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Monday Morning Outlook

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Consumers Resilient - Don't Buy the Tapped Out Story

It always seems someone, somewhere, is worried consumers are tapped out, and the economy is on the verge of serious problems. The theory goes that consumers have to use so much of their money to service their accumulated debts that little is left to increase their "discretionary" spending." At some point this could be true, but not today.

One reason we aren't worried is that according to the Federal Reserve, consumer net worth is at a record-high of $56.2 trillion, a $17.2 trillion increase since early 2003 when the stock market hit bottom. Another reason is that our measure of consumer "free cash-flow" is also at a record high.

To calculate consumer free cash-flow we start with total personal income, which includes wages and salaries, fringe benefits, small business profits, rent received, interest, dividends, and transfer payments. We then subtract income taxes (we can't spend what we pay the government) and adjust for inflation.

Next, we exclude a broad measure of financial obligations calculated by the Federal Reserve. These obligations include mortgage payments, homeowners insurance, property taxes, rent, car lease payments, and all the debt service we have to pay on auto loans and other loans, including credit card debt. Then we divide by population to get a per capita figure. The result is a measure of how much cash the average consumer has available to spend out of current income that is not needed to meet monthly obligations – what we call consumer free cash-flow.

To be sure, at 19.2% in the first quarter of 2007, the Fed's financial obligations ratio – the share of after-tax income consumers have to use to pay all their monthly obligations – remains near the record high of 19.4% set last year. But after-tax incomes are up so much that the amount of cash left over after meeting these obligations has been growing at a healthy rate.

Consumer free cash-flow is up 2.1% in the past year and 1.4% per year over the past five years. Growth in cash-flow is actually better than it was at the same point in the expansion of the 1990s.

This has not been caused by reduced tax burdens. Tax payments have actually climbed faster than income. It is a function of strong gains in income caused by rising productivity.

In our view, with unemployment low and productivity growing, the growth in worker income should accelerate in the next few years. Bottom-line: The US consumer is in solid shape and will continue to account for a substantial contribution to GDP growth.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-25 / 9:00 am	Existing Home Sales - May	6.000 Mil	**5.972 Mil**		5.990 Mil
6-26 / 9:00 am	New Home Sales - May	0.920 Mil	**0.922 Mil**		0.981 Mil
9:00 am	Consumer Confidence - Jun	105.5	**105.8**		108.0
6-27 / 7:30 am	Durable Goods - May	-1.0%	**-3.8%**		+0.8%
7:30 am	Durable Goods (Ex-Trans) - May	+0.2%	**-1.1%**		+1.9%
6-28 / 7:30 am	Q1 GDP Final	0.8%	**0.8%**		0.6%
7:30 am	Q1 GDP Chain Price Index	4.0%	**4.0%**		4.0%
7:30 am	Initial Claims - Jun 23	318K	**319K**		324K
6-29 / 7:30 am	Personal Income - May	+0.6%	**+0.6%**		-0.1%
7:30 am	Personal Spending - May	+0.7%	**+0.7%**		+0.5%
8:45 am	Chicago PMI - Jun	58.0	**59.3**		61.7
9:00 am	Construction Spending - May	+0.1%	**-0.3%**		+0.1%
9:00 am	U. Mich. Consumer Sentiment	84.0	**84.1**		83.7