Crisis changes American consumers
James Saft

The formerly unsinkable American consumer is taking on water, hit by high prices for food and energy, rising unemployment and fewer assets to sell or refinance.

And with the household sector accounting for about three-quarters of the U.S. gross domestic product, an end to American shoppers' remarkable run will have a big and self-reinforcing effect.

It is likely to hit corporate profits, prompting more layoffs, as well as putting the financial sector in line for further problems with bad assets, leading to still tighter credit conditions.

Excluding gasoline, U.S. retail sales dropped at an annual 2.2 percent rate in the first quarter.

"There are several head winds that the U.S. consumer is facing," said Harm Bandholz, an economist at Unicredit Markets and Investment Banking in New York.

"We have weakness on labor markets, which means incomes are slowing; we have tightness of credit; and we have negative-wealth effects from lower house and equity prices."

First, the labor market backdrop is not encouraging.

The number of Americans applying for unemployment benefits over the past four weeks is as high as it has been since Hurricane Katrina in 2005, while those on benefits is the highest since June 2004.

And while the unemployment rate is still relatively low at 5.1 percent, it is rising and many would expect it to carry on doing so if the economy continues to experience trouble.

"Companies are reducing investment because of lower earnings prospects," Bandholz said. "We will see an increase in unemployment, which in turn leads to lower income and consumption and a weaker economy."

And for the vast majority with jobs, there is still high-priced food and energy to contend with.

While U.S. core consumer price inflation, which excludes food and energy, is a seemingly manageable 2.4 percent on an unadjusted basis in the year to March, it's a bit like saying inflation is low if you exclude the cost of things that are going up in price.

Energy costs are up 17 percent in the year, gasoline is up 26 percent and food is up 4.5 percent, bringing the rate of inflation for all items in the basket to 4 percent.

Many argue that those prices will inevitably fall as recession bites, and perhaps they will, but they are still clearly having a real effect on spending and investment decisions now.

The difficulties were backed up by anecdotal evidence cited by the Beige Book, Federal Reserve's distillation of what the central bank's agents are hearing from their contacts and observing across the country in the real economy.

The report actually used the word "recession" for the first time in years, and generally shows a weak and deteriorating situation.

As for credit, the Beige Book said that consumers were less interested in taking out loans.

More signs of stress were to be found in Bank of America's first-quarter earnings, which showed that managed net losses in its credit card business rose 9 percent in the quarter to $2.37 billion.

Like unemployment, credit card arrears are still pretty low and manageable by historic standards, but the rate of change has been striking. There is very likely a significant minority of Americans who, unable to draw money from their houses, are now relying on credit cards. Banks in the current climate can be expected to see this and to pull back from lending.

One big positive that could support consumer spending is the U.S. government's $168 billion stimulus package now wending its way into taxpayers pockets. Under the terms of the plan, many will get several hundred dollars this spring.

It will definitely help, though a survey by Harris Interactive for TD Ameritrade, a major online brokerage company, showed that 85 percent of rebate recipients planned to invest, save or pay off debt with the money.

And remember, too, that the power behind the rise in food and energy prices is mostly coming from outside the United States. Oil at a record $117 a barrel and sharp rises in prices of grains and other food are arguably a result of long-term changes in consumption in places like China that are unlikely to be unseated by anything but a serious U.S. downturn.

It looks as if we are heading for a transition in the United States to a slightly less consumption-oriented economy with a higher rate of savings and investment. That may be a good thing in the long run, but will be painful while it is happening.

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