

Consumer Metrics Institute Members News

February 9, 2011: An Update Plus Mid February Odds and Ends

First of all, there are a number of "odds and ends" that deserve mention without meriting a full newsletter/commentary of their own:

-- If you have not yet read our general (i.e., "Home Page") [commentary on the impact of "strategic defaults" on consumer spending](#), we encourage you to do so now. We had previously seen suggestions in the press that mortgage delinquencies were a source of at least some of the consumer spending increases observed last year, but we were not aware of anyone attempting to quantify the impact. Per our calculations, the bottom line is that such delinquencies could be freeing up as much as \$90 billion per year for consumers at the expense of the mortgage bankers. If we further assume that somewhere between one-quarter to one-half of the \$90 billion actually ends up in consumer spending, we might expect to see discretionary durable goods gaining 2% to 4% annualized (relative to the pre-default era).

-- The "Owner's Equivalent Rent of Primary Residence" ("OER") component of the Bureau of Labor Statistics' ("BLS") Consumer Price Index ("CPI") is often misunderstood. It stands in as a proxy for the monthly cost of principal, interest, taxes and insurance for those who own their primary residence. It was nearly flat for calendar year 2010, reportedly only increasing by 0.3% during the year. Although this number is low, some of our readers have questioned how it could even be that high given the pounding that both home prices and mortgage rates took over that same span of time.

Adding to the confusion is the [explanation provided by the BLS on "How the CPI measures price change of Owners' equivalent rent of primary residence \(OER\) and Rent of primary residence \(Rent\)."](#) The explanation prominently states on the first page that the expenditure weight in the CPI market basket for Owners' equivalent rent of primary residence (OER) is based on the following question that the Consumer Expenditure Survey asks of consumers who own their primary residence:

"If someone were to rent your home today, how much do you think it would rent for monthly, unfurnished and without utilities?"

This prominently stated survey question misleadingly implies that the OER is derived from a homeowner guesstimate of the rental value of their home. Instead, the above question is used **only to determine the portion of a homeowner's budget** that is dedicated to the "equivalent of rent" for the owner-occupied residence. The actual monetary value for that equivalent is derived from a separate survey of renters.

Although the actual process is far better than having homeowners guess at what their homes might rent for, it is still flawed in a number of respects. First of all, it still uses the homeowner's guesses to allocate the "equivalent of rent" within the whole household budget. Secondly, and more critically, it assumes that homeowner's costs for shelter are moving in lock-step with those of renters.

This past year has been a time when rents have firmed as the availability of rental properties has

tightened, even while the real-world overall costs for owner-occupied housing has arguably dropped. On the surface it might seem surprising that the availability of rental properties has tightened, given something like 19 million residences vacant. Unfortunately, banks would rather auction than rent -- despite the "price discovery" inherent during an auction of any "impaired" asset. While it may seem reasonable to use a home rental equivalent as a proxy for home ownership costs in the CPI, in fact the two sets of costs respond to completely different market forces and dynamics.

Much better would be some process that utilizes the same types of mortgage weightings as what we performed while trying to quantify the impact of "strategic defaults" and mortgage delinquencies. If that process was properly done it would capture changes in monthly costs as a result of refinancing as well as recognizing that a growing portion of our population has been aging into paid-off mortgages (now some 25 million households), causing the actual aggregate monthly shelter costs for at least the "Baby-Boomer" demographic to be declining.

Add into that the \$90 billion per year in reduced out-of-pocket costs experienced in the real world by mortgage defaulters. However "illegitimate" or transient such cost reductions may be, they are real and they are being experienced by "Main Street" Americans. At any given moment some 5 million owner-occupiers currently have their actual "rent equivalents" near zero.

And one might ask where else that deflationary "cost of living" decline is shown?

-- We have been asked from time to time to provide copies of the PowerPoint presentation that we use during our speaking engagements. We've now made a modest start in that direction, with the publication of the first two of what we hope will be a series of "YouTube" videos that help explain what we do. The first two such videos cover (at a very high level) both our methodologies and their limitations:

[Economic Data for the 21st Century - Part 1](#) (Duration 7:35)

and

[Economic Data for the 21st Century - Part 2](#) (Duration 11:35)

Like us, they are neither slick nor highly polished. Instead they simply try to communicate, being nothing more than our PowerPoint slides with a voice-over done by the very definition of a vocal "non-talent." However the videos do explain what we are attempting to do and how that differs from the approach used at the Bureau of Economic Analysis.

We will let you know when we eventually add to those presentations.

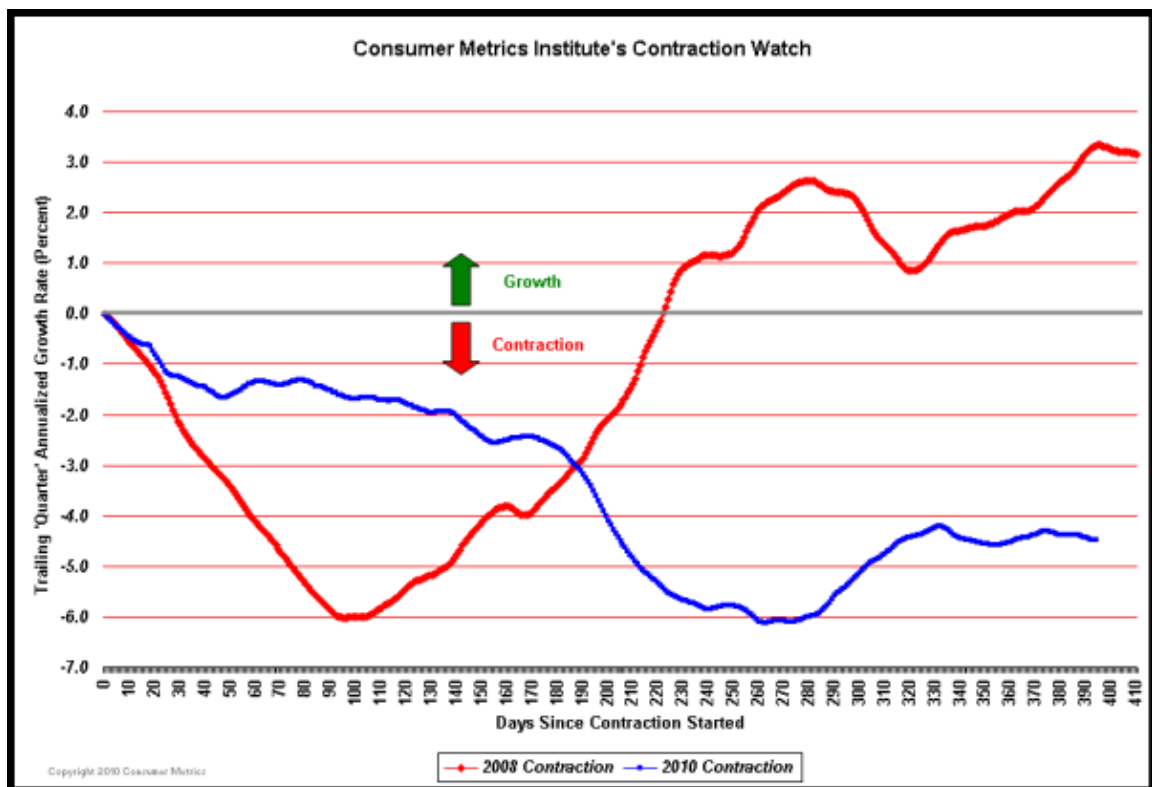
-- Over the past several weeks we have had a couple of occasions when we have not published updates to our indexes for several days. We always get a slew of e-mails at such times, wondering whether something has gone seriously amiss. Our standard reply can be found in one of our "Frequently Asked Questions", and it bears repeating here:

"Authentication and validation of our data collection process is our highest operational priority, and you may notice occasional multi-day delays in the publication of our indexes as we verify and/or aggregate samples for more statistically significant meta-analysis -- especially in cases where the sample sizes are less robust. From time to time one or more of our data sources may

experience a significant service interruption. Although for their purposes (providing targeted ads) the down time may not be critical, we still need to have every day's data captured and accounted for. As a consequence on such occasions we delay publication of the indexes until all of the data is complete and correct, with our end result still being day-by-day indexes -- only updated several times per week during those incidents instead of every day."

As always, we appreciate your patience.

A quick glance at our "Contraction Watch" tells us that on-line consumer demand for discretionary durable goods has not materially changed during the past 60 days:



In the above chart the day-by-day courses of the 2008 and 2010 contractions in our Daily Growth Index are plotted in a superimposed manner with the plots aligned at the left margin on the first day during each event when our Daily Growth Index went negative. The plots then progress day-by-day to the right, tracing out the changes in the daily rate of contraction in consumer demand for the two events. The 2010 contraction event is now more than a year old, dating back to January 15, 2010. Although the chart clearly bottomed at about 9 months into the contraction (at roughly 270 days), the rise since that bottom has been neither steady nor substantial. In fact, there is no way to forecast when the indicated contraction in on-line consumer demand for discretionary durable goods will end based solely on the recent course of the blue line.

It is important to remember that an index with a value substantially above or below zero for more

than a year is experiencing compounded (i.e., exponential) growth or collapse. A sustained value of +5% would indicate a compounded 5% year-over-year growth in consumer interest. Similarly, a sustained index value of -5% indicates a compounded -5% year-over-year 'death-spiral' of consumer interest. Thus our current Daily Growth Index readings in the -4.4% range are against year earlier values that were also contracting, and the contraction is now compounded with a change relative to January 15, 2010 of about -5.7%.

Since neither prolonged uninterrupted day-to-day growth nor extended contractions should be expected during normal economic times, any index should have a natural tendency to revert over time to 'normal' readings closer to the nominal long term growth rates for the consumer economy. Prolonged movements away from the long term trend line are most likely signs of an aberrant economy. So seeing signs of no material change in the above chart may ironically be the best possible signal that the economy is, in fact, undergoing material change.

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