

L.E.K. Consumer Sentiment Survey 8: Consumer Optimism Reaches Highest Levels Since the Recession

The persistent aftershocks from the recession have understandably colored consumers' outlook toward their finances and the economy. But that's changing as L.E.K. Consulting's Consumer Sentiment Survey (CSS) shows the highest levels of consumer optimism toward the economy and their personal finances since the height of the recession in fall 2008 when we launched the report series. We surveyed more than 2,000 U.S. consumers in May 2012 for our eighth L.E.K. CSS. The semi-annual survey tracks consumers' spending predictions for the next six months based on their perceptions of their personal finances and the economy.

Consumers' expectations of economic conditions during the next six months have increased nearly 29% since our fall 2011 L.E.K. CSS, but still reveal a slightly negative outlook. Another first since the recession is that consumers who believe that their financial situations will improve over the next six months outnumber those who believe it will deteriorate. While most consumers feel that their situations will remain the same, the net positive is a more than 9% increase since fall 2011. But despite the renewed confidence along these two economic measures, consumers remain cautious about their spending. Although they expect to spend slightly more than they projected in the fall 2011 L.E.K. CSS, they continue to tighten their fiscal belt and plan to spend less during the next six months than they did last spring.

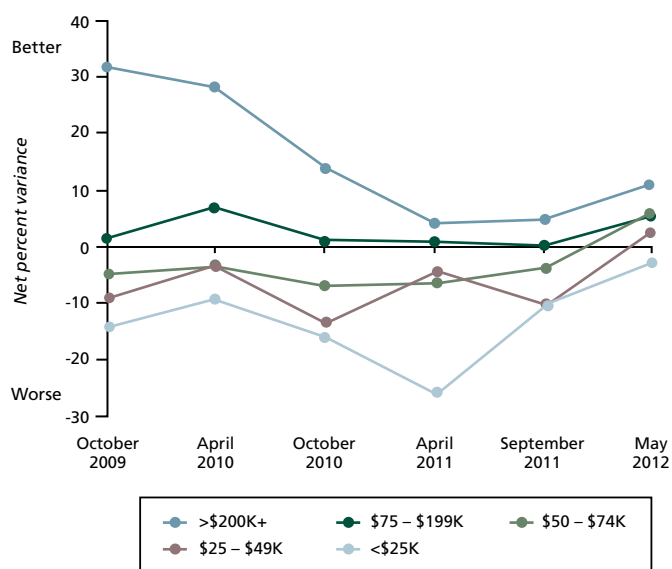
L.E.K. Consumer Sentiment Survey 8: Consumer Optimism Reaches Highest Levels Since the Recession was written by **François Mallette**, a Vice President and head of L.E.K.'s North American Private Equity Practice; and **Jon Weber**, a Vice President at L.E.K. Consulting in the Retail and Consumer Products Practices. Please contact us at retail@lek.com for more information.

The Income Divide

Households with incomes greater than \$75,000 contribute approximately 57% of total consumer spending. With this in mind, our findings that upper-middle class and affluent consumers expect their personal finances to improve could favorably affect spending and have an outsized impact on the economy (see Figure 1).

Figure 1

Sentiment on Expected Personal Finances by Household Income – Today vs. Six Months in the Future



Note: High-income consumers are defined as having a household income of over \$75K; low- and middle-income consumers are defined as having a household income of less than \$75K

Source: L.E.K. Consumer Sentiment Survey, May 2012

Affluent consumers (\$200K+) are the most optimistic about their personal finances improving, and all other income groups expect to see gains. Notably, the \$25-\$49K and \$50-\$74K income demographics have crossed the net positive threshold for the first time in recent memory, with each group reporting double-digit increases regarding outlook toward personal finances during the coming months (compared to the last report). The \$75-\$199K group also shares a similar level of optimism with these two income groups. And although the <\$25K households are signaling more confidence in this area, they still have a slightly negative net overall outlook toward their personal finances.

Separately, L.E.K. also surveyed consumers about their planned spending habits. We found that nearly one-fifth of affluent households predict spending more during the next six months, with an additional 60% planning to maintain their spending patterns. A similar percentage of households in the \$75-\$199K income bracket expect to increase their spending and nearly half (48%) plan to maintain current spending levels. Lower-income households (<\$49K) have a more uneven outlook, with nearly 20% responding that they will likely decrease their spending by more than 15% during this time period.

Spending Trends Across Key Industries

In addition to understanding spending trends by income level, L.E.K. also asked consumers to share their projected spending across multiple categories during the next six months (see Figure 2). Key findings include:

- Expectations for spending have increased across the board since the fall 2011 L.E.K. CSS; however, in many cases these gains are minimal and we project that many categories will still have an overall net negative spending outlook
- Categories such as groceries, home renovations and vacations are expected to fare much better than others

Figure 2

Projected Change in Category Spending During the Next Six Months

Category	Overall Percent Change
Groceries	1.3
Autos	1.0
Home renovations	0.6
Vacations	0.3
Health & wellness	0.0
Pet products	(0.1)
Sporting equipment	(0.6)
Personal care, cosmetics	(0.6)
Furniture, appliances	(1.1)
Computing, mobile, software	(1.4)
Footwear	(1.6)
Clothing, apparel	(1.6)
Books, magazines, etc.	(1.9)
Toys, games, arts & crafts	(1.9)
Fine jewelry and watches	(2.0)
Home entertainment	(2.5)
Dining out	(2.6)

Source: L.E.K. Consumer Sentiment Survey, May 2012

- Spending is growing among the \$50-74K income bracket in multiple categories. In fall 2011, this group only forecasted a net positive spending increase in groceries, while the latest results show this income group projecting to have a net positive spending outlook in six categories (automobiles, groceries, health & wellness, home renovations, pet products, and vacations & leisure travel)
- Income groups including \$75-\$199K and \$200K+ are also planning to bolster their spending across multiple categories

Key Takeaways and Implications

During the five-year course of the L.E.K. CSS, we've seen a relationship between changes in the direction of consumer sentiment and the magnitude of subsequent retail sales growth. This leads us to an expectation that retail sales could grow faster in the next six months than during the previous half year (although many other factors may ultimately determine actual spending through the remainder of 2012).

The L.E.K. CSS also illustrates the market polarization between affluent and lower-income consumers, where rising income inequality and an increasingly squeezed middle class are creating an "hourglass" economy. We anticipate this phenomenon will fuel greater spending by higher income consumers, and these consumers will also likely spend more on higher quality and premium brands. On the other hand, lower income consumers are likely to disproportionately shop for value, which will be reflected in the lower-tier brands and channels they choose.

Given this outlook, we encourage companies to take a hard look at their strategies to ensure they are aligned with the trends occurring at the top and bottom of the hourglass, as these can be important sources of growth in an otherwise still challenging economic environment.

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