The 2014 Consumer Outlook: Unresolved Contradictions

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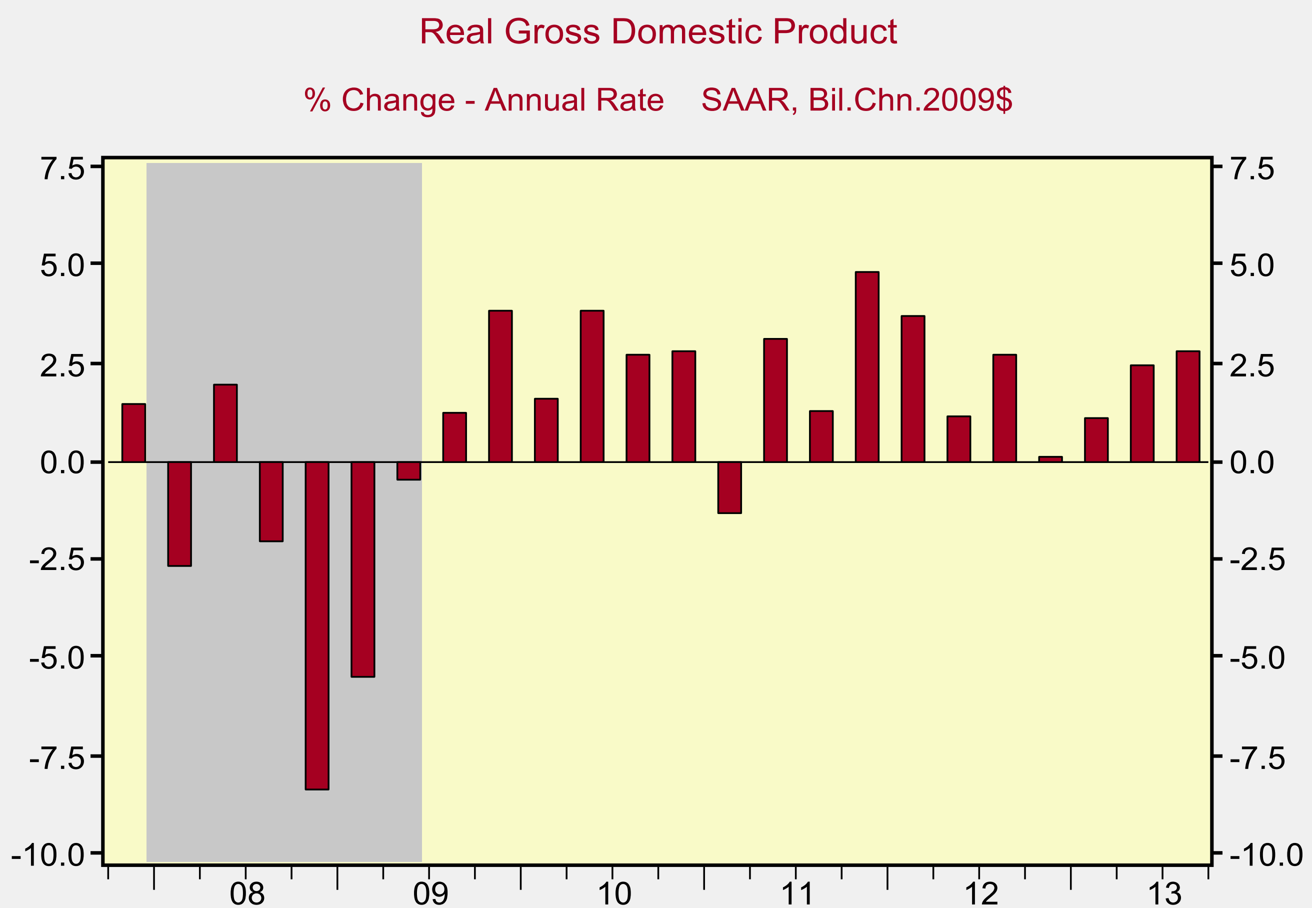
Overview

I. Can consumers drive GDP growth in 2014?
II. Labor markets: a slow healing process
III. Income: still a missing ingredients
IV. Confidence: feeling better, but not that great
V. Balance sheet repair: encouraging progress, but uneven
VI. Housing: a bright spot, but uncertainty persists
VII. Conclusions

GDP: modest-to-moderate growth

Revised data suggest a better performance than originally perceived, but still lacking consistency and momentum.



Source: Bureau of Economic Analysis /Haver Analytics

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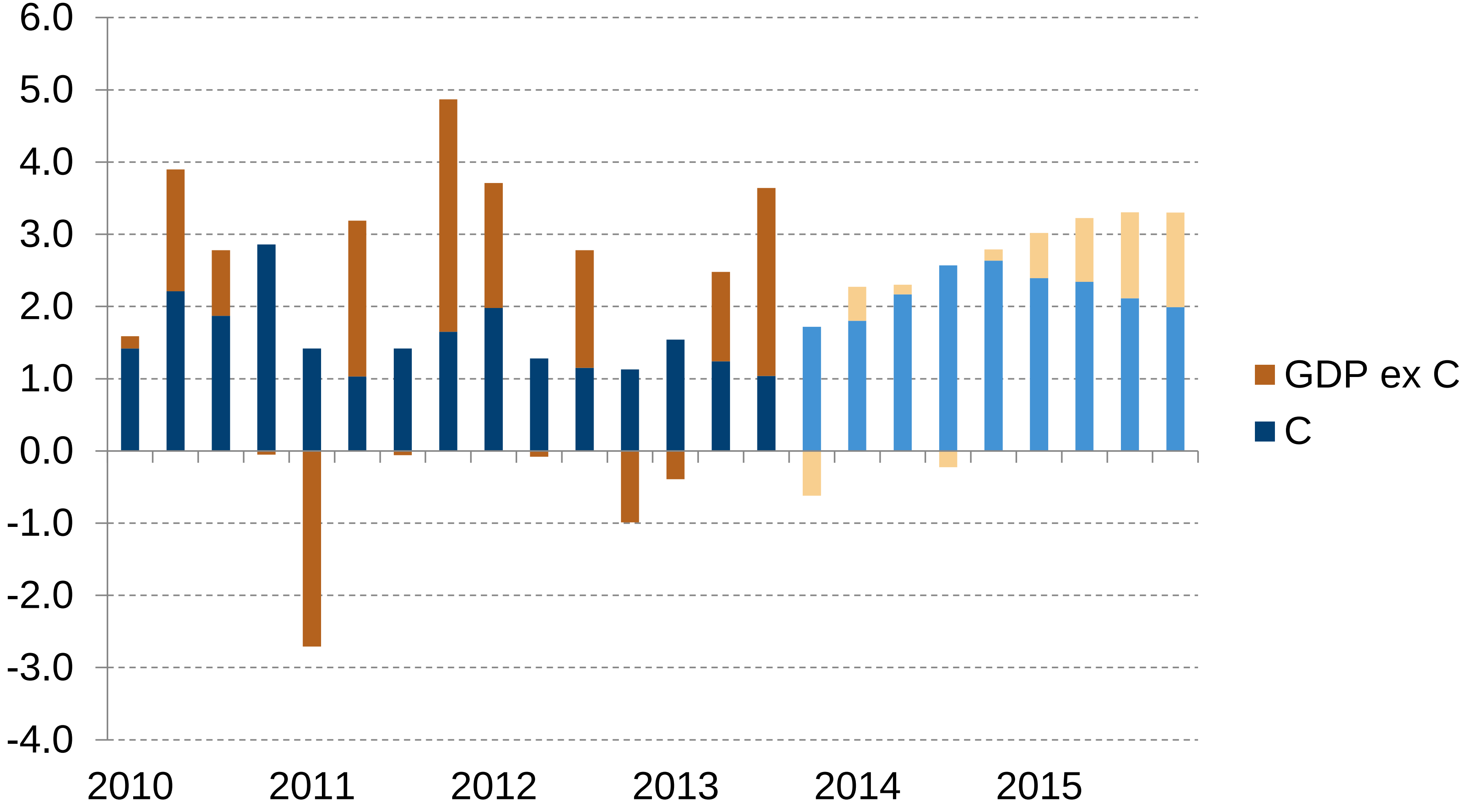
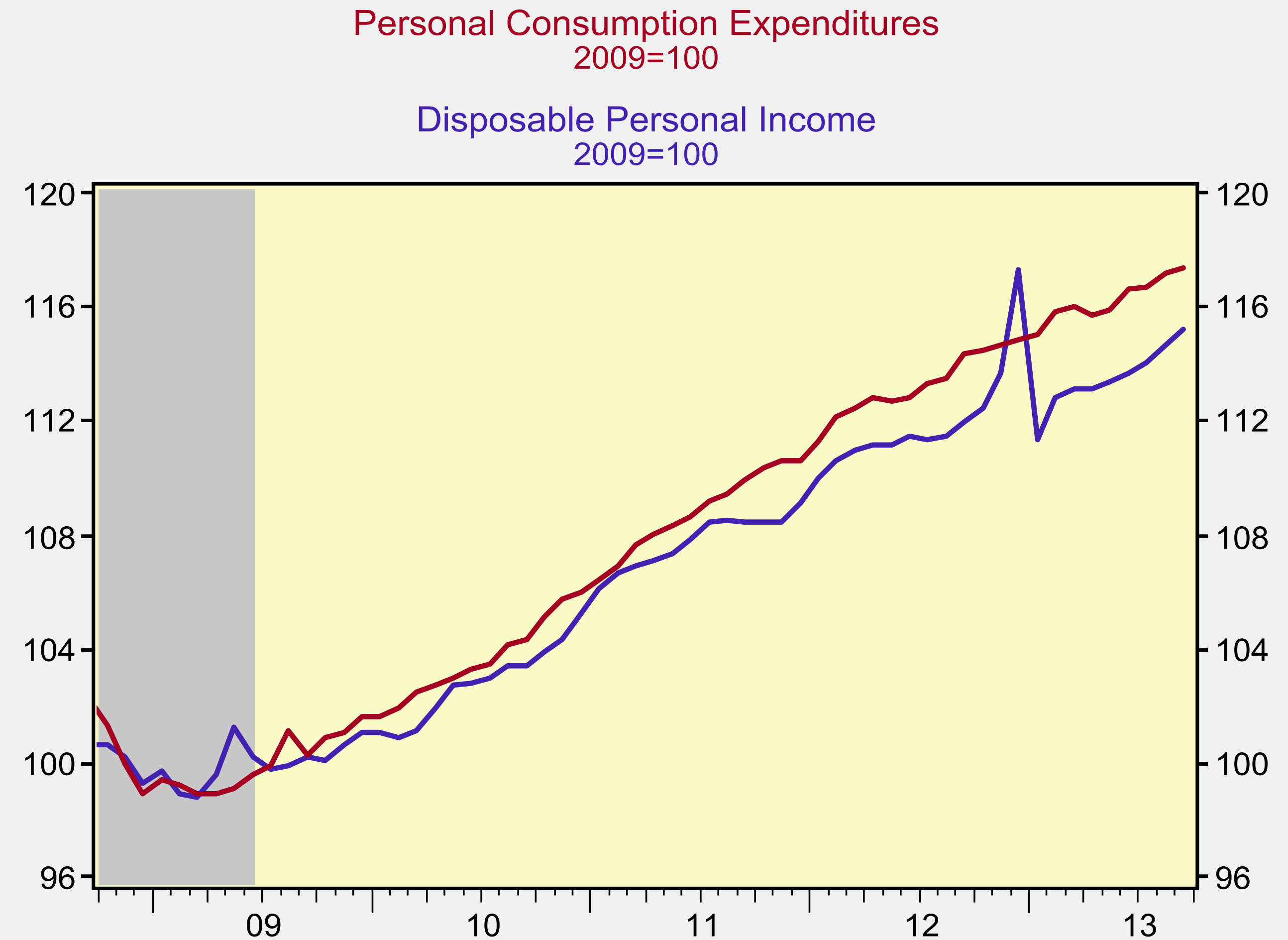
GDP: consumers are doing their part – but can they keep up?

Our forecasts suggest an improving outlook, but depend heavily on an acceleration in consumer spending. Downside risks are quite significant.



A puzzle: moderate consumption in a modest labor market

Since 2009, personal consumption has outstripped income growth.



Source: Bureau of Economic Analysis /Haver Analytics

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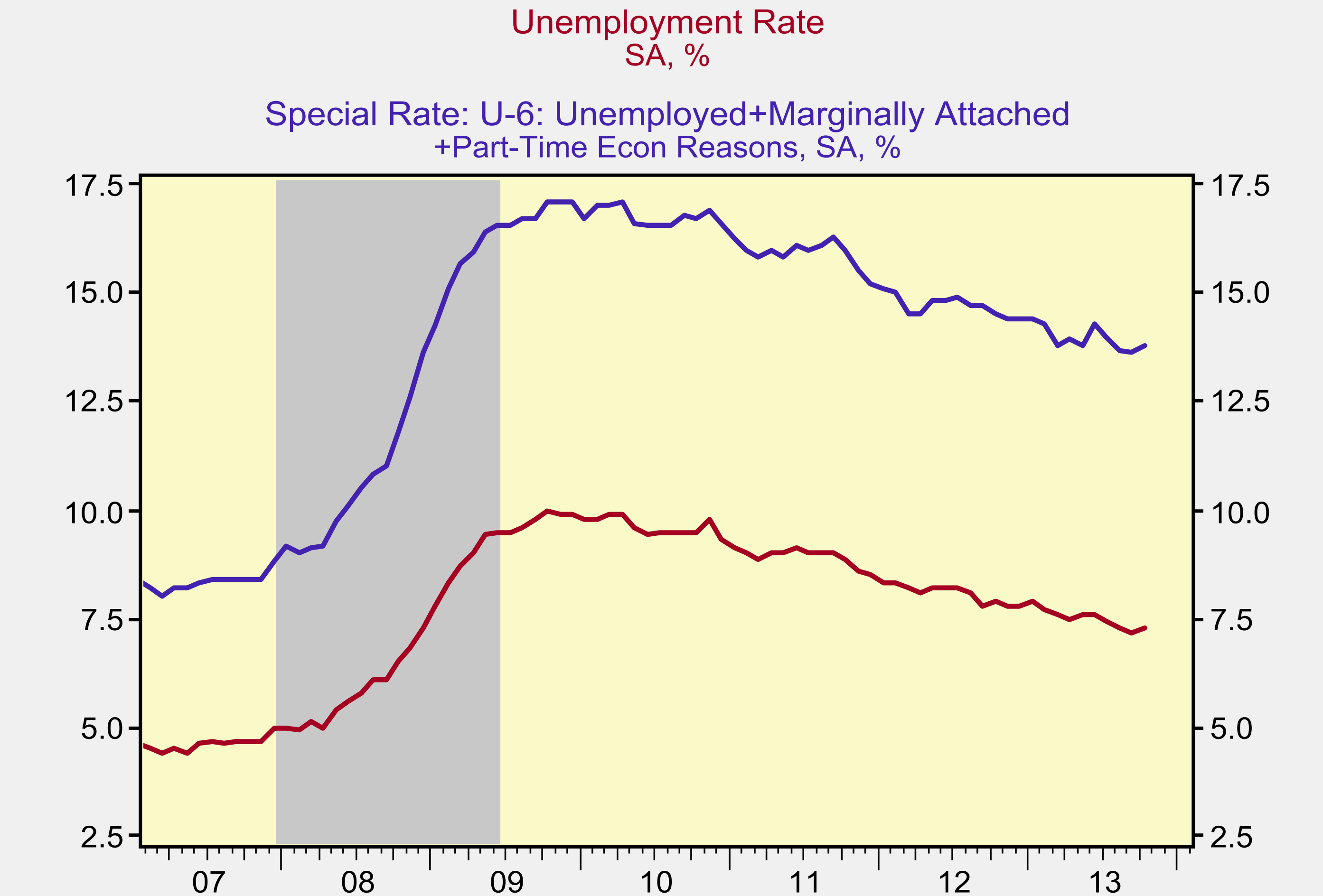
Labor market: slow recovery, long-lasting pain

Four years into the recovery, the unemployment rate remains at 7.3% and well above pre-recession levels.



Source: Bureau of Labor Statistics /Haver Analytics

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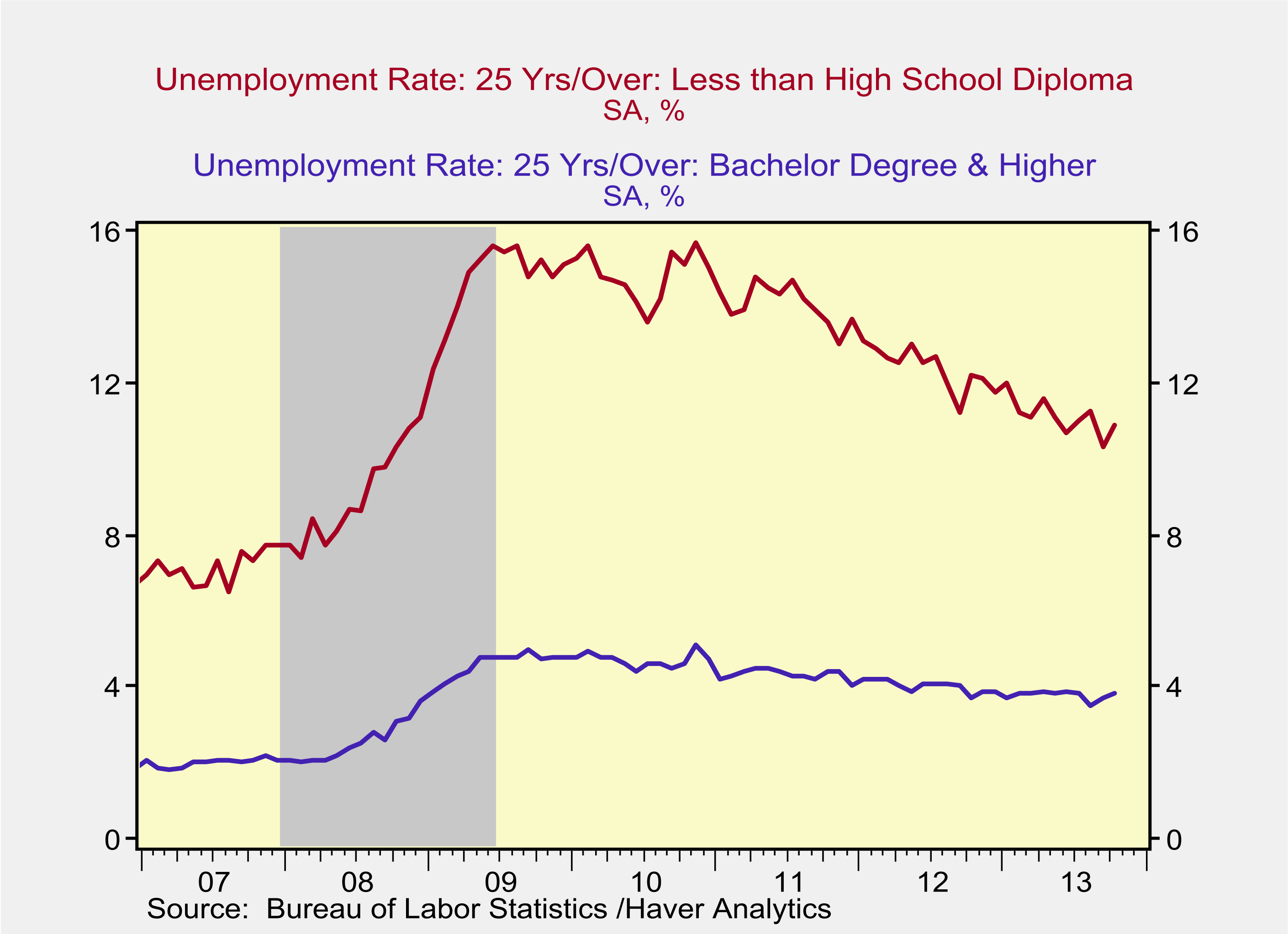
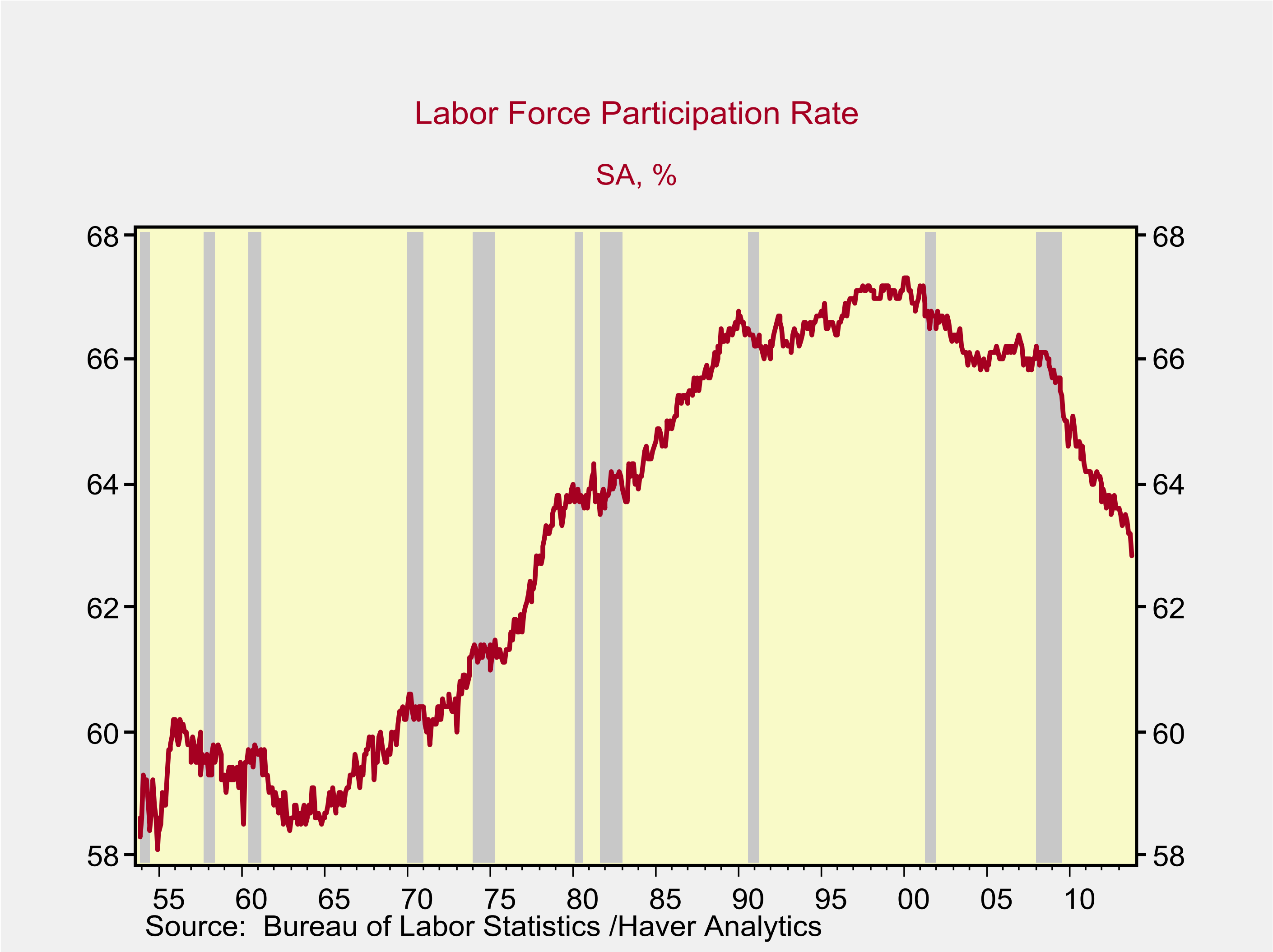
Labor markets: uneven progress

Despite recent improvements, progress has been uneven and, based on demographics and education, different categories of workers face very different challenges.



The fall of the participation rate: not just demographics

While the retirement of baby boomers was expected to reduce the participation rate, demographics alone cannot account for the entire magnitude of the decline.



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Participation rate: a back-of-the-envelope assessment

The participation puzzle has many moving parts. Adjusting for the changing size of population and its demographic distribution, and holding constant the participation rate of each age group as in 2005, we would still show a decline in overall participation rate, but less pronounced than what we are currently observing. At a corrected 64% participation rate, current unemployment would still be above 8%.

Age Group	2005			2013			Labor Force at 2005 PR	Adjusted PR
	POP	Labor Force	PR	POP	Labor Force	PR		
16-24	36,674	22,282	60.8%	38,841	21,270	54.8%	23,599	
25-54	124,175	102,759	82.8%	124,409	100,790	81.0%	102,953	
55+	65,233	24,254	37.2%	82,709	33,475	40.5%	30,752	
TOTAL	226,082	149,295	66.0%	245,959	155,535	63.2%	157,303	64.0%

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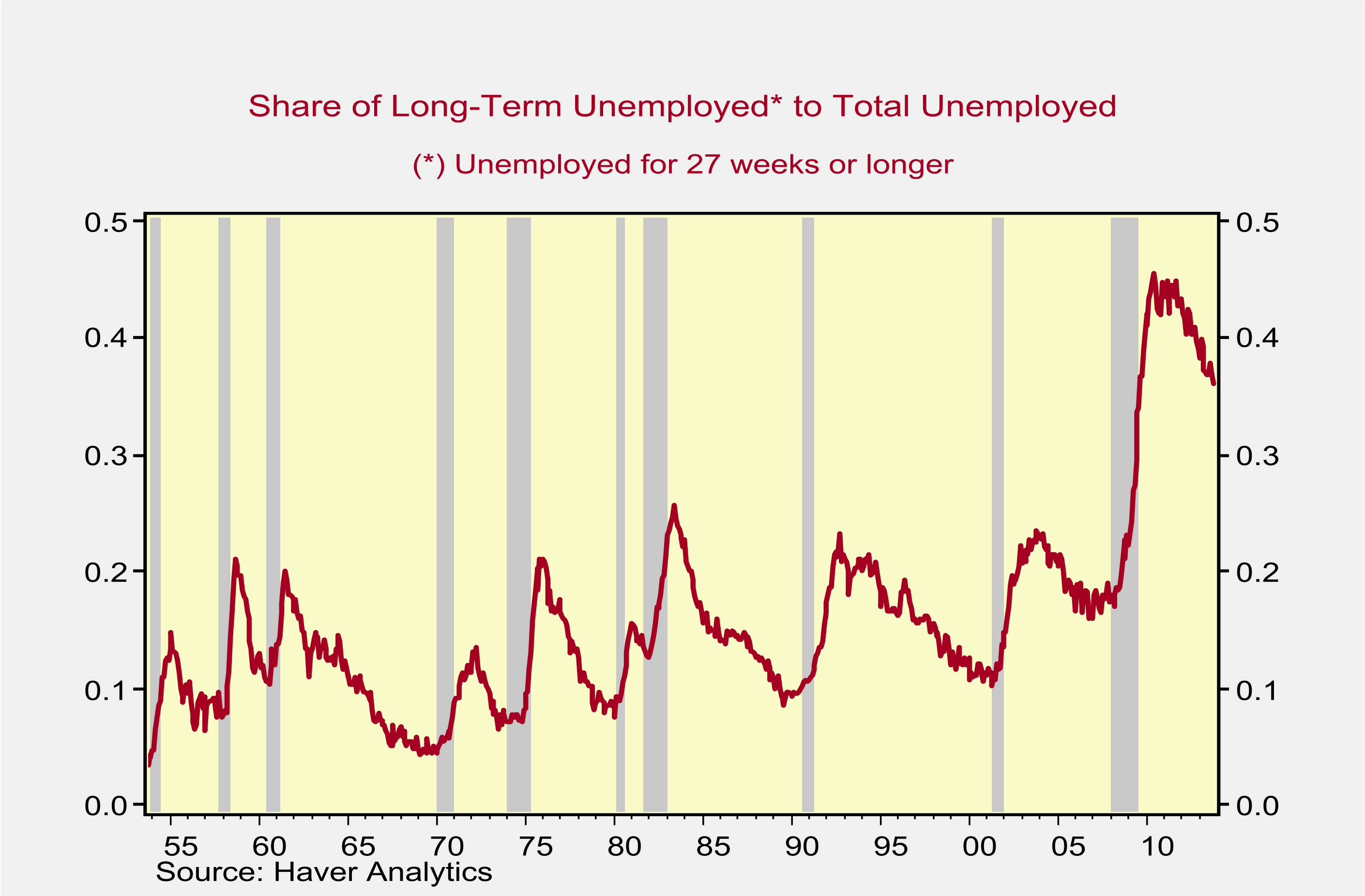
The persistence of long-term unemployment

Close to 40% of the unemployed have been out of work for 27 weeks or longer; even Federal Reserve Chairman Ben Bernanke concedes that “lengthy periods of unemployment and underemployment can erode workers' skills and attachment to the labor force or prevent young people from gaining skills and experience.”



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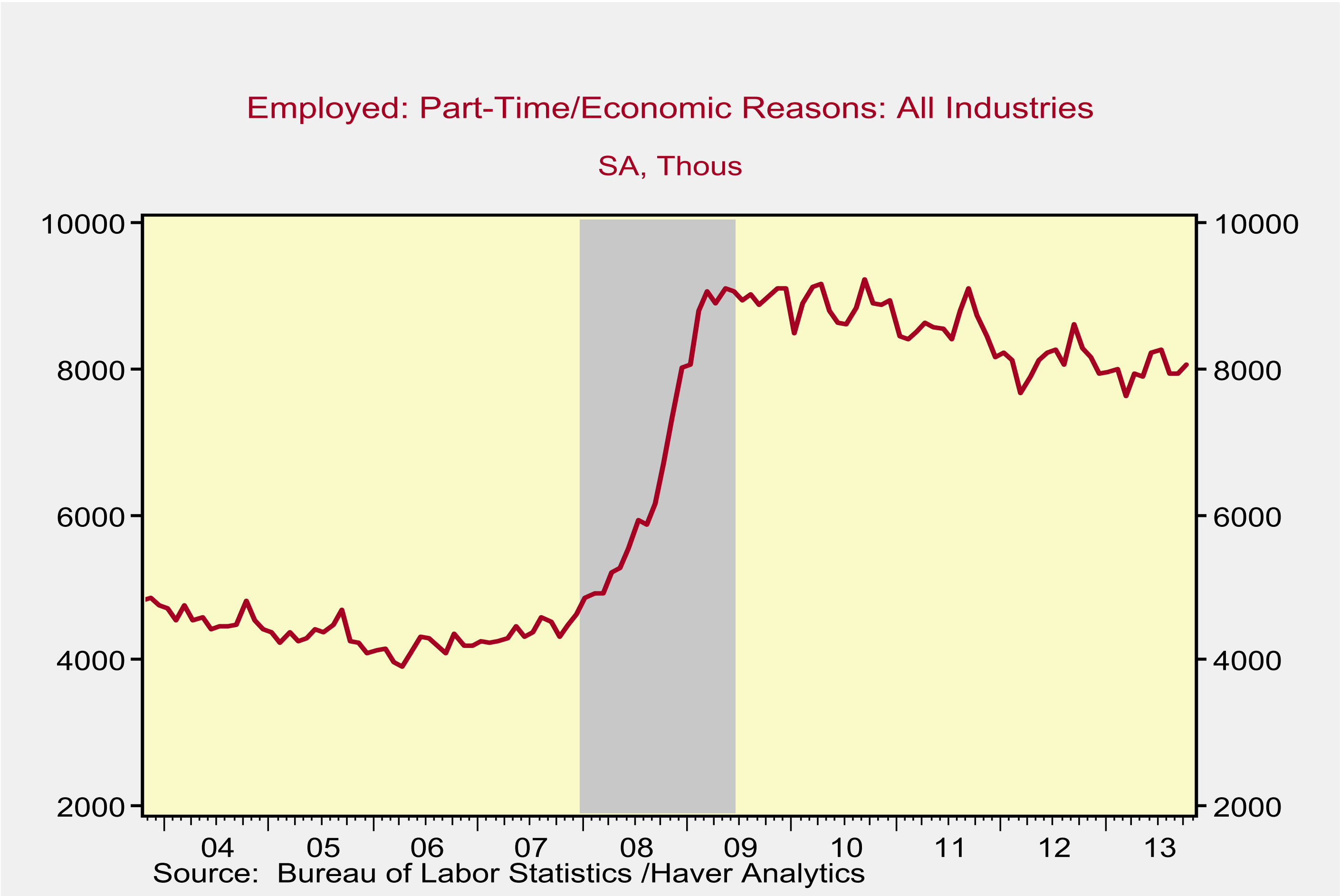
The rise of part-time jobs

Part-time work due to economic reasons remains at very high levels; more than 70% of the increase in the household measure of employment was accounted for by Americans working part-time.



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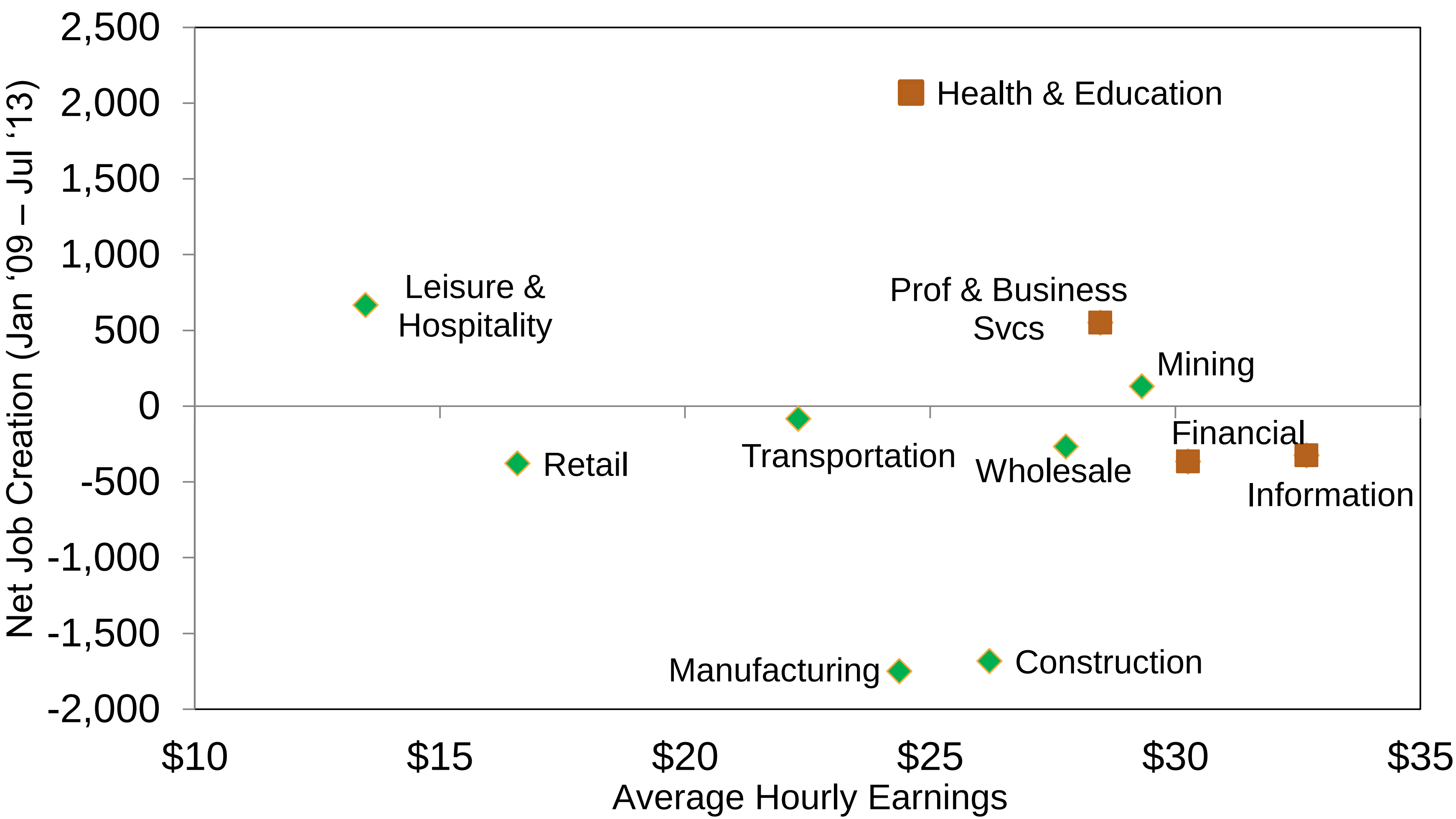
The changing mix of jobs

Net job creation has been nearly nonexistent in traditional, “blue collar” industries and subdued in better-paying sectors requiring higher educational attainment.



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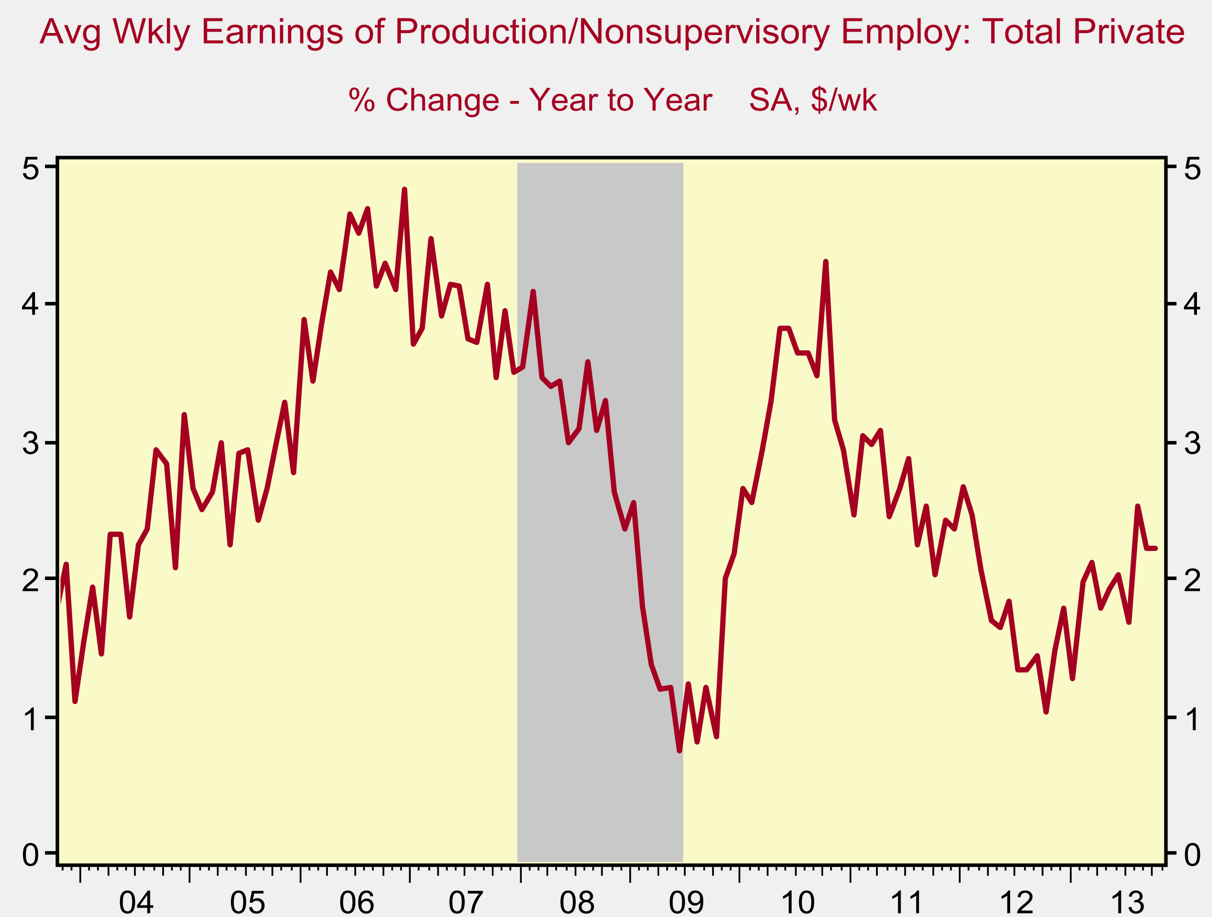
Wages: a double dip hit

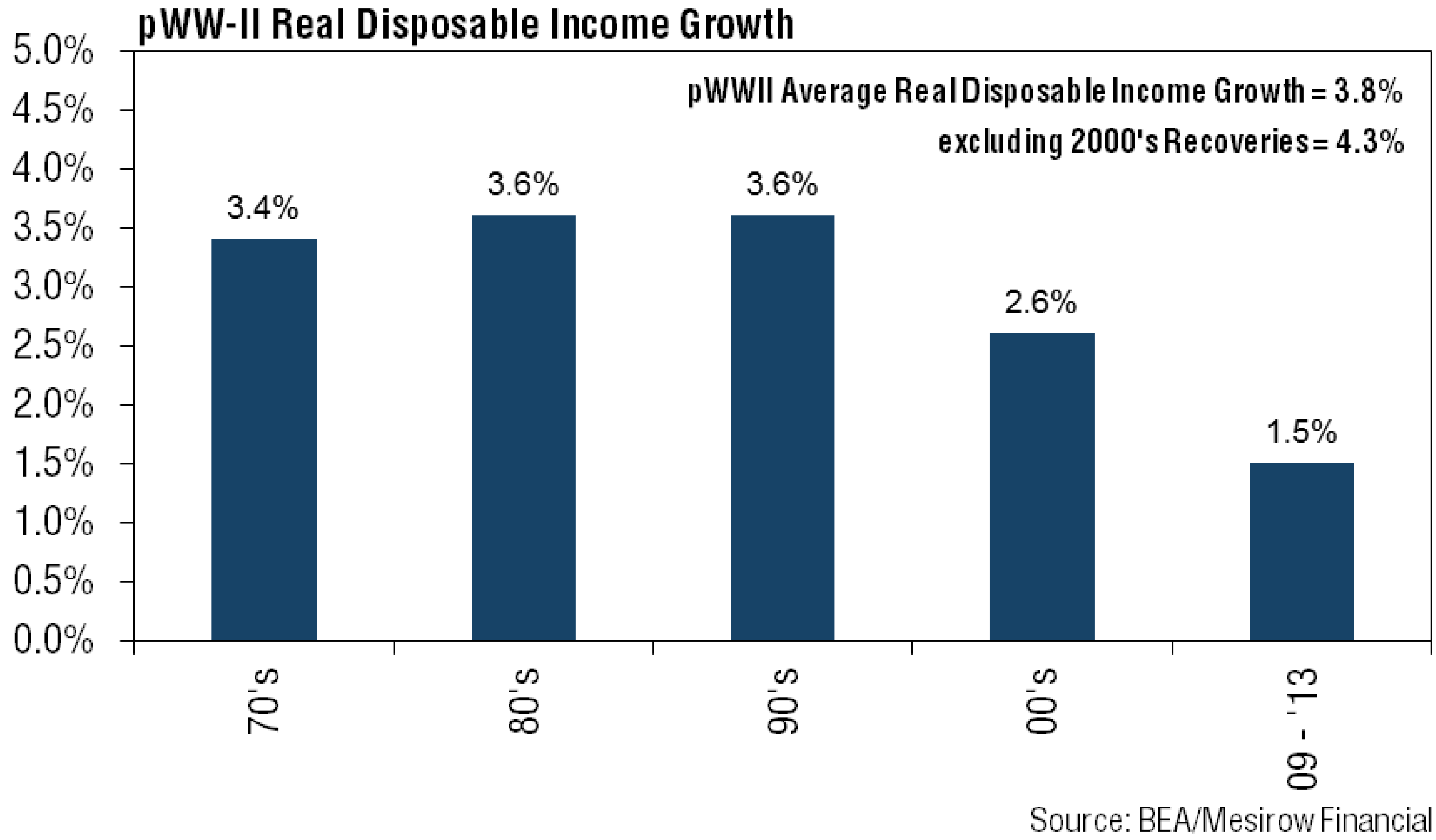
After a tentative recovery in 2010, weekly earning suffered a new setback and we are only beginning to see a turnaround in 2013.



Source: Bureau of Labor Statistics /Haver Analytics

Disposable income: more than a cyclical slowdown?

Growth in disposable income has disappointed since 2000 – cyclical factors may be part of the story, but there seems something else going on.



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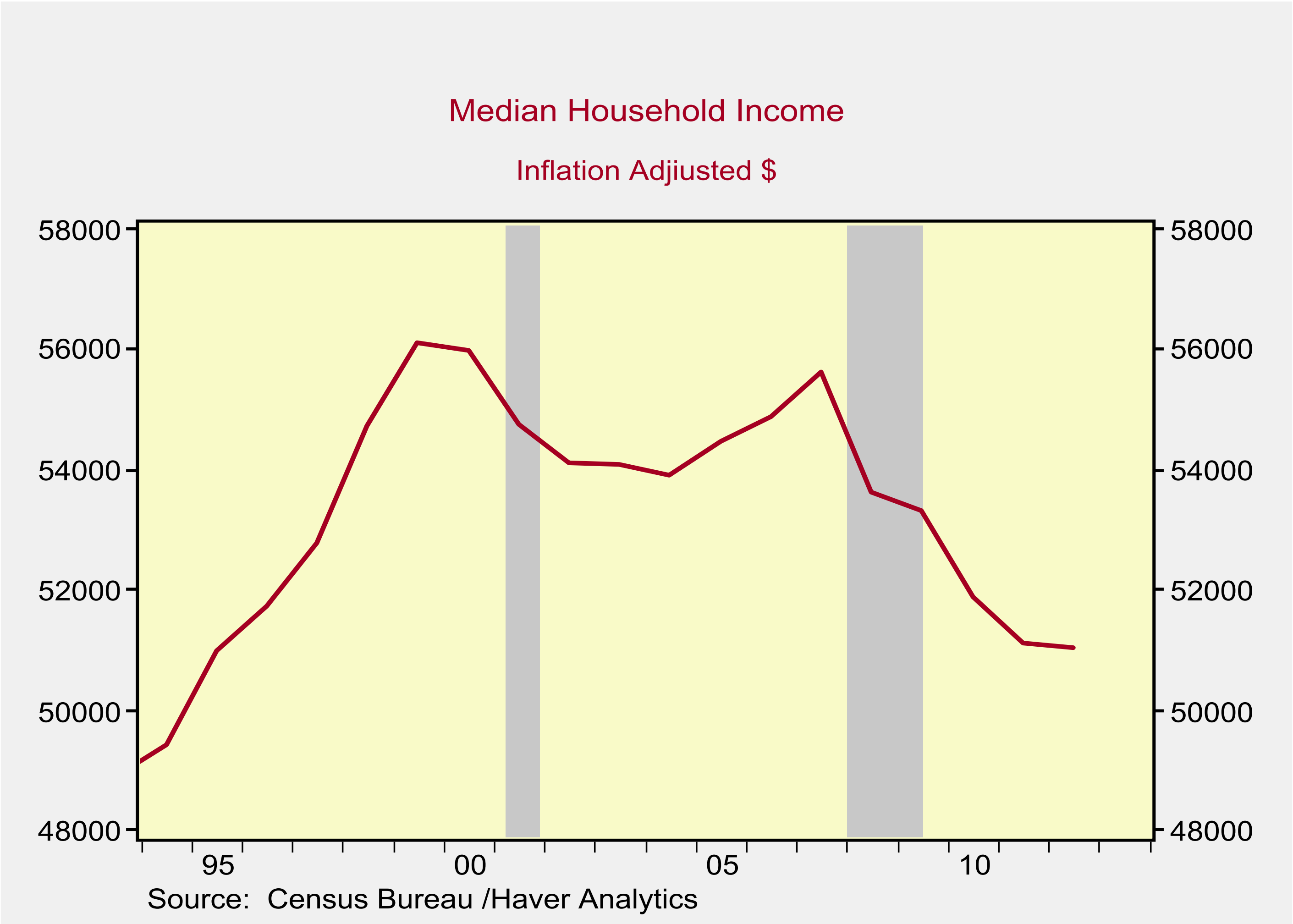
Median household income: a disturbing trend

Adjusted for inflation, household income is at 1995 levels and shows little progress since its 1999 peak.



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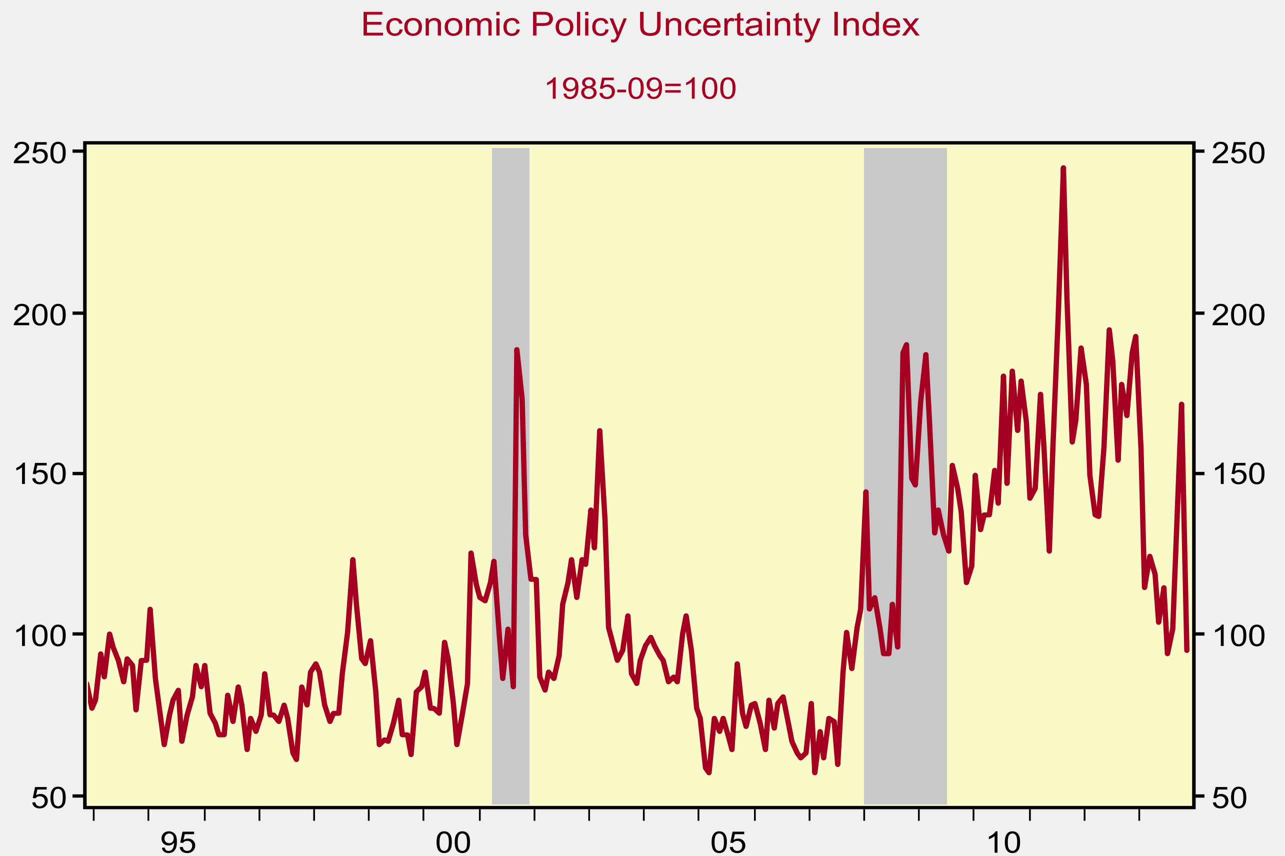
What about uncertainty?

Formal measures of uncertainty show somewhat improving conditions from historically high levels (the Policy Uncertainty Index is based on expiring tax provisions, market volatility and spreads across forecasts for monetary and fiscal policy.)



Source: PolicyUncertainty.com /Haver Analytics

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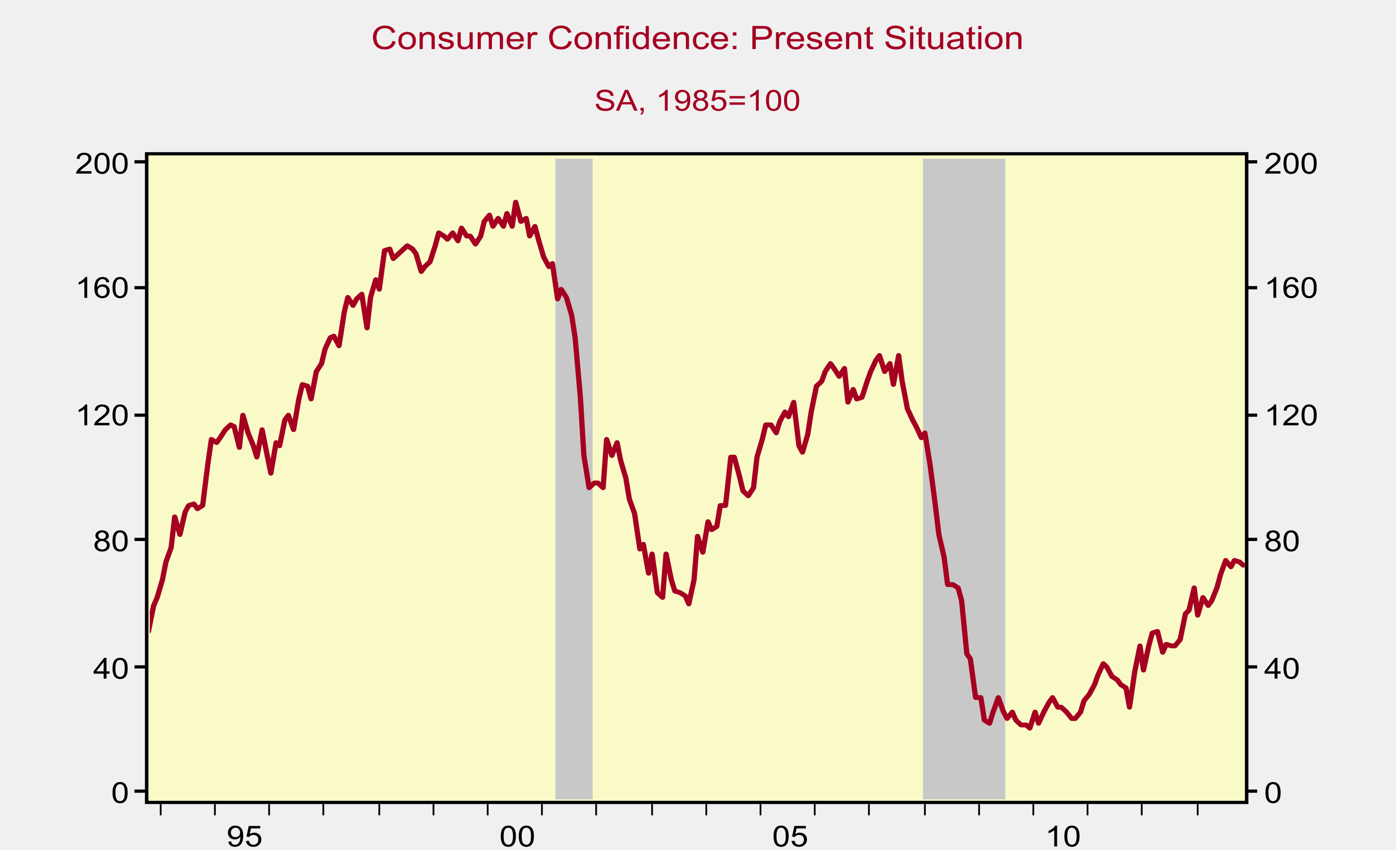
Consumer confidence: recovering from low levels

Consumers are becoming more optimistic about current economic conditions, but overall confidence remains well below the levels of the previous recovery, which in turn was less buoyant than the late 1990s.



Source: The Conference Board /Haver Analytics

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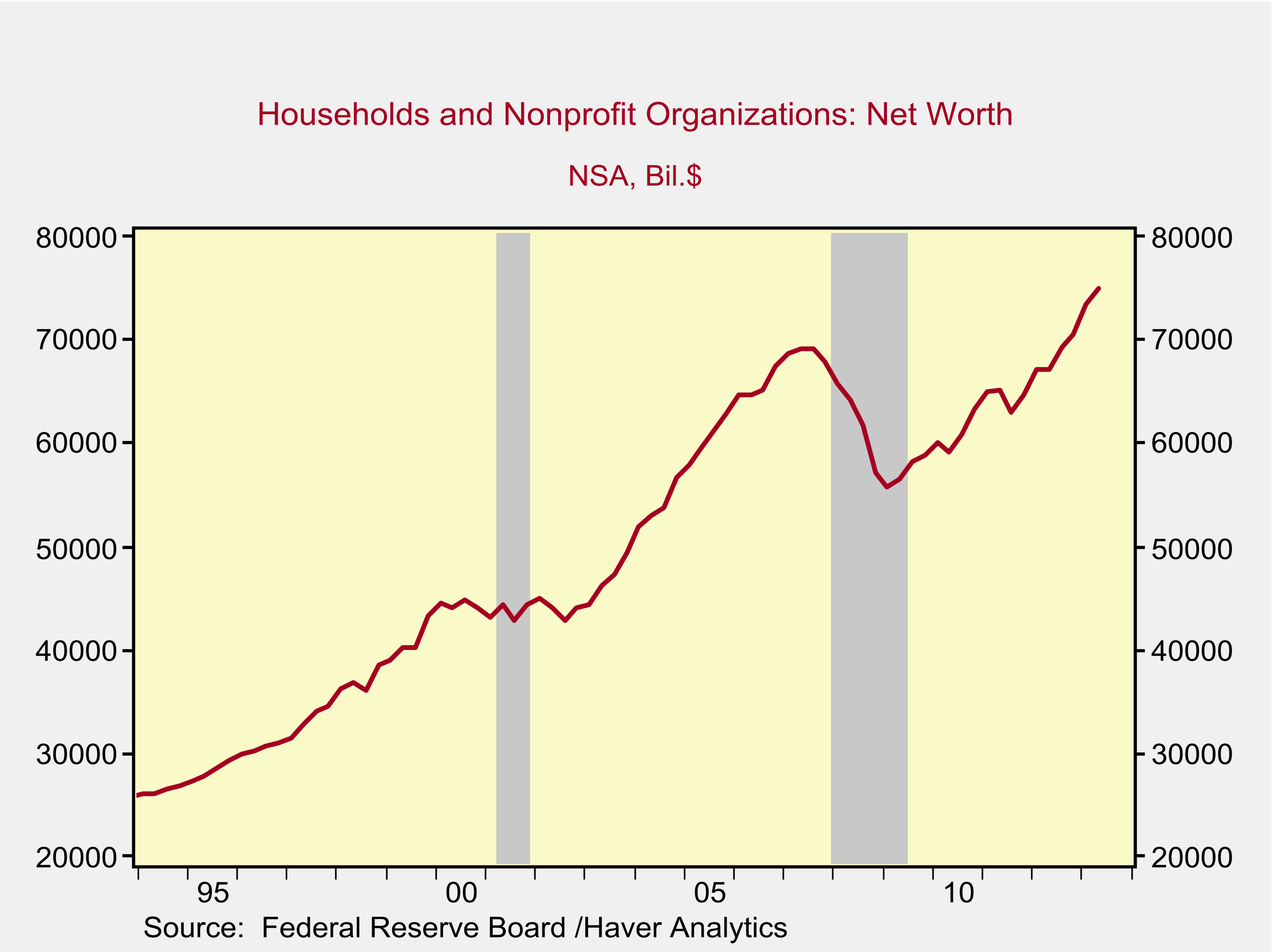
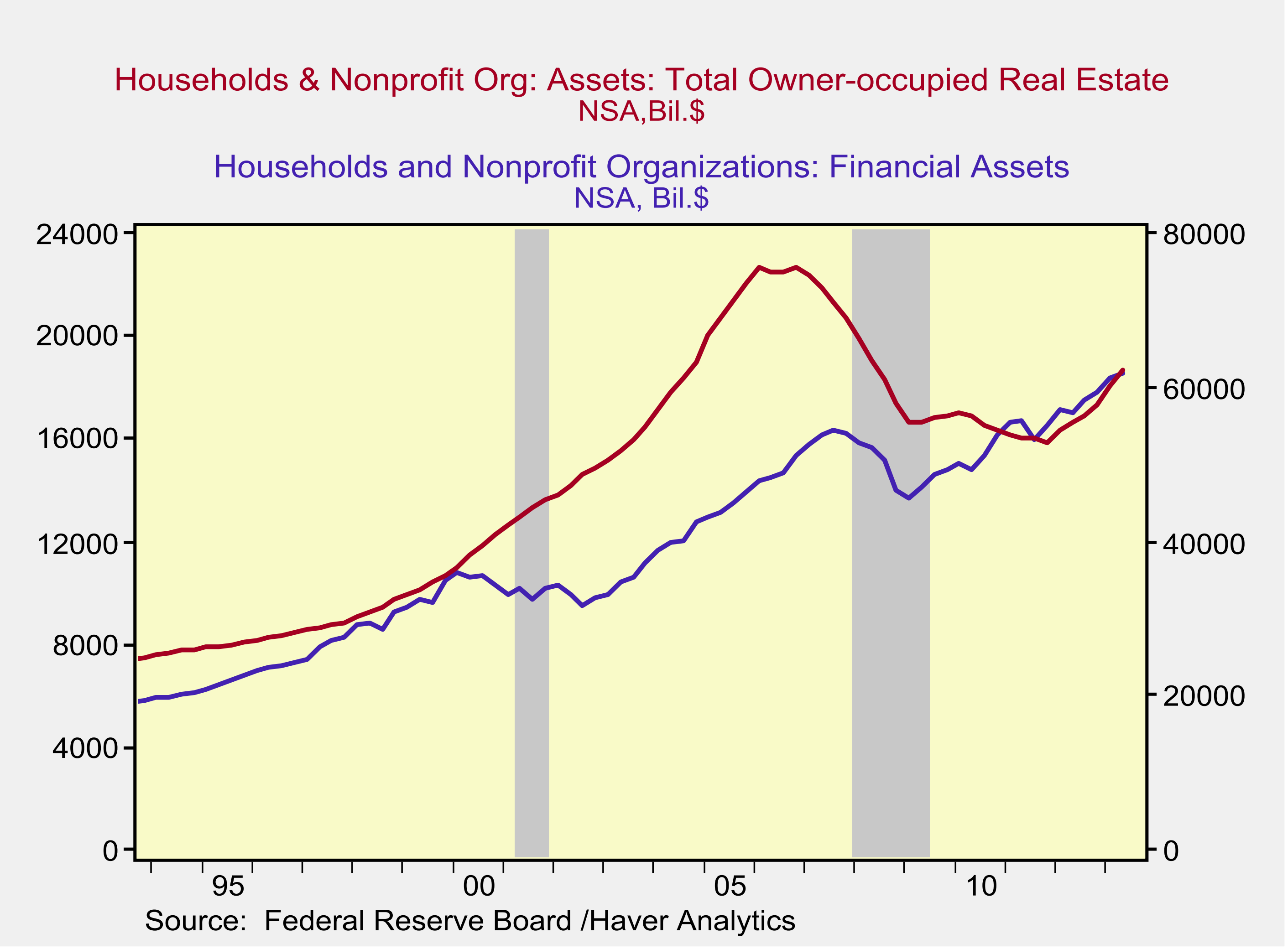
Balance sheet repair: net worth is rising



Net worth (I): good in the aggregate, good in composition

Improving in households' balance sheet are driven both by a turnaround in asset values (both real estate and financial), and a slowdown in liabilities growth.



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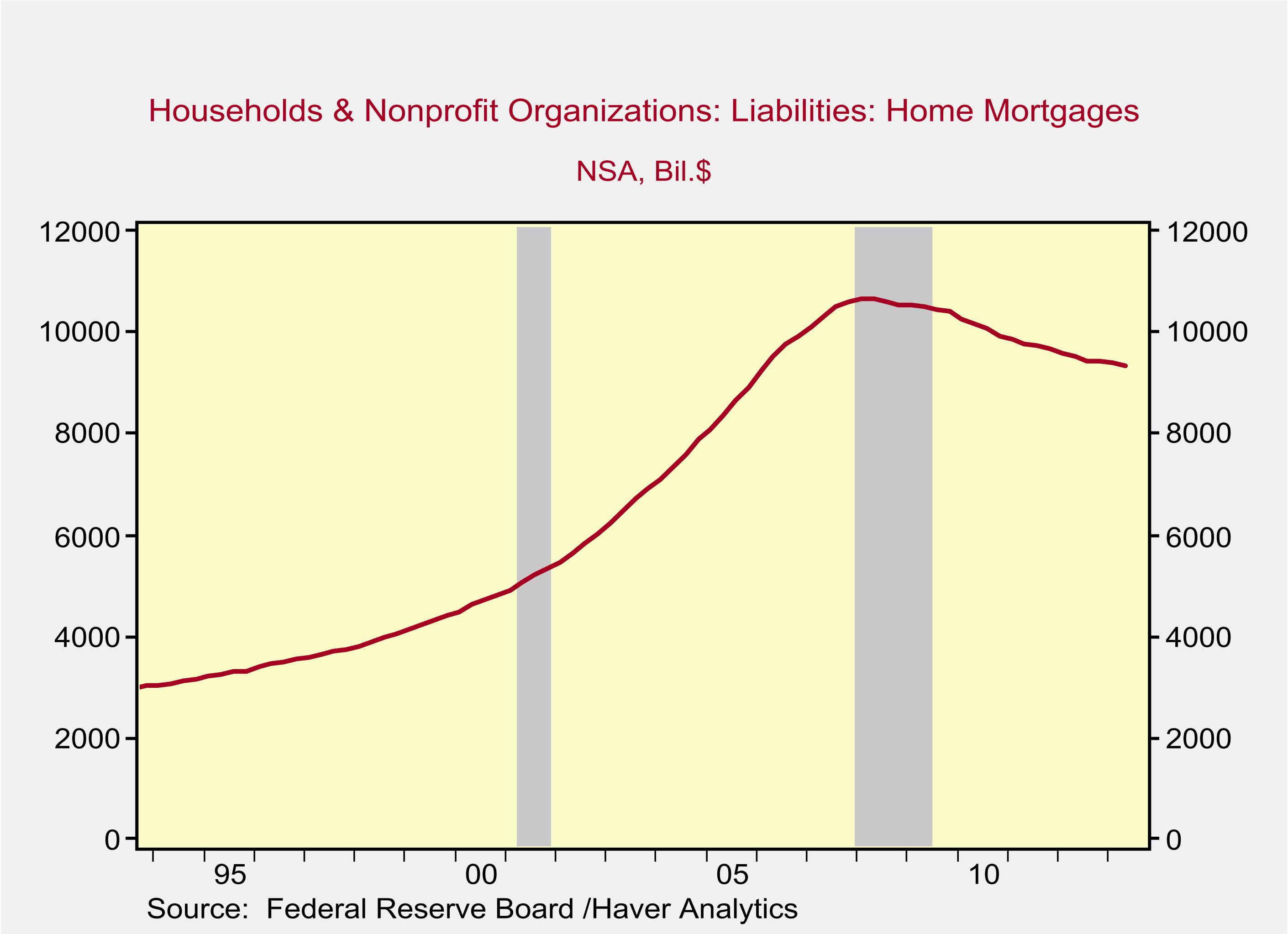
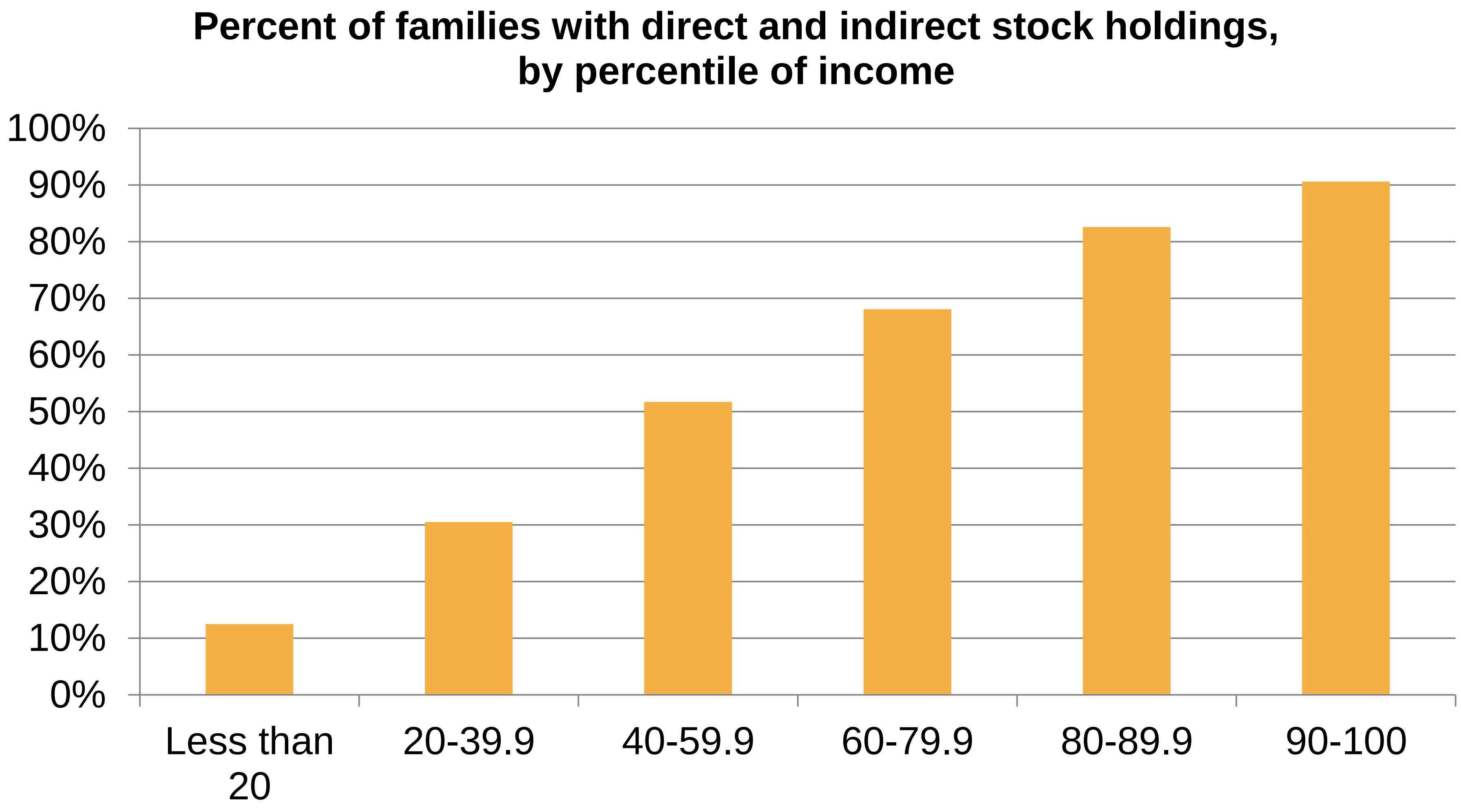
Net worth (II): good in the aggregate, good in composition

Total mortgage liabilities are declining, and for the good reasons: less defaults, more timely mortgage payments.



The devil in the details

Aggregate measures of balance sheet improvement hide some unpleasant disaggregate realities: not all households are equal beneficiary of the recent positive trends.



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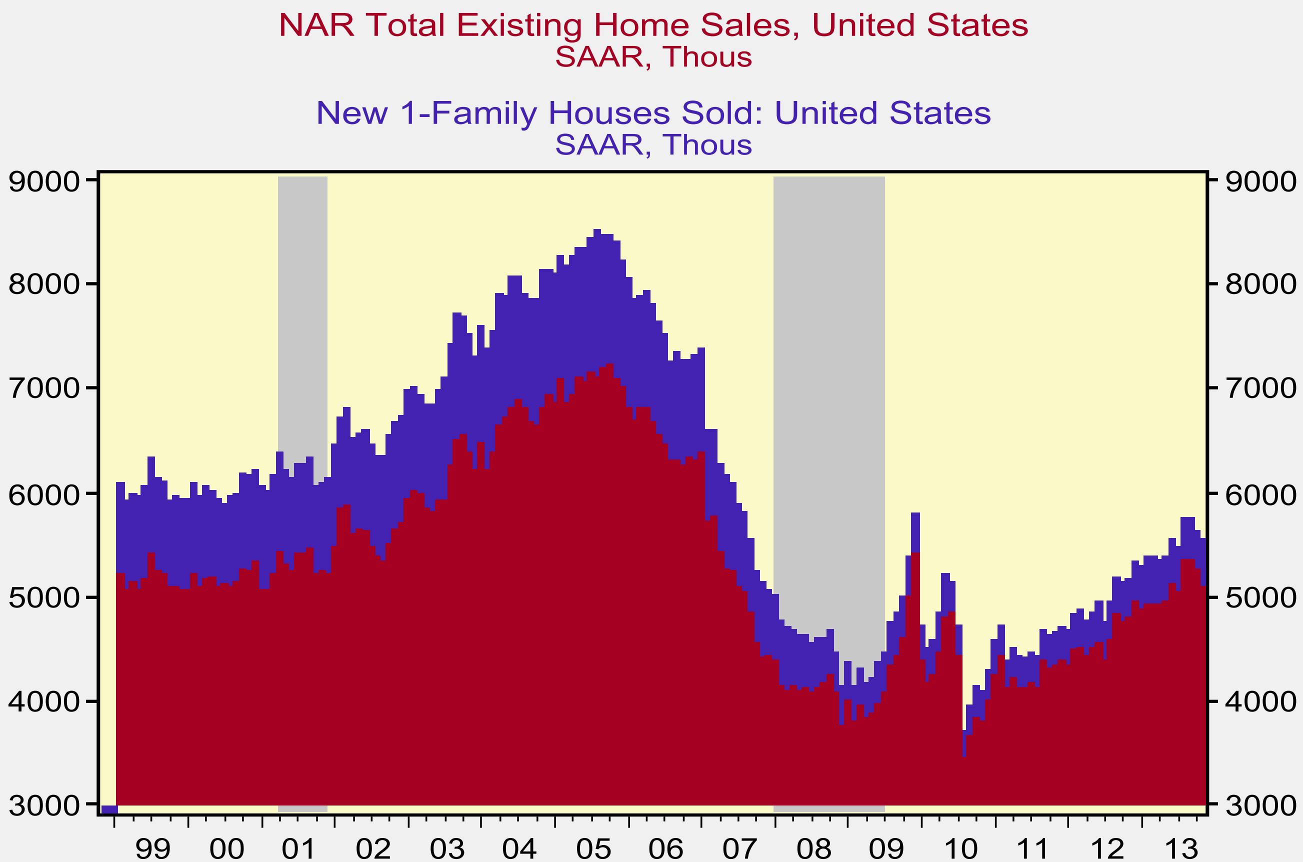
Home sales: improving, but…

… still at relatively low levels of activity. Many transactions are cash-only, and institutional investors are playing a greater role in the market. Crucially, many first-time home buyers have yet to enter the market.



Sources: National Association of Realtors, Census Bureau /Haver Analytics

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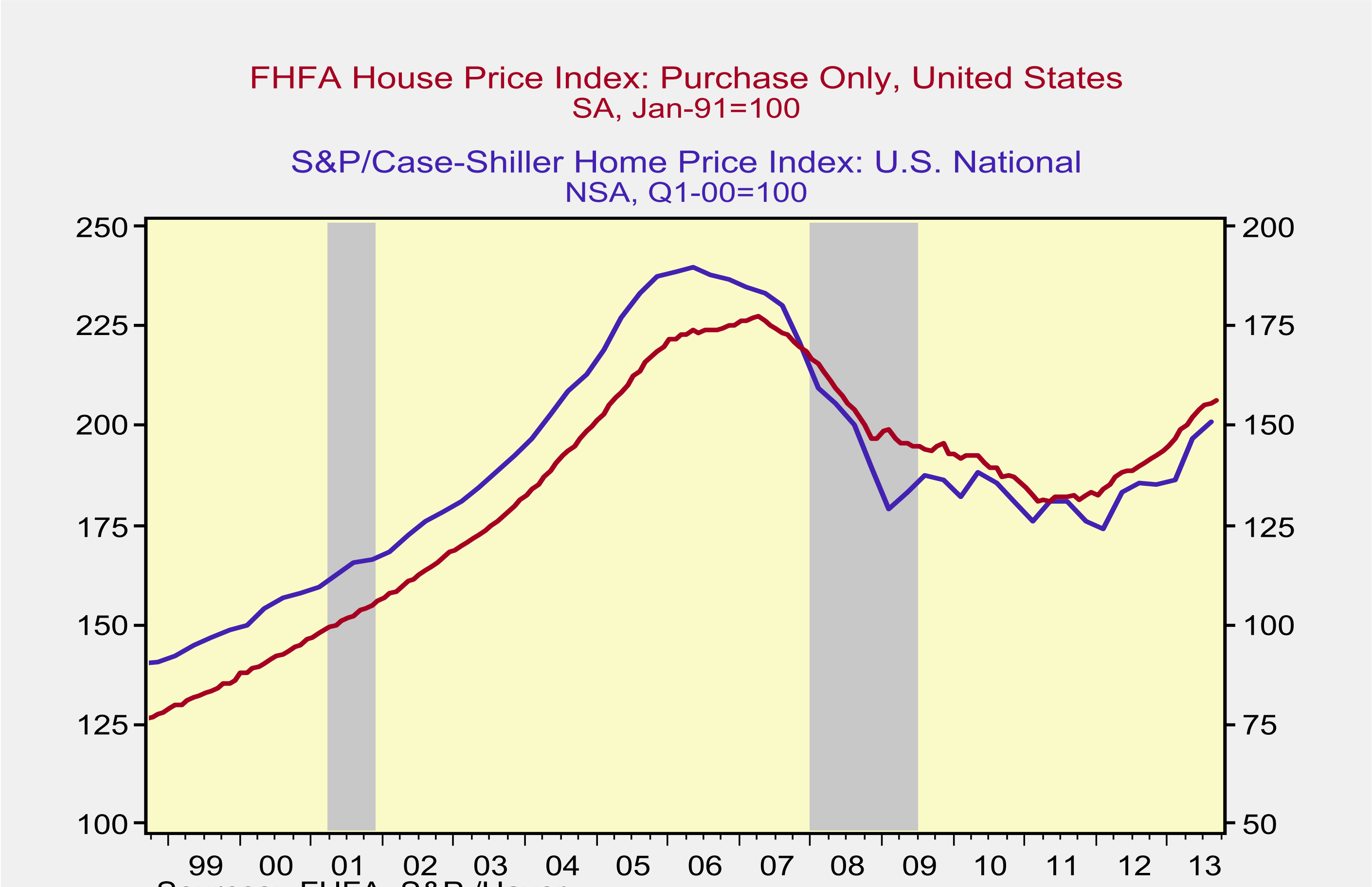
Home prices

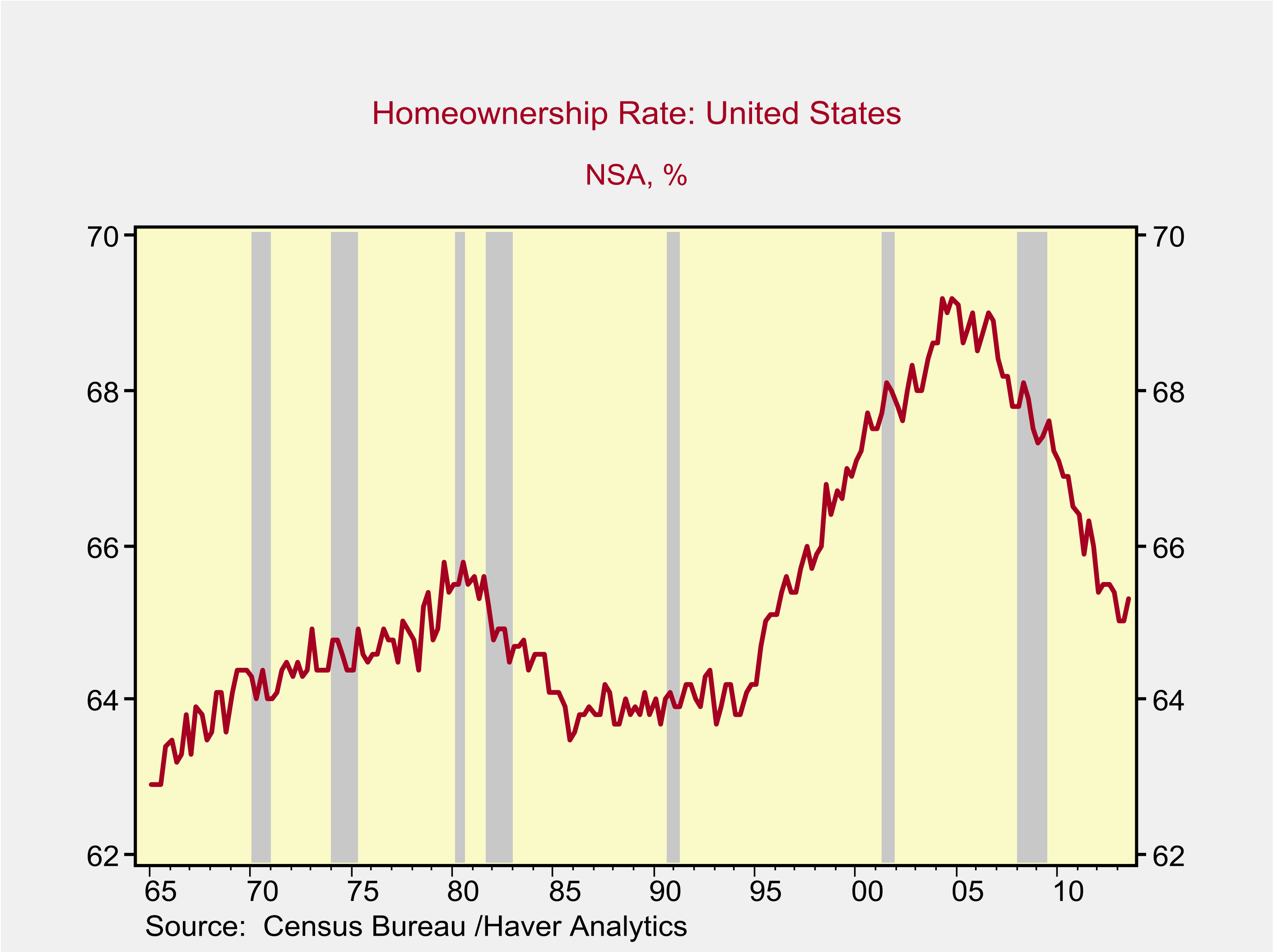
While still below the 2005 peak levels, home prices are improving, and fast. One wonders whether, with upside risk on mortgage rates and reluctant first-time buyers, current fundamentals are strong enough to last.



Sources: FHFA, S&P /Haver

Another devil in the details: homeownership rates

It took ten years for homeownership to rise from its stable levels in the early 1990s to its 2005 peak. How far are we from the new bottom, and how quickly will we get there?



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Conclusions

- The economy is improving, and a sum of small positive steps with begin to provide critical mass to the 2014 outlook.
- The recovery will continue to be uneven, and not feeling like a full “expansion.” We anticipate somewhat high levels of unemployment and labor underutilization will persist, and labor income will lag, especially in some segments of the labor markets.
- Household balance sheets are getting healthier, but again a disaggregate analysis should caution against any broader wealth effect to lift growth.
- In particular, the housing market is improving, but there is still significant uncertainty about how sustainable the current recovery will be once mortgage rates will normalize.
- On net, we expect better economic data in 2014, but we understand that economic conditions will be perceived as “more of the same” by too many people for whom the recovery has yet to offer an opportunity.

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