THE ECONOMIC OUTLOOK GROUP

475 Wall Street
PRINCETON, NEW JERSEY 08540   Tel: 609 - 529 - 1300
www.economicoutlookgroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

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Personal Income and Spending:
Consumers are ready to ramp up spending if only…

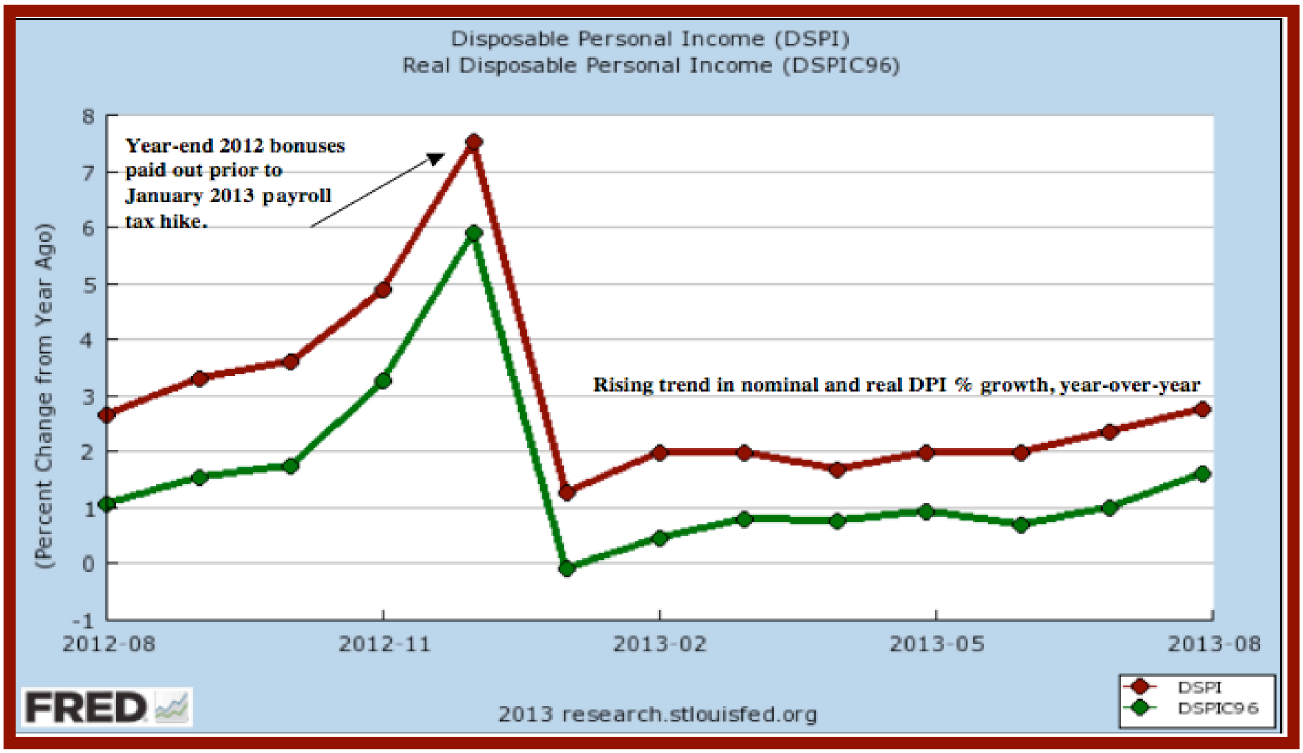
We have seen signs lately that the U.S. economy is poised to break out on the upside.

If we assume, at worst, a brief government shut down of just a few days ---and that House Republicans grudgingly vote to raise the debt ceiling, then the pent-up demand that has been building in the private sector will be unleashed to make this a better than expected holiday shopping season and an even stronger economy for 2014.

Today's release on August personal income and spending provides further support that consumers are now better positioned to ramp up shopping. How so? The job market has been improving, albeit at an agonizingly slow pace. But consumer spending is not just tied to employment; it is also linked to increases in pay. Unfortunately income growth has been lackluster most of the year. But fresh data suggests that is no changing.

But let's be clear here. We're not talking about some dramatic rebound in pay that would have people immediately rush and splurge on big-ticket items. All we're saying is that we have now seen a sustained increase in both nominal and real disposable personal income. It suggests to us that the slack in the labor market may be actually less than what is commonly believed, and this is has led employers to begin raising worker pay. In addition, retail price inflation has been so subdued, Americans continue to see their purchasing power climb. The improvement in both can be seen in the latest data.

Nominal disposable income increased by 0.5% in August, the most in six months. Adjusted for inflation, real DPI rose 0.3%, the largest monthly increase since last March. A more telling sign, however, has been the change we have seen in pay over the past 12 months. Nominal DPI in August was 2.8% higher than a year ago, and that represents the fastest annual leap all year. This trend of year-over-year increases has been consistently moving higher since April. Of course, with inflation dormant, such increases in pay translate into greater purchasing power too. Real DPI over the year rose by 1.6%, and while that is no reason to uncork Champaign bottles, the trend toward higher real pay has been improving during the year and the August jump was the largest so far in 2013.



But with so many questions lingering about a possible government shutdown, a national default and the U.S. getting embroiled in the Syrian crisis, one cannot be surprised that Americans chose to sock away a larger proportion of August's income in savings. The savings rate increased to 4.6% last month, from 4.5% in July and 4.4% in June. That anxiety has continued this month. The Thomson Reuters/University of Michigan index of consumer sentiment showed that confidence in September dropped to a five month low. (Earlier this week, the Conference Board reported a 4-month low in sentiment.)

Nevertheless, there are reasons to believe that once we get past the current budgetary gridlock (and with the odds diminishing of a US military attack on Syria), both consumer confidence and spending will rebound by the end of this year and through 2014. Among other reasons to support this:

• The more timely *weekly* report on household moods conducted by Bloomberg shows the Consumer Comfort Index turning back up. We'll see fairly soon whether this nascent transition to optimism is warranted.

• The Federal Reserve also noted this week that household wealth climbed another $1.3 trillion in the second quarter, which lifted the total net worth of Americans to a record $74.8 trillion. That is likely to reach a new high in the current third quarter since property values have kept climbing. Increases in household wealth is often followed by greater consumer spending.

• New applications for unemployment insurance plummeted to the lowest in level in 6 years last week. The more important 4-week moving average showed claims fell to a level not seen since June of 2007! Historically, employers tend to boost hiring at this level, and we expect they will do so later this year.

In short, the economic fundamentals of the US economy have improved. Banks are more willing to extend credit. Household debt burdens are at three-decade lows. Delinquency rates on consumer and business loans are the lowest the Federal Reserve has ever recorded. Housing and auto sales remain strong. In addition, Europe, Japan, and China also appear on the mend.

The global economic outlook is thus brightening. But U.S. households and business leaders are inclined --- for the moment --- to stay close to the sidelines while the White House and Congress grapple with some serious fiscal deadlines.

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THE ECONOMIC OUTLOOK GROUP, L.L.C.
475 Wall Street
Princeton, New Jersey 08540

www.EconomicOutlookGroup.com
Tel: (609) 529-1300

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