# Consumer Metrics Institute Members News

## July 20, 2012: The Economic Cost of Ugly Politics

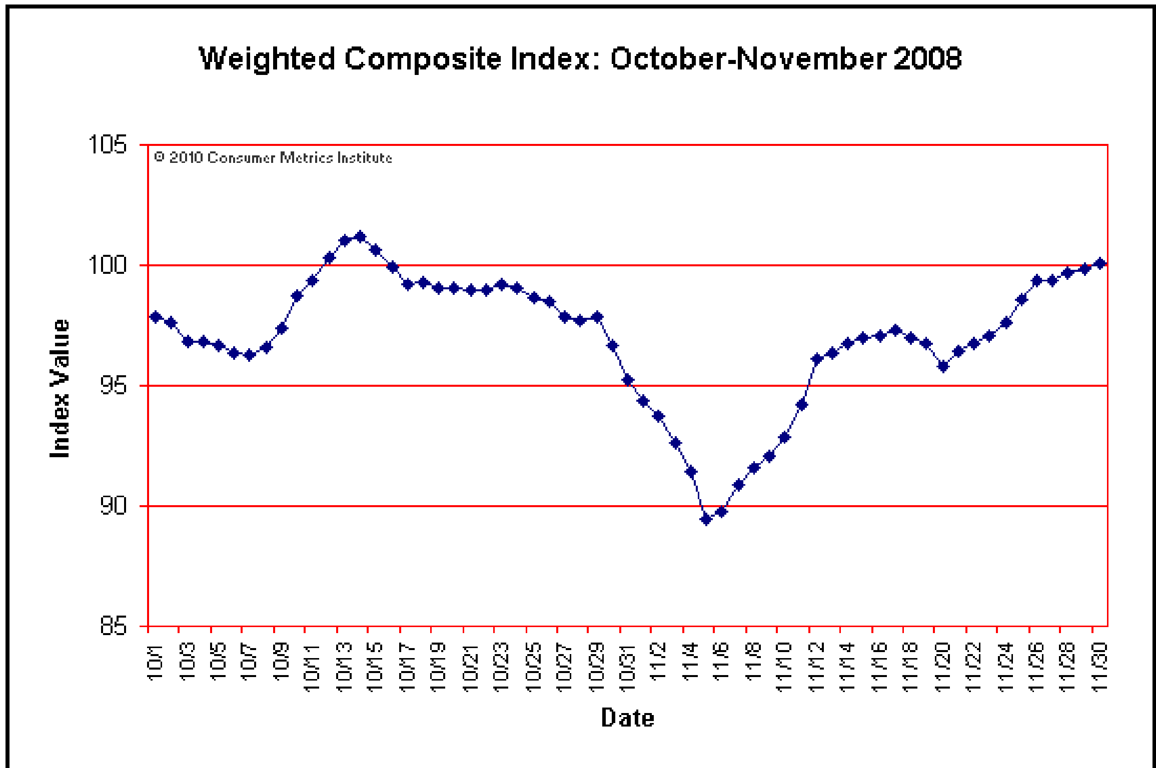
(Web page version is here)

Here at the Consumer Metrics Institute our "thing" is on-line consumer behavior. That is what we measure. That is what we report. And, as a consequence of our peculiar form of economic tunnel vision, that is how we view and interpret macro-economic phenomena -- such as the Great Recession of 2008-2009 ("GR-2008").

Our unique vision has both pros and cons. The principal strength is that our data has a daily resolution. The principal weakness is that internet transactions typically include only discretionary durable goods, intellectual property and financial products -- and not groceries, gasoline, utilities, taxes, roads or aircraft carriers. But the flip side of that "weakness" is that consumer discretionary expenditures are among the very best (and earliest) signals of organic growth or contraction in the economy.

We also believe that our data more closely tracks the plight of "Main Street" commerce than any of the questionnaire based surveys cranked out by Washington -- the establishment data containing strong sampling biases and over-represent the elite top-500 firms that have global access to vast monetary resources (at low or arguably negative real interest rates) that "Main Street" entrepreneurs can only dream about.

Yet our timeliness is likely our most unique quality. And because of our daily data resolution, we have always thought that the commonly understood root causes for GR-2008 (the 2007-2008 banking crisis, crashing home prices and soaring unemployment) fail to explain with any precision the timing profile of the behavioral changes that we observed for our on-line consumers during GR-2008. For example, the conventional explanations of GR-2008 can't explain the timing within the following data set**:**

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The above chart traces our day by day measurements of on-line US consumer behavior for October and November 2008. Even an extra-terrestrial economist might conclude from that chart that something significant happened during the first week of November 2008 -- with an apparent morning-after on Wednesday November 5th representing the culmination of some sort of economic shock that bottomed at a year-over-year contraction rate of more than 10%. The consequences of this economic shock would show up in earnings reports during 1Q-2009 -- some months after the fact (and some months after consumer behavior had actually started to rebound). But our extra-terrestrial economist would have problems attributing that chart's dramatic behavior to any of the conventional explanations of GR-2008.

We believe that the timing profile of our on-line consumer behavior tells us much about the proximal causes of the "Main Street" portion of GR-2008. Those proximal causes probably were **not:**

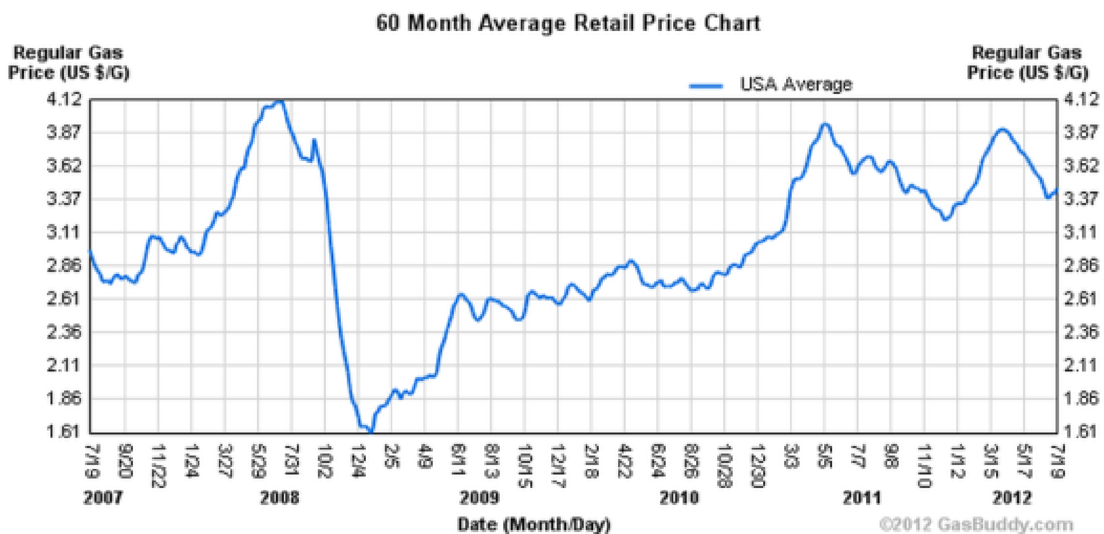
-- The 2007-2008 "Financial Crisis", which made for interesting reading but was largely irrelevant to "Main Street" commerce.

-- The "crash" in home prices, which from our perspective unfolded at a nearly glacial pace. After home prices peaked during the summer of 2006 the slope of the subsequent decline steepened until it reached a 19% year-over-year deflation rate in January 2009, some 30 months later. Clearly "Main Street" was severely damaged by the loss of construction activities -- whether those activities were building new housing or "flipping" resale opportunities. But the timing of those losses cannot explain the rebound in consumer on-line discretionary activities evident in the chart above -- which occurred at the peak of the home price "crash" and continued into August 2009.

-- Soaring unemployment, which was still a very new and very mild phenomenon in 2008. The U-3 headline number had been only 4.9% when published in March of 2008 (for February), and the last published number prior to the election was "only" 6.1% (released on October 3rd and covering September 2008) -- admittedly a sharp rise of 1.2% since the prior March, but still modest and less than a quarter of the way to the 10% recorded in October 2009. Again, we don't underestimate the impact of unemployment on the spending psyche of the US consumer -- but we just can't reconcile the timing of the unemployment mess with the behavior of on-line consumers (at least until deleveraging set in in earnest in late 2009).

But we feel that the proximal causes for changed consumer behavior in 2008 likely **did** include**:**

-- Rapidly dropping energy prices. Thanks to the terrific historical data at GasBuddy.com, we can find a chart that actually explains the timing of the late-2008 surge in consumer demand**:**

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-- But by far the best explanation for the day-by-day timing of the spending turn shown in the top chart above was the overnight resolution of the political uncertainty that had preoccupied US consumers since the summer of 2008. Even in its most innocuous form, political drama can provoke uncertainty and promote fear of the unknown. But it is also an inescapable distraction from normal commerce -- an unfolding train-wreck that nobody can ignore.

Unfortunately the only "Main Street" entities that benefit from heavy campaign spending are the local media outlets. Furthermore, that spending largely crowds out normal commercials for the stuff people actually buy. In fact we could argue that the loss of normal advertising exposure alone might account for a significant share of the pre-election economic swoon. It is no coincidence that the nadir of our consumer economic activity during GR-2008 occurred on Wednesday, November 5, 2008 -- the "day after."

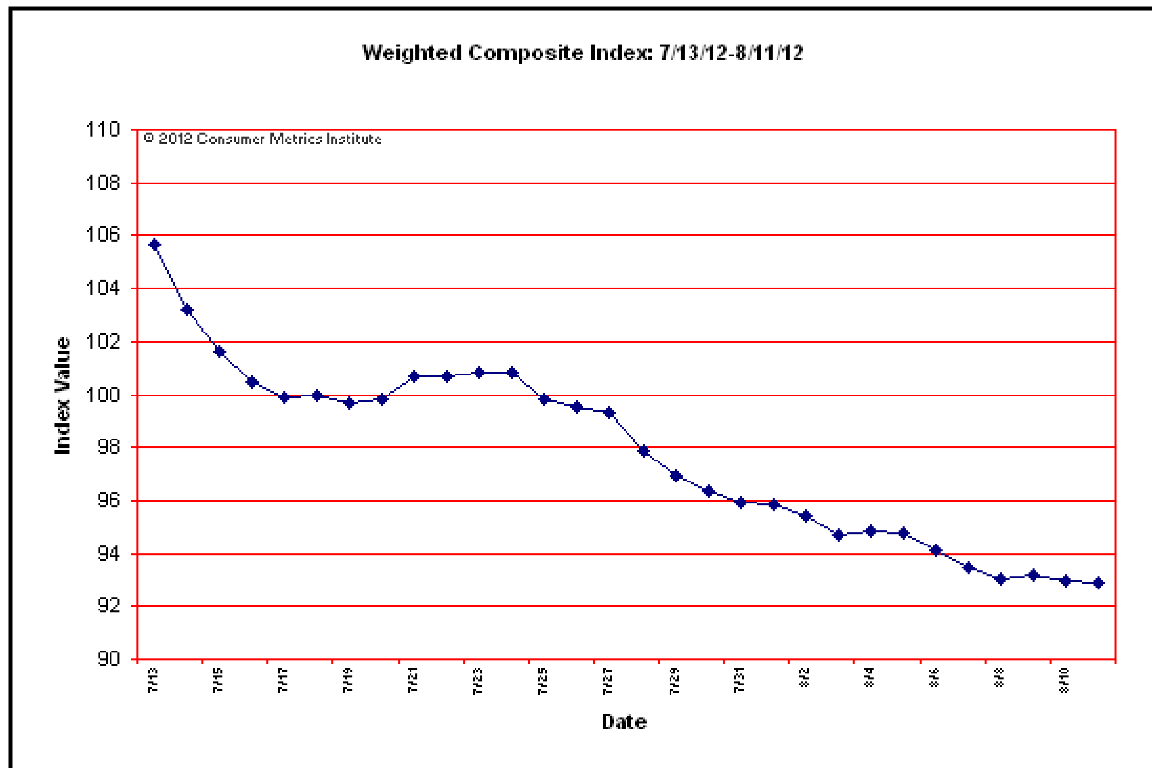
Sadly, this time around the situation is likely far worse. Energy prices are not plummeting like they were in 2008, and the campaign spending has ramped up earlier and with a viciousness not seen in recent memory. And the tone of the ads will hardly promote consumer confidence in either the economy or the nation's leadership.

We understand that the economy is a necessary focus for this election. But from the uncivil tone of the current rhetoric and its impact on the consumer psyche, we believe that the consequences of this especially virulent campaign will be negative for the economy in the third and fourth quarters -- in ways not generally recognized and utterly unrelated to (and compounding) the already worsening macro economic picture in the US and overseas. This election cycle will produce at best a Pyrrhic victory for the rank-and-file supporters of the winning candidate -- and in fact producing a big win only for the deep pockets that were fully enabled by "Citizens United v. FEC."

Perhaps Mercutio said it best**:** "A plague on both your houses!"

**Chart Updates**

We have long expected that during July our "Weighted Composite Index" would drop back into more normal territory. In fact, on July 17th the index dropped very slightly below the nominal 100 "zero year-to-year growth" level for the first time in over a year (since July 10th, 2011)**:**

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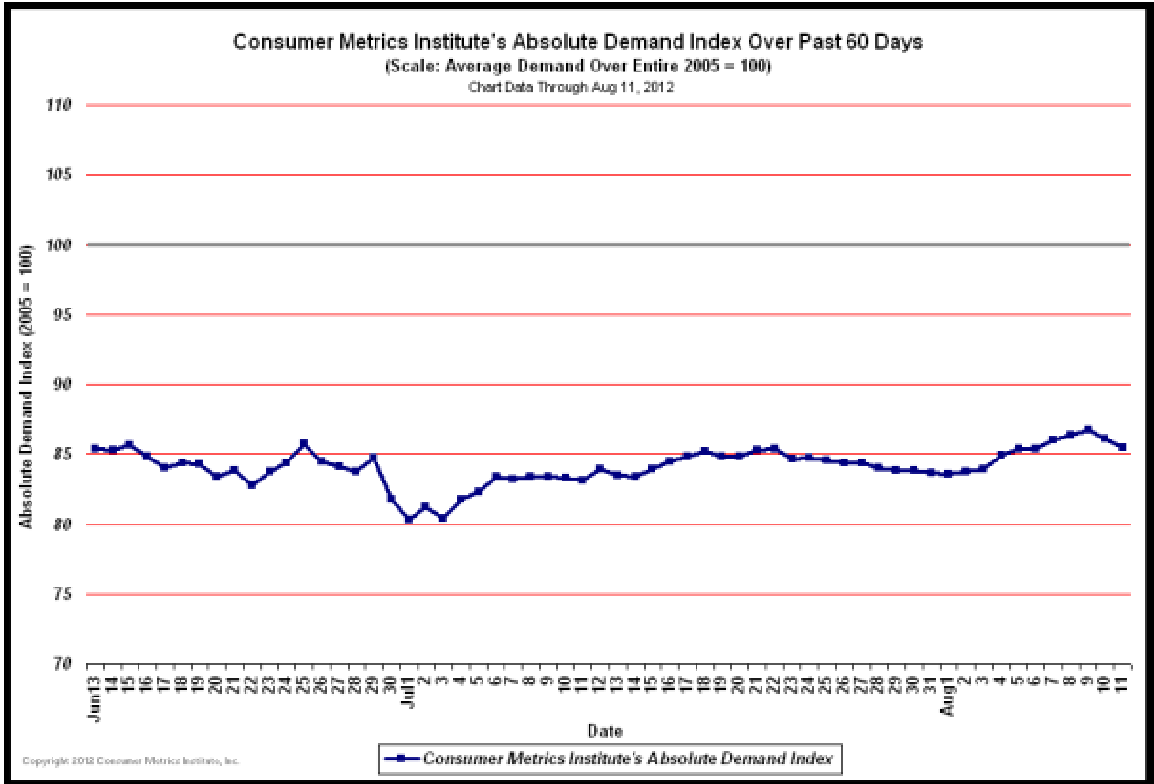
Since our base data is year-over-year, this drop does not necessarily represent a significant weakening of real-time demand -- and in this case the drop results primarily from poorer comparisons relative to strengthening year-ago demand. We have realized the difficulty in envisioning the implications of year-over-year metrics for some time, and as a consequence we developed our "Absolute Demand Index" to reflect the compounded effect of the year-over-year data**:**

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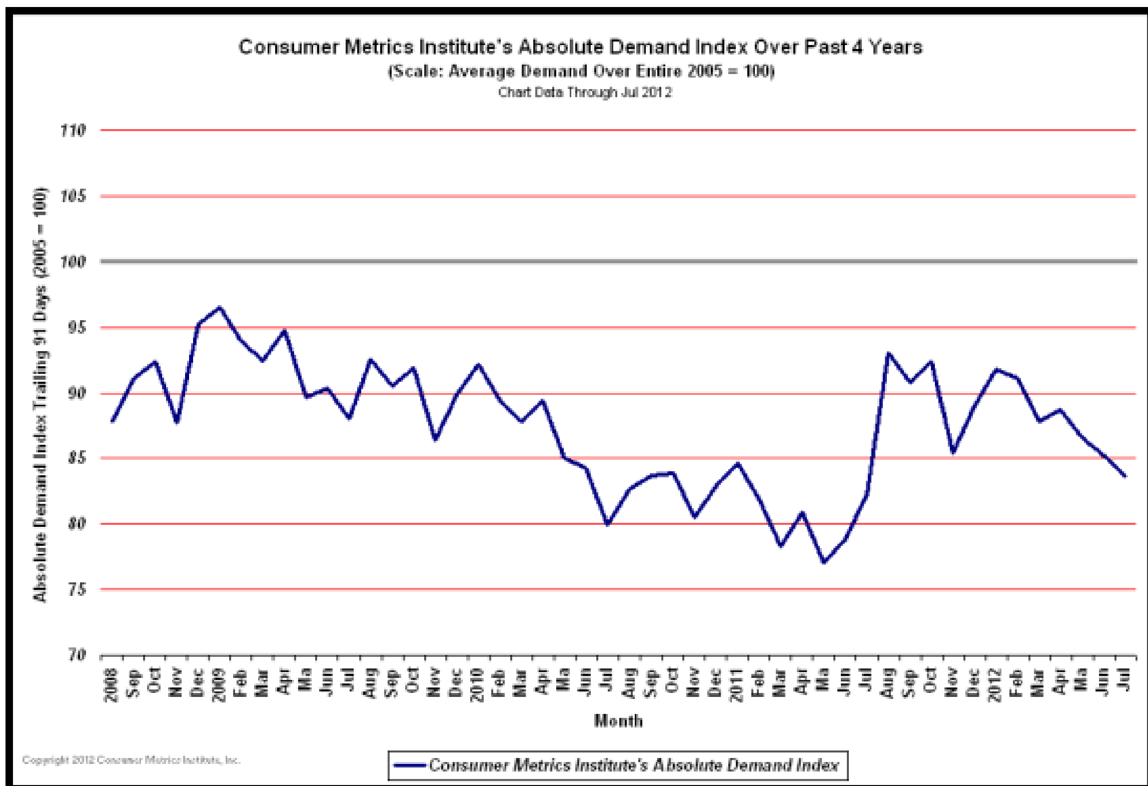
This chart for the past 60 days shows that in fact the "absolute" on-line consumer demand for discretionary durable goods has been gently rising during July, but it remains at levels about 15% below the levels experienced during the height of the housing mania in 2005. However, a look at our Absolute Demand Index over the past four years can give you a sense of why our year-over-year data had been so positive until the past week**:**



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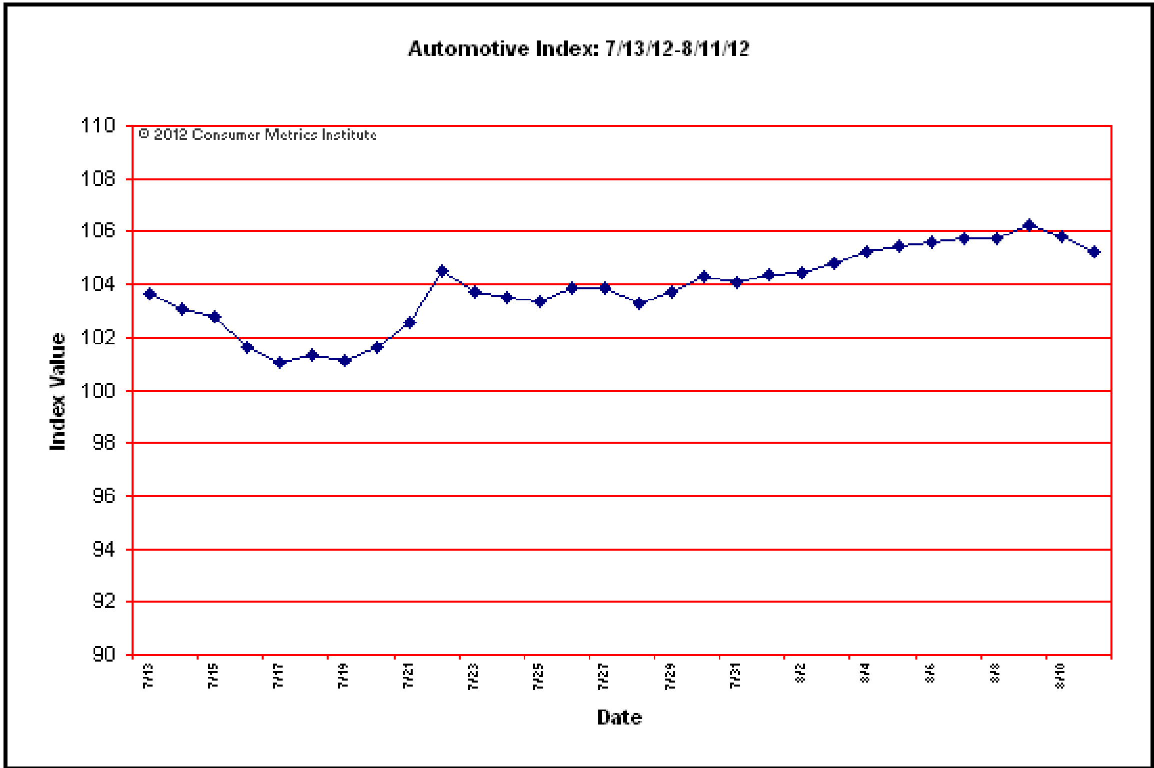
And for those of you who were paying attention to the gasoline price chart from GasBuddy.com above, you have probably already noticed that the May 2011 plunge of our measured demand coincides nicely with the May 5, 2011 peak in gas prices. It is the recovery from that plunge in activity that had generated the past year's favorable comparisons in our year-over-year data, which are just now ending.

Even our Automotive Index has returned to earth during the past week after spending the last quarter in rarefied air**:**

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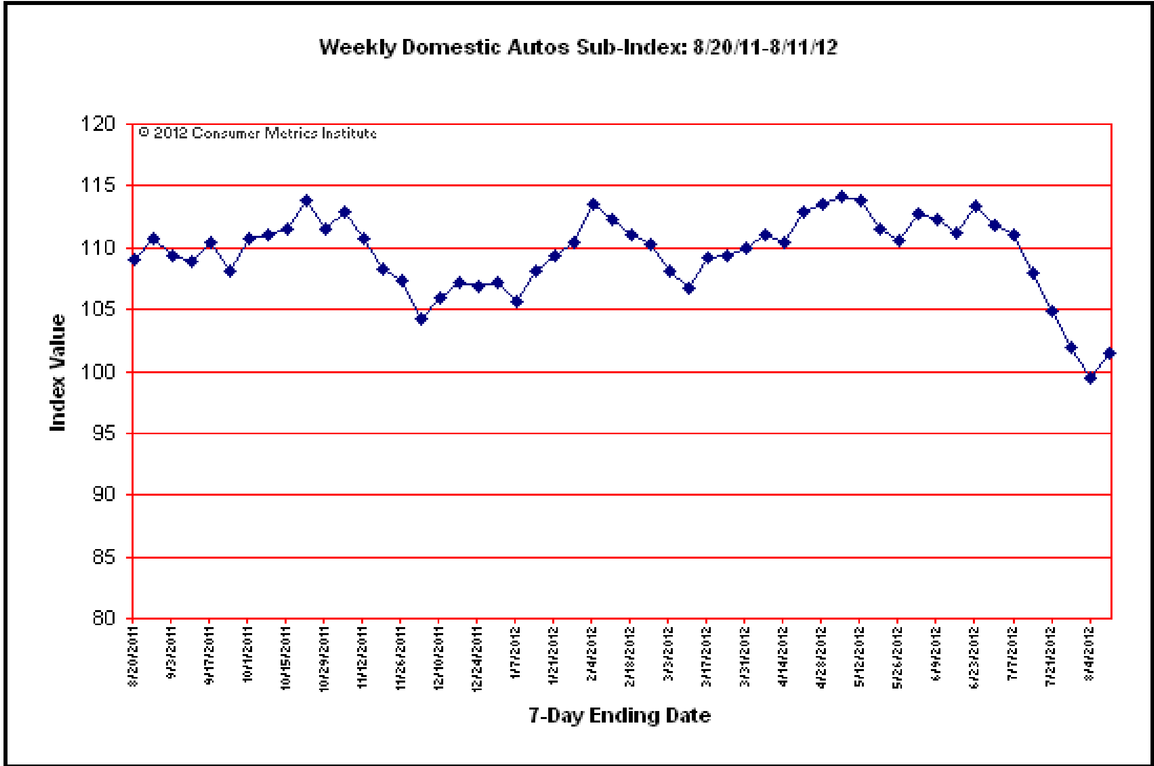
And the above drop is the net impact of shifting fortunes among the various brands of autos (and their sourcing nations). In particular, when compared to the US Domestic car brands**:**



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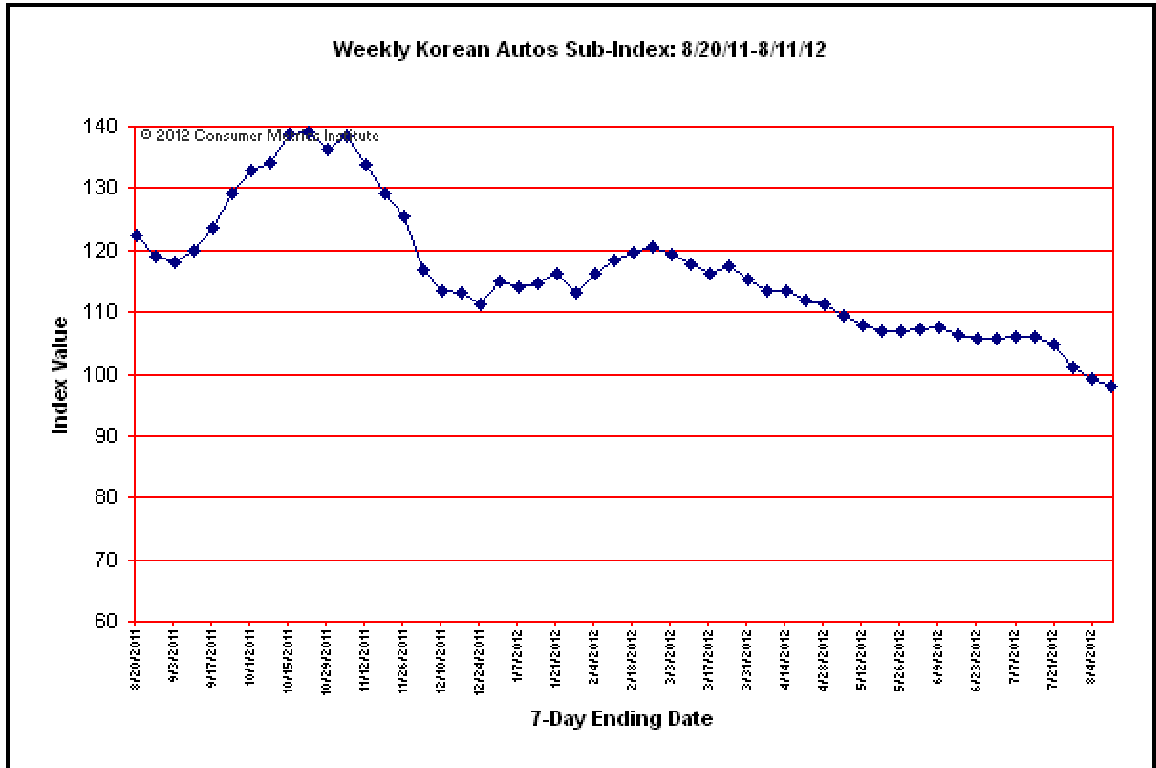
the Korean brands have had their recent historically greater year-over-year growth rates subside to about the industry average**:**

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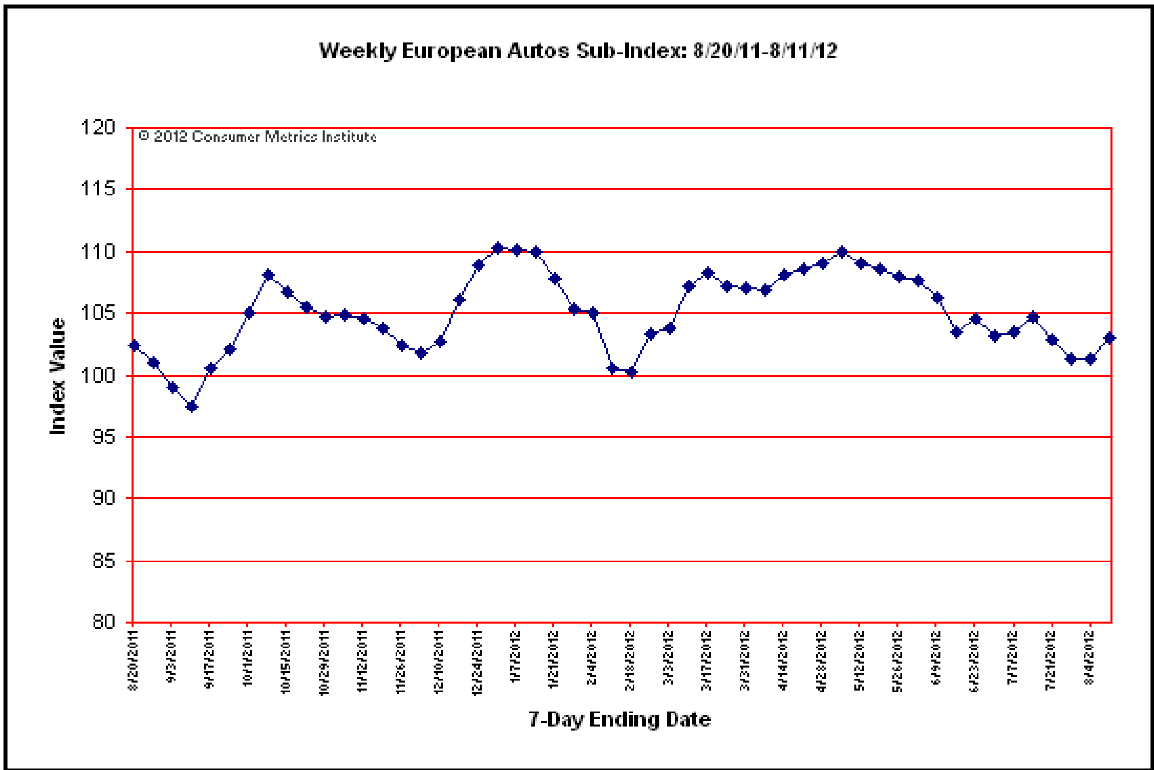
which is also about where the European brands**:**

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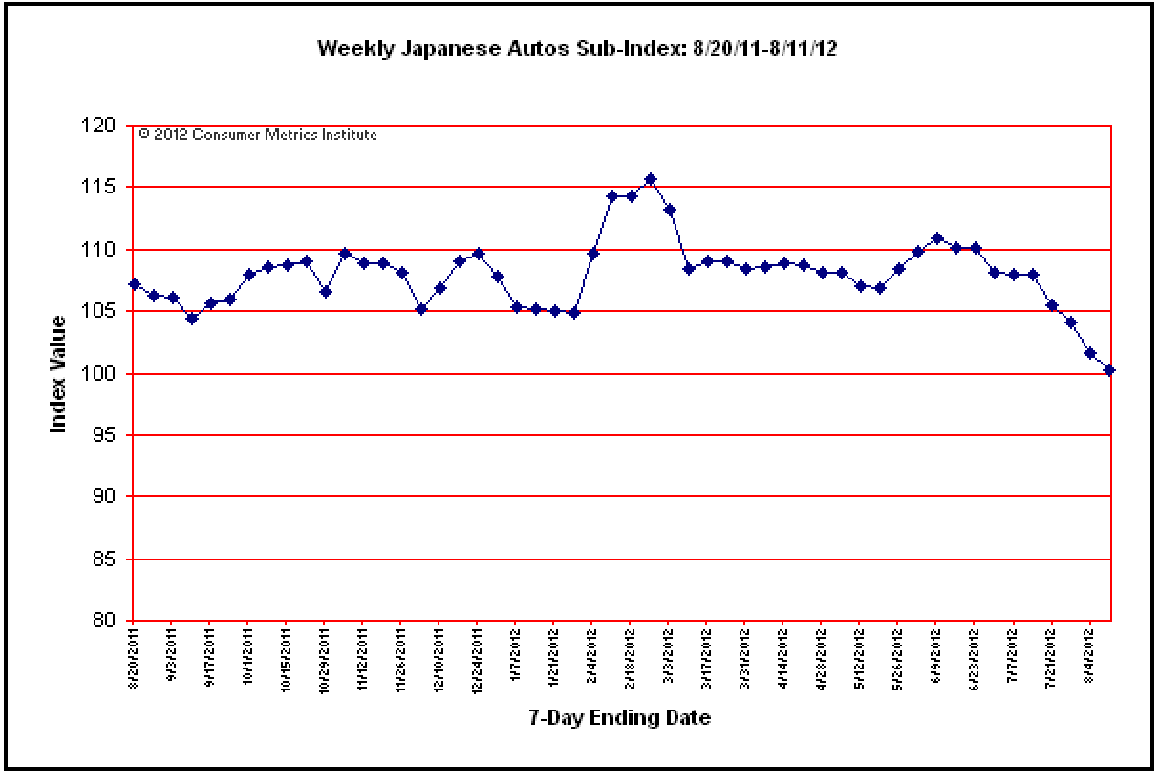
and the Japanese brands have also settled**:**

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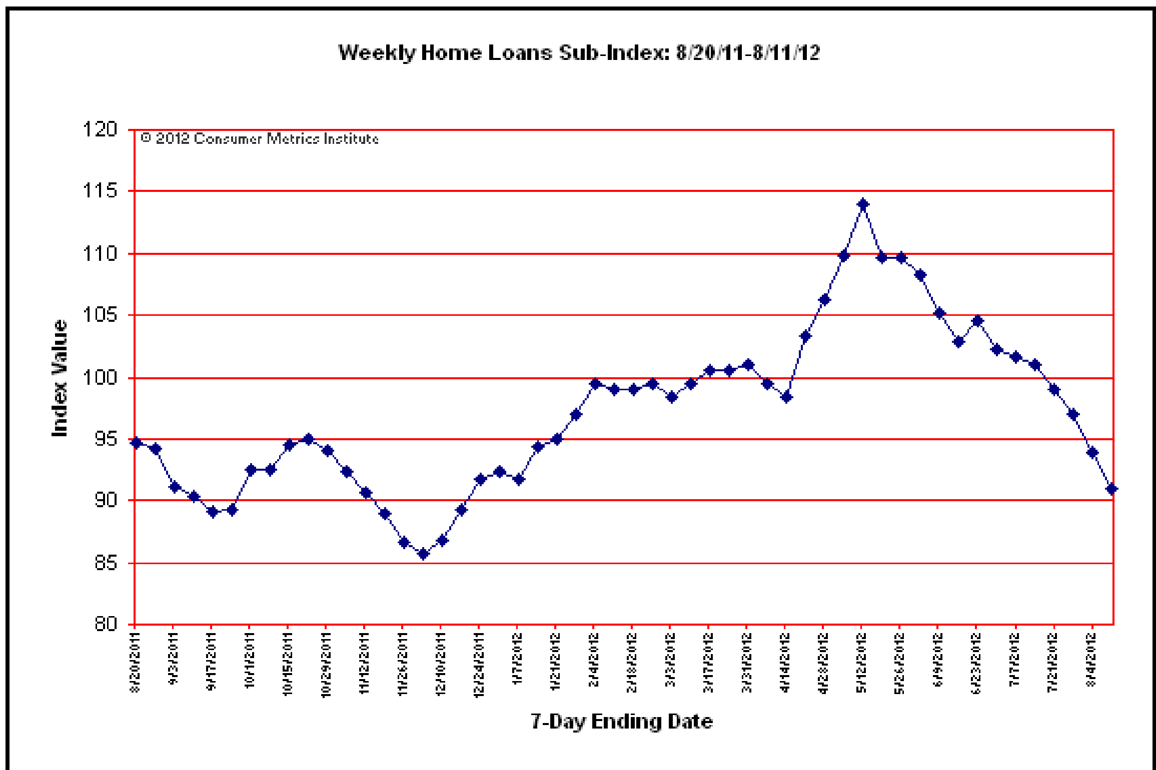
It would seem from the above charts that the recent historic pattern of selective regional or national competitive advantages has evaporated, and the growth rates have reached some level of global equalization. And anyone looking for harbingers, the last time that we had this level of parity was in August 2008.

And lastly, we would be remiss if we didn't revisit our Housing charts. Loan activity for newly originated loans for newly purchased homes has rapidly fallen back to nearly zero growth level after experiencing a late-spring spike**:**

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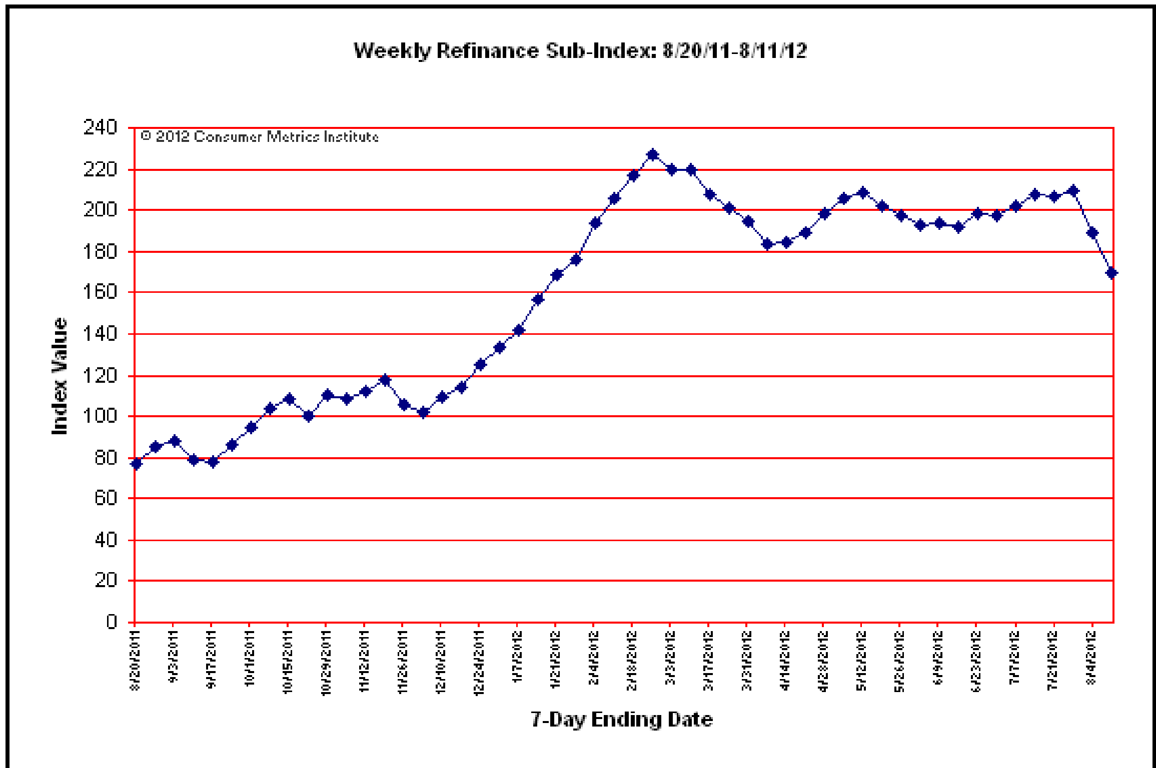
But refinancing activities remain strong, with consumer interest still running at about twice the levels seen last year**:**

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Historically low mortgage rates and a sense of a bottoming of home prices has likely fueled this trend. But this level has been sustained now for nearly six months, and soon the year-over-year comparisons must necessarily begin to weaken. And presumably there is also a bottom to the barrel of homeowners (with still favorable LTV ratios) who can qualify for refinancing (or who can still benefit from it enough to warrant the exercise). Our data, however, indicates that we clearly haven't reached the bottom of that barrel just yet.

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