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Popular Economics Weekly

Week of October 1, 2007

Consumers Are Recovering

The key to a recovery from the subprime debacle is the health of consumers. And so consumer spending is the most closely watched indicator at present, with the Federal Reserve now waiting to see whether its one-half percent rate cut will keep consumers, and so the economy, humming. Surprise, surprise. August consumer spending is the highest in 2 years; probably because the labor market is still creating jobs.

It is a pleasant surprise, given all the bad news in August. It means the Fed has room to cut rates further at its October 31 FOMC meeting should real estate sales continue to decline. August new and existing-home sales dropped 8.3 and 4.3 percent, respectively, and for sale inventories are up to a 10-month supply. Another surprise is that median prices are still holding, as higher-end homes continue to sell. The drop in the Prime Rate that determines most credit card rates could also spur more consumer spending over the holidays. August credit card debt rose a whopping 8.1 percent, or \$6.1 billion, according to the Federal Reserve.

September's unemployment report also generated optimism. Though the jobless rate rose from 4.6 to 4.7 percent, 110,000 new payroll jobs were created and past months' employment was revised upward. Health care and food services are responsible for one-half of all payroll jobs created this year, according to the Labor Department. Mortgage lending, its related services, and construction continue to lose jobs, however.

The good jobs picture is encouraging consumers to continue to shop. Real consumer spending increased a large 0.6 percent, while the inflation rate is back down to early 2004 levels. The Personal Consumption Expenditure index, the major inflation indicator, is up just 1.8 percent in 12 months. Average hourly earnings are rising 4.1 percent—double the inflation rate. The fact that incomes are rising faster than inflation has to make consumers feel more secure.

"Consumers -- so far -- are taking the recent financial turbulence in stride," said economists for Credit Suisse in their weekly outlook. They look for a 0.4 percent increase in September sales, boosted by moderate growth in general merchandise sales, and sales growth in restaurants, building materials and apparel.

But others think the retail numbers won't be so rosy. "Sluggish chain-store suggest that September was a disappointing month for retailers," wrote economists for Global Insight, who expect only a 0.1 percent gain in sales. "Consumers have become more cautious and resistant to outlays on big-ticket items," such as building materials and durable household goods.

For the third quarter as a whole, consumer spending increased at a 3 percent annual rate, double the growth recorded in the second quarter, economists said. This could mean that third quarter economic growth will exceed 3 percent, following the 3.8 percent Q2 final estimate of GDP growth, since consumer spending accounts for two-thirds of economic growth.

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