PopularEconomics.com

Popular Economics Weekly

CONSUMER EXPECTATIONS SPLIT

> "*The gap in financial prospects between those households with above median incomes and below median incomes has never been wider during the past decade." (U. of Michigan sentiment survey)*

The U. of Michigan's Index of Consumer Sentiment rose slightly in March, but only for half of American households. The gain in the Sentiment Index was among those households with incomes above $50,000 (+5.1 points), while it fell among households with incomes under $50,000 (-0.4 points).

And last week's unemployment report for March showed a gain of 211,000 private payroll jobs, but 1 in 5 were in low-paying sectors such as leisure and hospitality, "largely due to a sizable gain in food services and drinking places," said the report.

What is happening to the 'other half' of consumers—those with sub-$50,000 annual incomes? Accompanying the survey's release—a phone survey taken twice per month—was a cautionary remark:

> "Upper income households were half as likely as lower income families to report that their financial situation had been significantly weakened by higher prices, and higher income households were three times as likely to anticipate increases in their real incomes during the year ahead," noted survey director Richard Curtin. "*The gap in financial prospects between those households with above median incomes and below median incomes has never been wider during the past decade (my italics)".*

This is further evidence of a growing income disparity in consumers that could well affect future economic growth. A rising economy may "lift all boats", but some higher than others, it seems. The evidence is coming from many different sources. And with Americans having spent $33.5 billion more than they earned in 2005—for the first time since the Great Depression—it is important for us to understand the root causes of a society that must borrow to spend. Or, we could repeat a most unpleasant part of our history.

The Federal Reserve's Survey of Consumer Finances (SCF) updated to 2004 provides us with the latest income figures since the 2001 recession. The bottom 20 percent of households now live under the poverty level with $18,900 or less in annual income, while the top 10 percent have annual incomes of $129,400 or more.

It is true that all income brackets have risen more than 20 percent since 1995. The growing income disparity shows up most starkly in the distribution of household net worth. The average net worth of the bottom 25 percent of income earners grew just 8 percent to $13,300 from 1995-2004, while that of the top 10 percent grew 77 percent to $831,600. The primary residence now takes up 50 percent of all net worth, while Business equity (stocks, bonds, etc.) comprised 26 percent, according to the data.

The reasons for the growing disparity have been much discussed, but boil down to a tremendous shift in wealth that have benefited corporations, their stockholders and most-skilled employees. A study by the Economic Policy Institute's Jared Bernstein documented that the economic recovery since 2001 has been like no other. Whereas 80 percent of corporate net revenues in past business recoveries have flowed to wage earners (and 20 percent to corporate profits), the tables have been reversed since 2001. Now some 79 percent is retained by corporations as profits and excess cash—a cash hoard totaling $1 trillion at last count—while just 21 percent has flowed to wage earners.

Why? The advent of computers and other enhancers of higher productivity that have enabled employers to replace their employees with machines, as well as globalization that has moved their factories offshore. The result has been that average wages and household incomes after inflation have remained flat since 2001.

UNEMPLOYMENT—The jobless rate fell to 4.7 percent in March, as 384,000 more found employment in the Household survey (that includes self-employed), while the unemployment rolls shrank by 182,000. Most of the increase was in services—202,000—while manufacturing and construction grew by 9,000. Average hourly earnings have just kept up with retail inflation, growing 3.4 percent in March.

How does this affect the economy? Households have kept spending. Due to the easy credit policies of the Federal Reserve since 2000, poor and middle-income households have been able to borrow on a massive scale to finance their consumption. The result has been record debt levels.

As a consequence, the SCF reports that the fraction of families with payments more than sixty days or more in the year preceding the survey rose substantially—mainly in the bottom 80 percent of the income distribution. It is their indebtedness that is the problem. Household debt has soared since 2001, so that the amount of debt now exceeds 110 percent of annual household incomes, a record. Much of it has been from their homes. The median amount of home-secured debt rose 27 percent from 2001-04, while median home equity among those same homeowners rose 13.1 percent—i.e., median debt appreciated at double the rate of equity.

Federal Reserve Chairman Bernanke doesn't think this is a problem, since he says much of the home-secured debt has paid down higher cost credit card debt. It may not be a problem for the higher income brackets, but even our middle class has lost ground. The median income for those in the 60th percentile of income actually fell from $54,700 to $53,600 2001-2004.

This means even middle-class incomes have been shrinking. We therefore can see a scenario where continued Fed tightening will exacerbate an already growing income inequality that hurts those at the middle as well as low-income range. We hope Bernanke and his Fed Governors get the message.

© Copyright 2006