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Consumers' Slip Is Likely to Be Just a Blip

April Spending Drop of 0.2% Belies Signs of Strength in Confidence, Demand for Goods; Ms. Yao Goes Shopping in Chicago

By Neil Shah - June 1, 2013

Americans pulled back on spending in April after splashing out earlier this year, raising the question of whether they will be able to power the economic recovery through a rough patch of government cuts and slower global growth.

Despite the soft April spending—which fell 0.2% from March, according to Commerce Department data Friday—the answer appears to be: yes, they can.

Mounting evidence suggests Americans are becoming more upbeat. Consumer confidence rose in May to the highest level in nearly six years, according to the Thomson Reuters/University of Michigan's index of consumer sentiment, released Friday. Consumers stepped up their spending in the first three months of the year, while the nation's retailers and auto companies have been reporting healthy demand.

Iris Yao is among those starting to spend more. The 23-year-old financial analyst in Chicago just completed her first year at a new job and is no longer hearing stories of friends losing jobs—which makes her feel more secure, she says.

Earlier this year, when rents in downtown Chicago soared while Ms. Yao was searching for a new apartment, she switched gears and decided to buy. She closed the deal on her one-bedroom $292,000 condo a few weeks ago. "The housing market is going up. When I eventually sell, or rent it out, I will make out even, if not make a profit," Ms. Yao said. To decorate the place, she just bought a $2,000 couch—and plans to spend a few thousand dollars more.

The vibrancy of America's consumers is key to growth because personal spending accounts for about 70% of the demand in the U.S. economy and has been the catalyst for past economic recoveries. As demand for goods and services grows, employers hire more workers, whose rising incomes fuel more spending in a virtuous circle. That has been short-circuited in the current recovery, with heavy debts, a tough labor market and anemic wage gains depriving the economy of strength.

Americans continue to face headwinds—as the April spending and income data show. Incomes were flat in April from the prior month. Many consumers have raised spending even as their incomes stagnated, driving down the personal saving rate—which reflects how much people have after spending and taxes—to 2.3% in the first quarter. Those soft data points are fueling fears the economy will slow from its modest 2.4% annualized pace in the first quarter as the across-the-board government spending cuts called the sequester bite.

Still, rising stock prices, improving home values, steady job gains and easing credit conditions are making consumers more confident than they were last year. Much of April's spending dip was due to lower gasoline prices and less spending on heating after an unusually cold March. Meanwhile, lower energy and other costs are pushing down inflation and allowing Americans to spend money elsewhere. Adjusting for inflation, personal spending actually rose 0.1% in April.

U.S. businesses, for their part, remain on tenterhooks. Rising health-care costs are weighing on many employers, while Europe's recession and slowing growth in China are fueling economic weakness around the world, crimping U.S. exports and profits.

But increased spending is helping U.S. companies whose fortunes depend partly on the American consumer. "It looks like consumers are hanging in there," said Jack Koraleski, chief executive officer of Union Pacific Railroad in an interview in May. Mr. Koraleski said his company's business of transporting finished cars and car parts is up this year compared with last year.

Robert Shuman, owner of a car dealership in Detroit, says sales of new cars this January doubled the previous year's tally—and he has seen about 20% year-over-year gains every month since. His worry is having enough cars to sell—and finding new workers. He recently added four new salespeople.

"After more than five years of staying mostly on the sidelines, consumers are ready to unleash lots of pent-up demand," said **Bernard Baumohl, chief global economist at The Economic Outlook Group**. "Simply put, consumers are now back in the driver's seat steering this economy forward."