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UNITED STATES

Heading for a downturn in consumer spending in the third quarter

HIGHLIGHTS

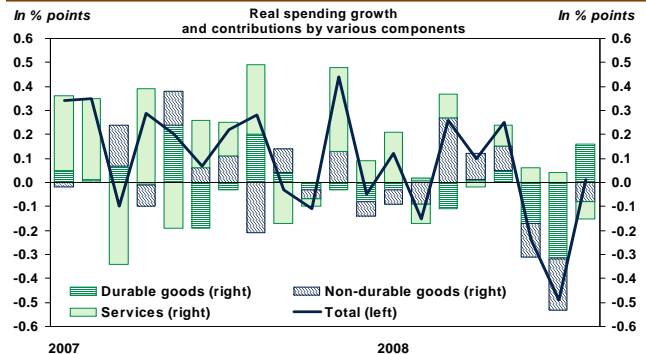
- Consumer spending remained stable in current dollars in August, after 0.1% growth in July.
- Personal income rose by 0.5% in August after a 0.6% drop in the previous month.
- The personal consumption expenditures (PCE) deflator was stable in August after a 0.6% increase in July. If we exclude food and energy, the core deflator is up by 0.2%. The annual variation in the PCE deflator dipped from 4.6% to 4.5%, with the core deflator edging up from 2.5% to 2.6%.
- If we remove the effect of price increases, real spending was also stable in August, while disposable income contracted by 0.9%.

COMMENTS

After two months of negative growth, flat real consumer spending comes as good news. At least the situation has not deteriorated too much. However, we note that contraction was avoided thanks to a single component: durable goods, which benefited from a rebound in automobile sales after very depressed numbers in the last few months. The other two primary components of consumer spending, i.e. non-durable goods and services, retreated in August just like most durable goods apart from automobiles. Therefore, given that the growth seems to be entirely due to the automotive sector, a return to negative territory is quite possible in the event that this sector experiences further downturns.

The anemic consumer spending reported in August will not be enough to compensate for the serious setbacks recorded in June and July. As a result, real consumer spending is likely to post a decline in the third quarter for the first time since the end of 1991. Even during the recession of 2001, consumer spending never contracted on a quarterly basis. The growth recorded so far for the third quarter now stands at -2.3%; that means that it would take exceptional numbers in September (monthly growth above 1.7%) to push the third quarter's consumer spending into positive territory. Unfortunately, despite an upturn in consumer confidence indexes thanks to lower gasoline prices, we cannot forecast a significant

Recent growth in household spending is anemic



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

rebound, especially since the weekly indexes of department store sales have so far shown dismal results. Moreover, the reduction in real disposable income (due to the end of the distribution of income tax rebates) and some enthusiasm for saving are likely to curtail future spending... not to mention the uncertainty that has prevailed in financial markets in recent weeks, and the difficulty in obtaining credit from financial institutions.

Implications: Although stagnation is better than contraction, future prospects for consumer spending are not very encouraging. There is still too much risk of the economy deteriorating. We can only hope that action by the federal government will be successful in relaxing the restrictions on credit that have been threatening to strangle consumer spending even further. As far as the Federal Reserve is concerned, the fact that core inflation is still relatively high should lead it to keep its key interest rates unchanged.

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