4 Reasons Why the Consumer (and the Economy) Are Still in Limbo
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Consumer spending helps fuel the economy, but, as Russ explains, still sluggish spending continues to limit growth.

Economic readings have been firm lately, with one major exception: retail activity. Retail sales continue to disappoint relative to expectations, as we saw again in August. While Hurricane Harvey certainly had a negative impact, the unfortunate truth is that retail sales have been decelerating since January.

Which raises the question: Why should spending slow when unemployment is at a cyclical low and confidence close to a cyclical high? Here are four potential reasons:

Wage growth has been conspicuously absent

Despite historically low unemployment, wage growth is not accelerating as the textbooks suggest it should (see the accompanying chart). Although there are a number of secular factors impacting the numbers—not the least of which is the retirement of lots of relatively well paid baby boomers—the reality remains that wages are not providing the tailwind many had expected.

U.S. wage tracker
Auto sales have peaked

After years of stellar sales on the back of historically low interest rates, U.S. auto sales have been decelerating for the better part of the past two years. This is important as auto sales, including parts, comprise roughly 20% of overall retail sales. August’s sales numbers, a shade above 16 million annualized, were the lowest since early 2014.

The savings rate is already low

One of the defining characteristics of the multi-decade consumer boom was a consistent trend towards lower savings. While that trend temporarily reversed following the financial crisis, by late 2016 the savings rate was once again closing in on 3%, not far from last decade’s low. Savings can theoretically fall further, but at this point in the cycle consumers may need to take a breather.

Consumers are spending, just differently

There is an argument that sluggish retail sales simply represent changing consumption habits. Retail sales only capture physical merchandise. This creates a measurement problem in an economy in which services are accounting for an ever greater share of consumer activity.

In fact, the “glass-is-half-full” retort to weak retail sales is that overall consumption is doing okay. During the first two quarters of 2017 household consumption grew at an average rate of about 2.5% annualized, close to the post-crisis average. Countering the above headwinds are falling inflation, a still robust labor market and, for high-end consumers, record wealth. On the latter, it is worth noting that at $95 trillion, total U.S. household wealth is up about 50% from the end of 2011.
For now, this leaves spending activity roughly where it's been. Consumption remains supported by a strong jobs market and a massive buildup in household wealth. At the same time, an already low savings rate coupled with a lack of wage growth makes a meaningful acceleration unlikely. And with consumption now back around 70% of overall gross domestic product (GDP), it will be hard for the overall economy to take off if the consumer remains in limbo.

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