

Consumer and Finance Outlook

Federal Reserve Bank of Chicago
Economic Outlook Symposium, November 2018

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NORTHERN TRUST

UNDERSTANDING WHAT CONSUMPTION MEANS



THE BALANCE SHEET FOR U.S. CONSUMERS

Assets

- *Very strong labor markets*
- *Very strong financial markets*
- *Tax cuts*
- *Moderating mortgage and credit card debt*
- *Steady saving rate*
- *High levels of confidence*

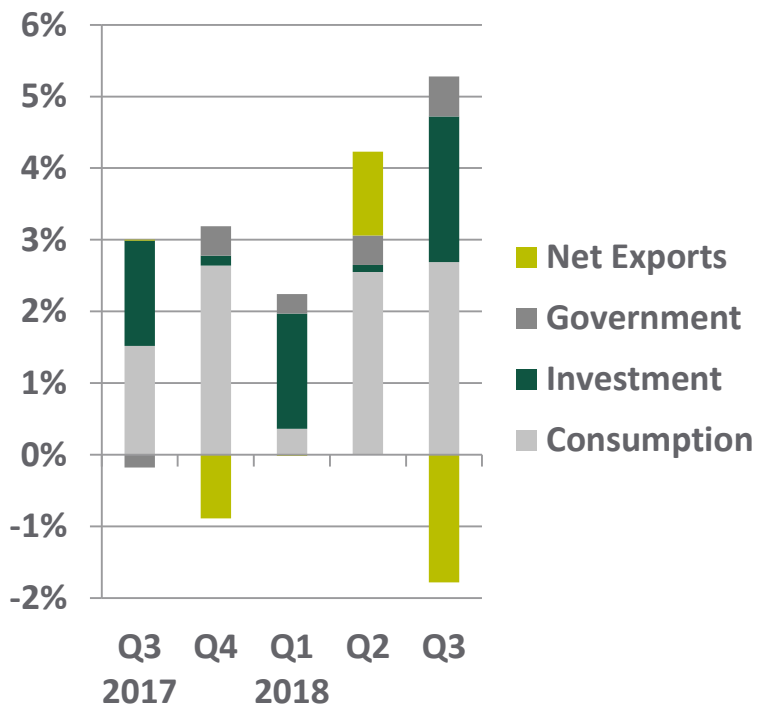
Liabilities

- *Modest wage growth*
- *Rising income and wealth inequality*
- *Very poor retirement preparedness (private and public)*
- *Substantial student debt*
- *Risk of job disruption*

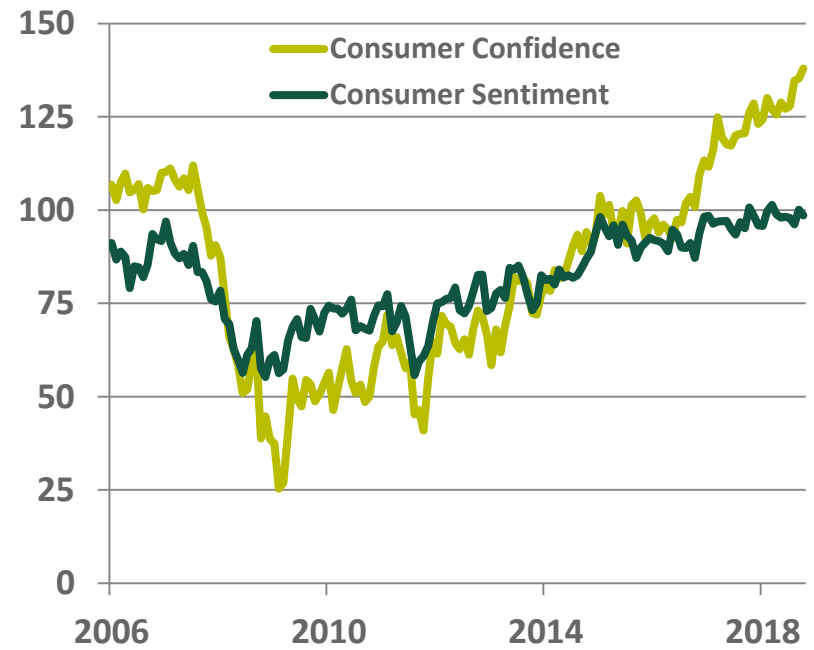
CONSUMERS HAVE LED U.S. GDP GROWTH

- *Consumers are driving this recovery*
- *Their optimism is at record levels*

Contributions to GDP Growth



Consumer Attitudes



Sources: Bureau of Economic Analysis, University of Michigan, Conference Board

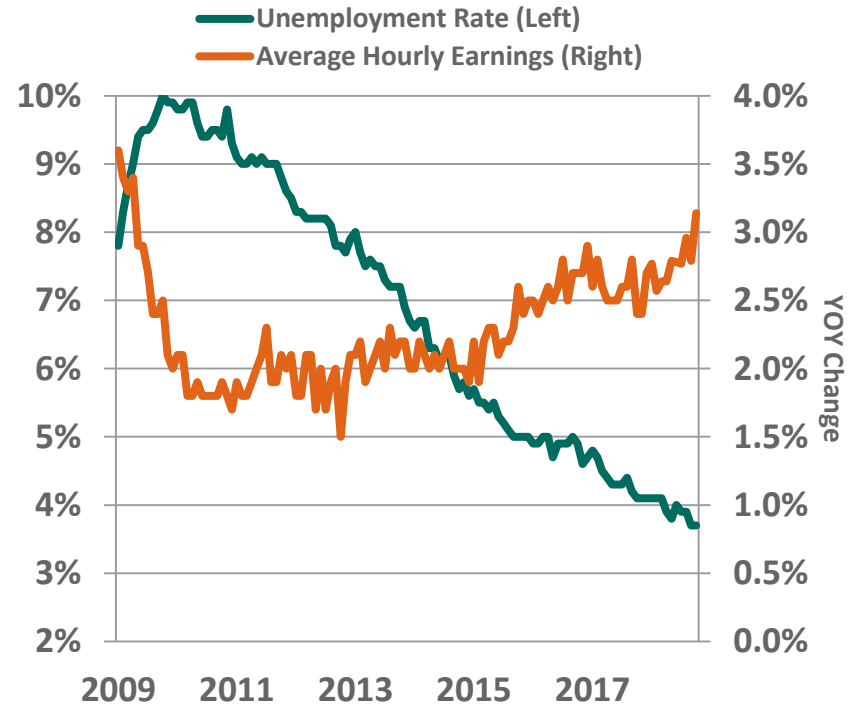
U.S. LABOR MARKET TIGHTENING

- *Very low unemployment creates opportunities*
- *Is the Phillips Curve dead, or just resting?*

U.S. Labor Market Conditions



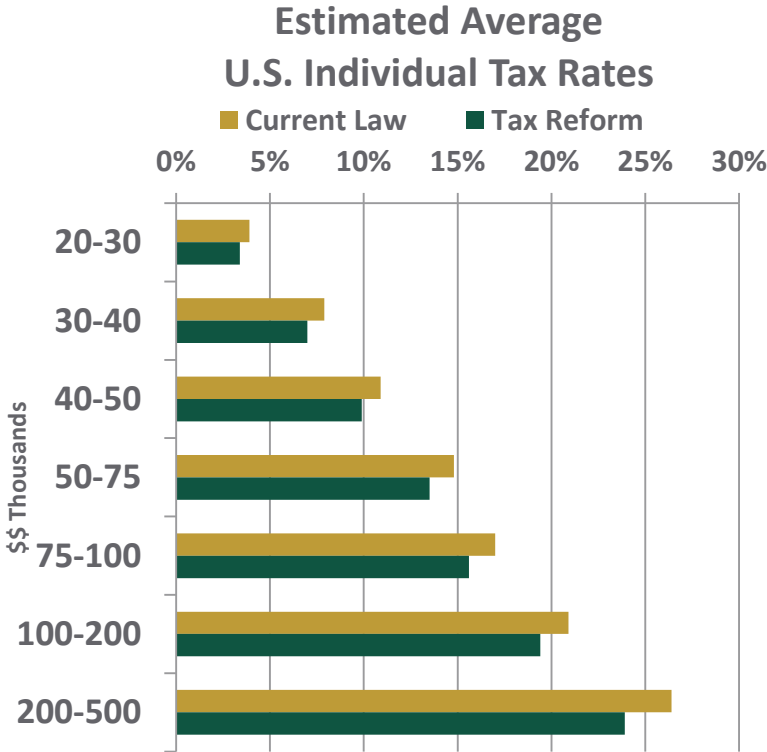
Joblessness and Compensation



Sources: BLS, Haver Analytics

TALE OF THE TAPER

- *U.S. marginal rates were been reduced across the board*
- *Reduced corporate rates prompted huge share repurchases*



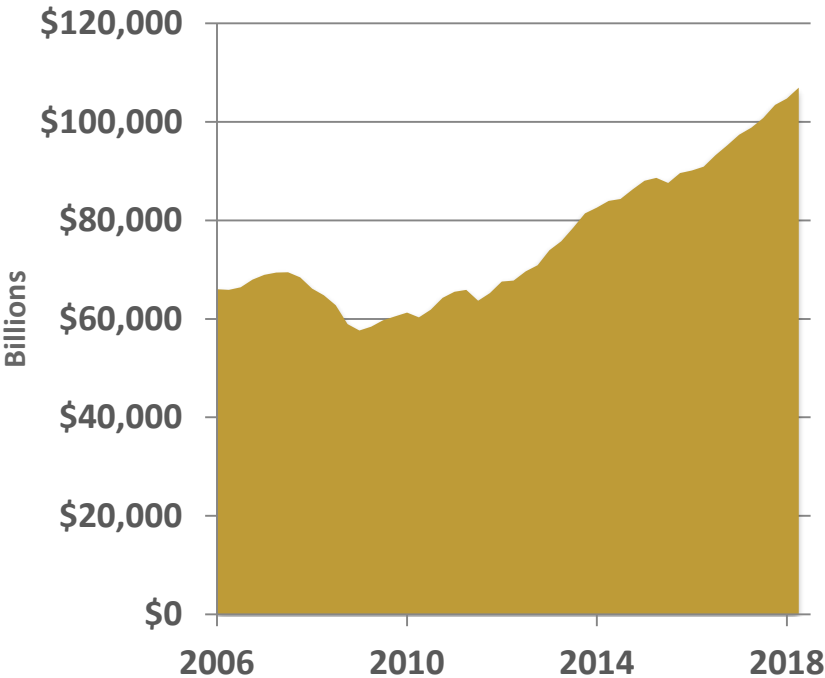
Source: Joint Committee on Taxation



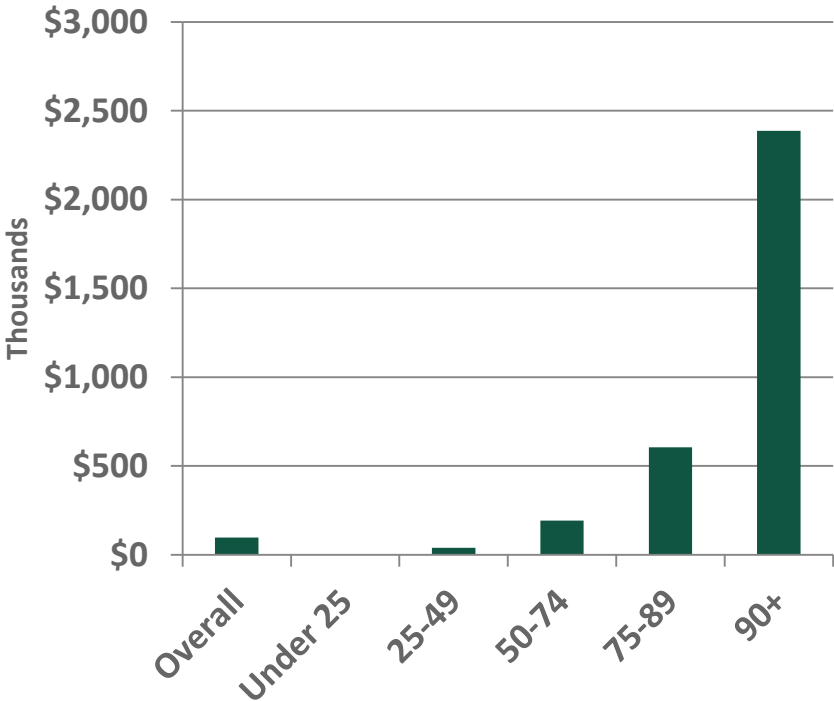
WEALTH IS GROWING BUT NOT SPREADING

- *Net worth continues to grow*
- *Gains have not accumulated evenly*

Total Household Net Worth



Median Family Net Worth, by Wealth Percentile

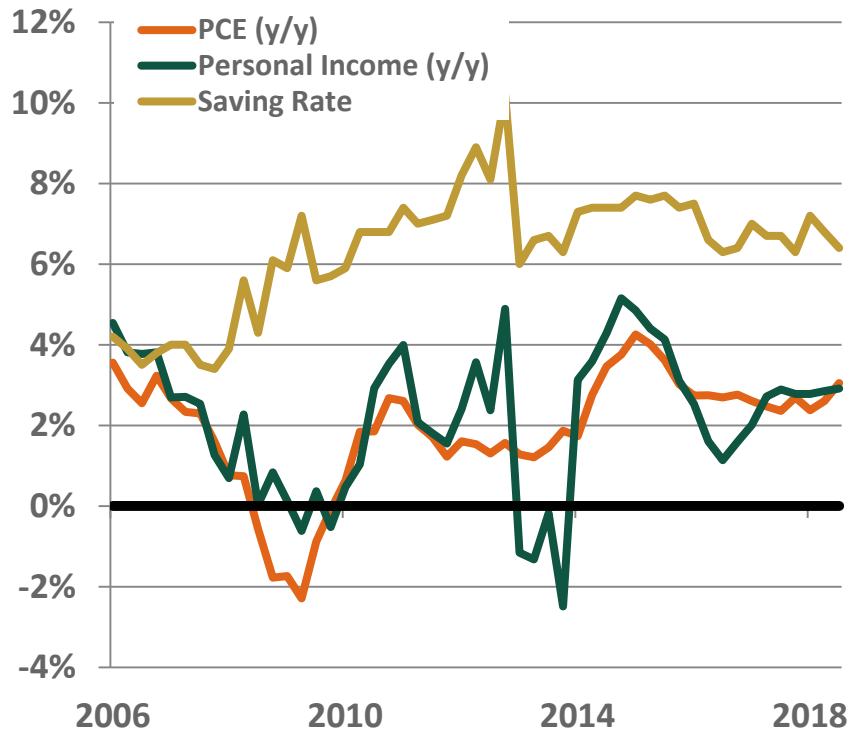


Sources: BEA, Federal Reserve, Haver Analytics

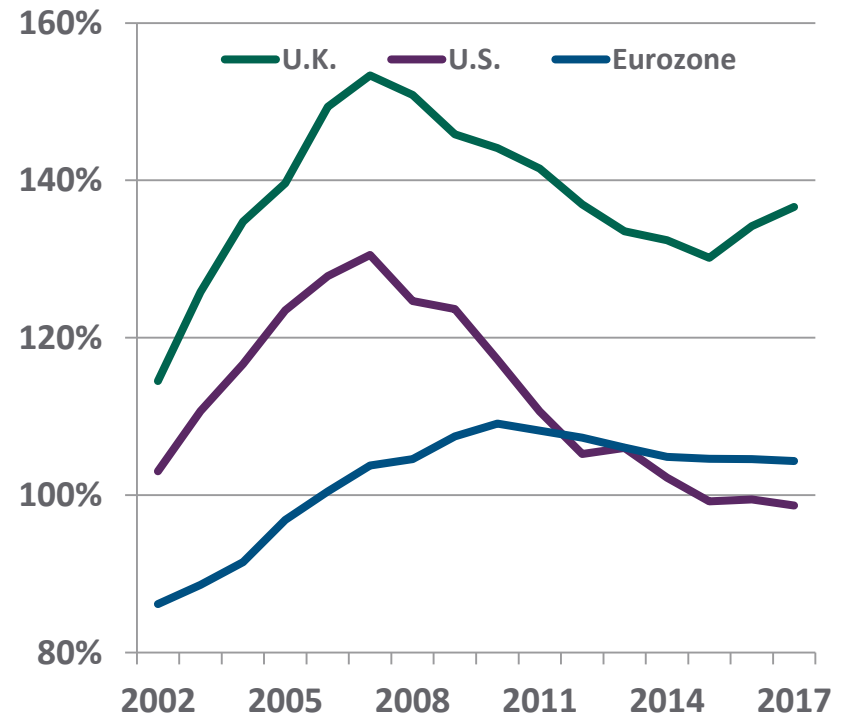
RENEWED FRUGALITY

- *Spending and income have become better aligned*
- *Household leverage is under better control*

Income and Savings



Household Debt/Income Ratio

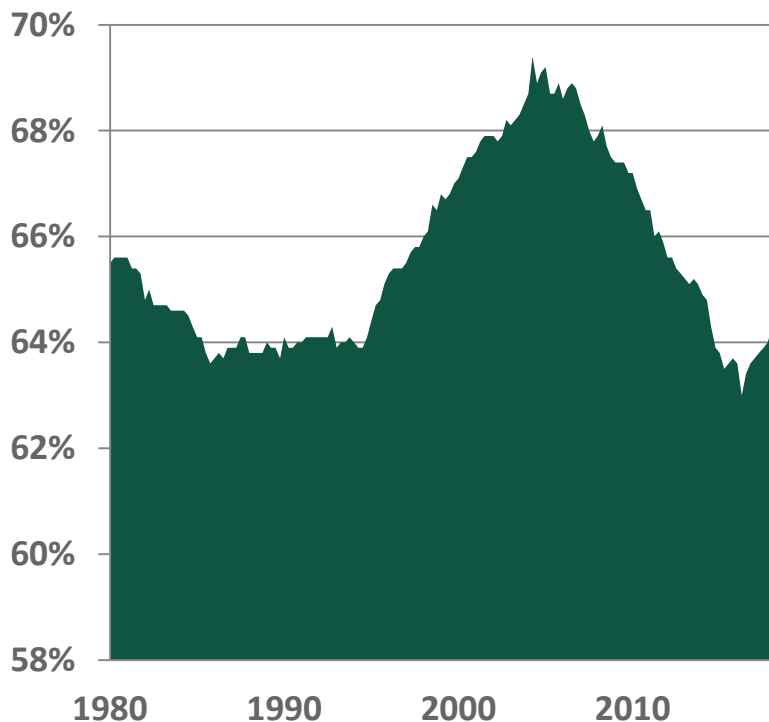


Sources: BEA, Haver Analytics, World Bank

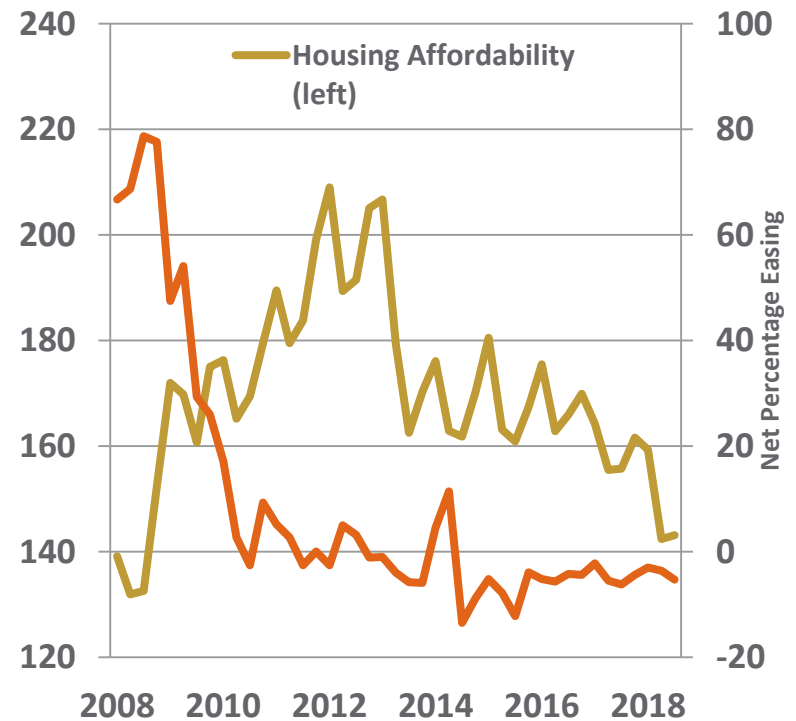
HOUSING

- *Housing has only recovered modestly*
- *A number of headwinds have held the sector back*

Homeownership Rate



Housing Conditions

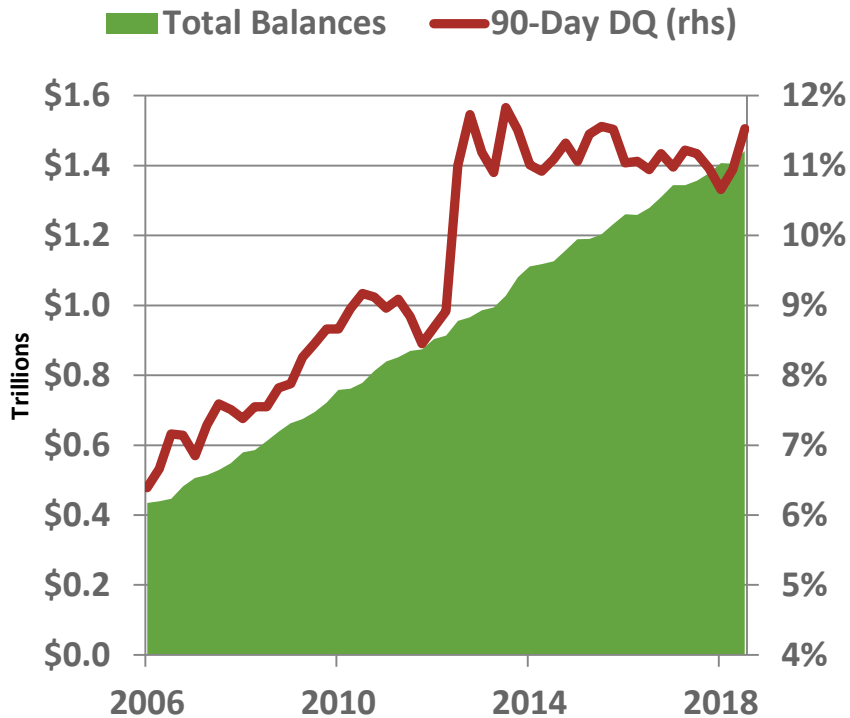


Sources: Census Bureau, National Association of Realtors, Federal Reserve, Haver Analytics

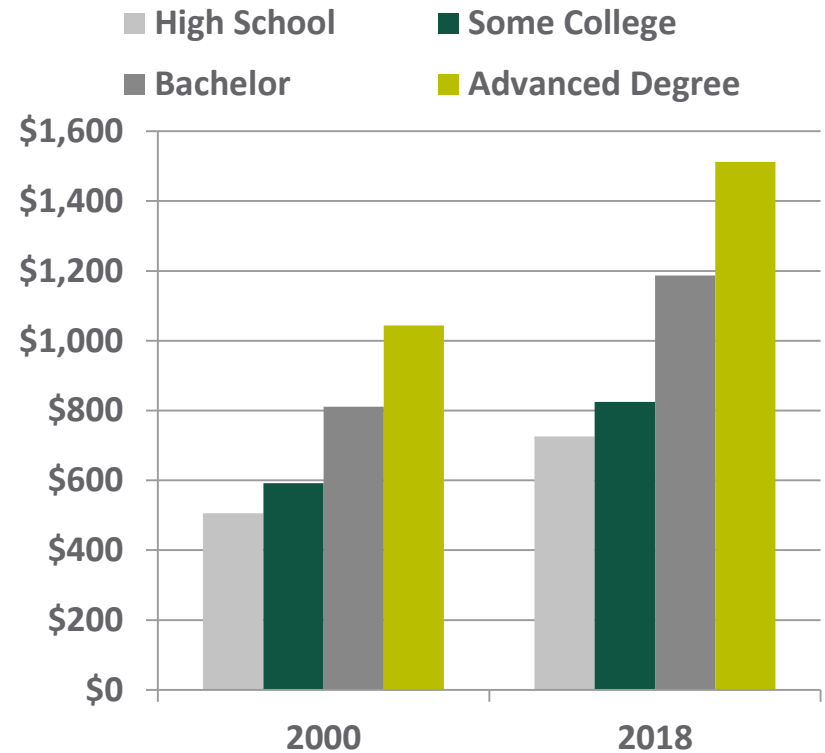
STUDENT LENDING

- *Substantial increase in balances; almost a third in deferral or default*
- *Gains to education are still positive for those who finish*

Student Debt



Weekly Earnings by Degree

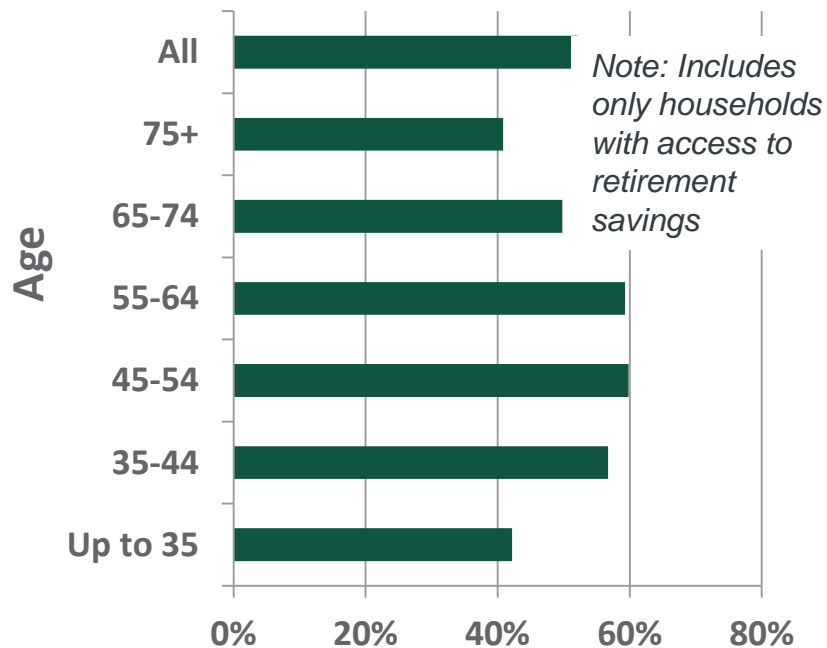


Sources: Federal Reserve Bank of New York, BLS

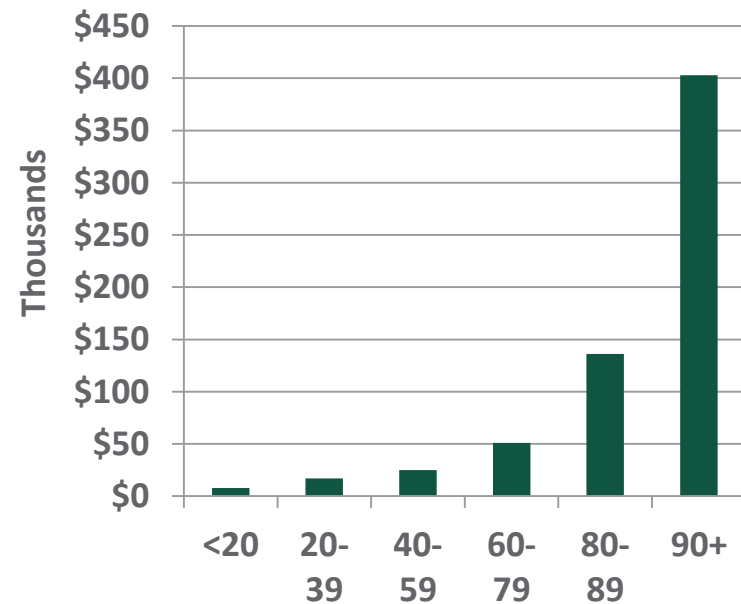
ARE SAVING LEVELS SUFFICIENT?

- *The data on retirement preparedness are scary*
- *A majority of households will have to watch consumption carefully*

Retirement Account Participation, by Age of Head of Household



Median Value of Retirement Savings Accounts by Income Percentile

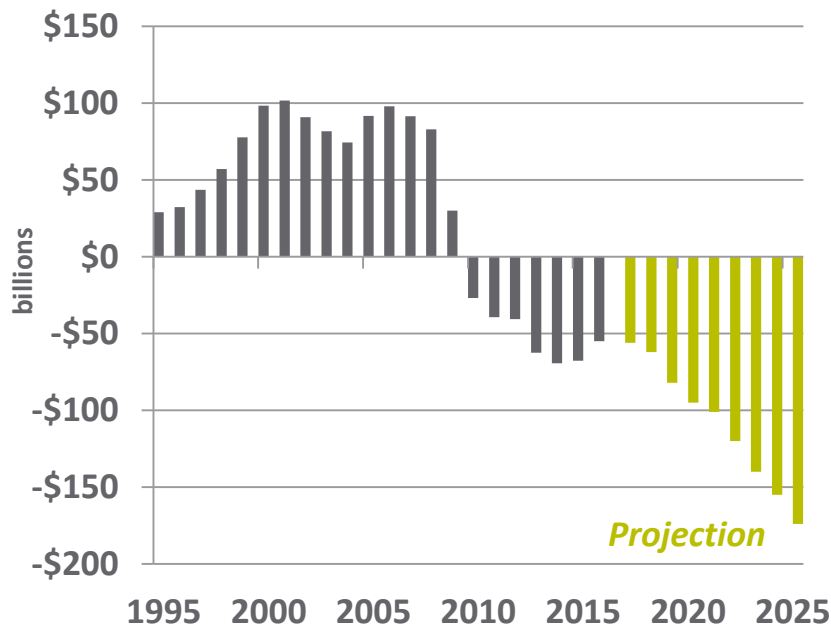


Sources: Federal Reserve Board Survey of Consumer Finances, Haver Analytics

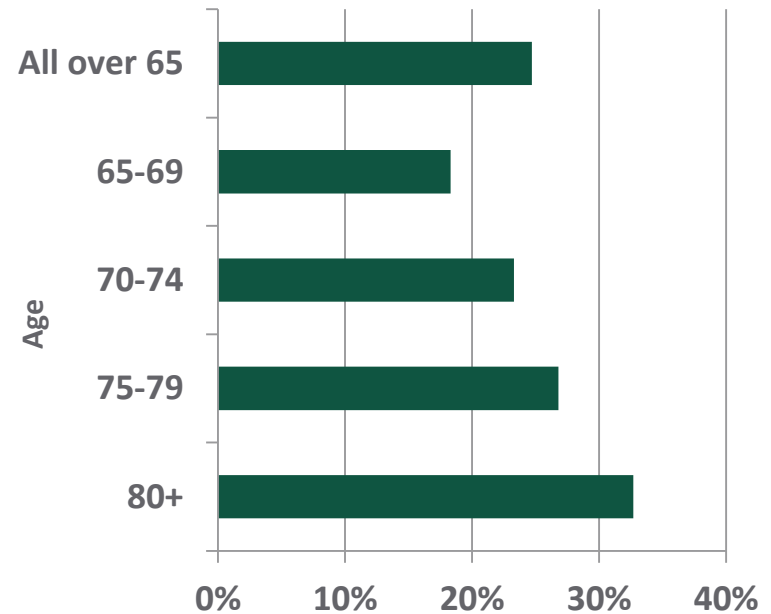
PUBLIC BACKSTOP

- *Demographics are taking a toll on Social Security*
- *Reliance on Social Security will make reform discussions difficult*

Social Security Trust Funds Cash Flow



Households Reliant on Social Security for 90% of Income



Sources: Social Security Administration, Government Accountability Office, Bureau of Economic Analysis, Haver Analytics

AUTOMATION AND ANXIETY

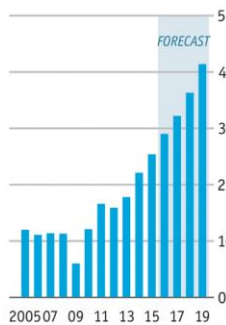
- *Man's love/hate relationship with machines is entering a new chapter*
- *How far and how fast will change occur?*

The life robotic

Global industrial robots

Sales

'000 units

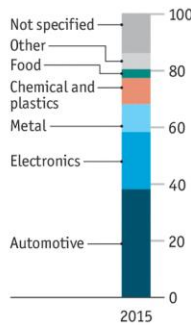


Source: International Federation of Robotics

Economist.com

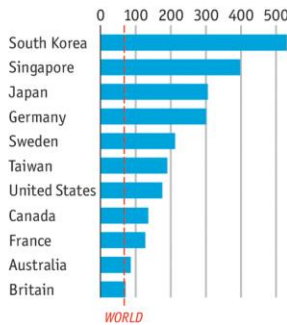
By industry

% of total

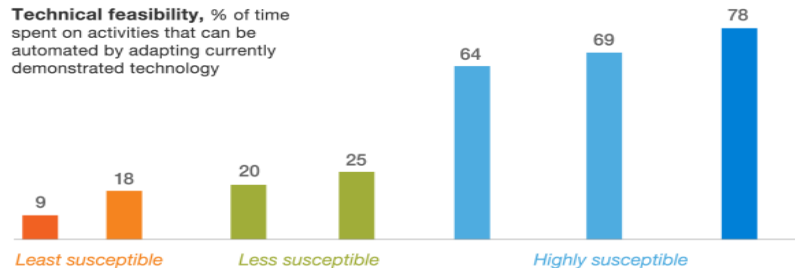


Number of robots

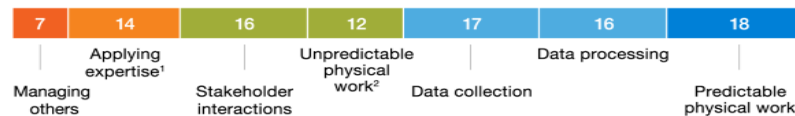
Per 10,000 manufacturing employees, 2015



Technical feasibility, % of time spent on activities that can be automated by adapting currently demonstrated technology



Time spent in all US occupations, %



Source: McKinsey

Catalogue of fears

Probability of computerisation of different occupations, 2013 (1 = certain)

Job	Probability
Recreational therapists	0.003
Dentists	0.004
Athletic trainers	0.007
Clergy	0.008
Chemical engineers	0.02
Editors	0.06
Firefighters	0.17
Actors	0.37
Health technologists	0.40
Economists	0.43
Commercial pilots	0.55
Machinists	0.65
Word processors and typists	0.81
Real-estate sales agents	0.86
Technical writers	0.89
Retail salespeople	0.92
Accountants and auditors	0.94
Telemarketers	0.99

Source: "The Future of Employment: How Susceptible are Jobs to Computerisation?", by C. Frey and M. Osborne (2013)

Economist.com

The Deleveraging Myth

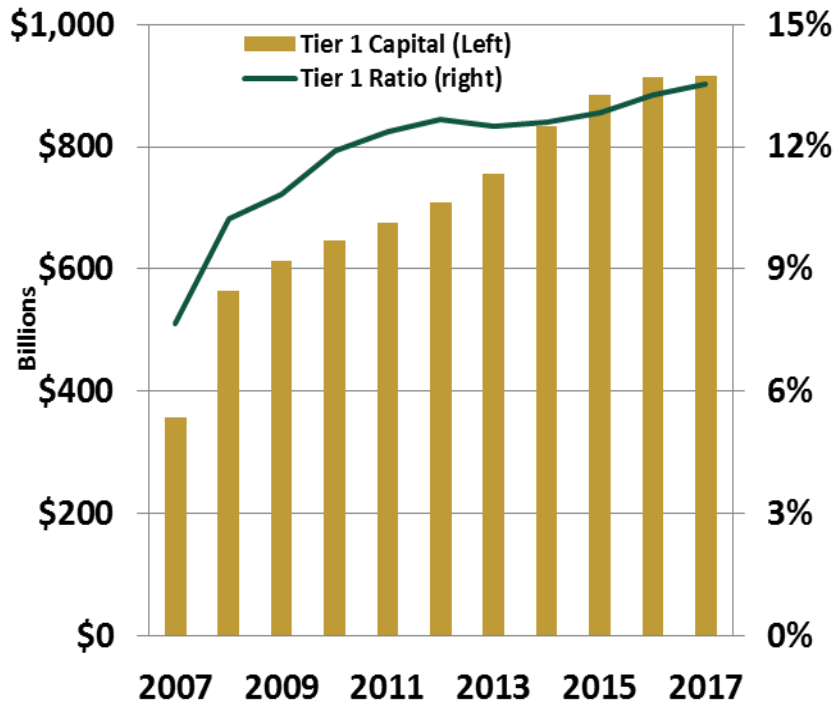
REFLECTIONS ON THE FINANCIAL CRISIS



SHORING UP FINANCE

- *Banks have much better capital positions*
- *Reduced use of volatile short-term funding*

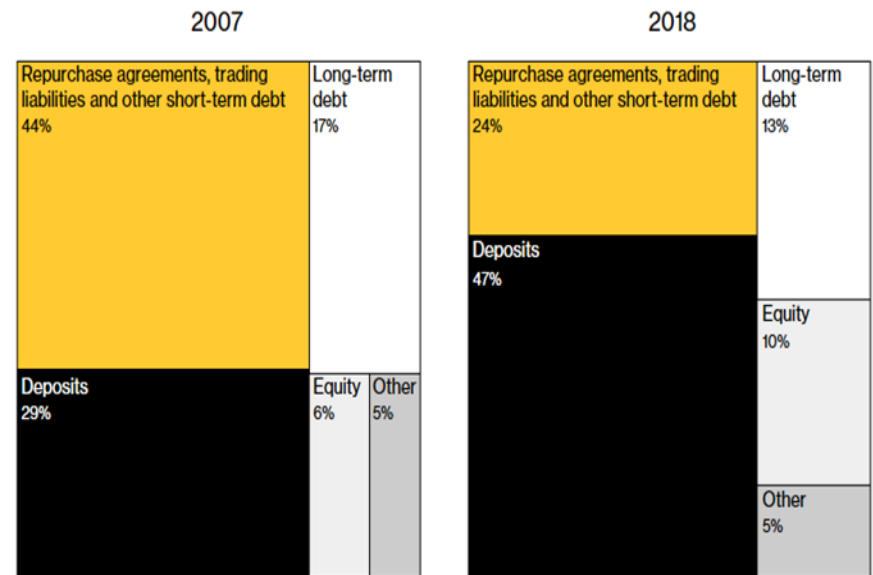
Capital Position: Top 10 U.S. Banks



Sources: FRB, SNL, Bloomberg

More Stable Funding

Big banks have reduced reliance on short-term funding that fled during the last crisis, replacing it with deposits



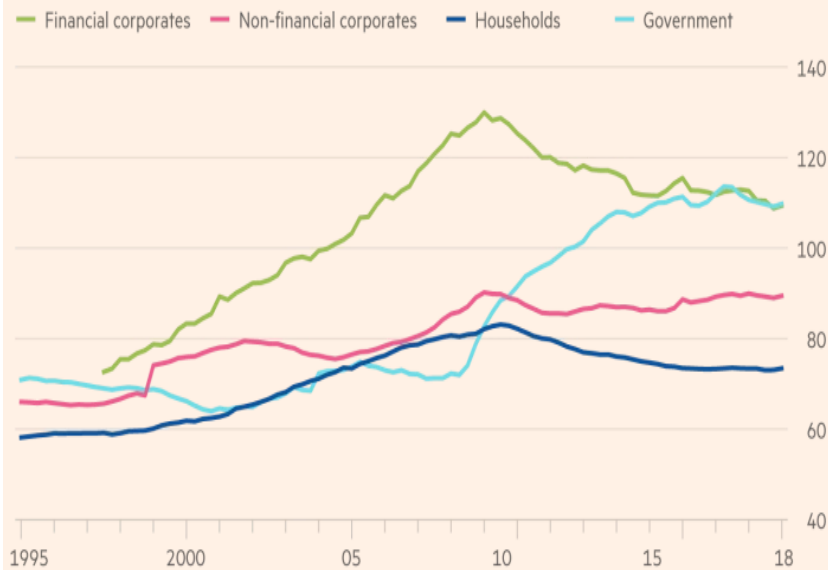
Note: Aggregate data for the liabilities of JPMorgan, Citigroup, Bank of America, Goldman Sachs and Morgan Stanley
Source: Company filings

THE EVOLUTION OF INDEBTEDNESS

- *Credit creation has moved from the private sector to the public sector, and from developed countries to China*

Private deleveraging is offset by government leveraging

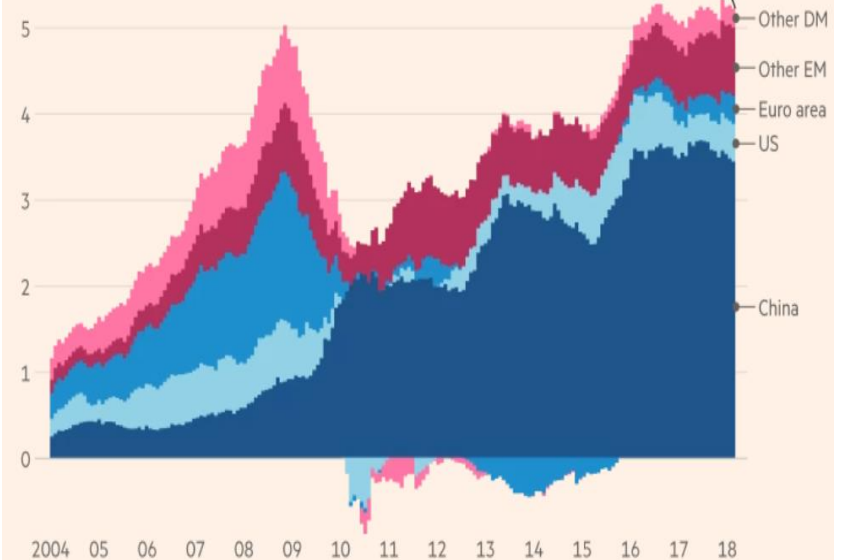
Mature economies (debt as a % of GDP)



Source: IIF
© FT

Private sector credit creation, rolling 12m, \$tn

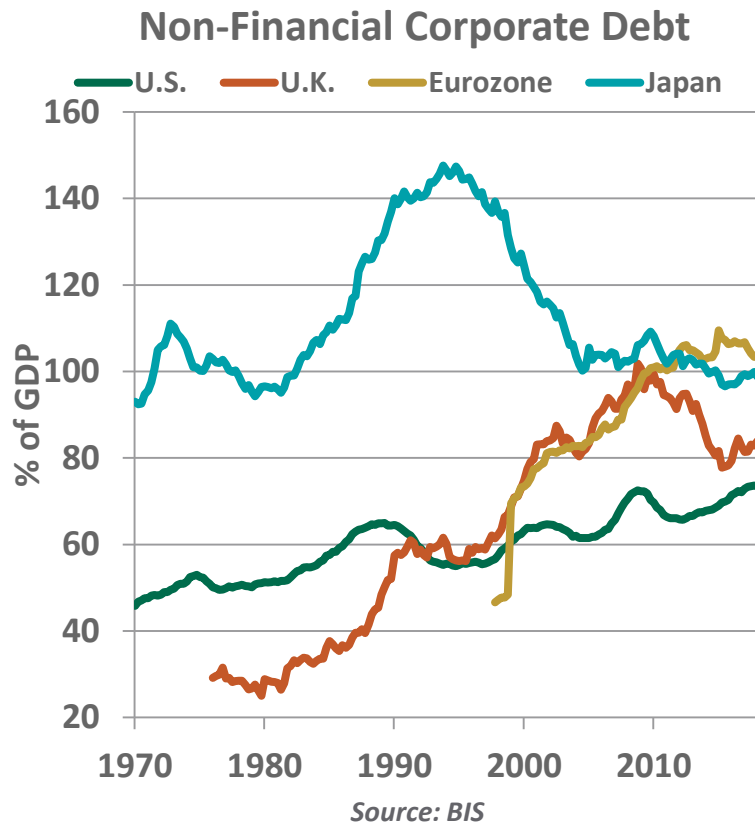
Recently, China has become the world's "borrower of last resort", accounting for 70 per cent of new credit from the private sector



Source: Matt King, Citibank
© FT

CORPORATE DEBT

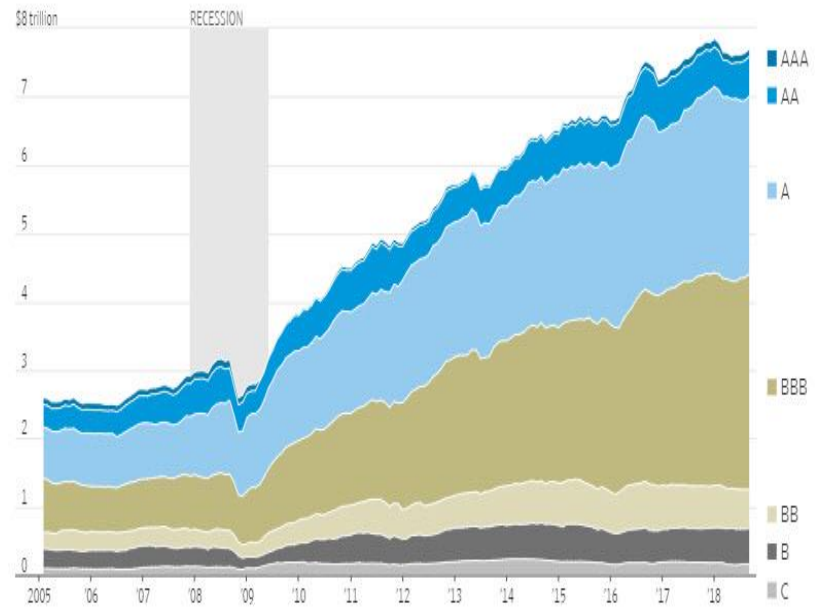
- *In most places, corporate debt has risen sharply*
- *The bulk of new issues are just above investment grade*



BBB My Baby

The explosion of corporate bonds since the last recession has been led by the lowest investment-grade rating, BBB.

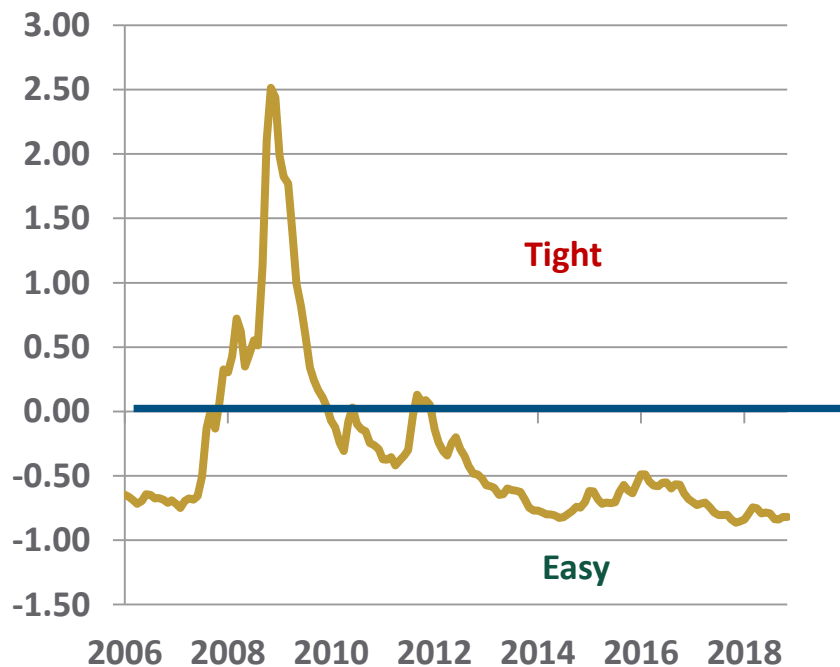
Value of U.S. corporate bonds by rating



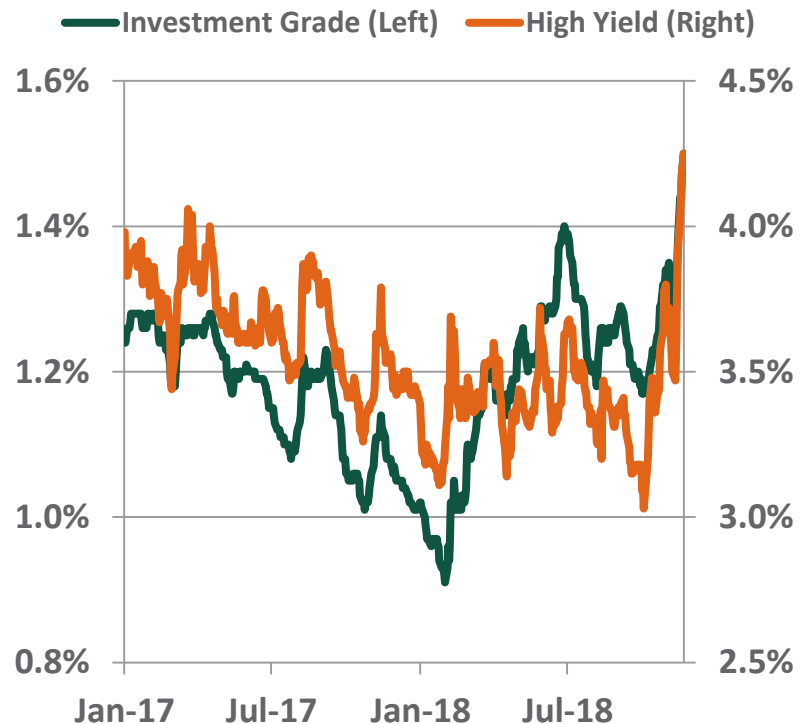
MEASURES OF FINANCIAL CONDITIONS

- *Access to capital is not difficult for most borrowers*
- *Bond spreads have widened of late, but remain modest*

FRB Chicago U.S. Financial Conditions Index



Corporate Bond Spreads

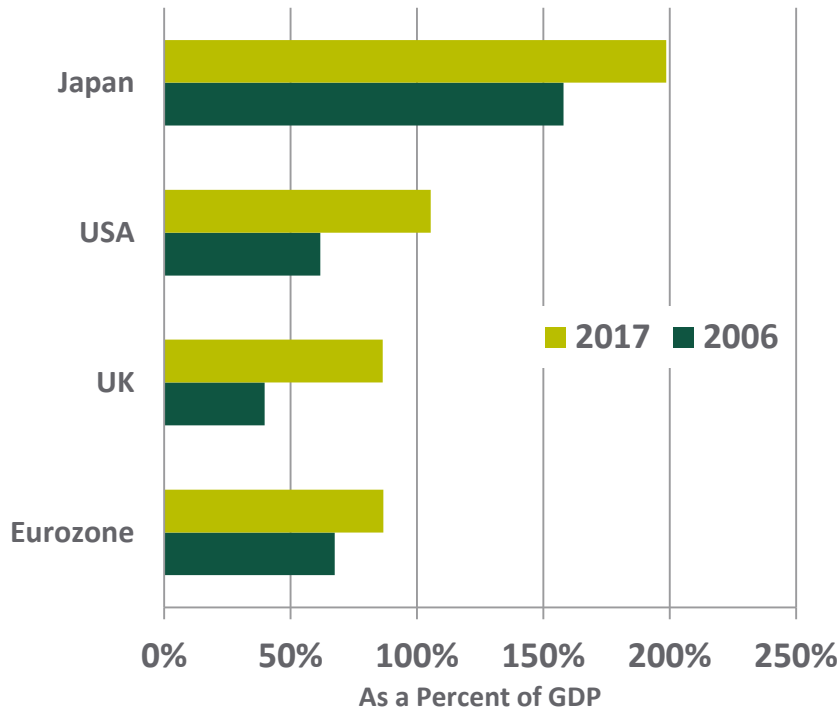


Sources: Federal Reserve Bank of Chicago, Barclay's, Bloomberg

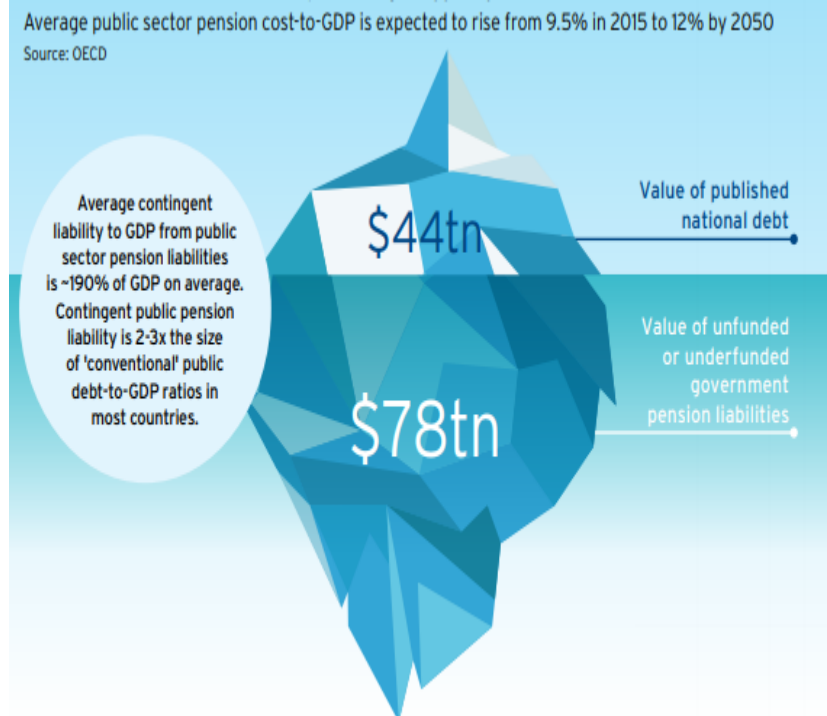
THE LIMITS OF GOVERNMENT LEVERAGE

- *Public sector debt has grown quickly since the crisis*
- *Unfunded pension obligations are immense*

Government Debt



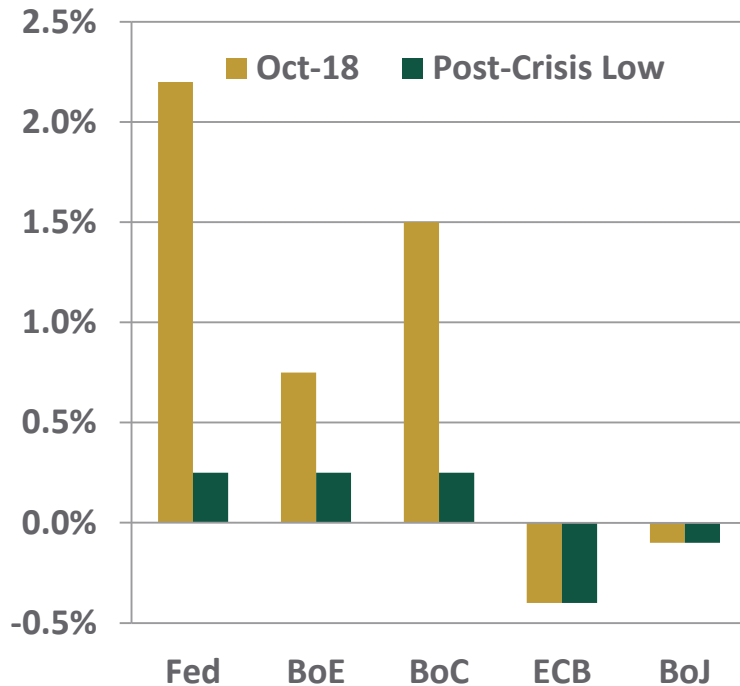
Sources: Haver Analytics, Citigroup



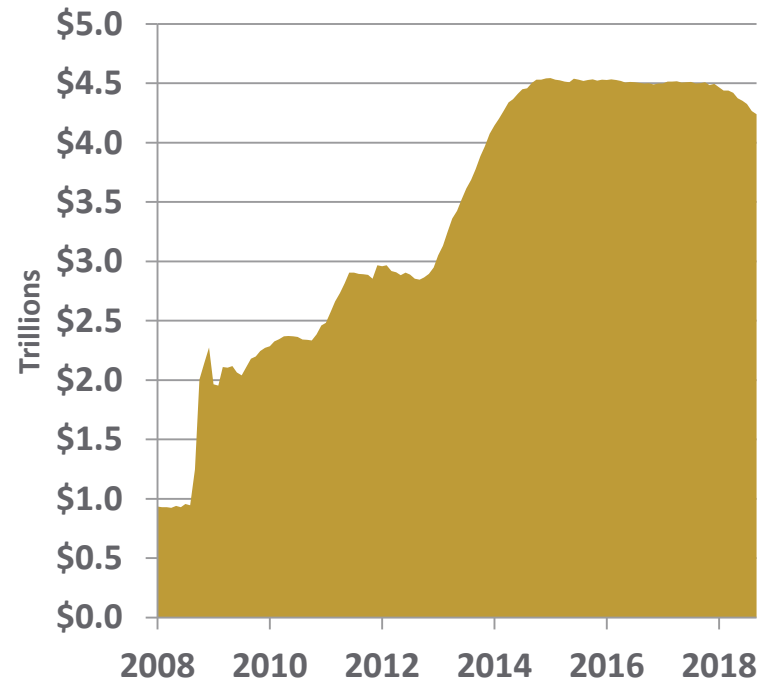
MONETARY NORMALIZATION

- *Crisis-era accommodation is being unwound*
- *The Fed has initiated “qualitative tightening”*

Central Bank Deposit Rates



Federal Reserve Total Assets



Source: Bloomberg

CENTRAL BANK INDEPENDENCE UNDER THREAT?



ECB's Draghi warns central banks' independence under threat

...The United States should not be penalized because we are doing so well. Tightening now hurts all that we have done. The U.S. should be allowed to recapture what was lost due to illegal currency manipulation and BAD Trade Deals. Debt coming due & we are raising rates - Really?

7:51 AM - Jul 20, 2018

China's central bank to pump US\$110 billion into economy as US trade war intensifies

India risks a high stakes fight with its central bank

Erdogan Expands Clout Over Central Bank, as He Promised

PARTING THOUGHTS

Household finances are improved, but may need further repair

- Retirement preparedness is a problem for many

Student debt will require enlightened attention

- Human capital accumulation should be stressed, but not at all costs

Financial stability surveillance is imperative

- Risks of a “Minsky Moment” are rising

Central banking is becoming more difficult

- Political pressure for easy money is rising

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