FYI: An Update on Emerging Issues in Banking

2005 Economic Outlook Roundtable
The U.S. Consumer: Hero or Has-Been?

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The consumer sector has played the lead role in supporting the U.S. economy over the last three years. Consumer spending was surprisingly robust during and just after the 2001 recession as low interest rates, soaring home values, and tax cuts allowed households to keep borrowing and buying at a rapid pace despite a slow job market recovery. But during 2004, consumers had to contend with rising interest rates and energy price inflation even as the marginal stimulus of the 2003 tax cut began to wane. These challenges have led some analysts to question the staying power of the consumer sector as an engine of growth for the U.S. economy in 2005.

The FDIC assembled a panel of experts late last year for the 2005 Economic Outlook Roundtable to address the outlook for the U.S. consumer sector. FDIC Chief Economist Richard Brown moderated a roundtable discussion that featured Carl Steidtmann, Chief Economist and Director of the Consumer Business Industry Group at Deloitte Research; Allen Grommet, Senior Economist at the Cambridge Consumer Credit Index; and Leonard Burman, Senior Fellow at the Urban Institute and Co-Director of the Urban-Brookings Tax Policy Center. The morning roundtable was followed by a lunchtime address on financial education by Donna Gambrell, Deputy Director for Compliance and Consumer Protection in the FDIC's Division of Supervision and Consumer Protection.

The panelists generally described a consumer sector that will continue to support the U.S. economic expansion in 2005, despite the presence of both short- and long-term financial challenges. Highlights from the roundtable discussion are provided below. The complete transcript of the roundtable discussion is available on the FDIC Web site at:
http://www.fdic.gov/news/conferences/2005_economic_outlook/transcript.html

Dr. Carl Steidtmann, Deloitte Research

Dr. Allen Grommet, Cambridge Consumer Credit Index

Consumers are expected to continue to support the U.S. economy.

Carl Steidtmann: "We see the broad economy losing a little steam, probably losing steam from a pretty high level. We have had the fastest growth, at least in the first half of this year, in 20 years. Quite remarkably, that's coming off what was the weakest, mildest recession in the previous 30 years. … I think the consumer, the household sector, has got a lot of cash flow going into [the coming year]. Our research shows that cash flow is what ultimately drives spending. I think that cash flow will continue to be quite strong."

Allen Grommet: "… [F]or the last several years … consumers have really been carrying the load [of the economy]. It was only in the last year that businesses came along and contributed to the growth. We are seeing that consumers are not on their knees at all—they're actually up. They're still trying, they're still helping the economy. So, to that extent, even though it has been a long road for consumers, I would see them as, on average, continuing to contribute to the recovery."

Len Burman: "Actually, in 2004 there's quite a lot of tax stimulus in the economy. It's $280 billion or so. The combined effects of the 2001, 2002, 2003, and 2004 tax cuts were actually even a little bit more than the [incentives] that were enacted in the business tax package a few weeks ago."

Job market conditions have finally turned around.

Carl Steidtmann: "This recovery started with unemployment at just about its lowest level of any post-war recovery. I think it's going to be much more challenging to businesses going forward to find people. That, I think, probably more so than demand, is what is going to keep payroll numbers down. We also look at [unemployment] claims, one of the better short-term snapshots of the labor market and of job growth. The steady decline in initial unemployment claims suggests to us that the labor market is gaining momentum, and that will be a factor contributing to what will be a pretty good consumer spending environment next year."

Allen Grommet: "One of the statistics … quoted a lot [in 2004] … was about the loss of jobs. Typically, you would see that you would recover all of those jobs within two years after the start of a recovery. Now we're three years into it and we still haven't recovered all of those jobs, which is yet another way of looking at this point about how slow employment growth has been in this recovery. And that, obviously, affects consumers a lot."

Longer-term concerns include benefit costs and the impending retirement of the Baby Boom generation.

Carl Steidtmann: “One thing that we should be worrying about is real hourly wages. We find real hourly wages to be a pretty good leading indicator of real spending. Again, it’s one of the factors that we look at when we're trying to measure cash flow into the household sector…. Real wages are going down now for a couple of reasons. One reason is we've had a bit of an acceleration in inflation. That, obviously, undercuts purchasing power. We've also had a real sharp increase in [the cost of] benefits. So, in a sense, you’re getting a little bit of a mix shift from the employer's perspective, away from wages and toward benefit costs. I think that's also depressing real wages. The impact falls more on middle- and lower-income households, those households that are more dependent on real hourly wages.”

Allen Grommet: “We're concerned about the effect of interest rates going forward, and it's not likely to get better. The rising rates will ultimately affect the housing market.”

Len Burman: “ … [I]f you adjust tax receipts for extension of the 2001–2004 tax cuts, you fix the [alternative minimum tax], you adjust spending for growth in entitlements and defense … by the year 2013, there's basically nothing left for anything else unless you finance it through deficits. … The problem is that [Baby Boomers] are all getting near retirement age now, and that's going to put immense demands on the budget. … Over the long run, unless we actually deal with these problems, this clearly will have a negative effect on the economy.”

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