# RISING FORTUNES OF US CONSUMERS

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*The latest reports on retail sales have been disappointing.*

*But I'm still optimistic about the health of US consumers.*

*I expect consumer spending to sustain this business cycle.*

During the first quarter of 2015, the list of economic worries has been long — slow business investment, subpar production growth in many sectors, weaker trade and central bank–driven currency dislocations, just to name a few. On top of that, financial pundits have been writing off US consumers, repeatedly describing them as overstretched, hobbled by low wages and too much debt, and discouraged about job prospects.

I'm not as worried as everyone else, however. As I've said before, one of the worst bets an investor can make is to "go short" the US consumer. After all, 70% of the US economy is driven by domestic consumption spending, a much greater share than in many other economies. And amid all the gloom, some shining statistics stand out.

## Consumption matters

In the fourth quarter of 2014, US GDP grew at a real rate of 2.2% — less than half the third quarter's pace and quite a bit below what many economists had predicted. But US consumers increased their spending dramatically that quarter, with personal consumption rising at 4.2% — the most rapid pace since the first quarter of 2006.

So far in 2015, we've been dealing with severe winter weather — especially here in Boston — that has been reflected in disappointing drops in retail sales as consumers have been trapped at home. But now we're finally beginning to see the piles of snow melt away, and I suspect there will be pent-up demand to dine out and shop for new cars.

## Consumer health checklist

Here are some reasons why I think the US consumer is in good shape:

- Employment prospects have been improving, with job openings rising and layoffs falling, particularly for workers in the private sector.
- Thanks to a better labor market, US consumers are now more confident about the future than at nearly any other time on record.

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- The assets owned by US households have been increasing in value, including stocks, bonds and, most importantly, their homes — the biggest asset of all. US collective net worth is now the highest ever.
- Houses and cars — the two big-ticket items for US consumers — are more affordable than in other cycles because the interest rates for financing these major purchases are lower.
- Households may be starting to borrow again, but this borrowing is not rising as fast as their assets or disposable incomes, so consumer creditworthiness is not being compromised.
- The inflation rate has been falling steadily, so each month at the grocery store the cost of a basket of common staples has been going down, not up. This big boost to the real buying power of consumers is just the opposite of what we had been seeing for most of the past 40 years.
- The drop in energy prices has been a huge help, as paying less at the pump for gasoline leaves more to spend on other goods and services that may be more supportive of US economic growth.
- And lastly, the US dollar has been gaining strength against other currencies, benefiting US consumers by lowering the cost of imports.

Lower prices for oil products and other imported goods can act like a tax cut, which is especially important for lower-income households with higher marginal propensities to consume — that is, they tend to spend more of every extra dollar — than higher-income households.

## Spring renewal

After decades of watching their debt-to-asset ratios rise while inflation eroded the purchasing power of their wages, US consumers have been making up for the time they lost in the last recession by stepping up their spending. Surveys show that consumers are strikingly more confident than the owners and managers of the companies that supply them with the products that were selling so well before this quarter's worries began.

In the second quarter, with the coming of warmer weather, I think consumers are likely to get out and spend, both at traditional retailers and online. The more they spend, the further the cycle of growth is pushed forward. And this old business cycle may look new again.



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