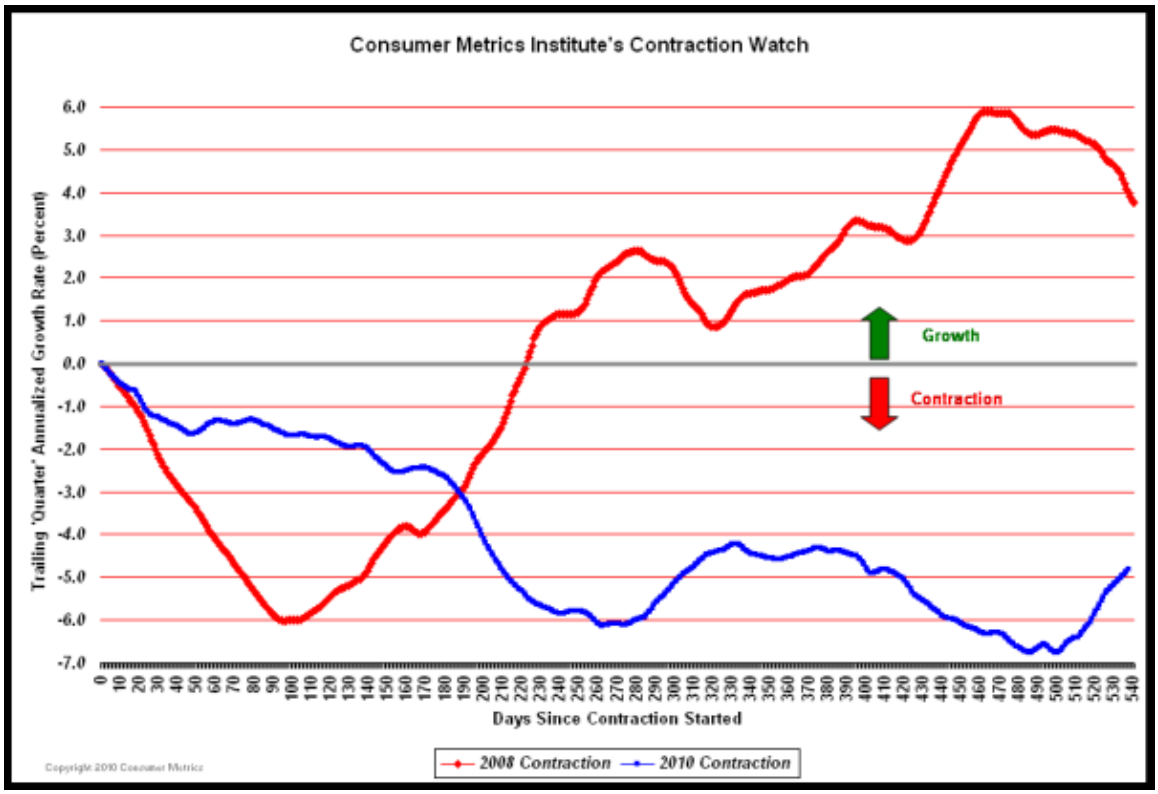
Consumer Metrics Institute Members News

July 2, 2011: Upturn in Daily Growth Index; Stimulating Despite Demographic Dilemmas

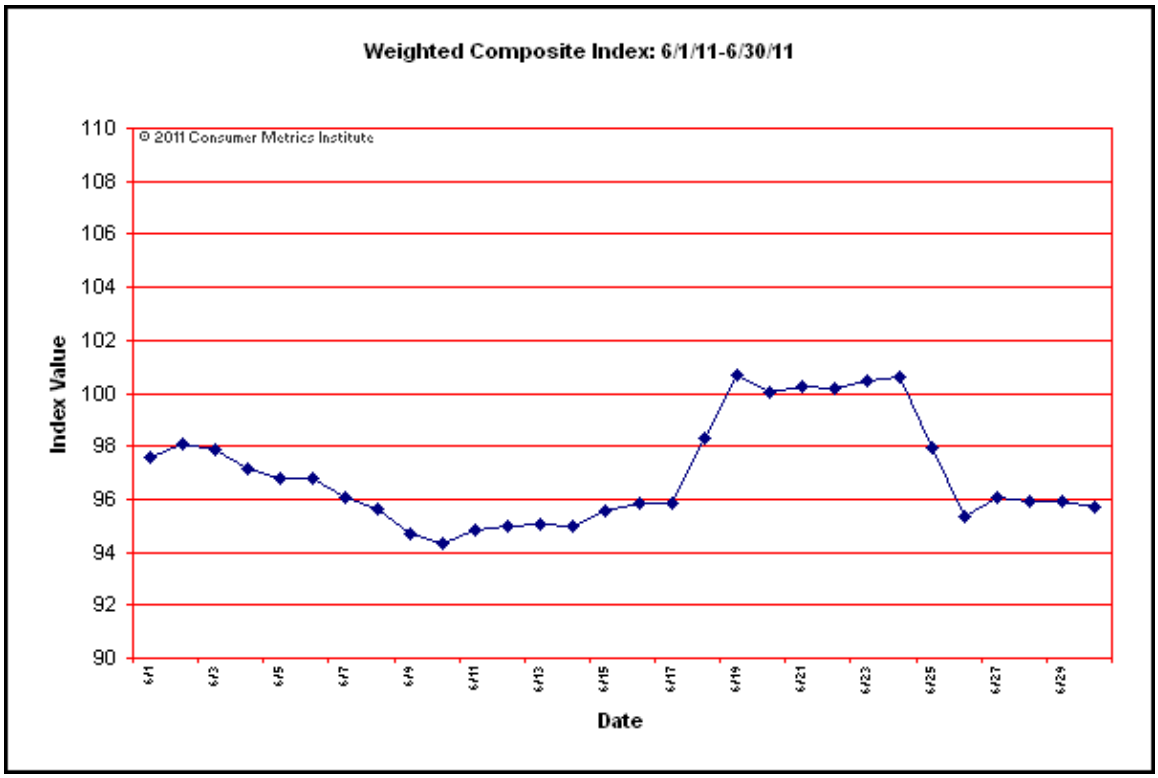
Our Daily Growth Index has now moved well off the historically low bottom that it reached roughly a month ago:



The above chart follows the course of our Daily Growth Index (actually just a 91-day moving average of the Weighted Composite Index, converted from the base 100 index to a +/- percentage) since that index first went into contraction (on January 15, 2010 -- over 530 days ago). The chart also shows what the Daily Growth Index was doing during the consumer contraction that occurred within the formally defined "Great Recession" of 2008-2009. The progress of each event is recorded as a track of Daily Growth Index values commencing on the left margin on the date that the index first went into contraction.

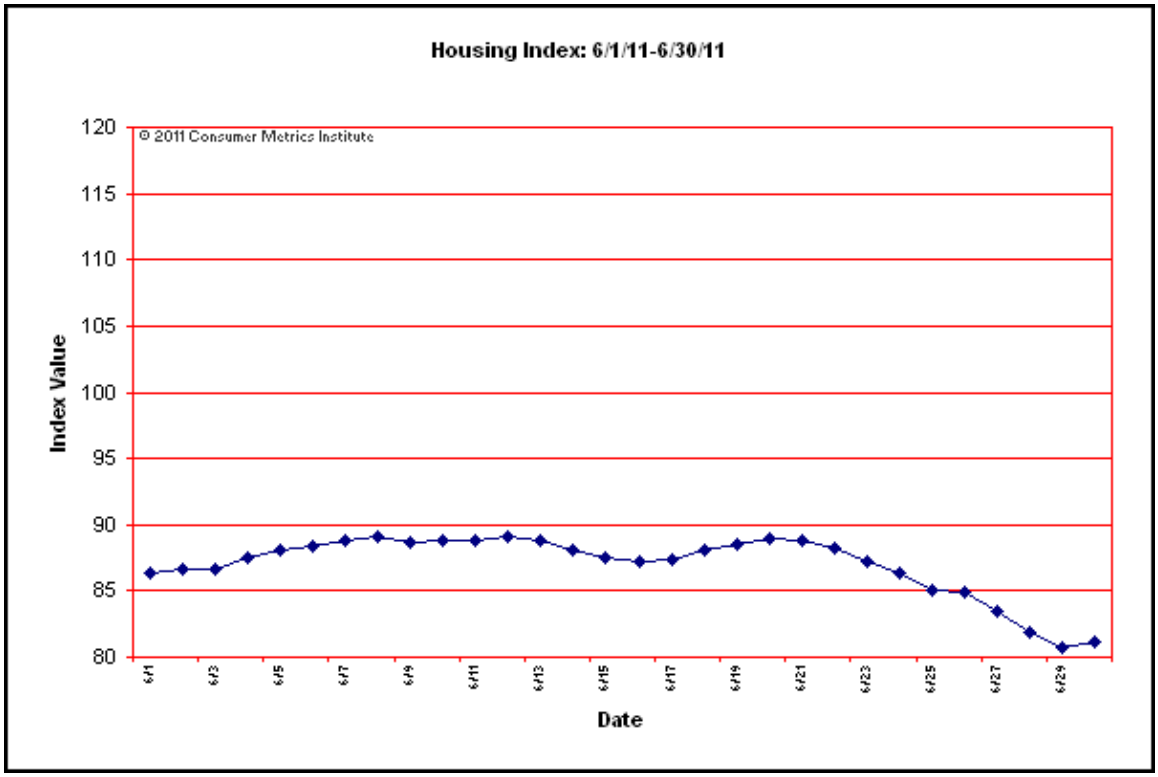
Although the recent movement of the Daily Growth Index has been encouraging, the key is whether it will continue to rise or whether it will plateau in the -3% to -5% range -- which based on the recent past may be more likely. If nothing else, this contraction has been protracted. And "bottom bouncing" aside, we would like to see some substantial and sustained year-over-year increases in on-line consumer demand for durable goods before we declare that the end of that contraction is nigh.

The good news is that our Weighted Composite Index momentarily broke into positive territory, briefly showing day-to-day expansion of consumer demand on a year-over-year basis**:**

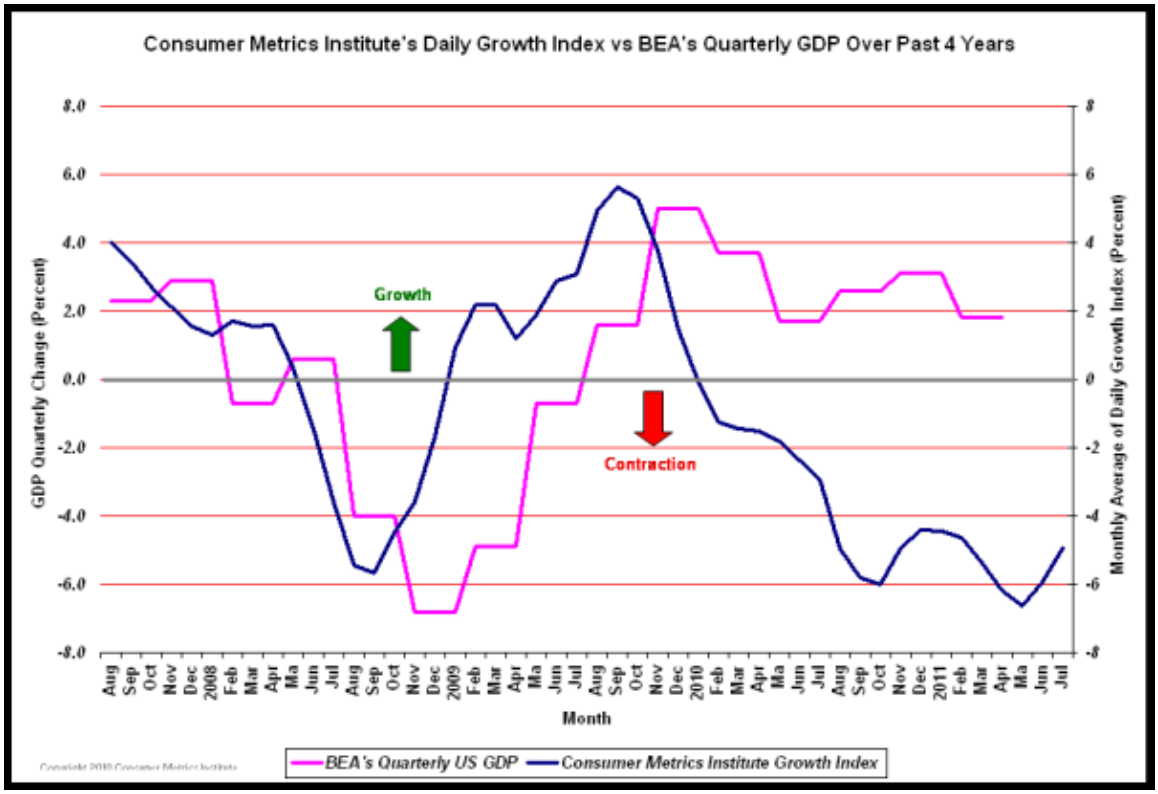


The bad news is that it just as quickly receded to levels consistent with a longer term plateau of contraction in on-line consumer demand in excess of -3%. But that upward blip did manage to break a string of 413 consecutive days of day-to-day contraction in year-over-year demand. For the record, our Daily Growth Index (which includes the smoothing of a 91-day moving average) has now been steadily contracting for 531 days, or nearly 6 consecutive quarters.

The upward blip was caused in large part by a temporary strengthening of the year-over-year data in our Housing sector, which benefited from year-over-year comparisons to periods immediately following the expiration of new home buying incentives. We have now cycled past those favorable comparisons**:**



The important thing is to keep all of this in perspective, especially as we face the expiration of the Federal fiscal and monetary stimuli that have to some extent levitated the GDP even as "Main Street" consumers have been retrenching**:**



Stimulating Despite Demographic Dilemmas

(In a number of recent articles we have explored potential "unthinkable" solutions to both the U.S. sovereign debt problem and the fiscal consequences of a suddenly balanced U.S. Federal budget -- given that a balanced budget would suck about 14% out of the country's GDP, meeting the clinical definition of a depression. We discussed the historical backdrop to sovereign debt end-games, and solutions possible without major regime change, others requiring modest regime change, yet more that involve radical regime changes, one that uses regime change to de-securitize the mortgage industry, another that would selectively stimulate "Main Street" America, still another that would stimulate the economy through genuine reform to the health care industry, one that addressed the costs within the higher education "industry" and the impact that growing student loan debt and defaults are having on U.S. economic growth, and most recently ideas that would address excessive regulation. As a point of reference we have used the report from the Simpson-Bowles commission as a sample framework for how to balance the budget, and have assumed that to prevent a Simpson-Bowles induced depression some form of non-fiscal stimulus would be needed that could provide excess growth to the U.S. economy on the order of 3% per annum over 5 or more years.)

We have been trying to identify strategies that could stimulate growth in the U.S. economy without resorting to additional deficit spending. Part of that effort involves recognizing that the U.S. today faces demographic, cultural and social challenges that will hamper any such attempts to stimulate growth -- challenges that include many of the same forces that have created "lost decades" in Japan.

We have previously made the politically incorrect observation that the U.S. economy has historically grown fastest when massive immigration, strip mines, smoke-belching factories, chemically enhanced agriculture, child labor and familial elder-care were normal and encouraged. Subsequent to those epochs of growth, the U.S. consciously shifted the nation's priorities between unbridled economic growth on the one hand, and environmental and social progress on the other -- resulting in a balance considered "more appropriate" for an enlightened and wealthy nation at the end of the twentieth century.

The tough question is simply this**:** are we still so wealthy that we can afford to be so enlightened?

In fact, an aging, post-industrial, "financialized," liberal, humane and environmentally responsible society may be a very poor scenario for the kind of strong economic growth necessary to painlessly avoid (or recover from) a Simpson-Bowles triggered depression. (It would also have been completely foreign to the experiences of the 1930's and 1940's that provided the framework for the economic theories of John Maynard Keynes.)

The Demographic Dilemma

As a case in point, consider only the demographic dilemma posed by the "Baby Boomers"**:**

-- The economic growth provided over the past 30 years by the 19 year-long cohort of Baby Boomers has been well documented (including the extensive work done by Harry S. Dent). But that spending likely peaked about 2003. Once retired, those 78 million Americans will largely abandon their former free-spending ways in favor of more age-appropriate frugality. End-consumer demand will inevitably be impacted.

-- Although the spending impact of Baby Boomer demographics has been thoroughly documented, the impact of their demographics on the flow of funds to and from the capital markets has been more difficult to quantify. According to the Census Bureau, "Boomers" headed about 31.5 million households with a gross wealth of about 1.75 times the annual GDP ($25.7 trillion in 2007 dollars). And more than $14.3 trillion of that wealth was in "financial assets" (i.e., not residences or other physical property), slightly more than the annual GDP for 2007. Assuming that those financial assets were acquired over a 20 year time span, the annual purchases alone would have created a sustained net buying bias to the financial markets' supply/demand curves. Little wonder that the bulk of those two decades were accompanied by a secular bull market.

Now that bias should start to reverse, with as much as the equivalent of 6% of the total S&P 500 market capitalization being sucked out of the capital markets each and every year. Unless "Generation X" is able to offset that capital draw-down, a net selling bias will now start to adversely impact the same supply/demand curves within the financial markets -- again for as long as a couple of decades.

-- Health-Care spending will increase as a percentage of GDP. Health-Care has become a capital intensive and arguably highly inefficient domestic services business, providing relatively low velocities for the monies spent and no measurable foreign exchange. Health-Care spending is actually a poor candidate for the stimulation of anything but Health-Care.

-- And although there will be many job opportunities created as the Baby Boomers retire from the

workplace, the loss of their experience (and the on-job training required by their replacements) will at least temporarily reduce the overall net efficiency of the economy.

In short, the U.S. is clearly an "aging" society that will be incurring direct economic drag merely as a result of the demographics of the "Baby Boom" generation.

(Incidentally, just this past March the Federal Reserve's Elizabeth A. Duke drew attention to the impact that the "financial crisis" was having on the spending behaviors of the "Baby Boomers," with the general conclusion that their nervousness about their future financial prospects has been a major contributing factor to the weakness of the "recovery". According to Ms. Duke: "The baby-boom generation, by virtue of its sheer size, has had an outsized influence on the economy as it has entered every stage in the life cycle, and its magnification of the preretirement effect is no exception. In addition, in 2007, this group held more than one-third of all household net worth." But by "2009, more than two-thirds of the preretirement group reported that their expected retirement age was at least a year later than what they reported in 2007. The share of families expecting to extend their working life was very similar regardless of their change in wealth. This likely suggests increased uncertainty about the future, no matter what their experience during the financial crisis, as also suggested by other results in the survey." Ms. Duke concluded that all "of this evidence may help explain the sharp drop in consumer spending as household wealth declined and the continued sluggishness of consumer spending even as asset values have recovered.")

The Cause

At least one major cause of the demographic dilemma is easy to understand: a declining national birthrate. According to the National Center for Health Statistics' Vital Statistics of the United States the number of live births per thousand in the United States has declined from over 30 per year in 1910 to somewhere near 14 today -- and that decrease was not on a straight line: the number dropped to 18.4 in depression-era 1936, rose to 26.6 during "baby boom" in 1947, and it reportedly recently plunged below 14 during the financial uncertainty of 2009. Fewer babies may be very good for the environment, and smaller families may provide women with liberalized career and social opportunities not available to their great-grandmothers. But the greatest attraction of smaller families is likely that they readily accommodate the improved lifestyle of a two wage-earner household. And this is not, by any means, exclusively a U.S. based phenomena: in fact, lower birthrates are considered one of the primary markers of a "developed" society and economy.

Some of the bad news lies in the longer-term demographics and the 1935 "fund-from-current-payrolls" model for Social Security:

-- In 1950, each retiree's Social Security benefit was funded by 16 active wage earners.

-- Currently, each retiree's Social Security benefit is being funded by approximately 2.8 U.S. workers (56 million beneficiaries and 158 million workers paying FICA taxes -- a ratio that is nearly one-half worker lower than what had been projected for 2011 only 5 years ago, another testament to the impact of recession induced "involuntary retirements" and declining workplace participation).

-- And it is currently anticipated that by 2025 there will be approximately two U.S. workers for each retiree.

(In fairness, the crux of the fiscal problem implied by the statistics above isn't demographic; the demographics merely exacerbate a social welfare and social insurance program whose liabilities have never been (even remotely) fully funded. There simply was no trust fund when the Social Security Act was signed into law on August 14, 1935. The first funding occurred through taxes collected in 1937, and the first monthly payments were issued on January 31, 1940. But actuarially sound payouts would never have been politically attractive, and as a consequence the actuaries were ignored: among the recipients of those first monthly stipends was Ida May Fuller, who paid a total of $24.75 into the trust fund but collected $22,888.92 by the time that she passed away at the age of 100. Ida is a classic example of the political bonanza enabled by the demographics of 1940 -- when only 222,488 beneficiaries were supported by over 50,000,000 workers (a 1:225 ratio) -- but her case also illustrates the fiduciary time bomb ticking away once the demographics inevitably turn.)

But, as mentioned above, old age pensions are just one part of the economic drag created by the demographic reality in the U.S. (and, indeed, in nearly all developed countries -- with the demographic consequences of China's 1978 "one child" policy having the real potential to derail the Chinese economic ascendancy long before the end of this century).

But, how can any nation "fix" its demographics? It is doubtful that most families would be willing to give up the lifestyle afforded by dual incomes, shorter child-rearing stages and fewer mouths (and college years) to feed. And even if families were willing to sacrifice their small-family lifestyle for the common good, a flood of new babies wouldn't positively impact net economic productivity for a full generation.

So, where are all the additional workers going to come from?

Importing Stimulation

Immigration is an enormously complex issue, fraught with both social and economic consequences. Additionally, it is one of the "third rails" of American politics. In an effort to provide a rational basis for policy making, in 1990 the U.S. Congress appointed a bipartisan commission to study the issue and make recommendations. In 1997 the National Research Council of the National Science Foundation released a report back to the commission entitled "The New Americans: Economic, Demographic, and Fiscal Effects of Immigration", a summary of which can be downloaded in PDF format. Although the report is now 14 years old (and focused to a large extent on the fiscal consequences of immigration on governments), some of the findings are worth noting and still resonate today:

-- "Using a basic economic model, with plausible assumptions, we show that immigration produces net economic gains for domestic residents ..."

-- "Immigration ... breaks the rigid link between domestic consumption and domestic production. From this perspective, the effects of immigration are comparable to those of international trade."

-- "In the long run ... immigrants can affect rates of economic growth only to the extent that they differ from the native-born -- if, for example, they arrive with a different mix of skills from those of native-born workers. (However, if the immigrants) come to be just like the native-born, then all that immigration does is augment the population and the scale of the economy; it does not change the rate of growth of income per capita."

-- "Immigrants arriving at ages 10 to 25 produce fiscal benefits for natives under most scenarios, whereas immigrants arriving in their late sixties generally impose a long-term fiscal burden. In fact, most immigrants tend to arrive at young working ages, which partly explains why the net fiscal impact of immigration is positive under most scenarios."

-- "The long-term fiscal impact of an immigrant also depends on his or her education: immigrants with more education have more positive long-term fiscal impacts. For example, under one set of plausible assumptions, the net present value of the fiscal impact of an immigrant with less than a high school education is -$13,000; in contrast, the net present value for an immigrant with more than a high school education is +$198,000."

Note that (per mid-1990's data) if the entire annual cohort of immigrants had more than a high school education, the net positive fiscal NPV of each annual cohort would be nearly 3% of GDP.

Social Skills

Quite apart from the economic and fiscal consequences of recent immigration, the report also addressed some of the general social concerns**:**

-- "The evidence points to the conclusion that immigration has had a relatively small adverse impact on the wage and employment opportunities of competing native groups."

-- "Even though recent new arrivals are better educated than their earlier counterparts, the education of the native-born has improved even more, so that the gap in skills, and thus in wages, has widened."

-- "Part of this growing wage gap may stem from the influx of illegal immigrants, who are generally more poorly educated, but it is not due exclusively to them. There is also evidence of widening in the gap among legal immigrants, brought about not only through shifts in their countries of origin, but also through changes in the composition of refugees and more severe limits on the entry of certain highly skilled immigrants (specifically, physicians)."

Reflecting back on U.S. economic growth rates from the first quarter of the 20th century, one addition observation caught our eye among all the data from the report**:**

-- "Moreover, since the resident population has more than tripled during the course of the twentieth century, the number of immigrants in the earlier decades represented a much higher proportion: 13 immigrants per 1,000 resident population in 1913, compared with 3 immigrants per 1,000 residents in 1994. However, immigration now plays a greater role in population growth than it did eight decades ago: it accounts for 37 percent of total growth, partly because of the decline in the fertility rates of residents."

This begs the sociological question of whether immigrants -- by virtue of their histories and thirsts for greater opportunities -- have a somewhat edgier work ethic (and lower sense of entitlement) than their native-born peers, providing yet another demographic stimulus to the economy as at least a partial offset for the otherwise aging population.

The Bottom Line

Our final observation from the report is actually from their opening comments**:**

-- *"As long as there is a virtually unlimited supply of potential immigrants, the nation must make choices on how many to admit and who they should be."*

If those choices were to be made on the basis of economic and fiscal concerns alone, the desired profile of new immigrants might look something like this**:**

-- 18 to 30 years old;

-- College educated, with substantial proficiency in English;

-- Proven entrepreneurial skills;

-- And bringing with them financial reserves that can keep them worst-case self-sufficient in the U.S. for at least 5 years.

If we were to permanently remove all quotas on potential immigrants that meet the above criteria, we might not only stimulate the economy over the next decade, but we could gain some relief to our demographic dilemma a full generation earlier than any home grown solution could provide.

The rub? Policy choices issued from Washington are irrelevant if there is have little or no control at Tijuana or Juarez.
