The 2008 Outlook for Consumption:
Testing the Limits of the Resilient Consumer

Richard Curtin
Research Professor and
Director, Surveys of Consumers
The University of Michigan
The consumers’ agenda . . .

• Slumping housing market
  – Rising credit standards, falling home prices, and diminished housing wealth
  – Main direct effects on employment; indirect effects via cash-out refinancing

• Increasing non-core inflation
  – Food and fuel prices
  – Differential impact on income subgroups

• Record low saving and record high debt
  – Ongoing reassessment of debt burden and risks of low savings
  – Constrained ability to cope with additional economic adversity

• Growth in jobs and wages key to past spending strength
  – Robust gains in real wages falter
  – Job growth expected to slow in year ahead

• Bottom line: average of 2.0% growth in PCE and 2¼% growth in GDP
  – PCE growth slows to just 1% in current quarter and 1st quarter of 2008
  – Just above stall speed, but not comfortably so
Chart 3: Index of Consumer Sentiment
Chart 4: Homeowner’s Perceptions of Changes in the Value of their Home

November 2007:
Increase = 37%
Same = 36%
Decrease = 27%
Chart 5:
Percent of Homeowners that Expect Declines in Value of Home During Year Ahead and Next Five Years

Year Ahead

Next Five Years

2007 F M A M J J A S O N

20% Nov

9% Nov
Chart 6:  
Annual Expected Change in Home Value During Year Ahead and Next Five Years
Chart 7: Home Buying Plans and References to Mortgage Interest Rates
Chart 8: Home Selling Conditions and References To Home Prices
Chart 9: Ratio of Old to New Mortgage Rates on Refinanced Mortgages

2007:2 = 0.98

2000:2 = 0.91

2006:3 = 0.91
Chart 10: Impact of Home Equity Extraction on Personal Consumption Expenditures
Chart 11:
Household Debt as a Percentage of Personal Disposable Income

2007:2
Total = 136%
Mortgage = 100%
Consumer = 24%
Misc. = 12%
Chart 12: Debt Service & Financial Obligations as a Percent of Disposable Income

Financial Obligations = 19.3% in 2007:2 (peak = 19.5%)

Debt Service = 14.3% in 2007:2 (peak=14.5%)

Mortgage = 11.7% in 2007:2 (peak=11.8%)

Renters = 25.9%
Homeowners = 18.0%
Chart 13:
Personal Saving Rates: NIA & FRB
(Four-quarter moving averages)
Chart 14: FRB: Net Acquisition of Assets and Debts as a Percentage of Disposable Income
(4-Quarter Moving Average)

Assets

2007:2
Assets = 13.1%
Debts = 15.4%
Chart 15: References to High Prices in Assessments of Personal Finances By Thirds of Income Distribution (Four-quarter moving averages)
Chart 16: Difference Between One Year and Five Year Inflation Expectations

Long-term Higher

Short-term Higher
Chart 17: References to Income Gains in Assessments of Personal Finances By Thirds of Income Distribution
(Four-quarter moving averages)
Chart 18: Annual Change in Real Average Hourly Earnings Among Private Labor Force
(Production and non-supervisory workers)

Aug 2007 = 2.2 (current $ = 3.9%)
Sep 2007 = 1.2 (current $ = 4.0%)
Oct 2007p = 0.0 (current $ = 3.8%)

Averages:
1965 - 2007 = 0.3%
1997 - 2007 = 0.9%
Chart 19:
Real Personal Disposable Income
(Annual Rates of Growth)

1960s=4.5% 1970s=3.7% 1980s=3.2% 1990s=2.8% 2000s=3.0%

2007:3 = 4.1% (y/y)
Chart 20: One-Year Outlook for National Economy
Chart 21: National Unemployment Rate

Decade Averages:
- 1950s = 4.5%
- 1960s = 4.8%
- 1970s = 6.2%
- 1980s = 7.3%
- 1990s = 5.8%

October 2007
- All Workers = 4.7%
- Married workers = 2.7%

Age Groups:
- Age 16 – 24 = 10.8%
- Age 25 – 54 = 3.8%
- Age 55 or older = 3.1%

Education Levels:
- Less High Sch: 7.3%
- High School: 4.6%
- Some College: 3.5%
- College Degree: 2.1%
Chart 22: Labor Force Participation Rate and Employment Population Ratio

- Participation Rate: October = 65.9
- Employment Ratio: October = 62.7
- Unemployment Rate: $1 - (0.6274/0.6585) = 4.7\%$
Chart 23: Employment Population Ratios: Men and Women Under Age 25

- Men:
  - October = 53.9%
  - 1999 Peak = 62.7%

- Women:
  - October = 51.4%
  - 2000 Peak = 58.2%
Chart 24: Employment Population Ratios: Men and Women Aged 25 to 54

Men
October = 87.2%
1999 Peak = 89.7%

Women
October = 72.3%
2000 Peak = 74.9%
Chart 25: Employment Population Ratios: Men and Women Over Age 55

Men
October = 43.6%

Women
October = 32.3%
Chart 26: Unemployment Expectations & Growth in Personal Consumption Expenditures
The Outlook and the Risks

• 2008 growth in personal consumption expenditures of 2.0% due to:
  ➢ Declines in housing wealth
  ➢ Higher energy and food prices
  ➢ Record high debt and low savings
  ➢ Slowing growth in jobs and wages
  ➢ Negative quarter in consumption possible

• Major Risks to outlook:
  ➢ Impact of housing slump greater than expected
  ➢ Unrelenting surge in oil prices
  ➢ Higher interest rates to battle rising core inflation
  ➢ Electioneering: negative on jobs; shifting tax burdens
  ➢ Increased vulnerability to exogenous shocks