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Consumers missing link in full-blown recovery

By Jeffry Bartash / November 9, 2014

WASHINGTON (MarketWatch) — The puzzle that is the U.S. economy is almost complete: Most industries are steadily adding jobs, workers are churning out more goods and services and companies have firmed up investment. The Republican takeover of Congress also offers the hope of more business-friendly policies next year.

There's still a few key pieces of the puzzle missing, however. A clear acceleration in how much workers earn per hour and a related rise in consumer spending. The U.S. economy cannot fully recover until wages grow faster and Americans feel confident enough to spend the extra cash.

The retail sales report for October, due Friday, might offer another clue on the behavior of consumers. It's the star attraction on a light economic calendar this week.

Sales at retailers have been lackluster for several years. Americans continue to watch their money, wait for markdowns and bargains and shop online where prices are usually lower.

The cautious attitude of consumers has a huge impact on the economy. Sales at retail stores account for about one-third of consumer spending, which in turn generates about two-thirds of all U.S. economy activity. If consumers are really feeling good, the first place it will show up is in retail sales.

Online stores such as Amazon are among the few retailers to perform well since the recovery began. Auto dealers are another big winner. Consumers have taken advantage of low-interest loans to replace aging vehicles.

The rest of the industry has not been so fortunate. In October, economists polled by MarketWatch forecast a mild 0.1% rise in retail sales, partly because of flat auto purchases last month. The headline number, however, rarely tells the whole story. One of the main categories of retail spending is gasoline. Sometimes a big increase in spending is the result of higher gas prices — bad for consumers — while a decline in retail sales might reflect falling gas prices that benefit households.

Fortunately for consumers the U.S. is entering another phase of falling gasoline prices, the result of a soft global economy and soaring domestic oil production that could soon turn the nation into the world's biggest producer of petroleum.

The average U.S. price of a gallon of regular gas, for example, has fallen 18% since June to about $3 a gallon, according to government statistics. The price is lower in many parts of the country and it's expected to go even lower.

Since it's cheaper to fill up at the pump, retail sales are likely to be a bit stronger if gasoline is excluded. What remains to be seen is if consumers pocket the savings or spend it on other goods and services such as clothing, eating out or more gifts for the holidays.

"Lower gasoline prices will likely provide a spending boost to consumers but may take time to show up in the data," economists at Wells Fargo wrote.

While lower gas prices might stoke U.S. growth, the only way to truly restore the economy to prerecession levels is by an uptick in wages. Yet as last week's October employment report showed, hourly pay is still only rising about 2% a year despite a drop in unemployment to 5.8%. That's the lowest rate in six years.

Some economists downplay the trend in hourly pay, however, and point to other indicators such as total employee compensation and the number of hours people work, both of which suggest earnings really are starting to rise.

"It's clear the transition to faster wage growth has begun," argued **Bernard Baumohl**, chief global economist of The Economic Outlook Group.

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