

“The U.S. Consumer – Shocked into Submission”

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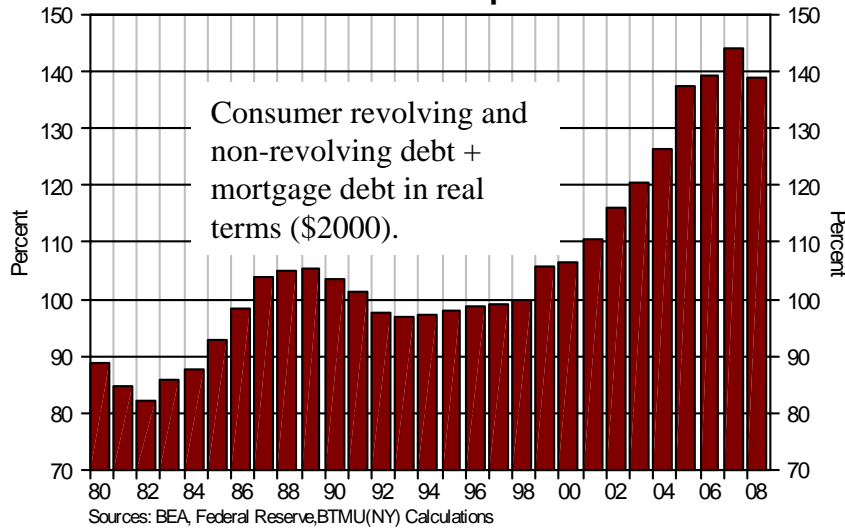
Recession Comparison

Peak	Trough	Duration in Months Peak-to-Trough	% Change Peak-to-Trough		Jobless Rate		
			Real GDP	Nonfarm Payrolls	Low	High	Change
December 2007 (IV)	May 2009 (II)	18	-3.7	-5.2	4.4	10.1	5.7
March 2001(I)	November 2001 (IV)	8	-0.4	-2.0	3.8	6.3	2.5
July 1990(III)	March 1991(I)	8	-1.3	-1.5	5.0	7.8	2.8
July 1981(III)	November 1982 (IV)	16	-2.9	-3.1	7.2	10.8	3.6
January 1980(I)	July 1980 (III)	6	-2.2	-1.3	5.6	7.8	2.2
November 1973(IV)	March 1975 (I)	16	-3.1	-2.7	4.6	9.0	4.4
December 1969(IV)	November 1970 (IV)	11	-1.0	-1.4	3.4	6.1	2.7
April 1960(II)	February 1961 (I)	10	-1.3	-2.3	4.8	7.1	2.3
August 1957(III)	April 1958 (II)	8	-3.8	-4.4	3.7	7.5	3.8
July 1953(II)	May 1954 (II)	10	-2.7	-3.3	2.5	6.1	3.6
November 1948(IV)	October 1949 (IV)	11	-1.7	-5.1	3.4	7.9	4.5
Average for Post WWII Recessions		10	-2.0	-2.7	4.4	7.6	3.2

-- While we've seen a similar correction in economic growth in the past, the change in the jobless rate over the Great Recession far outstrips any experience since WWII.

Rapid Change in U-Rate Caught Debt-Ridden Consumers Off-Guard

The Breaking Point
Debt as a Percent of Disposable Income

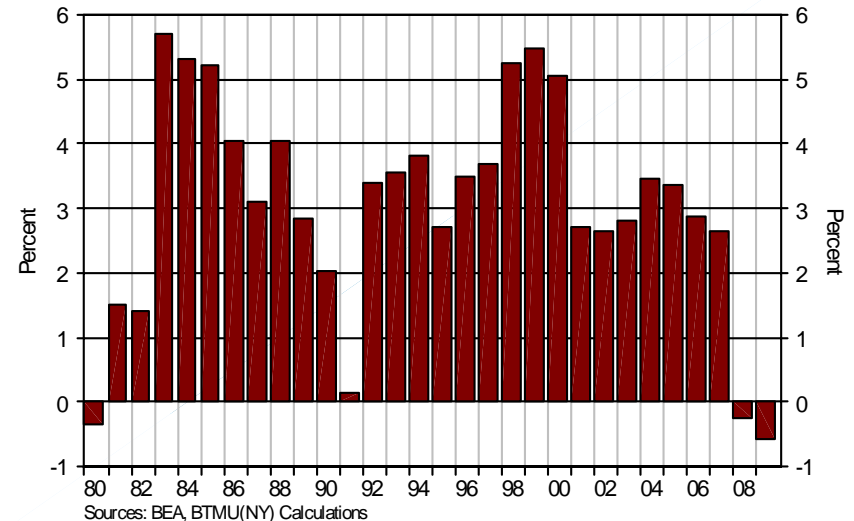


- Households increasingly turned to credit to supplement slowing wage growth.
- Low interest rates, easy credit, high household wealth encouraged debtloads to skyrocket.
- Household balance sheets were unprepared for job loss.

- Real consumer spending fell -0.6% in 2009.
- Largest contraction since -0.8% in 1974.
- First back-to-back contraction in real personal spending since 1933.



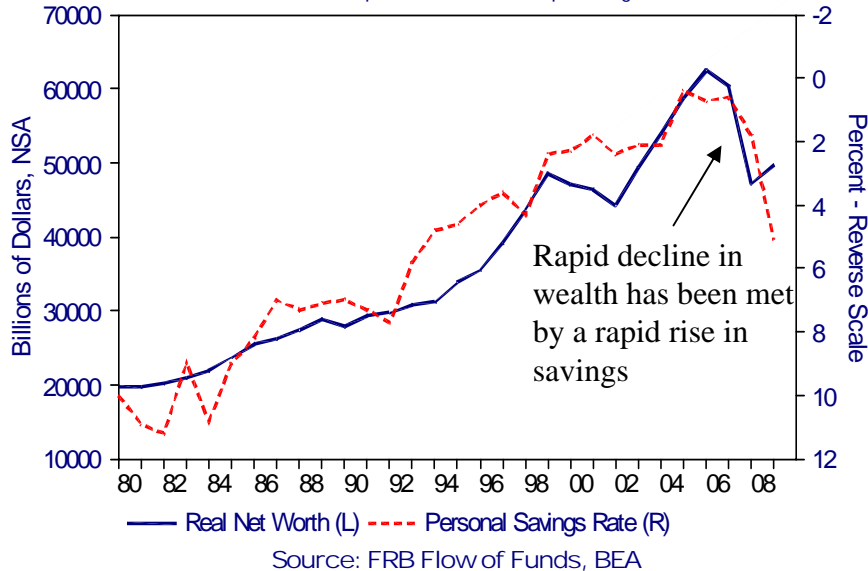
Back-to-Back Decline in Consumer Spending
First Time Since 1933



Households Began Saving and Paying Down Debt

Household Net Worth vs. Personal Savings Rate

Massive Drop Has Led to a Record Jump in Savings



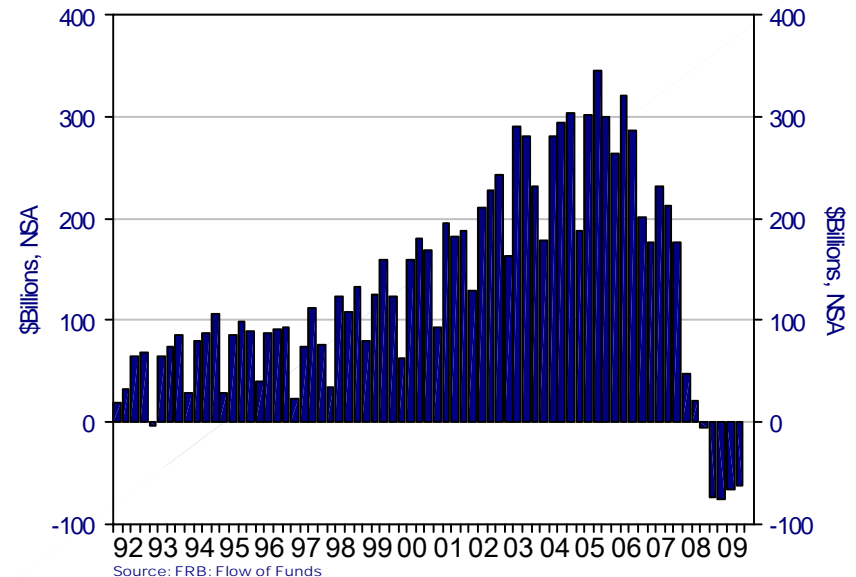
-- Net worth highly correlated to the personal savings rate.

-- Savings rate declined since the 1980's because we felt wealthier over time, helped by the invention of savings vehicles.

-- Flow of Funds data going back to the 1950's shows that households have never paid down debt this aggressively.

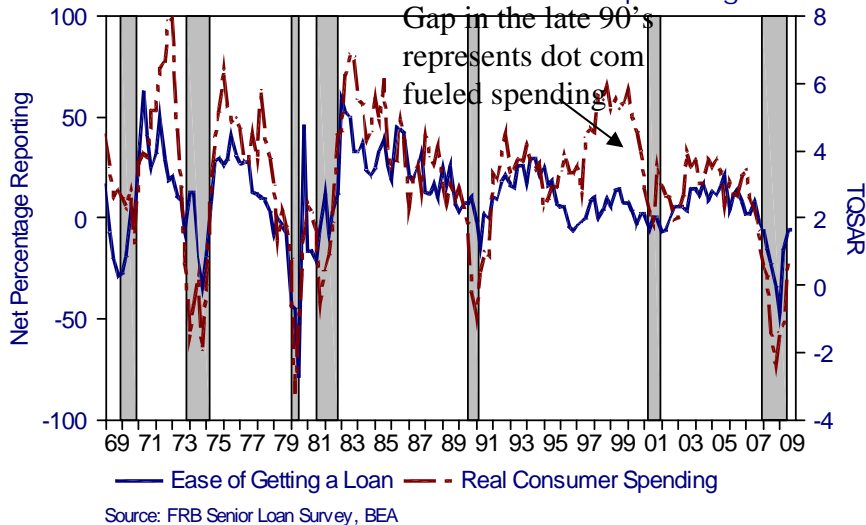


Change in Household Liabilities
Paying Down Debt for the First Time



Two Sides of the Lending Coin

U.S. Lending Conditions Over the Business Cycle
Willingness to Make Consumer Installment Loans
and its influence on consumer spending

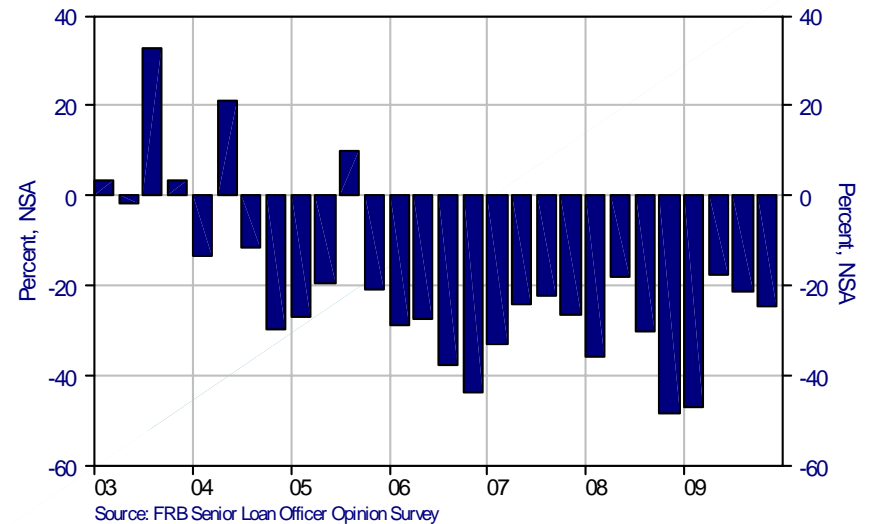


- Banks tightened lending back to late 70's standards.
- Availability of credit directly influences consumers' ability to spend.
- Lending standards have loosened over the past few quarters.

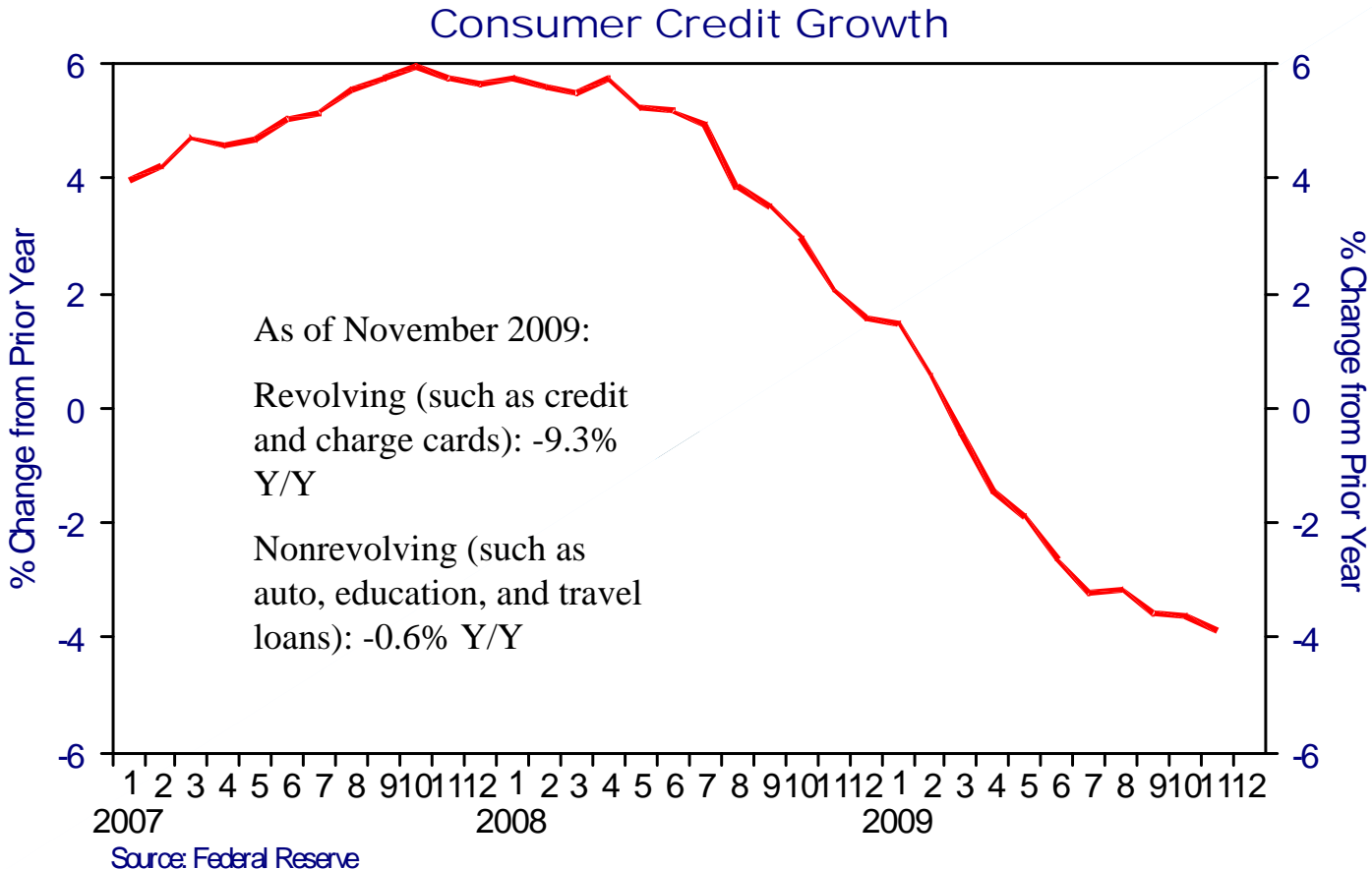
- However, at the same time households are uninterested in taking on more debt.
- It's no longer about keeping up with the Jones', but finding better bargains than the Jones'.



Net % of Banks Reporting Stronger Demand
for Loans to Households



That's Why Consumer Credit is Dropping at a Record Rate



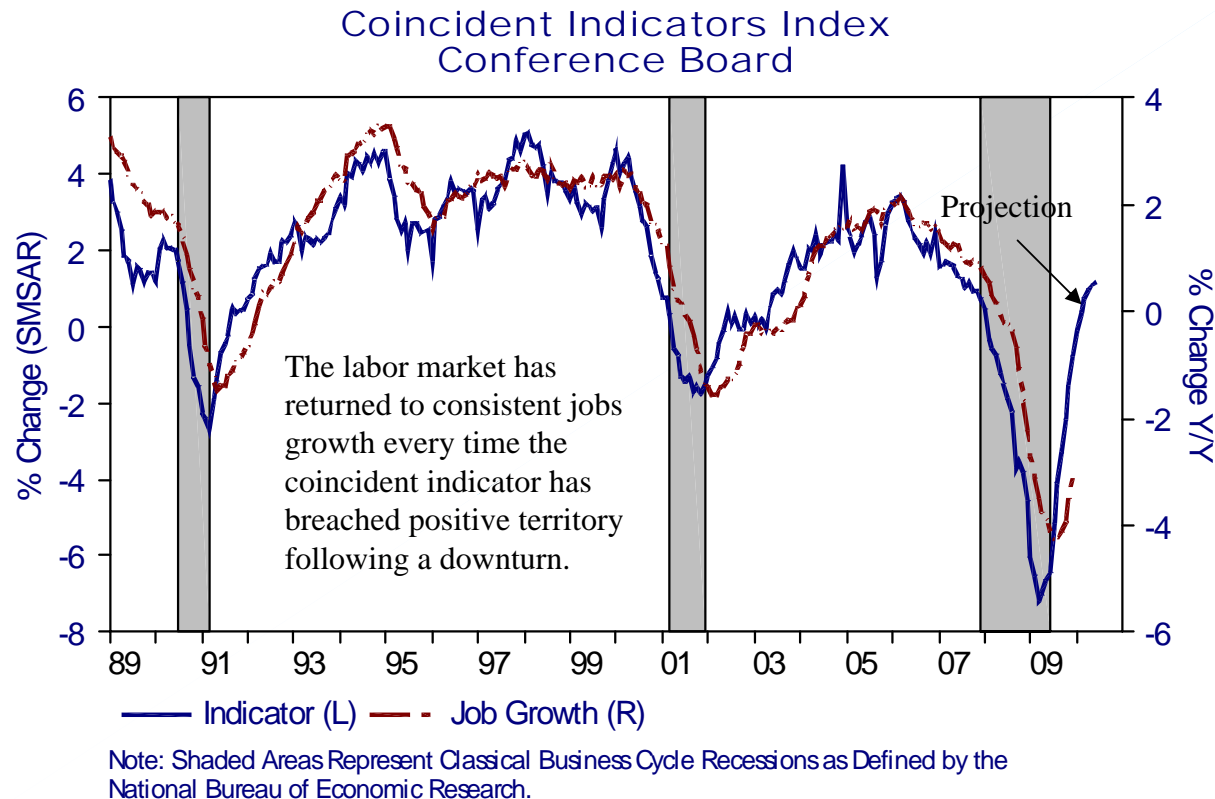
-- Consumer credit was down -3.9% year-over-year in November 2009. The average annual growth rate since 1980 is about +7%.

Current State of Consumers Sounds Pretty Dismal

- Wage growth has been slowing for decades.
- To maintain their standard of living households turned to credit.
- Debt piled high for decades. Buy now pay later became buy now pay never.
- Households are aggressively paying down debt, but debt burden still 30% above disposable income.
- Massive job loss has led to record high defaults so lending remains tight.
- Wage inflation now nonexistent. In fact wages are falling year-over-year.
- Unemployment rate will remain high for years and it will take years to gain back the more than 7 million jobs lost (closer to 8 million after benchmark revisions).
- Job satisfaction at a record low.
- 63% of Americans polled say they their spending and saving habits are “forever changed” due to the recession.
- Personal savings rate will fluctuate between 3.5 and 4.5% for the long haul.

****So why are we forecasting +1.8% *growth* in real consumer spending for 2010?***

#1 Reason: Job Growth is Here



-- For the private sector, the coincident indicator implies a return to *consistent* jobs growth as early as February/March.

-- Add to that the 1.2 million census workers and 2010 could see an average 150K jobs created per month.

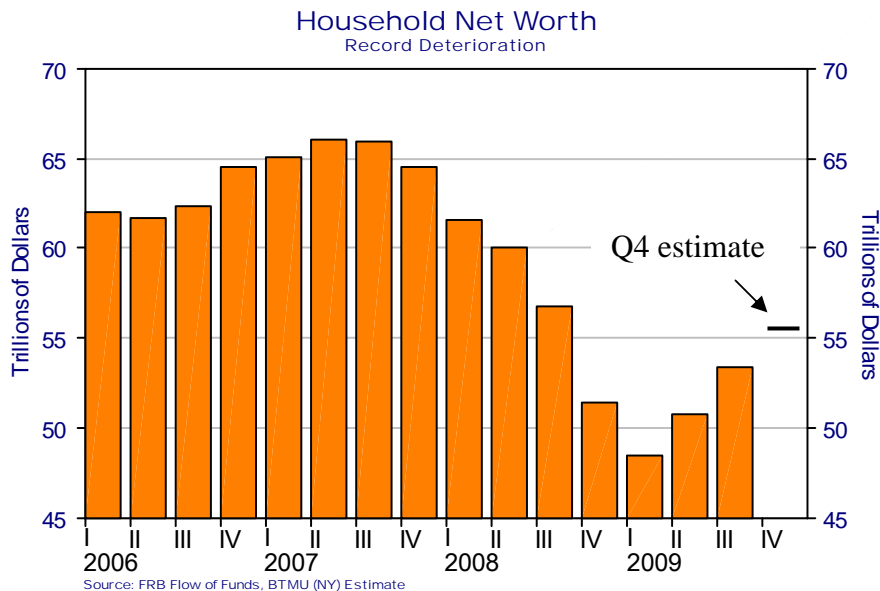
Let's Talk Census

- The 2010 Decennial Census will add 1.2 million (temporary) workers to payrolls.
- That's about 3 times as many hires when compared to the 2000 Census.
- Workers will be employed for 3 to 6 months and will be paid between \$10 and \$25 per hour.
- According to the Census Bureau, about 180K workers will be hired from January through March and roughly another million will be hired from April through June. Census operations wind down from September through December.
- Forecasting monthly payrolls in 2010 will be challenging. I'll first form a baseline forecast and on the back-end add the number of Census workers I believe were hired that month. Later in the year I will also have to guesstimate how many Census workers were hired *and* separated.

Any way you slice it, it all adds up to a boost in aggregate income and since our savings rate isn't 100% a good amount of it will show up in the economy.

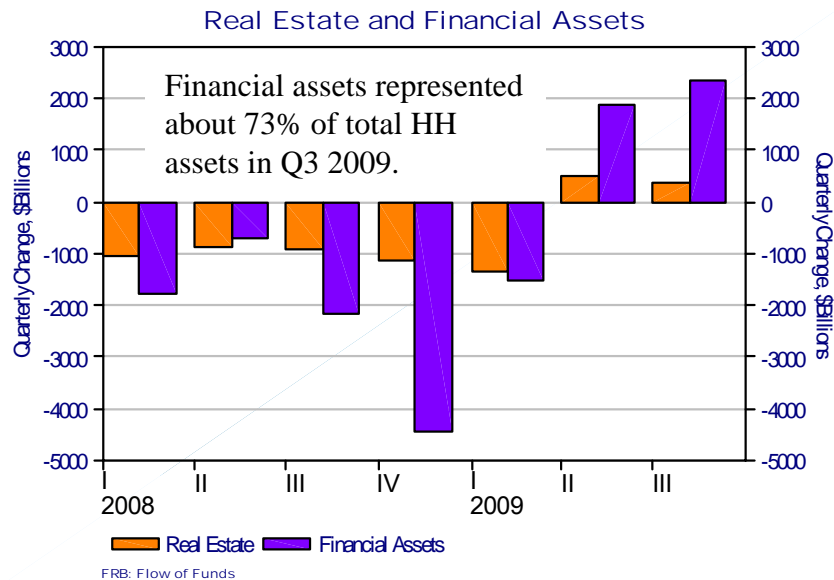
That forms the baseline of our consumer spending forecast for 2010 because higher aggregate income allows consumers to spend more while still maintaining a higher savings rate.

#2: Housing Market/Stock Market Help Recovery in Household Wealth



-- In the three quarters ending Q4 2009 BTMU (NY) estimates about \$7 trillion of household wealth has been recovered of the more than \$14 trillion that was lost over the Great Recession.

-- Helped mostly by a rebound in the stock market since the March 2009 bottom.
-- And helped (but much less so) by stabilization in property values.



BTW, +1.8% is a Low Growth Rate for Spending

-- In fact it's much slower than the average historical growth rate since the 1950's, and compares to an average +5.0% during the recovery phase of the biz cycle.

-- Job growth will be too slow to move the u-rate significantly downward.

1. Employers will first extend the workweek and move part-timers/furloughs back to full-time before hiring new staff.

2. A higher percentage of new staff will consist of temporary and contract labor.

3. The backbone of job creation – small biz – still has little access to credit to fund expansion and payrolls.

4. Baby Boomers who lost retirement savings will remain in the workforce longer.

5. The labor market won't expand fast enough to accommodate new entrants.

6. Therefore, the u-rate remains very sticky over the next several years, which will keep downward pressure on wages.

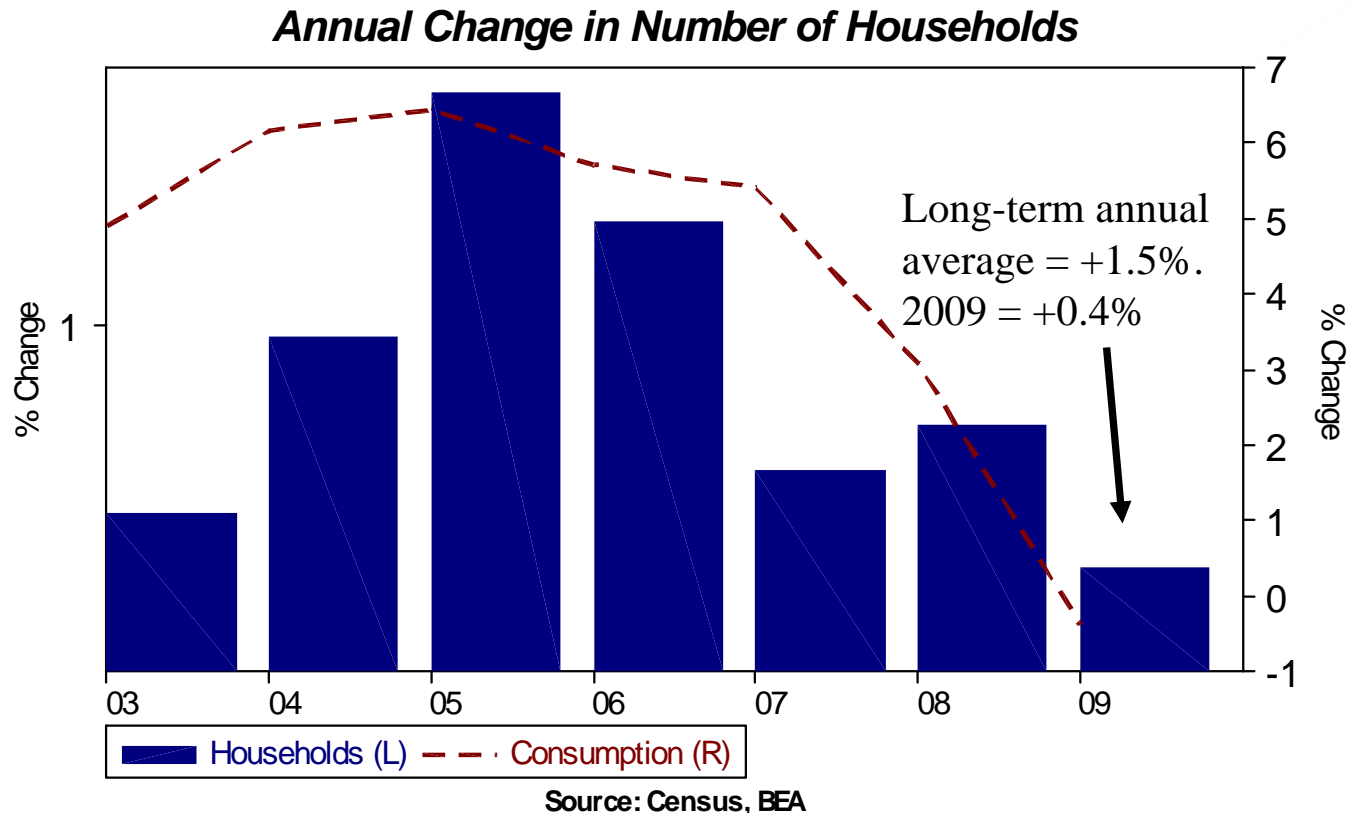
-- Housing market recovery is not strong so housing-related spending won't jump back.

-- Household formation has slowed.

Why Being NEET is Not a Virtue

- NEET = Not in Employment, Education or Training.
- First used in the UK, but has become a widely used classification in Japan as well.
- In UK it covers ages between 16 and 24, while in Japan it covers ages 15 to 34.
- In 2007 a UK study estimated that one million of their NEET costs the economy £3.65 billion each year.
- In Japan, there is also the term “freeter” (or *furitā*) which describes the young people that move from low-paying-job to low-paying-job, perpetually underemployed.
- In the U.S. this is most similar to the “lost generation”, which describes any generation that is disproportionately affected by an economic shock resulting in a lengthy period of unemployment.
- All three terms are similar in that they result in lower household formation (instead living with parents), lower lifetime earnings, and are a substantial cost to society and government (not to mention their parents).

Household Formation



- Household formation is a big driver of consumption. When formation slows, households are consolidating, which tends to be a precursor of recession. The household formation data series from the Census Bureau is often used in leading indicator indices.
- Growth in households was at its slowest pace in 2009 going back to the 1960's.
- Economic recovery greatly depends on a pick-up in household formation.

Echo Boomers = Lost Generation in the Making?

- Echo Boomers (or Generation Y) are 5 million stronger than Baby Boomer generation.
- Youngest are 16 and the oldest are 24. Their unemployment rate averaged 17.6% in 2009, highest since 17.8% in 1982. Underemployment rate closer to 25.0% in 2009.
- Starting their careers at a time when high unemployment means they are much more likely to remain underemployed for some time.
- Social economics studies have shown that starting a career underemployed tends to depress lifetime earnings potential.
- Echo Boomers are the poorest generation in our post WWII economy.

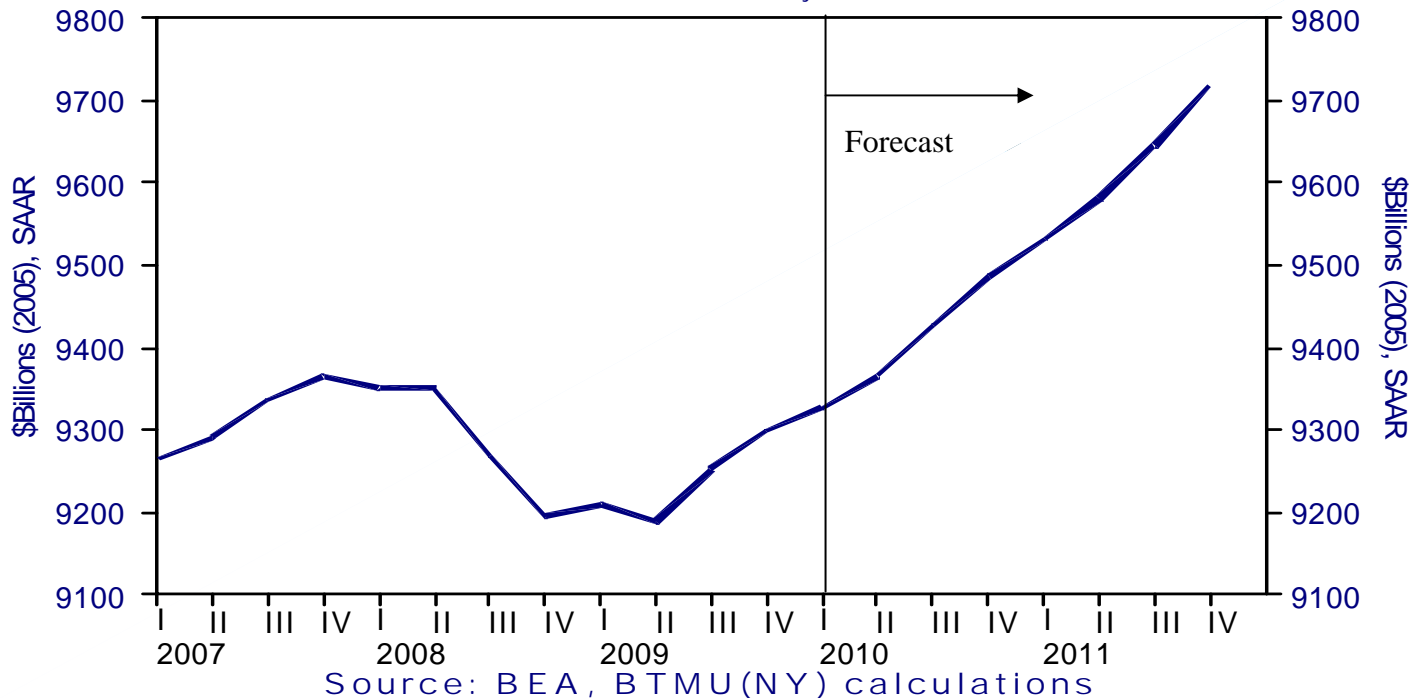
How they will shape the future of household spending behavior:

- This generation has seen Dad and/or Mom lose a job, putting the family in jeopardy with little savings and high debt. They will not embrace debt as their parents did.
- This generation thinks of owning a home as a burden, rather than a sound investment with potential for appreciation. They are much more likely to be renters.
- This generation will be “do-it-yourselfers”, a one income household, and put more emphasis on quality of life.

Closer on the Horizon

Real Consumer Spending

Back to Pre-Recession Level by Q2 2010



- Consumer spending is in recovery and will reach its pre-recession peak by Q2 2010.
- Better-than-expected holiday shopping season provided much needed momentum.
- Pent up demand (especially for motor vehicles) will come forward, but wages that barely pace inflation, higher savings, and high debt levels will keep a lid on growth rates.
- Jobs growth and stock market recovery matter most.

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