Investment GUIDE with Eric Tyson

Unobligated Income Suggests Consumers Have Spending Power

An economic recovery will be slow in coming because consumers are over-burdened with debt, we're told. Unemployment is sky-high, and consumers without jobs won't spend. So says Peter Coy, an "economics editor" at *BusinessWeek*, in his recent article entitled "Five reasons it's too soon to declare the recession over." Coy said, "People who are out of work can't spend, and people who fear being out of work won't spend."

In Coy's world, the unemployed can't spend, and those who are working but are fearful of being laid off won't spend. For starters (and I don't mean to pick on Mr. Coy), he has no training in economics. Coy was a history major in college and has never held a job in the financial-services sector or private sector that required financial or economic analysis. He's a writer — nothing more and nothing less.

Now, it might have been accurate for Coy to state that those who have lost their jobs or who are worried about layoffs may consider cutting back on some spending. Of course, some people who lose their jobs are forced to make significant changes to some of their spending. But, even those folks don't literally stop spending, as Coy suggests. You still eat, pay rent, drive and repair your car, pay your utility bills, get care for your pet, etc.

What matters is what money consumers have to spend. For most people, their current employment income is what enables them to spend. But, the best savers and higher-income folks have excess funds and investments for those rainy days. These people spread their spending out over time and don't make radical spending changes from month-to-month or year-to-year.

But, what about lower and moderate income people who rely on their paychecks for current spending? There's a

little-known government statistic called "unobligated income," which provides insight into consumer spending power. According to First Trust economist Bob Stein, unobligated income is derived by starting with income and subtracting obligated payments: taxes, mortgage payments, car loans, debt service on credit cards, student loans.

2008 was a horrible year, right? Well, you might be surprised to learn that unobligated income actually was up 1.7 percent from the prior year. Now, Stein is quick to caution that that a 1.7 percent increase "won't generate a boom but will generate a moderate growth in consumption."

Recently, the first quarter 2009 numbers for unobligated income came out, and those were up 3.4 percent from a year earlier and grew at a 7.9 percent annualized rate in the first quarter.

How could it possibly be true that consumers actually have more, not less, income to spend after making their obligated payments? Well, taxes are down thanks to various enacted changes benefiting non-high-income earners. Taxes are also down because one of the good things about earning less money is that you owe less in taxes.

What about the horrible real estate market and all those foreclosures? It seems that most journalists and pundits forget that the final result of a foreclosure is that the homeowner ultimately is relieved of that debt, so shrinking mortgage debt frees up more money for consumers to spend.

Now, it is the case that the total consumer debt load versus the size of the U.S. economy, as measured by gross domestic product, is up substantially throughout the past decade, and that's primarily due to mortgage-debt increases. However, Stein points out that other consumer debt relative to GDP is not up over the past decade.

In fact, total consumer debt isn't really that bad, according to Stein. How could that be, since we've been told again and again how consumers have been taking on more and more debt of all kinds in recent years? Quite simply, you've got to look at the size of the required debt payments, and that is not up nearly as much over the past decade, because interest rates are down versus a decade ago.

Required payments experienced a rare decline during the first quarter of this year. For homeowners, 17.3 percent of their after-tax income now goes to meet financial obligations, which is only a little above historic norms. Mortgage payments now account for 11.3 percent of folks' after-tax income, which is a bit high; 10 percent is about normal, according to Stein.

All in all, these numbers paint a far better picture for U.S. economic health than you'll read and hear in most places. **N**

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