

# What the \*!?!# Is Going on With This Economy?

TRMA Summer Meeting  
June 6-8, 2001



**Dr. Ken Mayland,**

**President**

***ClearView Economics, LLC***

# The Almost-Perfect Storm!



Greenspan lifts interest rates



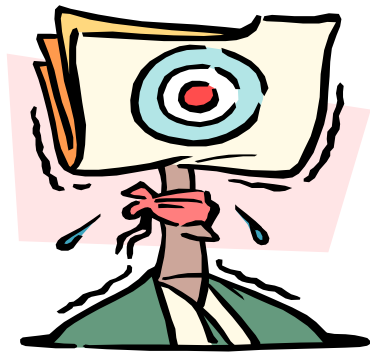
Oil prices skyrocket



**THE ECONOMY**



Inventories build



Confidence plunges



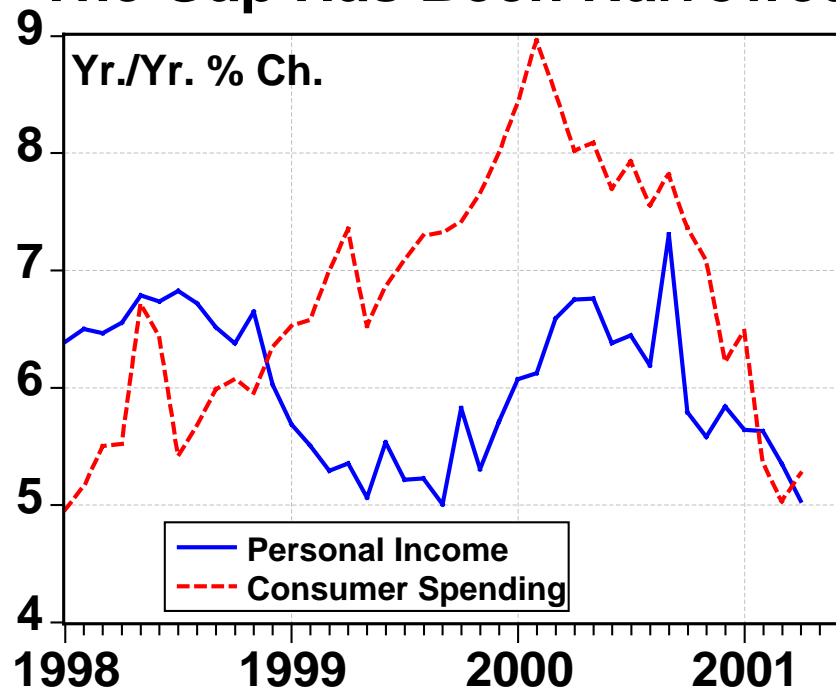
## Focus on the Consumer

- What explains the astounding growth—so late in the cycle—of consumer spending?
- Why is the saving rate *negative*?
- Is the consumer “spread too thin?”
- What are the implications for credit volumes, delinquency, and credit loss?
- Are your consumer behavior models obsolete?

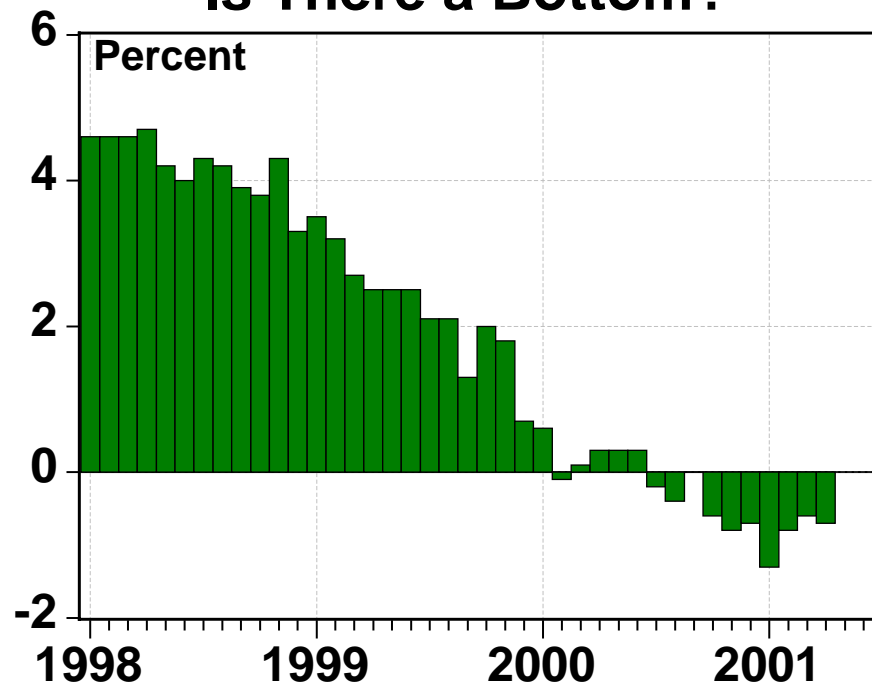


# The Consumer: Spending and Saving

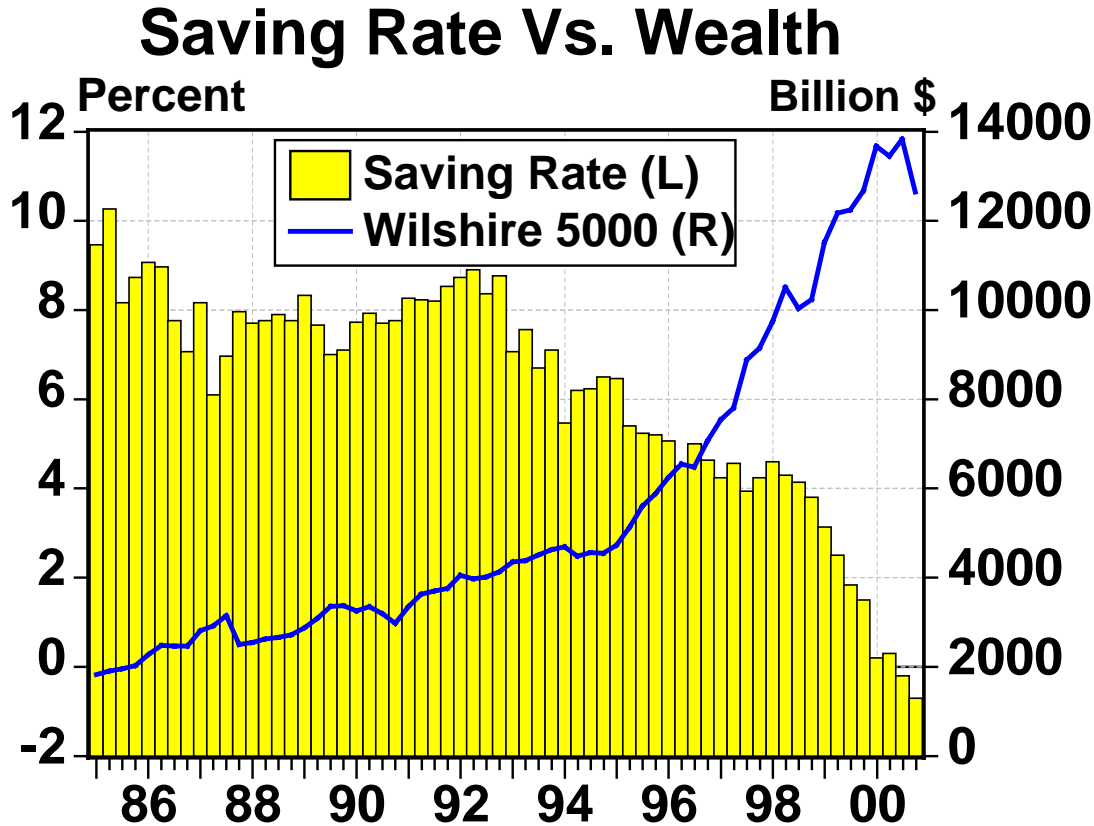
**Personal Income and Spending:  
The Gap Has Been Narrowed**



**The Personal Saving Rate:  
Is There a Bottom?**



# The Savings Rate and Wealth



*Families don't save to satisfy GDP accountants! They save to meet financial objectives: homes, college, retirement, etc. About 1/2 of all families have involvement with equities; more have housing wealth.*



# What Is the “Right” Period of Change To Judge “Wealth Effect” Impacts?

<i>Equation R<sup>2</sup>:</i>	<i>Period of Change, in Quarters Wealth Variable</i>	<i>t-statistic on Wealth Variable</i>
.24	None	NA
.24	1	0
.29	2	2.7
.32	3	3.5
.31	4	3.5
.29	6	2.8
.28	8	2.3

*The y/y % ch. of stock prices went negative in '00q4; it is STILL <0. No wonder the spending-income growth gap closed!*

Results of a regression of consumption on income and wealth.



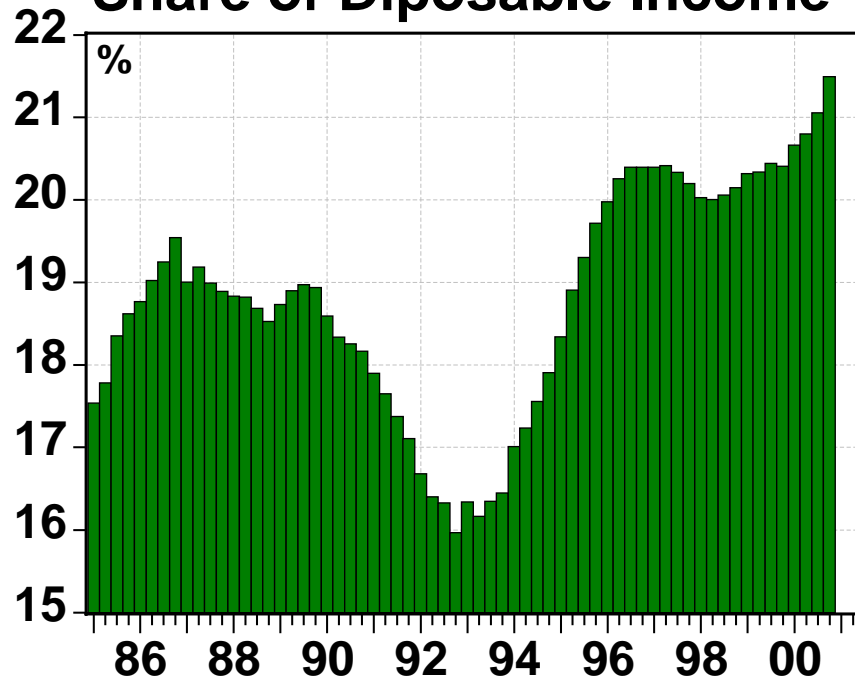
# The “Personal Saving Rate”

- Definitional: don’t confuse “savings” (common usage) and “savings” (Commerce Dept./NIPA)
- Savings = *income not spent* (a residual, and a flow)
- Imputed spending
- Excluded income

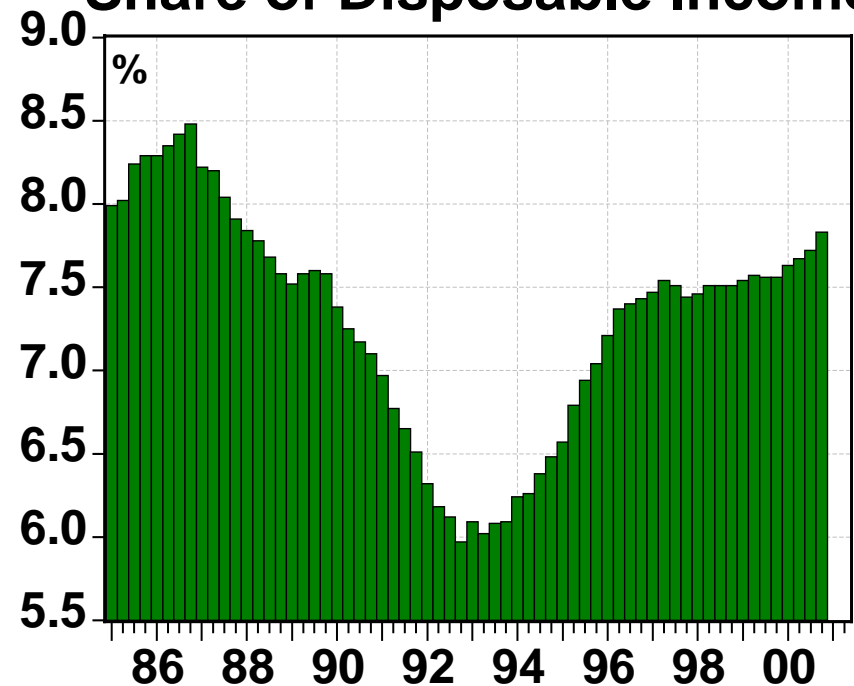


# “Standard” Consumer Debt Measures

## Consumer Credit as a Share of Disposable Income



## Consumer Debt Service as a Share of Disposable Income



# The Household Balance Sheet

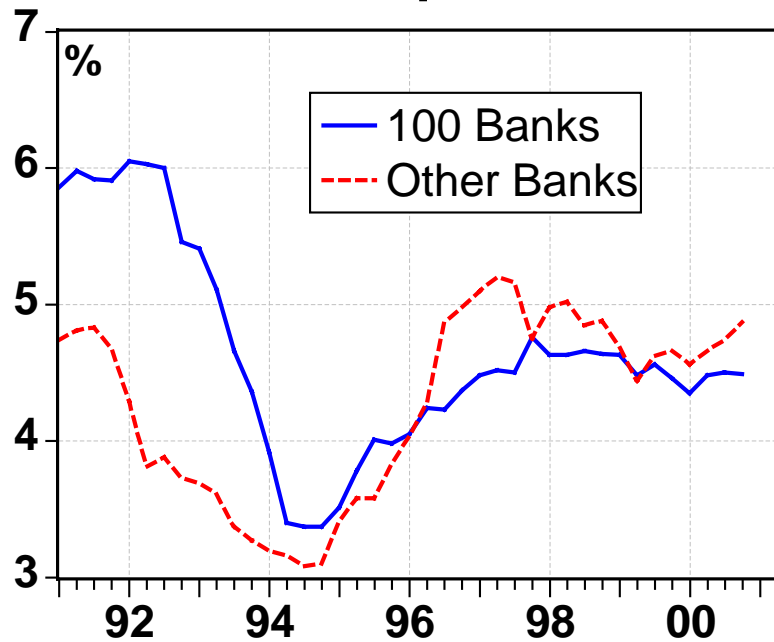
Category	1996	2000	Change
Deposits incl. MMMF	\$3,632B	\$4,851B	\$1,220B
Equities incl. Mutual Funds	\$6,182B	\$9,605B	\$3,423B
Home Mortgages	\$3,711B	\$5,196B	\$1,485B
Consumer Credit	\$1,212B	\$1,569B	\$357B

End of year figures; source: Federal Reserve Flow of funds.

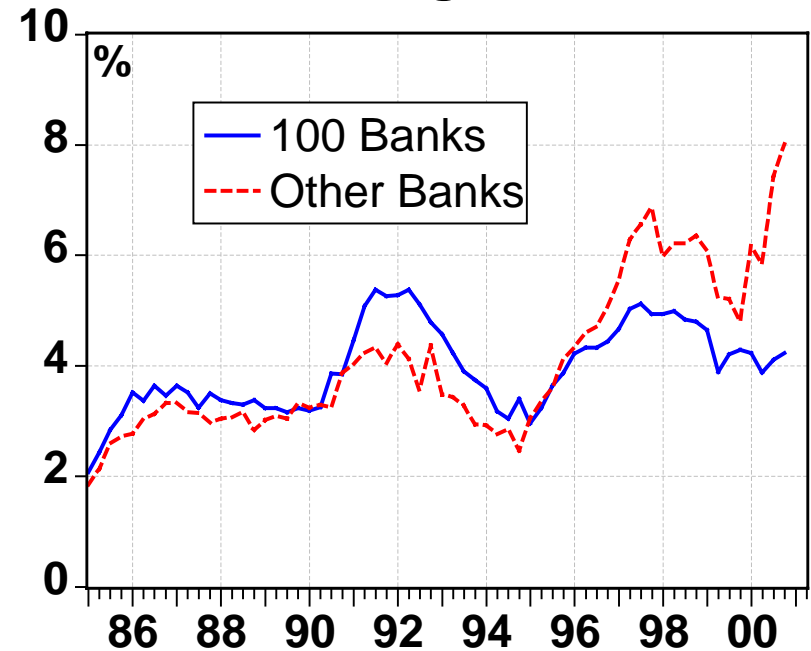


# Credit Card Delinquency and Charge-Offs

## Credit Card Delinquencies at Banks

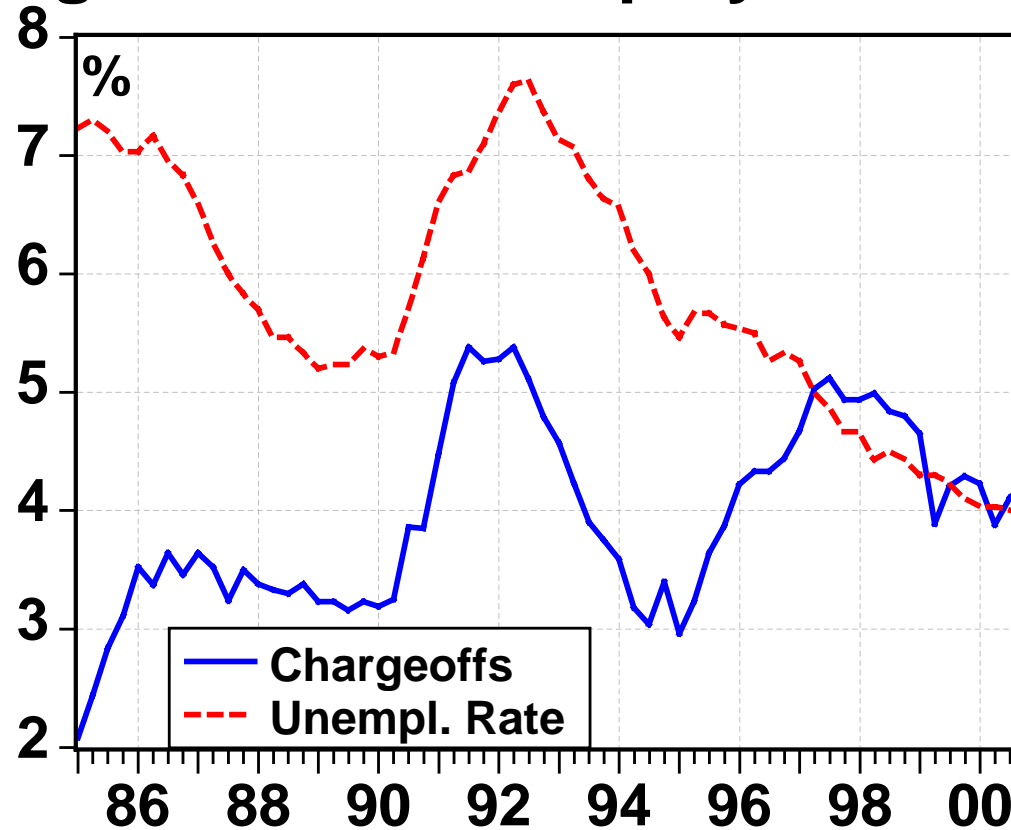


## Credit Card Chargeoffs at Banks



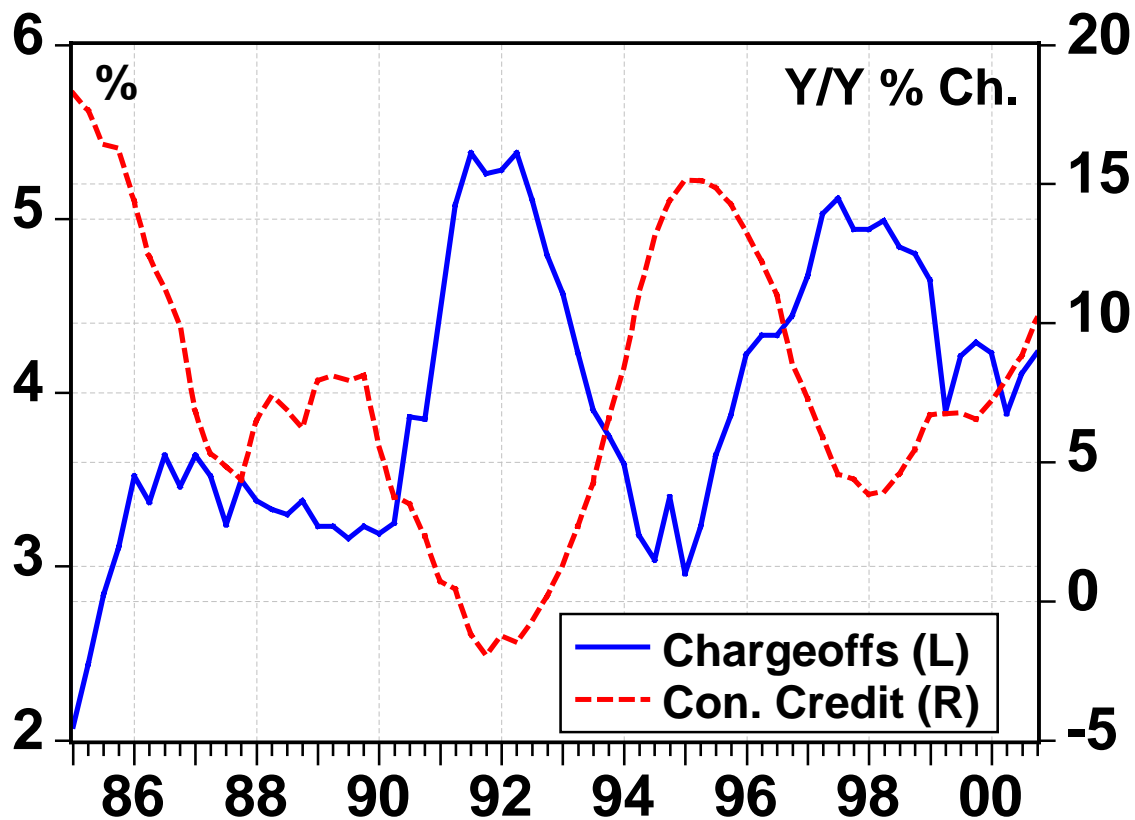
# Explaining Charge-Offs

## Chargeoffs Vs. Unemployment Rate



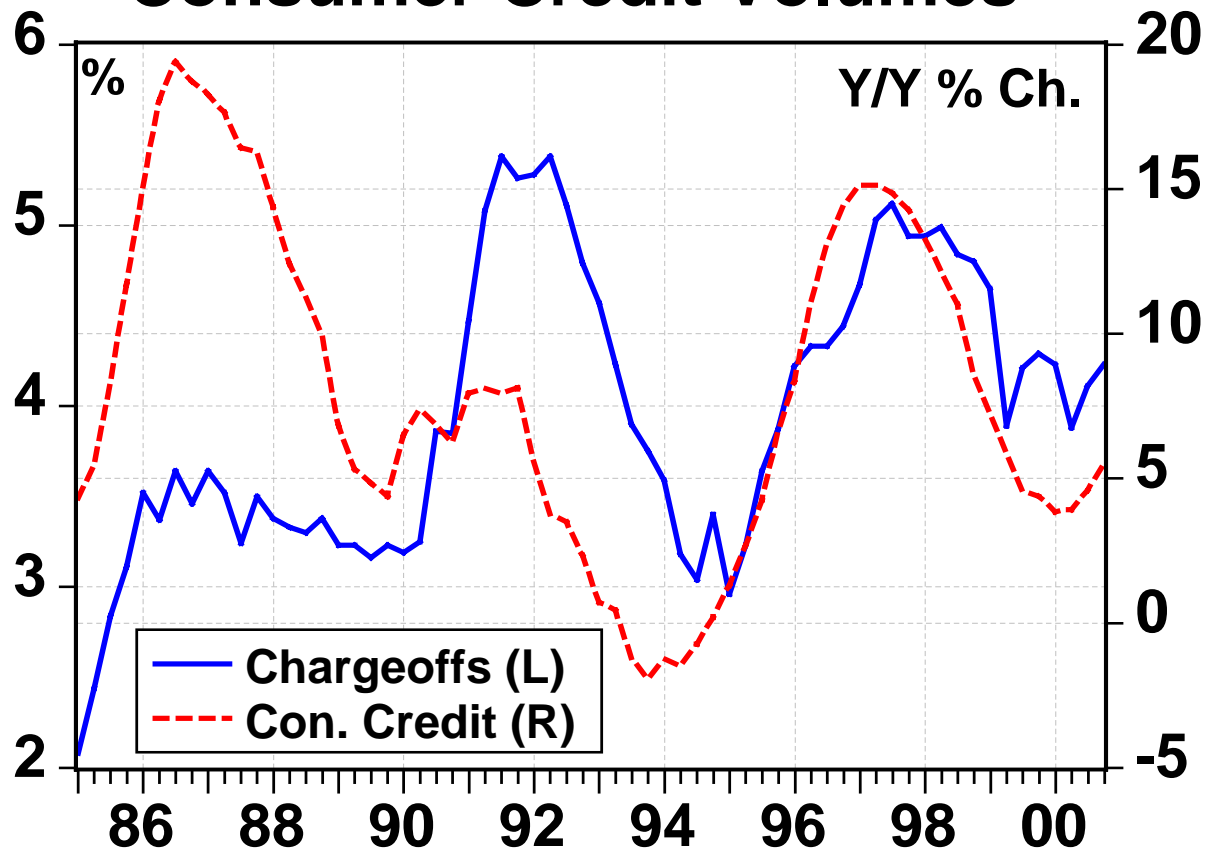
# Explaining Charge-Offs, Cont'd

## Chargeoffs Vs. Consumer Credit Volumes



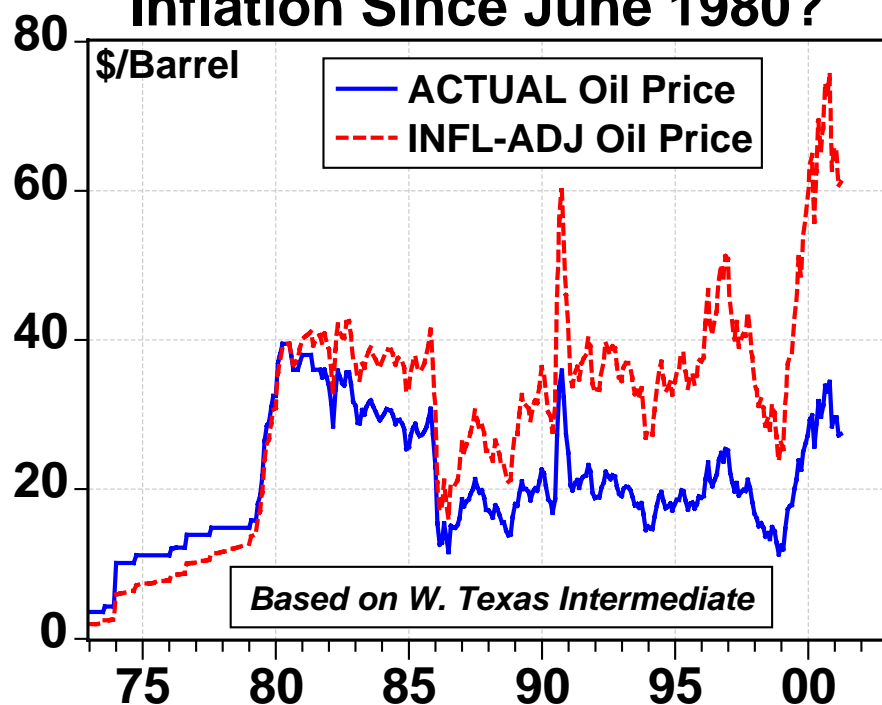
# Explaining Charge-Offs, Cont'd

## Chargeoffs Vs. LAGGED (8Q) Consumer Credit Volumes

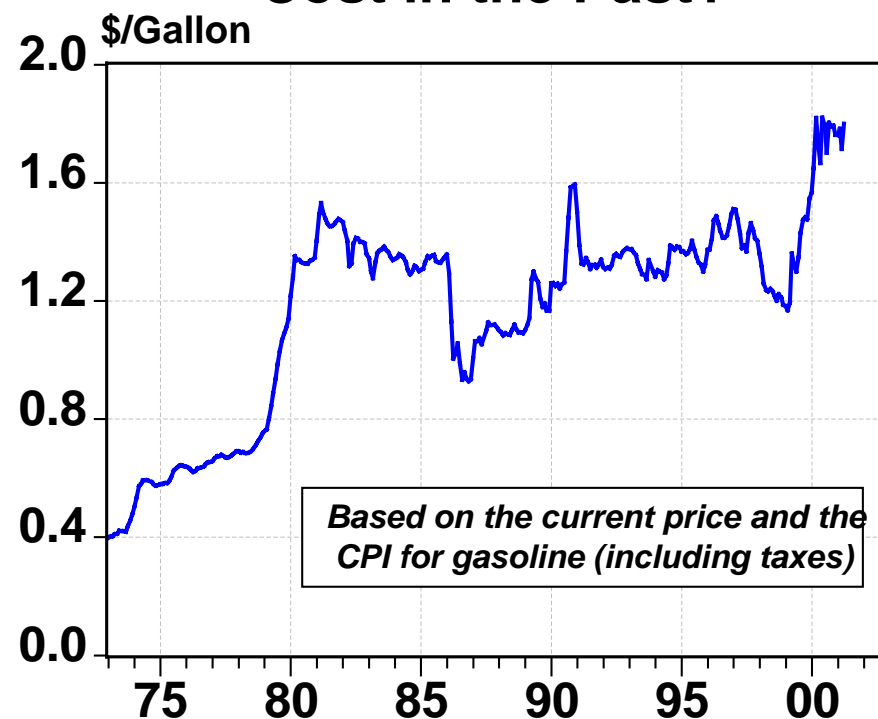


# What About the Energy “Curve Ball?”

## What If Oil Prices Rose In Concert With Non-Energy Inflation Since June 1980?

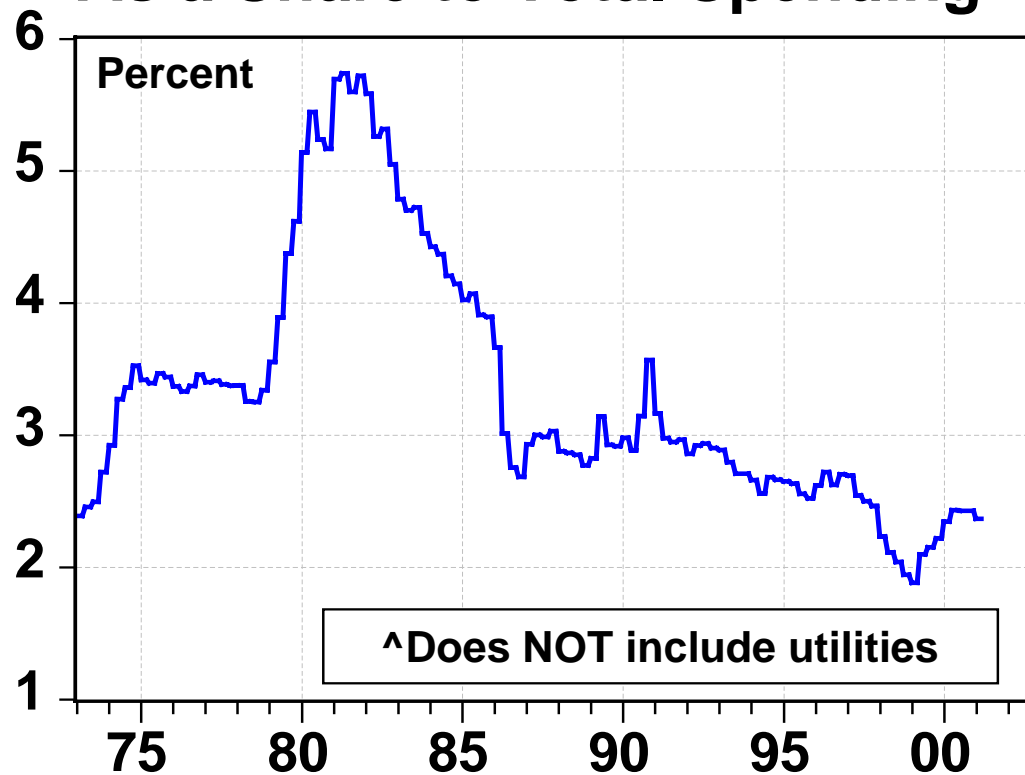


## What Did Gasoline Cost in the Past?



# Energy Price Impact, Cont'd

## Consumer Spending on Energy Nondurables, As a Share to Total Spending<sup>^</sup>



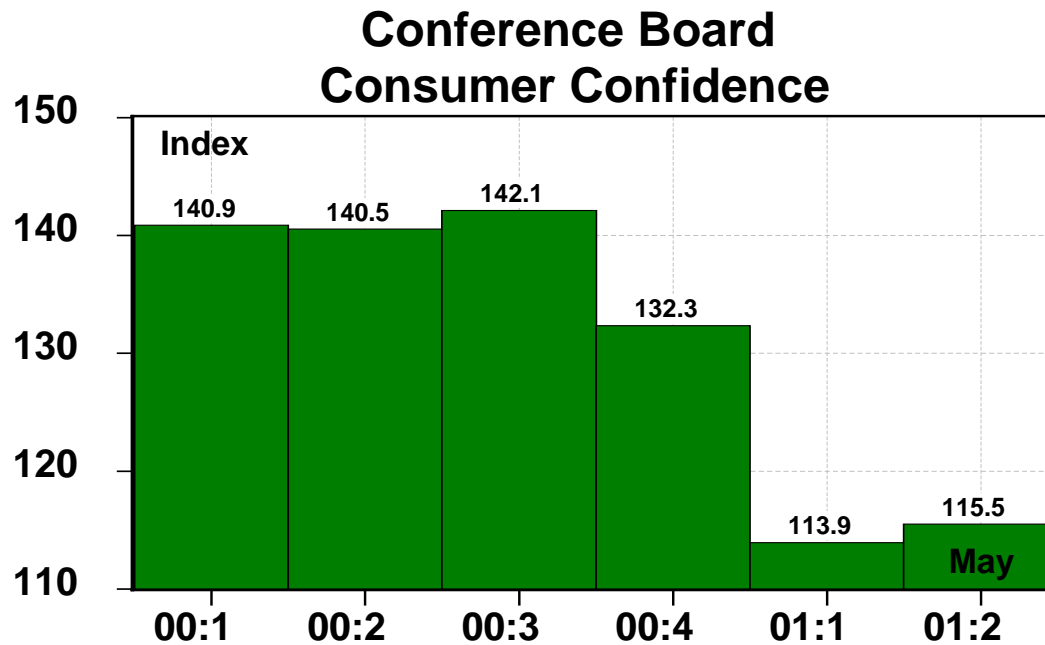
# Won't the "New Economy" Save Us?

- Size of the "high tech" economy:
  - Computers, communications equipment, and semiconductors = 8.5% of industrial production (which is  $\frac{1}{4}$  of the economy)
  - <20% of factory shipments (using a generous definition)
- Subject to the cycle! 3/01 vs. 3/00:
  - Computer shipments (nominal \$): **-1.3%**
  - Communications equipment: **-2.5%**
- But high tech will sustain high growth



# Traps to Avoid

- The personal saving rate
- Layoff headlines
- Consumer confidence



Amidst the  
bad news...

# Visibility!

Why?



# Duration

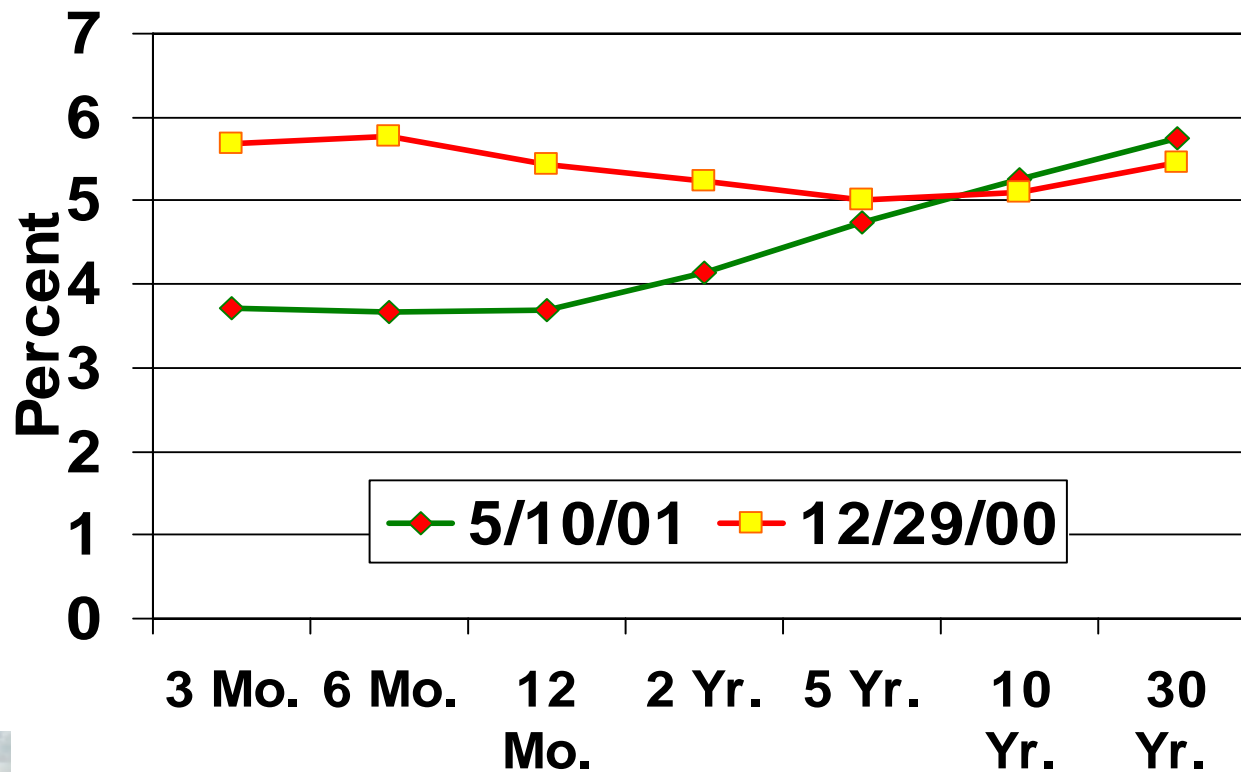
<b><u>Recession:</u></b>	<b><u>Length (Mo.)</u></b>
45:2 – 45:10	8
48:11 – 49:10	11
53:7 – 54:5	10
57:8 – 58:4	8
60:4 – 61:2	10
69:12 – 70:11	11
73:11 – 75:3	16
80:1 – 80:7	6
81:7 – 82:11	16
90:7 – 91:3	8
<b>Average</b>	<b>10</b>

Don't forget: we are already **12** months into this cyclical slowdown!



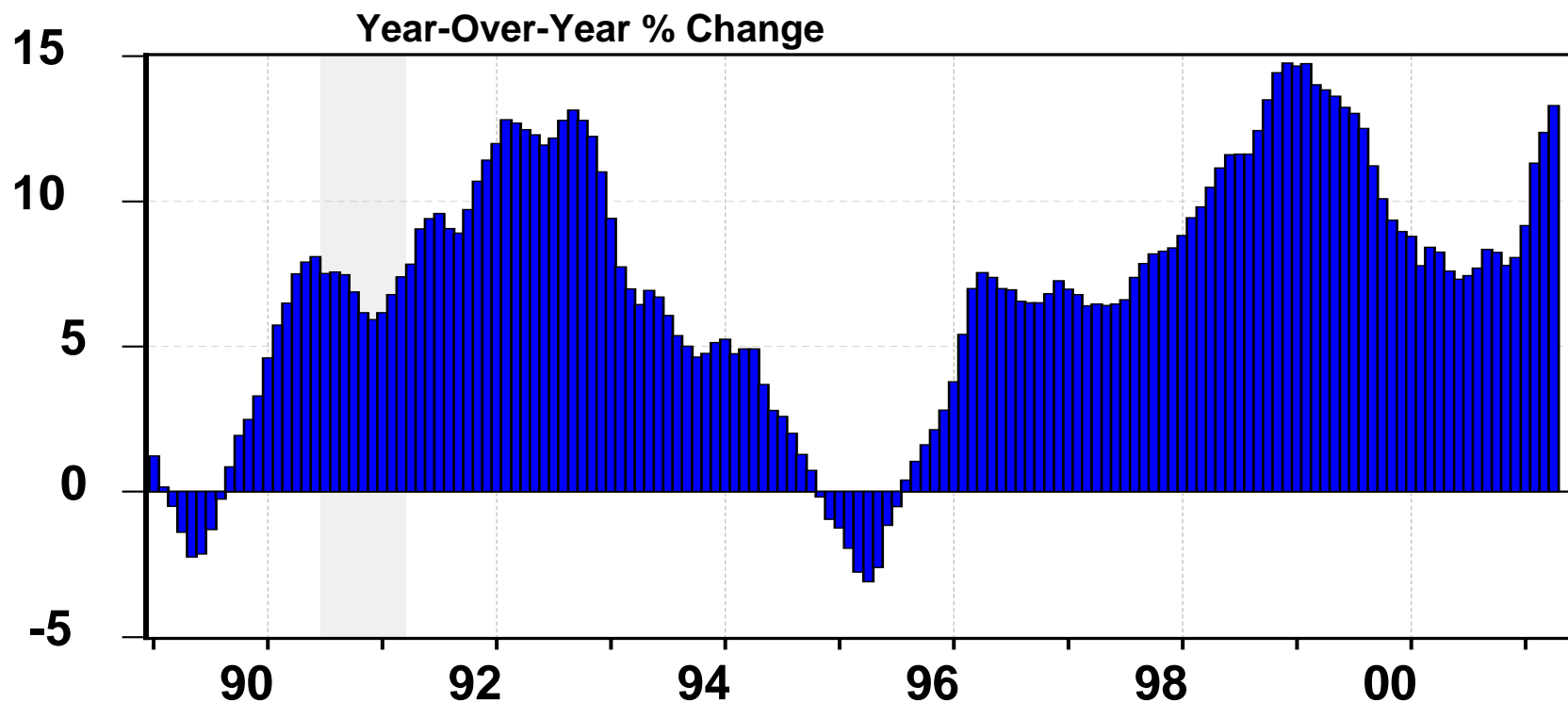
# Monetary Policy

- MP timing “**model**”: shifts affect the economy with a *one-year* lag
- The “yield curve”: *steepening*



# Monetary Policy, Cont'd

## Money Growth: MZM



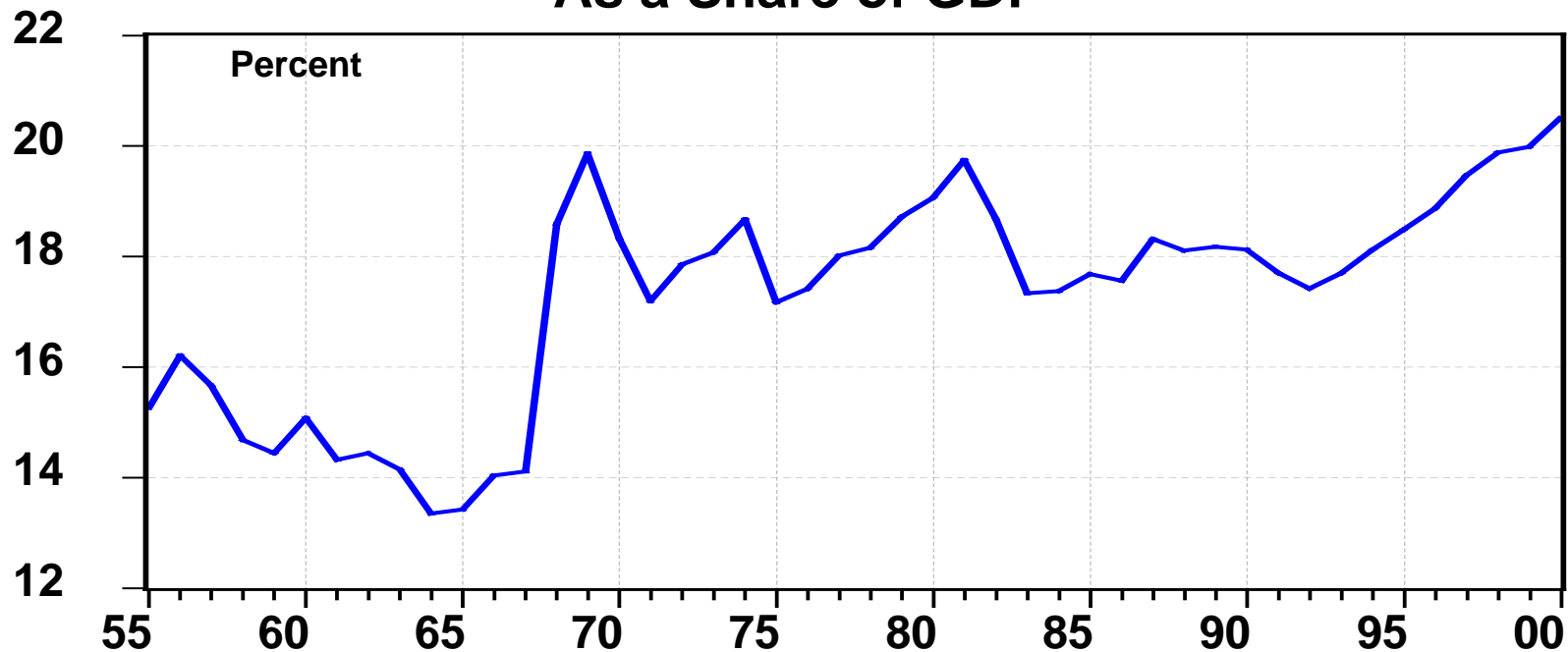
- Near the end of the rate cuts!



# Fiscal Policy

- Long-term: \$1.35 T!
- Short-term (2001-2002): \$100 B!

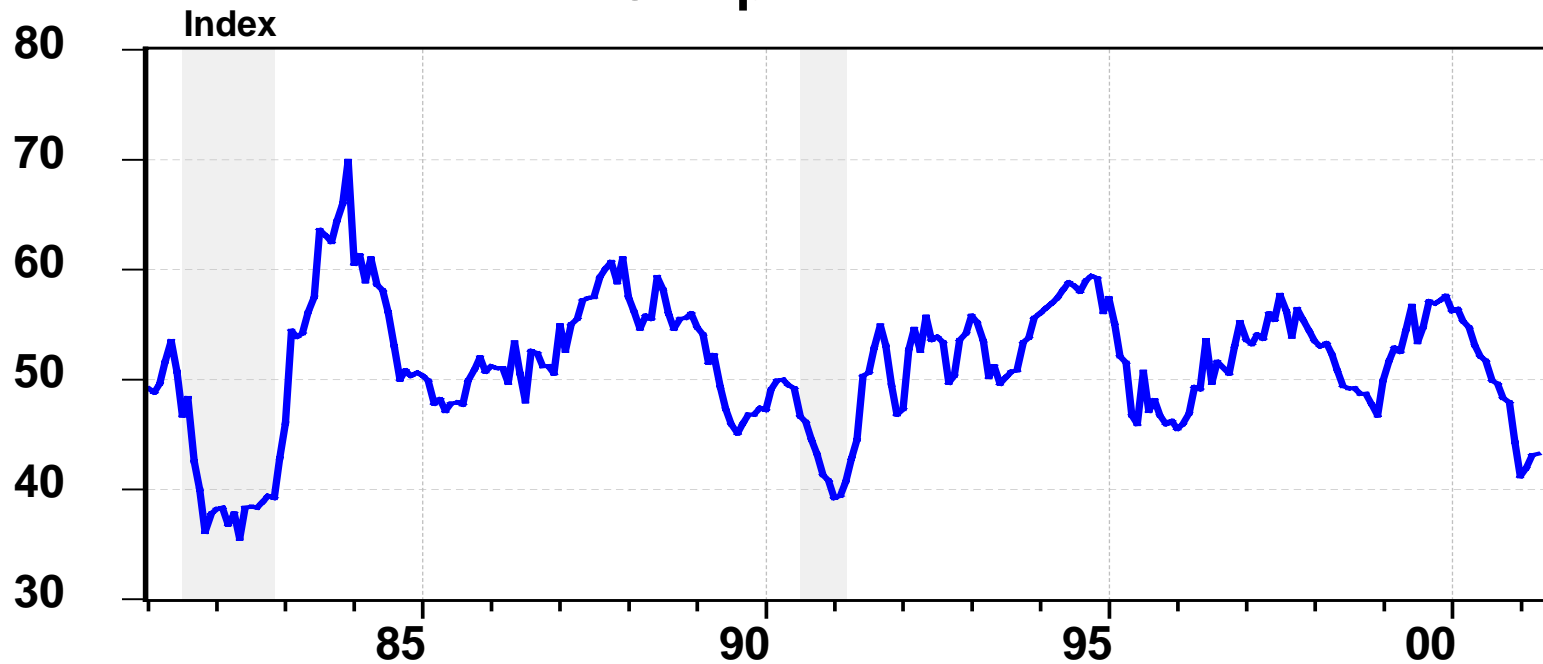
**Federal Government Receipts  
As a Share of GDP**



# Purchasing Managers' Survey

- Typically, “V-shaped” bottoms
- Few “false signals”

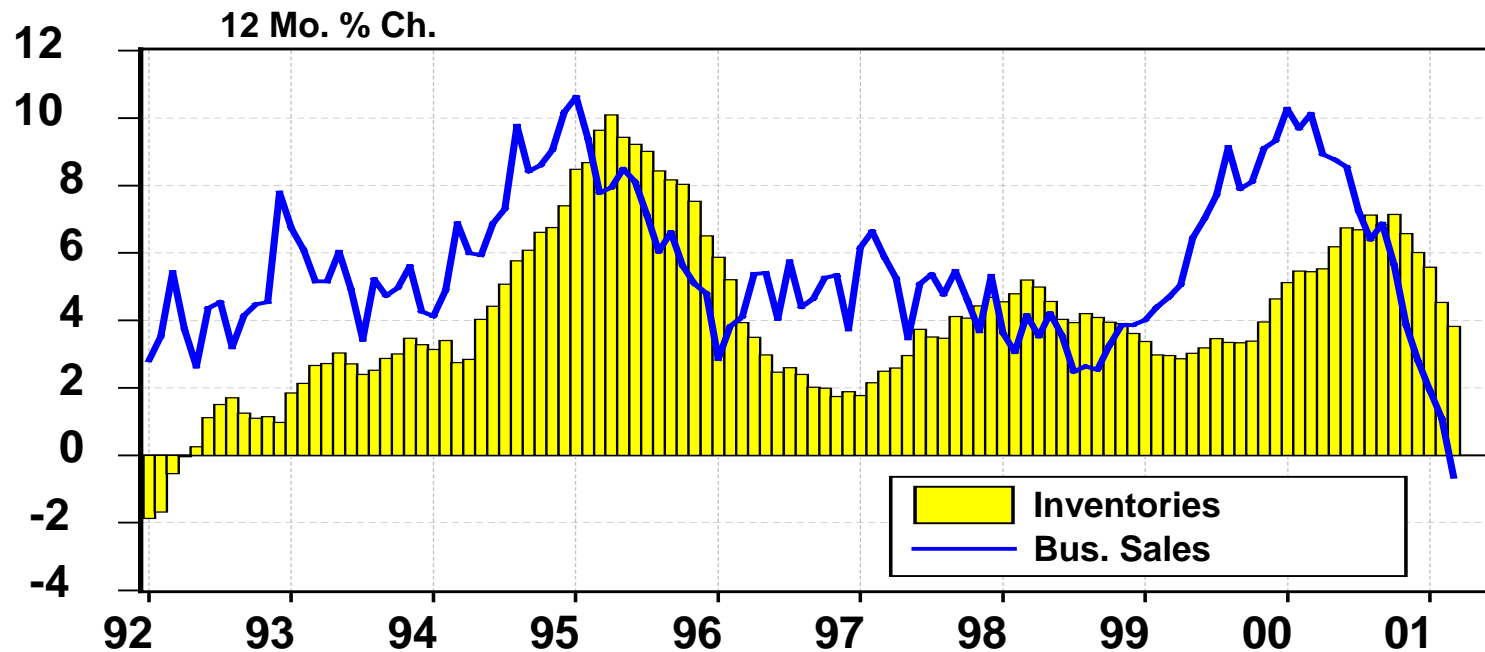
Nat'l Assoc. of Purch. Mgrs:  
Composite Index



# Business Inventories

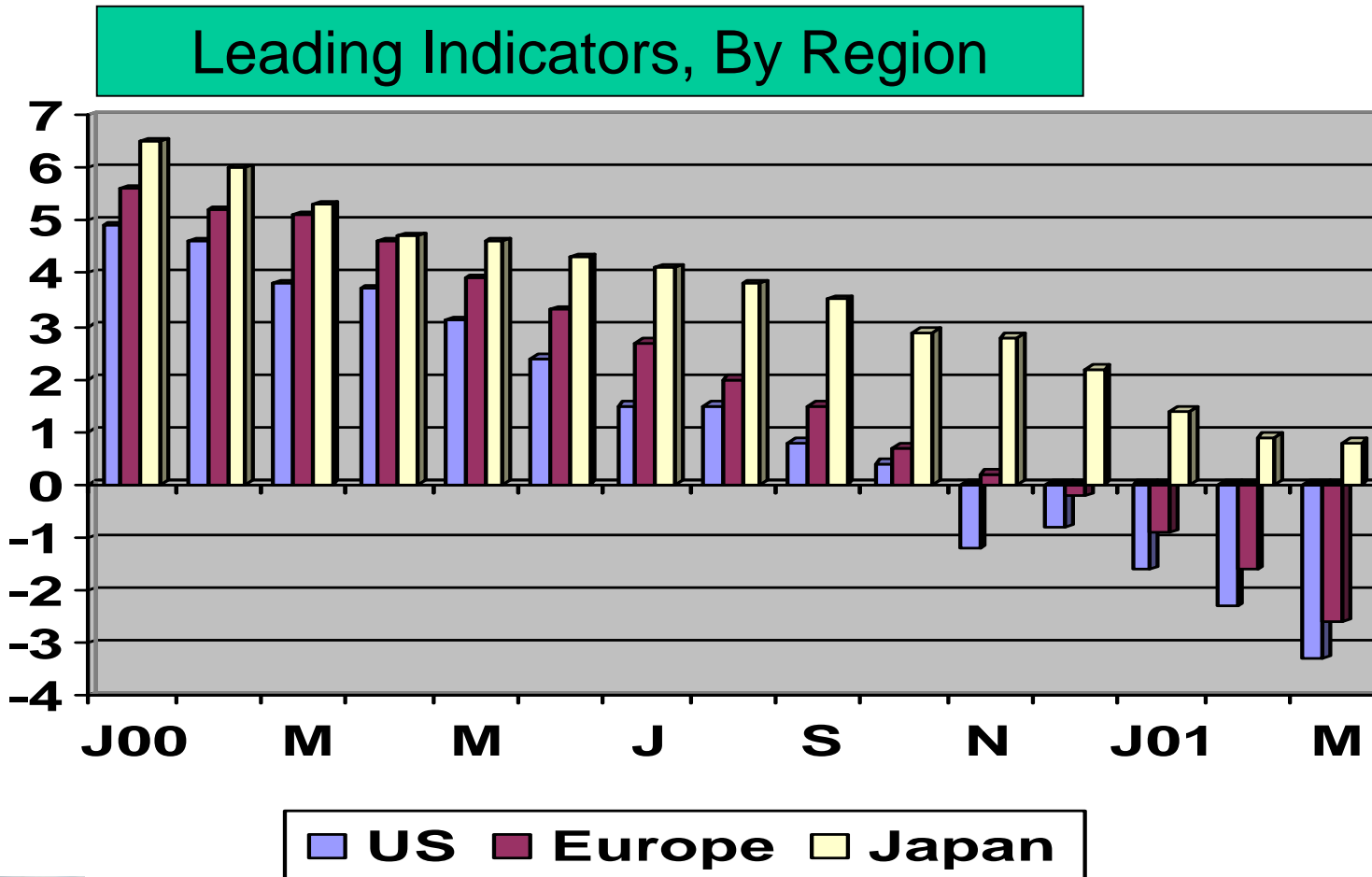
- Still in a dampening mode
- The end of the inventory correction is on the horizon

**Business Inventories Vs.  
Business Sales Growth**



# What About the Int'l Situation?

- A *synchronized* world growth slowdown...



## Conclusion for the *Next Few Months*

- **Manufacturing:** sweat it out!
- **Unemployment:** higher (by design!)
- **Inflation:** unwinding, but...
  - Wage growth
  - Core inflation
  - Money growth
  - = a higher base for the **NEXT** cycle
- So, sluggish growth now, but...



# The Fix Is In!



# Conclusions RE: Do Your Models for Understanding Consumer Behavior Need to be Thrown Out?

- The “high tech” sector underlying much “new economy” thinking is still relatively small (but its importance will grow)
- “High tech” has NOT made the economy bullet proof!



## Conclusions, Cont'd

- Orthodox models do just fine in explaining recent growth, inflation, and productivity performance
- Regardless of high tech contributions, the economy is **STILL** cyclical!!!
- Indeed, even the high tech world is cyclical, subject to the laws of gravity and orthodox economic models



## Conclusions, Cont'd

- A low personal saving rate is not so much a “new economy” behavior, but a rational response to balance sheet realities (the rise of stock market wealth)
- Stock price fluctuations, as well as other “shocks” (such as big energy price increases) do create economic and credit loss *vulnerability*



## Conclusions, Cont'd

- A *cyclical* economy should be expected to produce a *cyclical* delinquency and credit loss experience!
- The credit loss cycle *lags* the credit expansion cycle
- Bankruptcy reform: Yeah! Great in the long run, but get ready for an onslaught of late-night cable commercials!



## Conclusions, Cont'd

- We are now on the shady side of the economic and credit loss cycle: loss experience (with appropriate lags) **WILL** be on the rise...
- ...But to the treetops, or to the Moon?  
The economic outlook for 2002 is *good!*



# What the \*!?!# Is Going on With This Economy?

TRMA Summer Meeting  
June 6-8, 2001



**Dr. Ken Mayland,  
President**

***ClearView* Economics, LLC**

**(216) 595-9931**

**maylake@stratos.net**