FEB 24

Zak Stambor

Retailers offer a cautious outlook even as consumer spending remains strong

Article

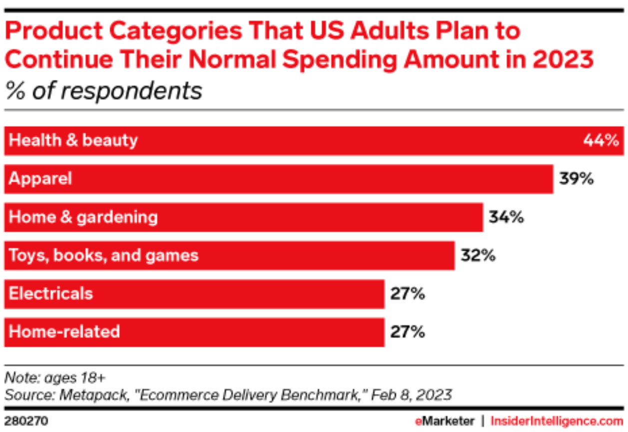
The challenge: Consumer spending remained resilient in January even as inflation ticked up.

- **The US economy remains strong.** Spending by US households rose a seasonally adjusted 1.8% month-over-month (MoM) in January, the largest increase in nearly two years, and a marked shift from a small decrease in December, per the US Commerce Department.

- **Inflation persists.** The personal consumption expenditures (PCE) price index—the Fed's preferred inflation gauge—rose 5.4% year-over-year (YoY) in January, up from 5.3% in December. Core PCE price index, which excludes volatile food and energy prices, rose 4.7% YoY, up from 4.6% in December. Both measures rose 0.6% MoM.
- **Consumer confidence ticks up.** Consumer sentiment rose modestly in February, per the University of Michigan. While that's the third consecutive month of gains, sentiment remains far below its historical average.

The combination of stronger-than-expected economic activity and slower-than-expected progress on inflation will likely drive the US Federal Reserve to continue hiking interest rates.

- That will likely hinder retailers' long-term investments and slow retail sales, which is why retail companies across several categories—including **Home Depot**, **Walmart**, **Dollar General**, and **Steve Madden**—recently offered cautious guidance.



Retailers look ahead: The past few years have presented retailers no shortage of unexpected challenges and shifts in consumer spending patterns, which is why many have come to bake the unforeseen hiccups into their guidance.

- After missing analysts' expectations for the first time since November 2019, Home Depot expects sales to be roughly flat in the new fiscal year due to shoppers growing more price-sensitive and shifting their spending toward experiences rather than home projects.

- Walmart has what CFO **John David Rainey** referred to as a “cautious outlook” on the macroeconomic environment. It expects US comparable sales to grow between 2% and 2.5% for the full year, excluding fuel sales, with sales growth strongest in the first half then moderating in the second half. But Rainey offered a caveat: “While the supply chain issues have largely abated, prices are still high, and there is considerable pressure on the consumer. Attempting to predict with precision these swings in macroeconomic conditions and their effect on consumer behavior is challenging.”
- Dollar General expects its full-year profit to rise between 4% and 6%, far short of analysts’ expected 10.6% increase, due in part to higher-than-expected borrowing costs.
- Steve Madden expects revenues to decline between 6.5% and 8% in 2023 compared with 2022 as wholesale pressures weigh down its results. Retailers have pulled back their orders due to excess inventory and slowing demand.

The big takeaway: Despite the uptick in consumer spending in January, we expect growth to slow throughout this year as the Fed continues to hike interest rates to curb demand and weaken inflation.

- That will undoubtedly produce some stiff headwinds for retailers that rely on discretionary spending.