says. Delinquencies are also up. "When they begin to trend down, that will be an indicator that people are going back to work."

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Menzies doesn't stick to paper indicators to show him where his business might be headed. "I can tell you that we have some of the best rock fishing in the history of the Chesapeake Bay, and I'm the only boat out there right now," he says, wondering if his fellow fishermen are having trouble putting fuel in their boats. Another possible economic sign for Menzies: restaurants. "When people eat, they feel good. ... [Right now], restaurants are average to slow. In this community, when the restaurants pick up, it indicates people are making money and going out to eat."

For some bankers, the careful consumer is actually good for business. Arkadi Kuhlmann, president and CEO of ING Direct--an online bank based in Wilmington, Del., that advertises low fees and simple ways to save -- has seen an influx of new customers since the recession took hold. The number of children's savings accounts jumped 28% this year, for example. "Parents are opening accounts for their children and teaching them how to save," he says. "I think Americans have gotten the message of getting your debt down. ... We're not going back to the way it was before. ... I haven't talked to a person in the last year who hasn't cut back on a trip, decided against a purchase or scaled back in some way. ... People are saving. And they're actually reducing their debt more than they're saving."

Kuhlmann sees signs that his customers are still under economic duress. While there is evidence of new customers opening savings accounts and retirement plans at the bank, there is also a troubling trend of customers borrowing from their 401(k)s and IRAs. "It's a bit strange that we have an increase in saving, a decrease in debt, and people are still taking money out of their 401(k)s." Kuhlmann says. "People tapping into their 401(k)s show they're still under stress." A decrease in 401(k) withdrawals will be a sign for Kuhlmann that the economy has turned around.

He even sees signs of the weakened economy in his staff, who have held on to their jobs since the economy slowed. Company surveys show employee engagement is down--yet turnover has all but ceased. "If turnover increases, that means people are out there looking for more opportunities," Kuhlmann suggests. "We traditionally have about an 18% turnover. This last year it's been 3%. ... People just don't move. [Our first thought] is that this is really great. ... People are staying because they want to be here. The truth is that probably a bunch of people do want to leave but can't."

Low turnover is bad business for Douglas E. Frost, owner and president of Frost Manufacturing in Worcester, Mass. Frost is in the "marking and identification business," making name plates, badges, building directories, rubber stamps and placards for companies in Massachusetts and beyond. One bit of steady work has typically come from a Fortune 500 company that makes information storage systems. For years, the company contracted with Frost to make name plates for new hires. Before the downturn, he churned out 50 to 70 name plates a week. Today, he's lucky if he makes 30. Work from other clients showed a similar drop. "In October to November of last year, the faucet just turned off. I've been through a lot of recessions," says Frost, who is the fourth-generation owner of the company. "I've never seen orders stop so fast. Sales dropped 40% in a month and they have stayed down since."

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One bright spot for Frost is local universities and colleges, which continue to demand signage as they renovate dorm rooms and build new buildings. And of course, there's always the weather. "When the snow goes away, we get some business from all those signs that get wrecked by the plows," he says.

For the nation at large, there are a few early indicators of economic thaw. November brought hope on the job front when the nation's unemployment rate dropped to 10% from 10.2% and U.S. employers cut 11,000 jobs, the lowest monthly job loss in nearly two years. But experts say jobs remain a lingering concern that will continue to reverberate into other areas of the economy.

Jobs are an essential component of a full real estate recovery, says Wharton real estate professor Peter Linneman. "Jobs are what fill space -- think of an office building. A lot of [economic indicators] matter, but jobs really matter."

Linneman says he couldn't pick just two or three economic indicators that would tell him where the economy was headed, saying he watches about 50 metrics involving GDP, jobs, manufacturing, output, capital flows and more. "I view the world as a Seurat painting--a whole lot of dots that alone mean very little, but taken in a larger context, they make a bigger picture. You have to get far enough away to see the picture, but close enough to see the dots. And the dots constantly change. It's like a motion picture of dots rather than a still-life of dots. It's like a Seurat movie. And the picture is the economy."

For Erin Armendinger, managing director of Wharton's Jay H. Baker Retailing Initiative, dots come in the form of shopping bags. And she is starting to see some positive paper-bag indicators: There seem to be a few more shopping bags on the streets of Manhattan, for example. Many of those bags sport store logos--a switch from the end of 2008, when flagrant spending became taboo.

"People are more comfortable purchasing at this point than they might have been last year," Armendinger says. "During holiday 2008, we heard stories of people asking for plain whitebags at high-end stores [because]they were not comfortable with what others thought of them spending money. We are not seeing that now."

Still, there's a long way to go, especially if unemployment persists. "Unemployment has a psychological effect on people," Armendinger adds. When unemployment is rising, even people who have jobs may be skittish about splurging on discretionary items, putting a damper on retail sales. She thinks the retail industry will be watching comparable store sales during the holiday season to see if shoppers spend more than they did in the same period last year. Retailers will also be watching "conversions"--that is, how many shoppers who walk into the store actually buy something instead of just looking around. And in the malls, retailers will be paying attention to foot traffic as a sign of consumer confidence.

"If people are not confident enough to go to the mall, then there's not even a chance of converting them," says Armendinger. Retailers need to get consumers "through the door, get them spending, and get them spending at full price. Until that happens, we don't really have a healthy economy."

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