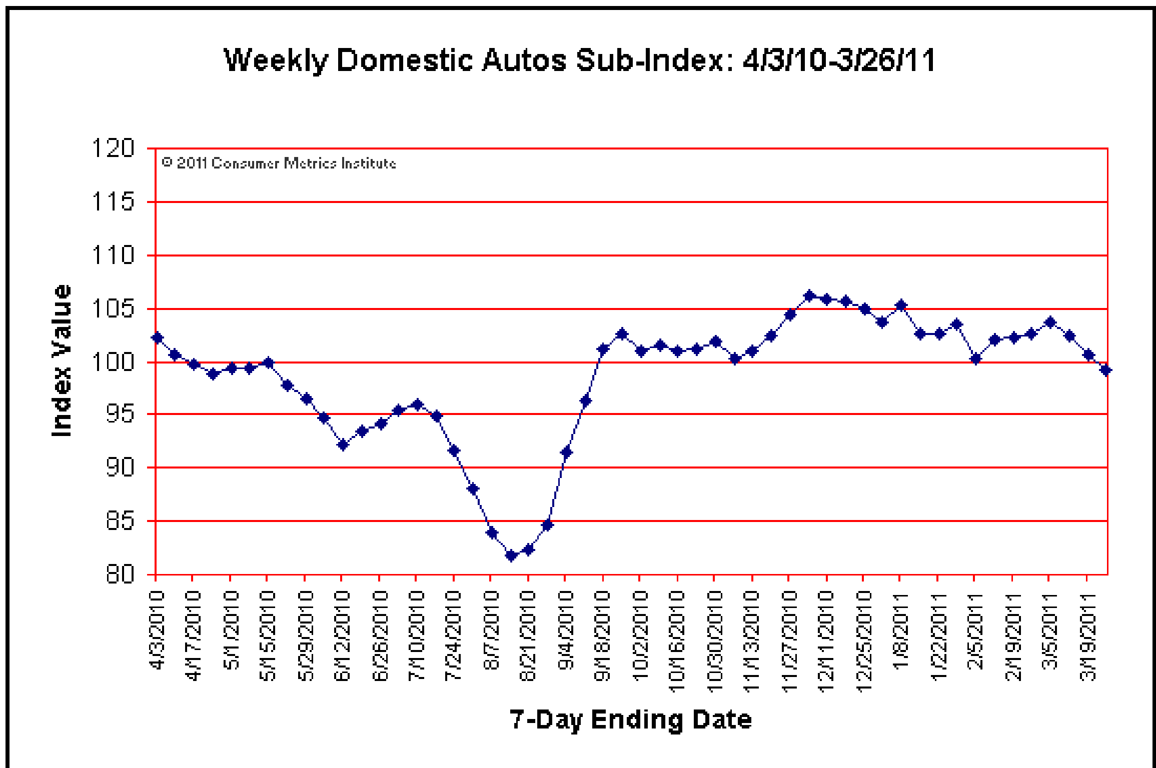
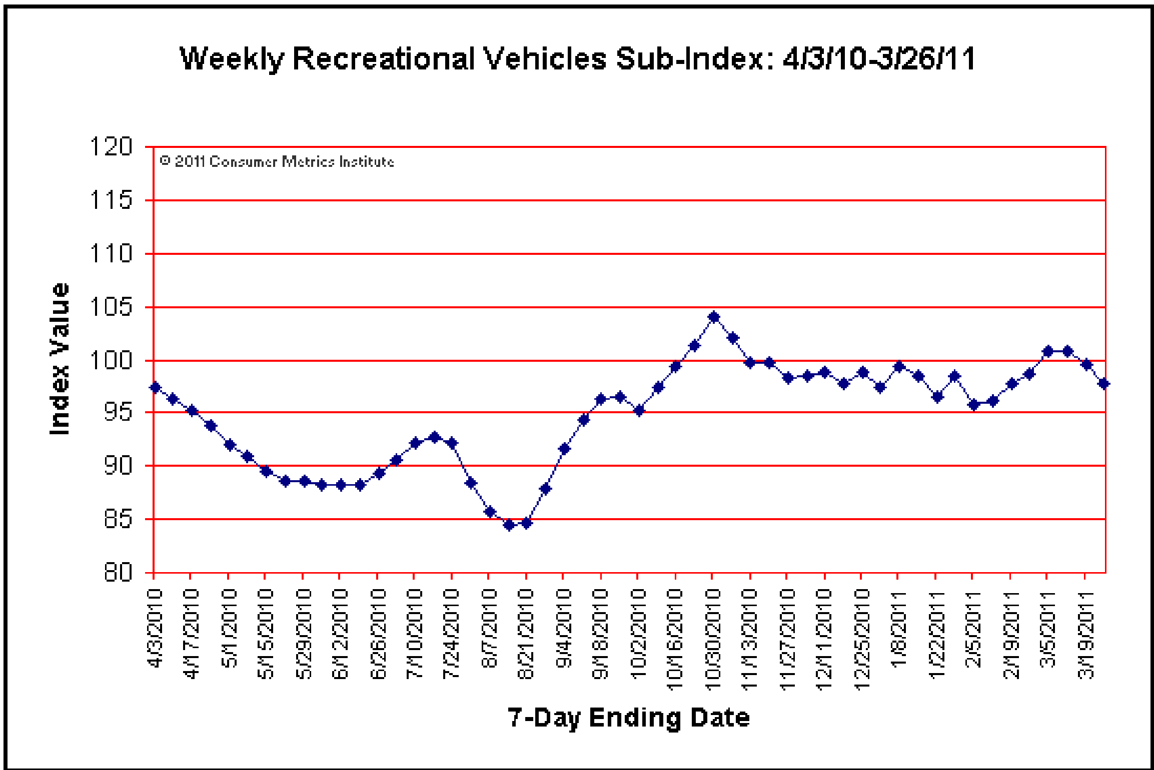
Consumer Metrics Institute Members News

March 23, 2011: Data Update; Sendai and Japan's Wealth -vs- GDP

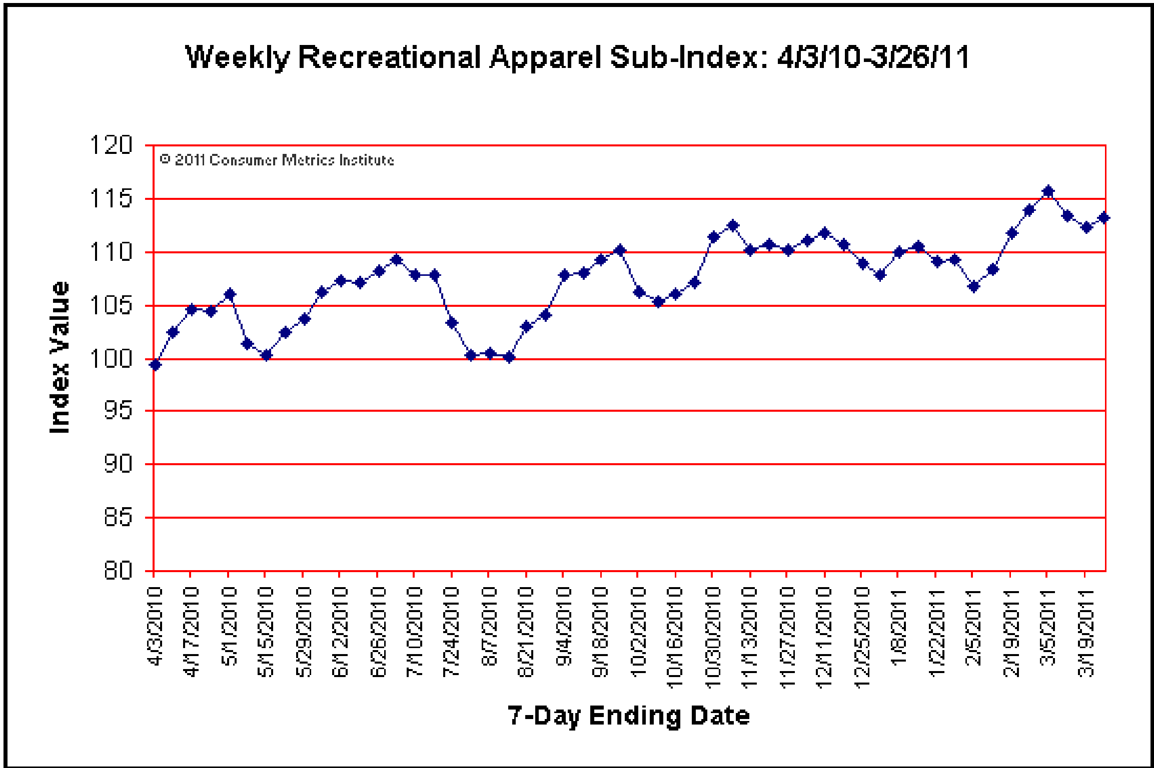
From time to time we need to remind our members that our Weighted Composite Index is indeed a composite of a number of disparate portions of the economy. There are some parts of the economy that are performing as one might expect after nearly two years of "post-recession recovery." Included in those sub-sectors showing respectable year-over-year consumer demand are the Domestic Autos market:



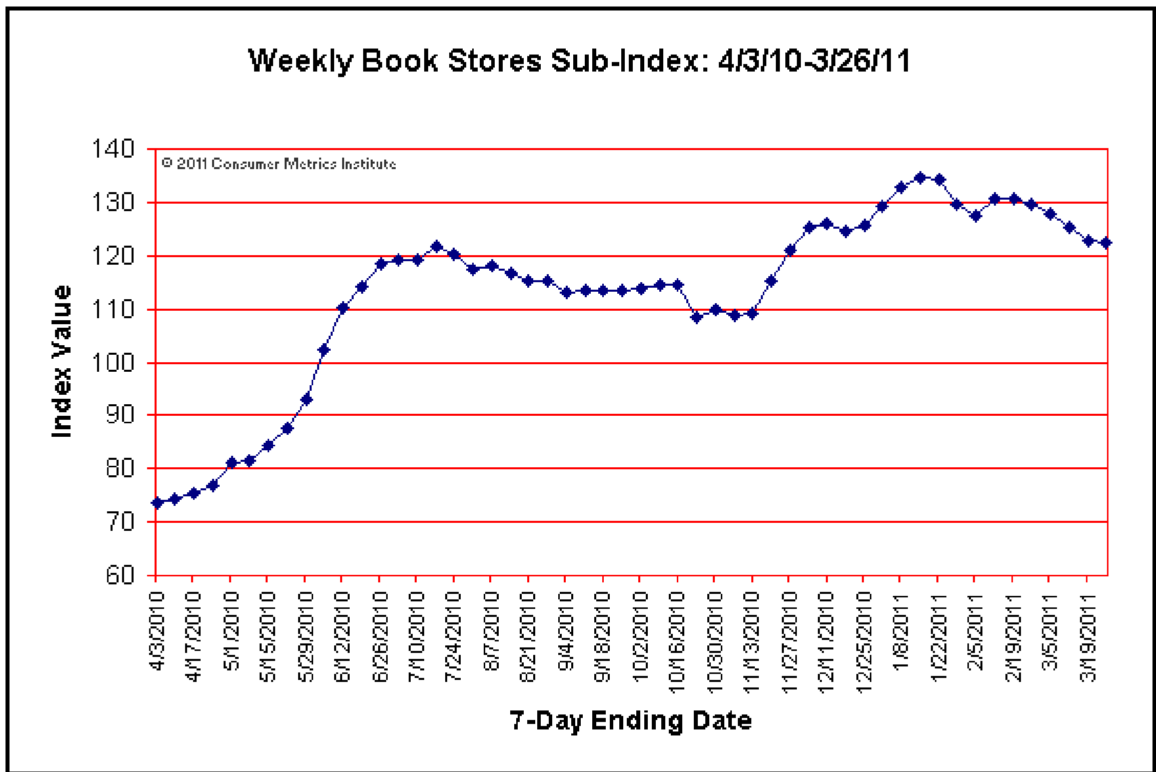
which has been showing continuous year-over-year growth since last September. Automobiles are arguably only marginally "discretionary," and although they are certainly "durable," they do need to be replaced from time to time (the average U.S. consumer will own 12 different cars during his or her lifetime). Even substantially more discretionary Recreational Vehicles have staged something of a return to normalcy, after seeing double-digit declines in consumer demand at the end of last summer:



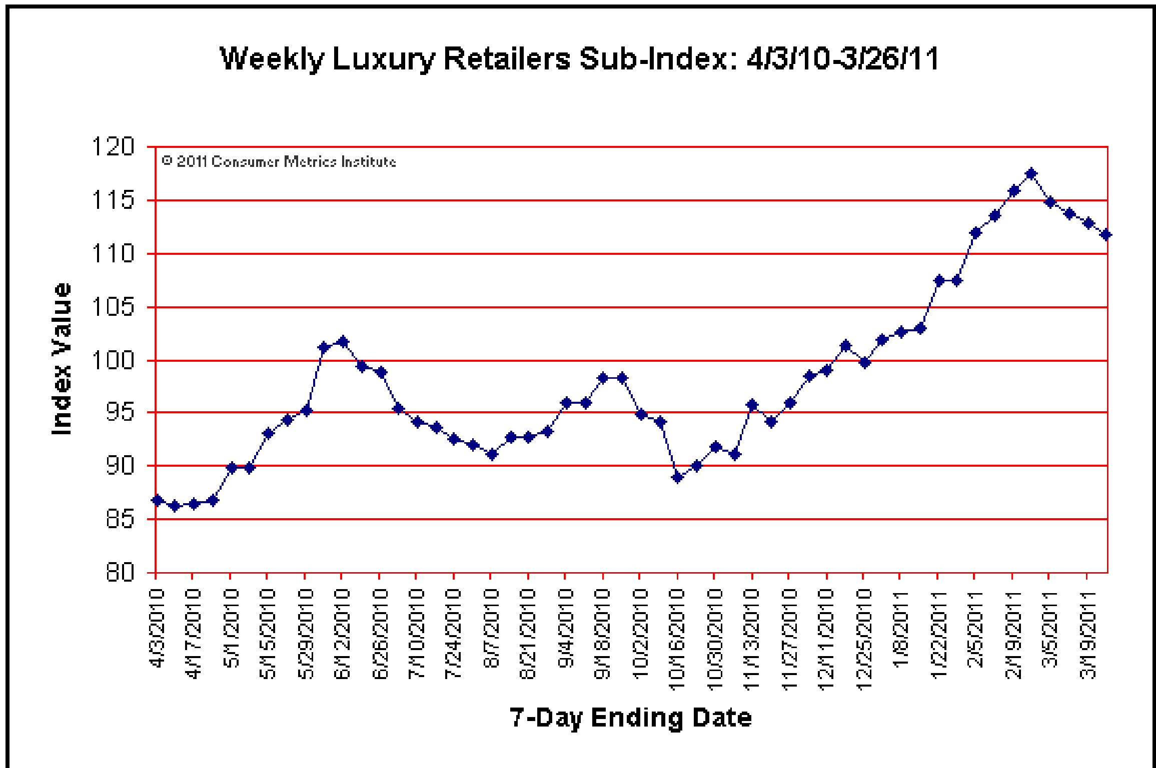
And some less expensive discretionary goods such as Recreational Apparel are showing persistent upturns in year-over-year demand after being significantly depressed during the core of the "Great Recession":



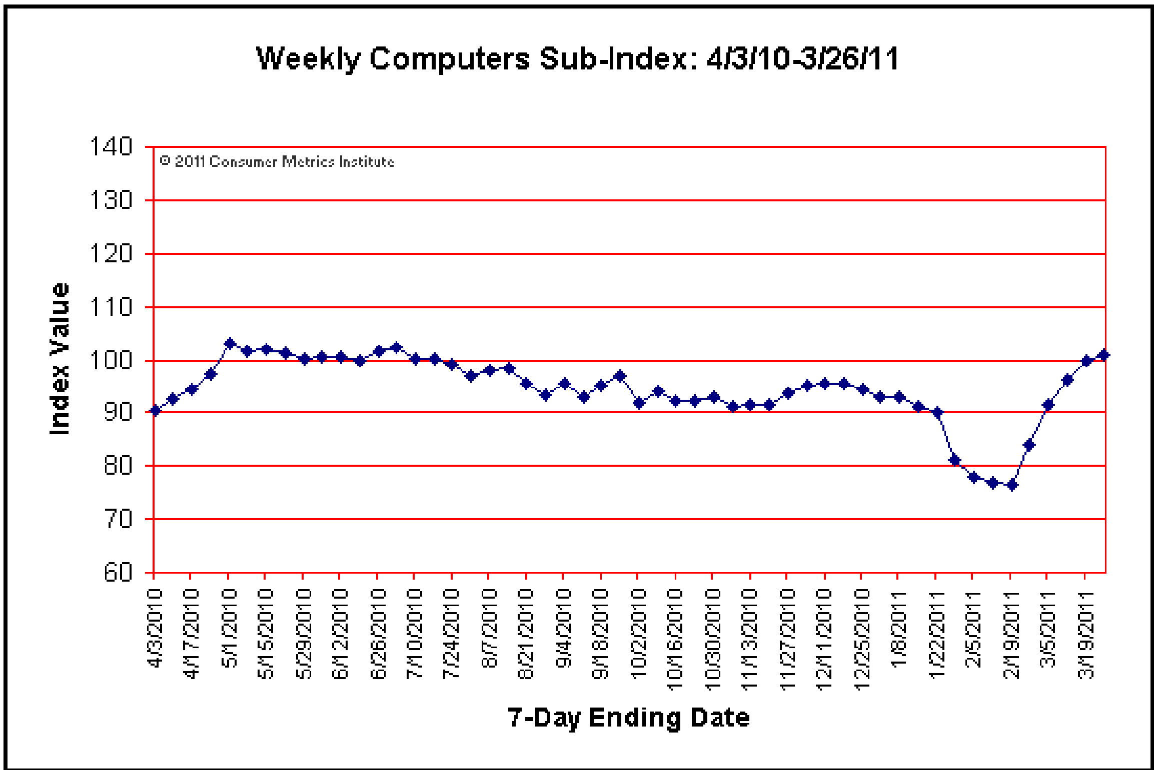
Additionally, the merchants selling affordable indulgences have fared relatively well -- although the extent to which this demand in Book Stores has been impacted by highly visible clearance sales is difficult to judge:



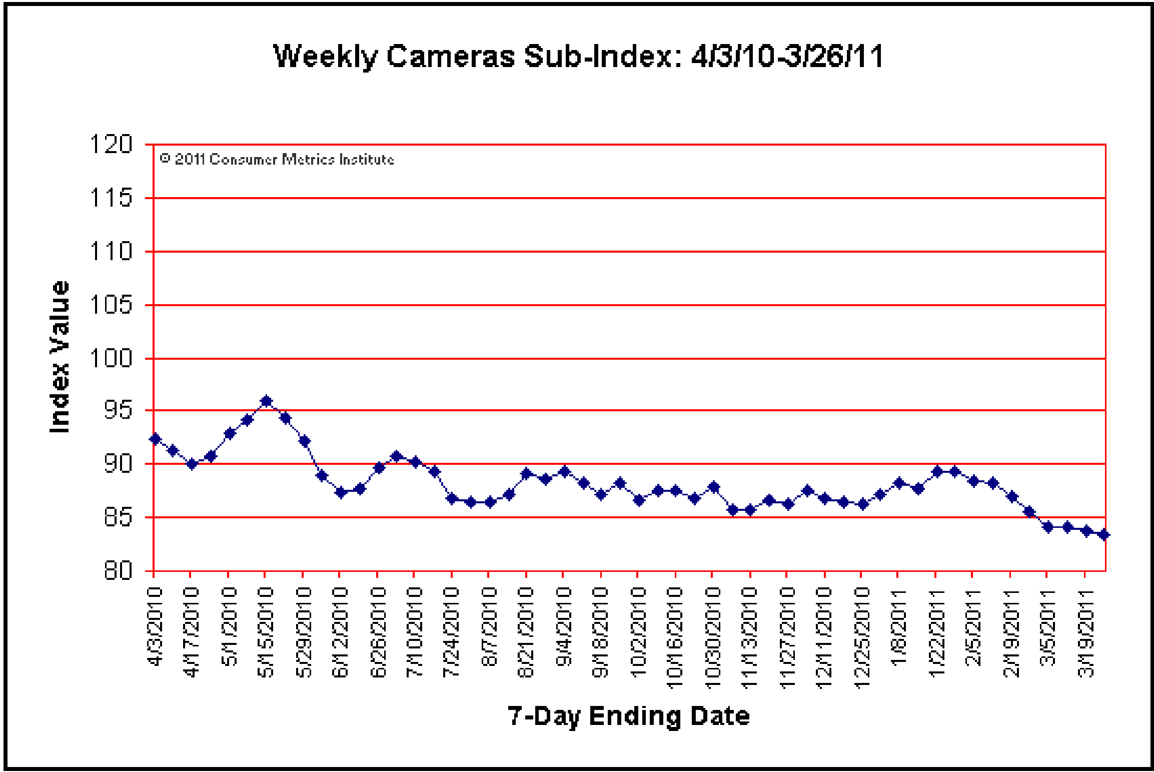
True indulgences have also picked up year-over-year, and (surprisingly) most of that strength has occurred after the traditional holiday season:



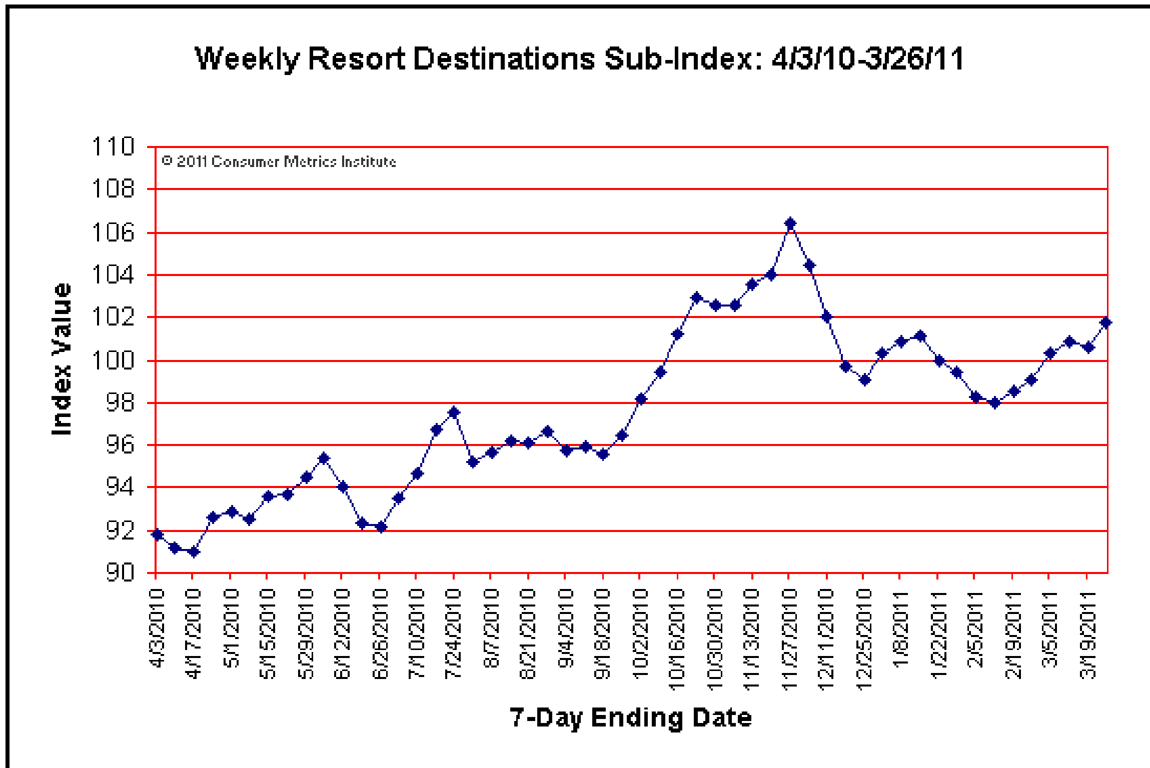
Technological goodies have perhaps the shortest lifetime of any common discretionary durable goods, and churning between product types is very common. Computers have shown very recent improvements in year-over-year data (although only to a neutral position), coincidental with the hype over the new iPad (which impacts both our "computers" and "mp3 players" categories -- since our original screens for Apple products couldn't have anticipated the entire tablet phenomenon):



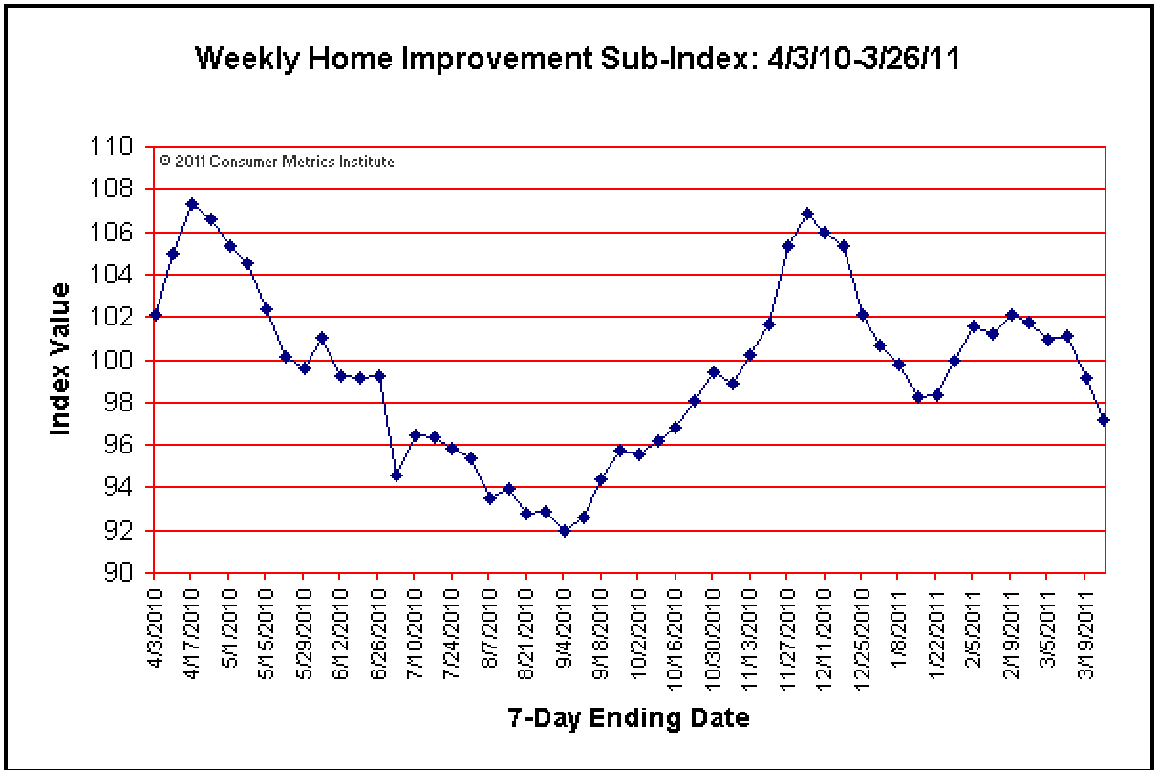
While other formerly hot products (e.g., digital cameras) eventually reach a market saturation point:



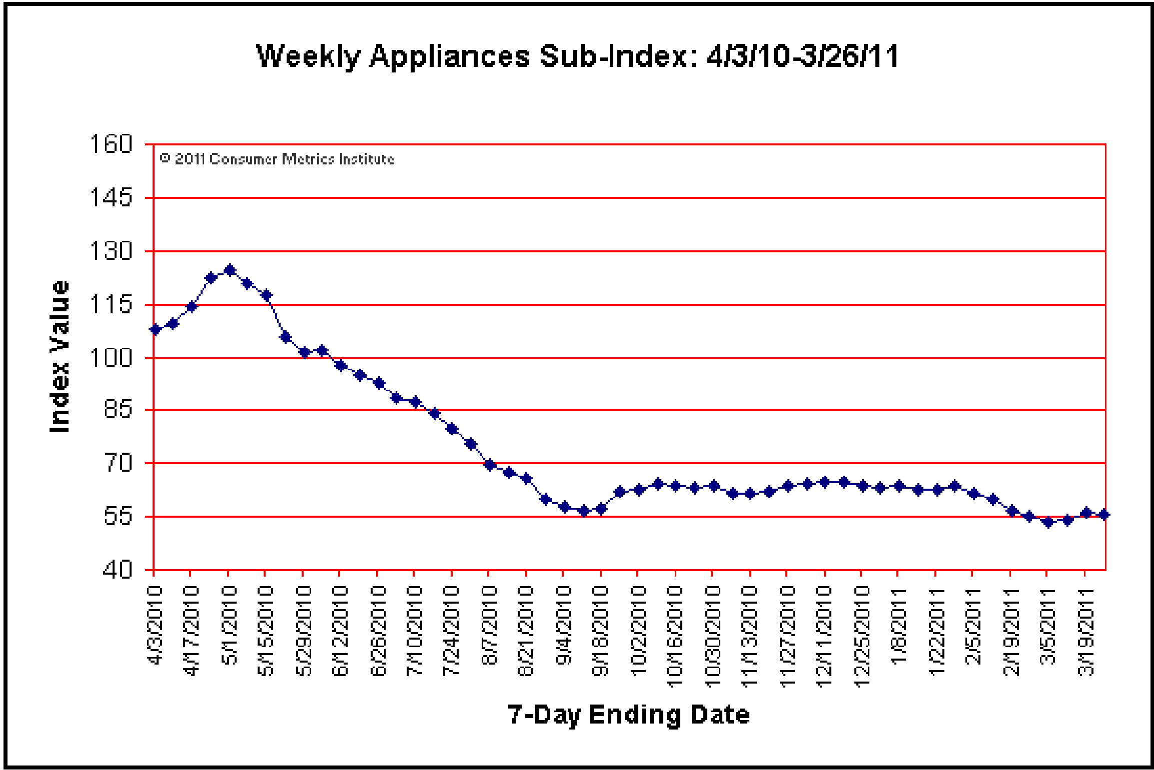
At the present time families still appear to be considering trips to family Resort Destinations (e.g., Disneyland), although that may change when the full impact of increased gasoline prices begins to hit home:



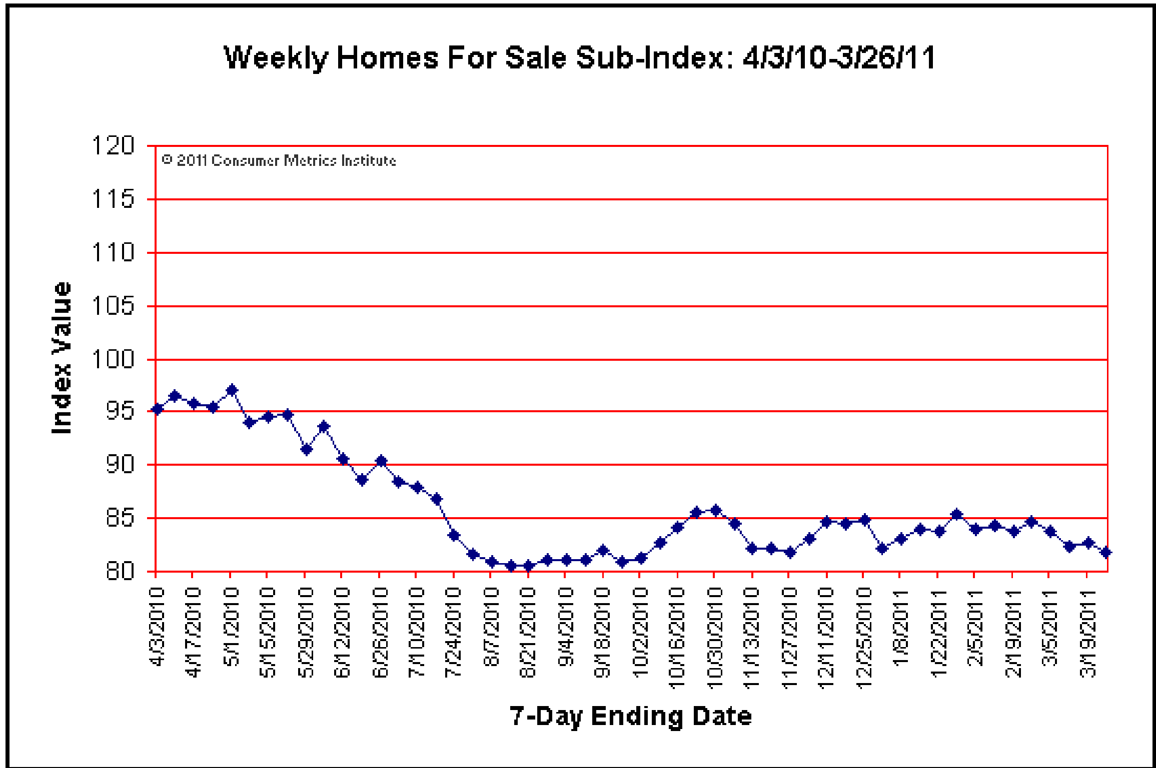
That said, there are still segments of consumer demand that are in year-over-year contraction, and a significant share of them are associated with the residential housing market. As examples, overall demand for Home Improvement products have started to soften again after showing surprising strength over the holiday season:



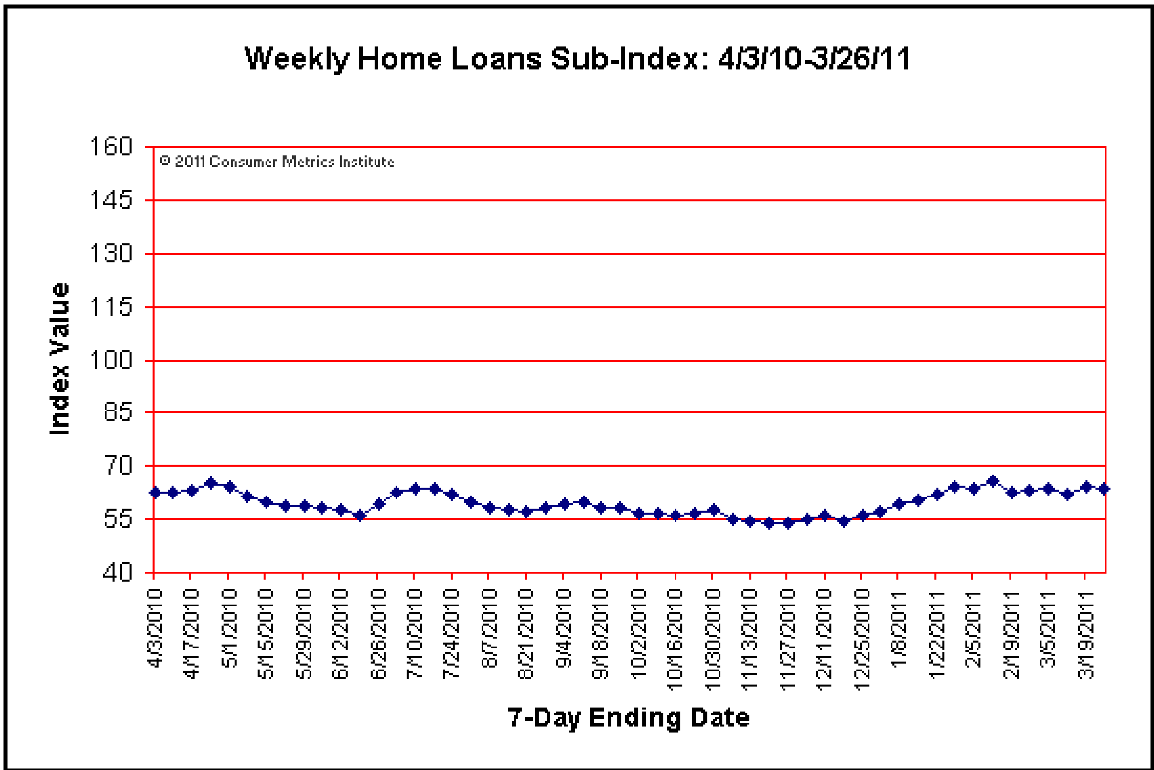
But consumer demands for Major Appliances remain as low as we have ever measured:



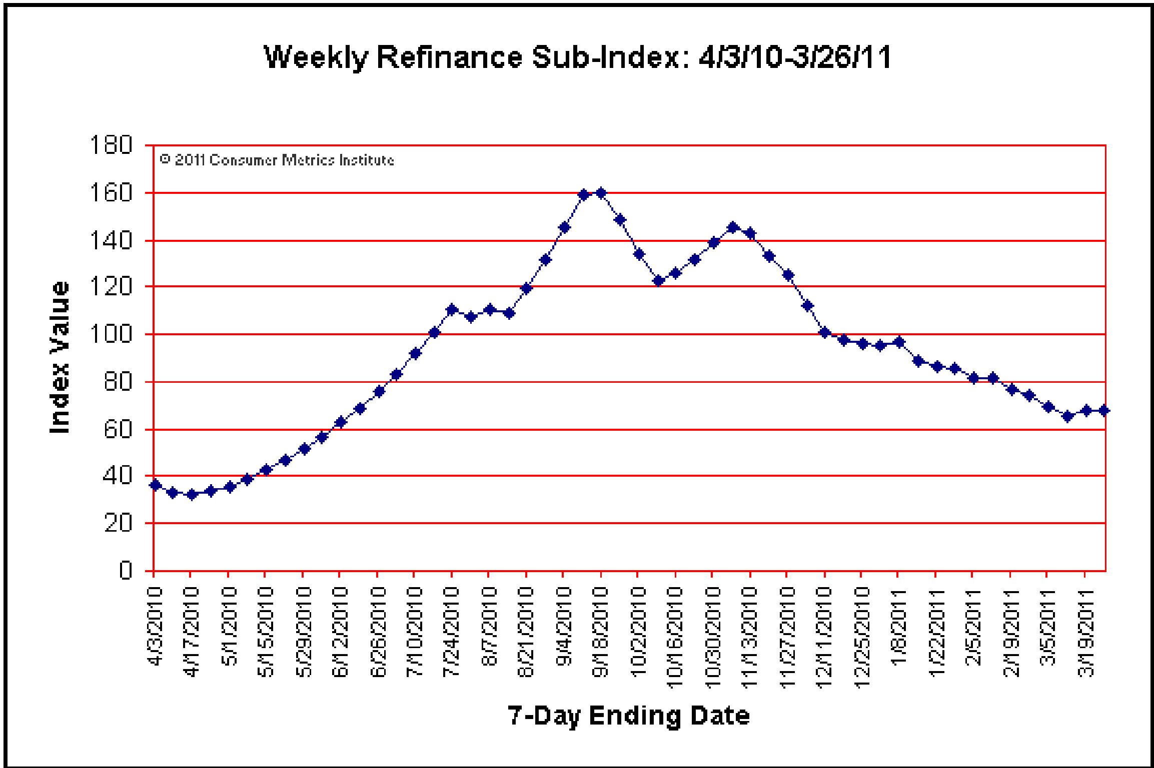
All of this stems from the historically poor market for new housing, with our data showing a 17% year-over-year slump in demand for new homes:



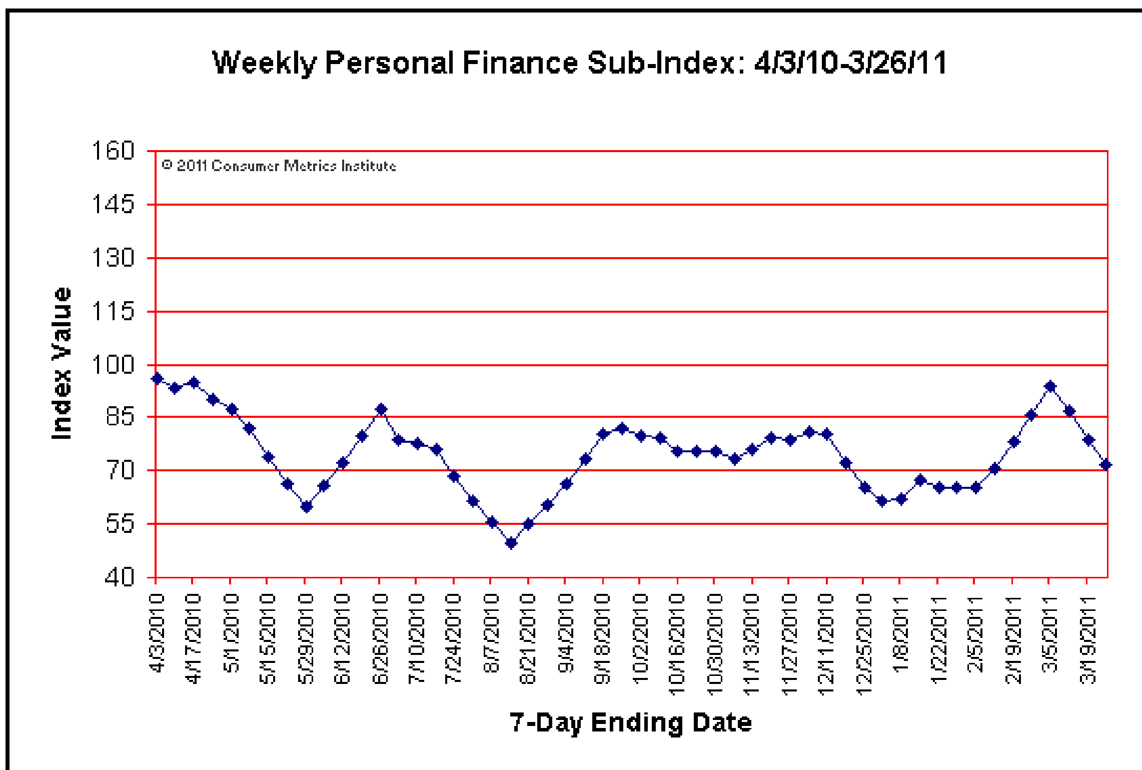
Although even that fails to capture the drop in demand for new loans for newly acquired primary residences:



And last year's surge in refinancing activities seems to have run its course, either as a consequence of rising rates or simple saturation -- most people who could both qualify for and afford refinancing activities have apparently already transacted:



And lastly, one of our favorite charts follows (inversely) consumer demand for products and services designed to assist them during loan defaulting and foreclosure processes. An increase in demand for such products will drive our Personal Finance sub-index down, while drops in the need for those goods and services will cause the index to move up. Historically, dips in this index have been a good leading indicator of increasing foreclosure activities, and over the past few weeks the index has once again turned down:



Japanese Wealth and GDP

Current estimates for the capital losses associated with the Sendai earthquake and tsunami are now about $310 billion (and still climbing), nearly 6% of Japan's 2010 nominal GDP. Meanwhile most financial pundits have focused almost exclusively on the impact of the event on the 2011 Japanese GDP, with many estimating that the production interruptions would only shave 2% (or less) off of annual production.

Even if you are skeptical about either of those numbers, the impact of the earthquake and tsunami on the Japanese GDP over 2011 seems instinctively small given the estimated monetary extent of the property damages suffered in the Miyagi and Fukashima Prefectures alone. The instinctive discrepancy offers a reminder that most headline economic data focuses obsessively on shorter term "production" concerns, often ignoring to a large extent the "wealth" issues that may matter only in the longer run.

Most investors know that you cannot judge a company solely by its operating statement. The strength of its balance sheet is also a relevant (if not arguably more important) part of the analysis. By loose analogy, Japan's GDP is the country's operating statement -- where the impact of the disaster will only be measured in lost productivity caused by supply chain interruptions and the manageable production losses from coastal farms, fishing fleets and power plants. Lives, homes and capital tragically washed away simply do not factor in the GDP equations. And, unlike GAAP prepared operating statements, a country's GDP never "recognizes" through charge-offs the losses suffered by the country's capital base -- except to the extent that those losses directly reduce ongoing production.

And at a more human level, disasters such as the Sendai Tsunami or Hurricane Katrina damage the wealth of ordinary (but unfortunate) citizens far more than they damage the productive capacity of corporations or the entire country. Ironically, even if the Japanese Government fully replaced the property of the surviving citizens through new bond funded construction projects, the long term economic impact would actually amount to a boosted GDP by virtue of increased deficit spending.

This brings us back to Claude Frédéric Bastiat's parable of the broken window. In 1850 Bastiat published an essay containing an economic parable that illustrated the hidden costs associated with the loss of property. Bastiat imagined a situation where a shopkeeper's son carelessly breaks a window in the shop. The fallacy centers on subsequent comments by onlookers -- who offered that "it is an ill wind that blows nobody good. Everybody must live, and what would become of the glaziers if panes of glass were never broken?" The onlookers (and production obsessed measures such as the GDP) focus on the glazier's increased commerce.

Bastiat asserted that the onlookers completely missed the macro-economic loss of the previously productive window -- that ultimately the economy is net poorer by the amount of the capital lost when the window was broken. Unfortunately most headline economic data suffers from the same myopic view of the economy as Bastiat's onlookers -- seeing as the only losses those sales missed by the shopkeeper while the glazier's crew does their work.

Simply put, Japan is poorer by virtue of the earthquake and tsunami than will ever be reflected in its GDP.

Our real point in this discussion is that any obsessive focus on GDP fails to capture the complete economic condition of any country. Most investors would be cautious about investing in a corporation that creates modest operating statement growth at the cost of vastly increased debt. Why should that not also be true for countries?

The governments that are dealing with the consequences of Sendai or Katrina have borrowing options and underlying strengths that were not available to Haiti. They can follow Keynesian prescriptions for recovery knowing full well that their country's GDP will never fully recognize the assets lost -- let alone the new debt assumed or the inflationary impact of "injected" liquidity.

Transparent GAAP style reporting is essential to maintaining fiduciary responsibility in banking management. Why should we require less of a "central bank" that is managing nothing short of an entire economy?

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