The consumer may be all the U.S. economy has going for it

By Bryden Teich
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The September jobs report released last week served as an important milestone for the U.S. economy. We have now had 72 consecutive months where the U.S. economy has added jobs. In this time, more than 14 million jobs have been added – the equivalent of 200,000 jobs a month for six years. By all accounts, this suggests that the U.S. economy should be firing on all cylinders.

In light of this, why has the U.S. consumer not kicked into high gear to power the economy forward? Well, the data shows that the U.S. consumer is already in high gear. It may be the only thing that the U.S. economy has going for it.

Economic growth is measured by the sum of consumption, investment, government spending and net exports within an economy. Economic theory would tell you that seven years into an economic expansion, you should expect a broad-based contribution to growth. Seven years on from the Great Recession, this is not the case.

If we dissect each segment of the U.S. economy, we start to recognize some worrying underlying trends. Let's pick on exports first. A strong U.S. dollar and weak global demand do not provide a good backdrop for growth in exports. Net exports have been negative in eight of the previous nine quarters. With the U.S. Federal Reserve inching toward raising interest rates, one can expect the U.S. dollar to remain strong. A strong dollar combined with a weak global growth scenario is not a conducive dynamic to growth in exports. Cross out exports as a source of growth.

Next, let us look at inventories. The data shows us that the U.S. economy is sitting with the highest inventory-to-sales ratio since 2009. At times in the past, an increase in this ratio would be viewed as a recessionary indicator. However, this is not always the case. Despite the drag on the economy that changes in inventory levels have caused, it has not been enough to push the U.S. economy into recession. One should pay close attention to the inventory liquidation cycle to come over future quarters, as this could have implications for corporate profitability.

Business investment also remains low. In a slow-growth world, corporate executives become more cautious and defensive about making long-term business investments. This has been a key contributor to the push toward share buybacks, as opposed to capital expenditures and long-term investment. If you are unsure about economic growth, you will be inclined to buy back your shares or conduct mergers and acquisitions activity as a source of earnings growth.

The collapse of commodity prices and the billions of dollars of capital expenditure and investment plans that were scrapped have also served to limit business investment in recent quarters. An increasingly hostile regulatory environment and a shift toward populist politics also provide a negative backdrop for long-term business investment decisions.

Government spending can provide important support to an economy during periods of recession. However, seven years into an economic expansion, the government spending component of GDP should not be heavily relied on as a source of growth. On the home stretch of an election cycle, every politician in the United States is focused on getting elected. Outgoing President Barack Obama is watching this all from the sidelines, and nothing will get done in Congress. One should expect the government to make a limited contribution to economic growth over the next few quarters.

Last but not least, we have the U.S. consumer. The consumer has emerged resilient through this seven-year economic expansion. The 14 million jobs created have led to an increase in disposable incomes and a buoyed level of consumer spending. Household balance sheets have largely recovered, and personal savings rates are up.

With other segments of the U.S. economy creating a drag on growth, the burden placed on the consumer segment will become increasingly significant over coming quarters. A case in point is Q2, where the consumer contributed 2.9 per cent toward GDP growth, while the economy only grew at a real rate of 1.4 per cent. This means that the other segments of the economy caused a drag of -1.5 per cent. This dynamic has been present for the past three quarters. It’s not a sustainable pattern.

The September jobs report served as an important milestone and reminded us that the U.S. consumer remains strong. However, we should not pacify ourselves in the expectation that the consumer will triumphantly return the U.S. economy to a high growth level. Rather, we should be appreciative for the strong growth that he or she is already giving us. As we enter cold and flu season, let us all hope that the U.S. consumer doesn’t catch a cold.

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