



## “Consumer spending advances sharply but incomes lag”

-Associated Press, May 3, 2010

It has been a long time since we’ve heard the words “consumer spending advances sharply,” and it is a welcome change from the constant barrage of negativity that has been the norm for the past two years. So, everything is back to normal now, right? The American consumer is back in the malls, and the recession is over!

Not so fast. Before we pop that champagne cork, we need to take a look at the second half of that headline: “incomes lag.”

According to the Commerce Department, consumer spending rose 0.6 percent in March, but personal incomes edged up just 0.3 percent. Does anyone else see a problem with this? Wasn’t spending more than we earn and taking on too much debt *exactly* what got us into this mess in the first place?

Let us attempt to make sense of it all. To start, you have to keep a few things in mind when looking at growth rates. Most importantly is “what was your starting point?” We should remember that 2009 was a horrendous year for the US consumer. A lot of purchases got postponed or eliminated, creating some amount of pent-up demand that we are seeing today. So, it’s not too surprising that 2010 is seeing growth over 2009’s depressed levels. It is important, however, that we don’t reach the wrong conclusions from this. These are the facts:

- A one-off jump in consumer spending does **not** indicate a new trend.
- Consumer spending cannot continue to rise without a commensurate rise in incomes.
- Incomes are highly unlikely to rise with unemployment still near 10%.
- The unemployment rate is unlikely to fall without a strong increase in GDP growth—creating a circular problem in which consumers do not spend because of high unemployment, and the unemployed never get hired because consumers are not spending!
- The price of homes continues to fall, pushing more Americans “underwater” on their mortgages.

So, while we are certainly happy to see American consumers spending a little money on themselves, we are very reluctant to let ourselves get too excited. The turmoil of 2008-2009 changed something in many Americans, particularly those close to retirement. They saw how quickly their life savings can evaporate, and it scared them. With their kids now out of the nest, many would love to sell their large suburban homes and downsize to something more affordable. While they still want to treat themselves to the occasional restaurant meal, perhaps they think twice about ordering that bottle of wine. And large credit purchases like autos and appliances? Well, they already have everything they need. It doesn’t make a lot of sense to buy more on credit.

In short, while the American consumer is out of “bunker mode,” he is still a shell of the swaggering, credit-card-swiping gunslinger he used to be. And that is unlikely to change anytime soon.

Sincerely,

*Jeremy E. Portnoff*

Jeremy E. Portnoff, CFP<sup>®</sup>, AIF<sup>®</sup>, CRPS<sup>®</sup>, CES<sup>™</sup>, CFS<sup>®</sup>, CTS<sup>™</sup>, CAS<sup>®</sup>

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