

Pricing Power Test Time

February 7, 2005

One of the leading headlines today reads “EBay cuts fees to appease customers.” On a more personal basis, we know of a local advisor who upon learning that a certain radio station has raised their advertising rates, cut them out of their budget. Let us ask the question – why are Procter & Gamble and Gillette merging? Why are SBC and American Telephone merging? Why is Qwest looking at MCI? The answer to all of this comes right down to globalization. **The only way** a business can stay in business is to become a low cost producer or have some “sex or snub” appeal, such as Starbucks. In aggregate, there is no pricing power. Note that the mergers mentioned together will cut 20,000 jobs (7,000 from Gillette and 13,000 from telephones).

Note the following numbers as they pertain to employment. George Bush needed 30,000 new jobs to be created in January in order for the economy to have not lost jobs during his four year tenure to date. January produced 146,000 so he’s off the hock. No Hubert Hoover here – yet. Also, as you know, we have been tracking “lost employment” numbers since the recovery began in November of 2001. As of the end of January 2005, it amounts to 9.8 millions less jobs when compared to past recoveries. In buying power that amounts to something like \$196B less. Now some of that was made up from tax cuts, which are now gone, as well as borrowing, which continues to this date. But my friends, borrowed money is on borrowed time.

Have you noticed that, on the retail side, those at the high end continue to do well a la Neiman Marcus and Nordstrom’s, but those such as Wal-Mart remain in the very low single digit increases? Why? Wall Street is doing well (those who sell, not those who buy) but Main Street (you and I) are not. This also can not last forever. Please note the following table, which compares personal disposable income to GDP. Note that income is approaching the level of the recession year of 2001. One of these days, the lending institutions will say “*no mas.*” At any rate, they had better, for their own salvation.

| U.S. GROWTH OF DISPOSABLE PERSONAL INCOME IN % (IN CHAINED DOLLARS, ANNUALIZED) | | | | | | | |
|--|------|------|------|------|-------|-------|-------|
| 1999 | 2000 | 2001 | 2002 | 2003 | Q1 04 | Q2 04 | Q3 04 |
| 3.0 | 4.8 | 1.9 | 3.1 | 2.3 | 2.4 | 2.8 | 2.0 |

| GROWTH OF GDP IN % (IN CHAINED DOLLARS, ANNUALIZED) | | | | | | | |
|--|------|------|------|------|-------|-------|-------|
| 1999 | 2000 | 2001 | 2002 | 2003 | Q1 04 | Q2 04 | Q3 04 |
| 4.5 | 3.7 | 0.8 | 1.9 | 3.0 | 4.5 | 3.3 | 4.0 |

SOURCE: BUREAU OF ECONOMIC ANALYSIS, U.S. DEPARTMENT OF COMMERCE