

## Worry, But Be Happy About Economic Outlook

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Ellen Zentner, Morgan Stanley's chief U.S. economist, expressed surprise over how consumers were choosing to spend their savings from lower fuel prices. *Source: Hart Energy*

Don't look now, but in a macroeconomic sense, things are pretty good.

"We think that the expansion globally and in the U.S. could be one of the longest on record," Ellen Zentner, managing director and chief U.S. economist for Morgan Stanley, said at the recent Duff & Phelps 7th Annual Private Capital Conference in Houston.

Energy folks in the crowd, reeling from the fall in commodity prices, were ready to take happy statistics where they could find them, even those numbers that were pinching their own business.

“Look at the drop in gasoline prices,” Zentner said. “It’s just incredible. If we annualize these savings, it’s about \$165 billion in disposable income that’s been freed up because of lower gasoline prices. What we care about is: What are consumers doing with all that extra cash? They’re not spending it as much as we thought they would.”

Zentner’s forecasting team at Morgan Stanley found that consumers were spending rather cautiously, following a pattern set during the 2008 to 2009 financial crisis. They were choosing to divert funds formerly dedicated to fuel consumption toward diminishing credit card debt and repairing balance sheets. These prudent habits are good for the U.S. economy in the long run, but led to a smaller bounce from low fuel prices than expected. Nevertheless, there is an immediate impact for the economy—right to the stomach.

“Consumer spending growth has picked up,” she noted. “No matter what, even if you make a concerted effort to spin those gas savings, it does bleed into the economy. We go to the gas station, we put gas in our tanks. It costs half today than what it did a month ago. We’re excited, what do we do? We go out to eat.”

Restaurant sales shot up 8% year over year in the U.S. Census Bureau’s January retail sales report. Other elements of that report indicated weakness, but Zentner was not concerned.

“I always tell people, look at the line item for dining out services,” she said. “If that’s growing, the kids are all right, because that’s the first category we cut if we feel that our finances are pinched, and it’s the first category that benefits when we’ve got some extra cash to spend.”

Another benefit from low energy prices? More demand for energy.

“It’s one of the ways from a demand standpoint that you do end up finding a floor in oil prices eventually because it actually does spur demand when energy prices drop,” Zentner said. “We’ve already seen, in auto sales, that people are being less picky about the mpg of the vehicles. We’ve seen SUV sales rise. People are happy just to get out on the road and drive more. Maybe they kicked their share ride person out of the car and said, ‘I don’t have to share a ride with you anymore. You were annoying anyway. I’m going to do the commute on my own.’”

On the whole, Zentner considers lower energy prices as an overall positive for the U.S. economy. That’s because the country remains a net importer of oil, and the consumer sector, which accounts for 70% of the economy, enjoys cost savings when gasoline prices fall. But that upfront boost to the economy fades over time.

“If you sustain \$40 or lower, let’s say, on oil, it boosts the economy by a little more than four-tenths of 1%,” she said. “But there’s a drag from a 10% sustained rise in the U.S. dollar. So basically, the two are canceling each other out. We went into the year thinking we would get this big bang to growth from lower energy and a lot of it is actually being counteracted right now from the strength that we’ve been seeing in the U.S. dollar.”

Long term, though, Zentner is optimistic because demographics are shifting back into an advantage for the U.S. Concern about the impact to GDP resulting from the aging population of

post-World War II baby boomers has given way to the promise brought by the new major demographic segment: 20- to 24-year-olds, i.e., the children of those baby boomers.

“This, to me, sets the U.S. apart on the global stage over the next decades really, because this demographic trend is unique,” Zentner said. “Japan’s birth rates remain very low after World War II. China has just relaxed its one-child policy. Europe’s has remained very low after World War II.”

This generation will need affordable housing once it unburdens itself of student loans. Zentner expects it to wield considerable influence over what retailers provide.

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