First Trust
Monday Morning OUTLOOK
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The Consumer Is Not Dead

If US consumers could speak as one, they would paraphrase Mark Twain and announce "the reports of my death are greatly exaggerated."

Not a day goes by where we don't hear a talking head say something like, "the consumer is not spending" or "the consumer is weak." A weekend headline from the Wall Street Journal was more specific. It said, "Spenders Become Savers, Hampering Growth." The WSJ based its theory on some interesting anecdotes, but the authors missed some very basic facts.

Retail sales in September were up 7.9% from a year ago, 7.8% excluding autos. Auto sales – the kind of big-ticket item skittish consumers would shy away from – are up more than 10% from a year ago. In fact, based on early estimates for October from Edmunds.com and JD Power, auto sales may be hitting their highest levels since before the collapse of Lehman Brothers – other than the brief flurry caused by cash for clunkers in August 2009.

All consumer spending, goods and services combined, are at record highs, both on a nominal basis and adjusted for inflation. We believe real consumer spending increased at about a 2% annual rate in Q3 (official GDP data arrives Thursday).

What the story got right is that households are still deleveraging, or paying down debt. The "financial obligations ratio" measures all the monthly payments households have to make based on the things they've already purchased: mortgages, rent, car loans/leases, other kinds of debt service…etc. After hitting a record high back in 2007, the Fed estimates that these obligations have fallen to the smallest share of after-tax income since 1993.

Conventional wisdom says that deleveraging can limit consumer purchasing power. But this only looks at one side of the equation. When consumers pay down debt, the money that they shift to savings (or debt retirement) goes back to the lender, who now has money, and can spend. At the same time, rising incomes can allow consumers to spend more and deleverage at the same time.

Or, if consumer deleveraging continues, but at a slower pace, overall consumer spending can still go up. Here's a simple example: if you make $50,000 every year and the first year you pay down $5,000 in debt, you can spend $45,000. If the next year you pay down $2,000 in debt, your spending grows to $48,000. You're still deleveraging, just not doing so as quickly as before.

But even the "savings is bad" crowd misses a logical conclusion of their own model. If the US saves more our trade deficit can shrink relative to the size of our economy, meaning a larger share of what we buy is made in the US. In other words, even if spending grows more slowly, domestic production can still go up faster.

The bottom line is that organic changes in consumer behavior are not responsible for any lack of rapid economic growth. Instead, the economy would be growing much faster if we had a better set of policies coming from Washington, DC the past few years, in particular, if policymakers had focused on restraining the size of government rather than expanding it.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-25 / 9:00 am	Consumer Confidence - Oct	46.3	**46.5**		45.4
10-26 / 7:30 am	Durable Goods - Sep	-1.0%	**-1.2%**		-0.1%
7:30 am	Durable Goods (Ex-Trans) - Sep	+0.4%	**+0.5%**		-0.1%
9:00 am	New Home Sales - Sep	0.300 Mil	**0.300 Mil**		0.295 Mil
10-27 / 7:30 am	Q3 GDP Advance Report	+2.5%	**+3.5%**		+1.3%
7:30 am	Q3 GDP Chain Price Index	+2.4%	**+2.7%**		+2.5%
7:30 am	Initial Claims - Oct 22	401K	**401K**		403K
10-28 / 7:30 am	Personal Income - Sep	+0.3%	**+0.3%**		-0.1%
7:30 am	Personal Spending - Sep	+0.6%	**+0.7%**		+0.2%
8:55 am	U. Mich. Consumer Sentiment	58.0	**58.0**		57.5