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Volume 23, Number 6

March 12, 2014

The Liscio Report

On the Economy

For John Liscio 1949-2000

Big freeze in sales tax receipts

In February 45% of the states in our survey met or exceeded their forecasted sales tax collections, down from January's 57%, and the percentage reporting growth over the year slipped to 77% from January's 89%. The average rate of change also fell, to 2.7% fro January's 3.7%, and the margin below forecast widened to -3% from January's -0.9% (all averages weighted by state population).

• weather takes a toll on sales taxes, and on retail sales we presume as well

• financial review: household balance sheets improve, corporate ones don't

• time to worry about stocks?

• nifty new websites: labor market and prices

We heard repeatedly that the winter weather depressed sales, and business contacts suggested to state revenue officials that the weather really did have an impact. Also, receipts were strongest in southern and western states, and we continue to hear decent news from our contacts in most recovering housing states.

household incomes

It's been a while since we looked at the monthly series on median household income from Sentier Research. Sentier, formed by two Census Bureau alums, aims to come up with timely estimates of the annual household income figures that Census publishes every September for the previous year.

The series is graphed on the top of p. 3. (The most recent month available is December 2013; the January figures have been delayed by revisions to source data at the BLS.) Note that real income went essentially nowhere during the 2002–2007 expansion—but actually held up for a while during the Great Recession. But as the recession ended and recovery kicked in, incomes fell, and fell hard. From the peak in January 2008 through the trough in August 2011, real household income fell by 10.3%. It's since risen by a mere 2.4% (total, not annual rate), leaving it 8.2% below where it was at the peak.

Really, when you look at this graph,

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you have to wonder how retail sales have managed to recover from their recessionary depths.

financial report

It's time for our quarterly review of the Federal Reserve data series formerly known as the flow of funds—a name we just can't shake—and now called the financial accounts of the U.S. Highlights:

• households balance sheets continue to improve

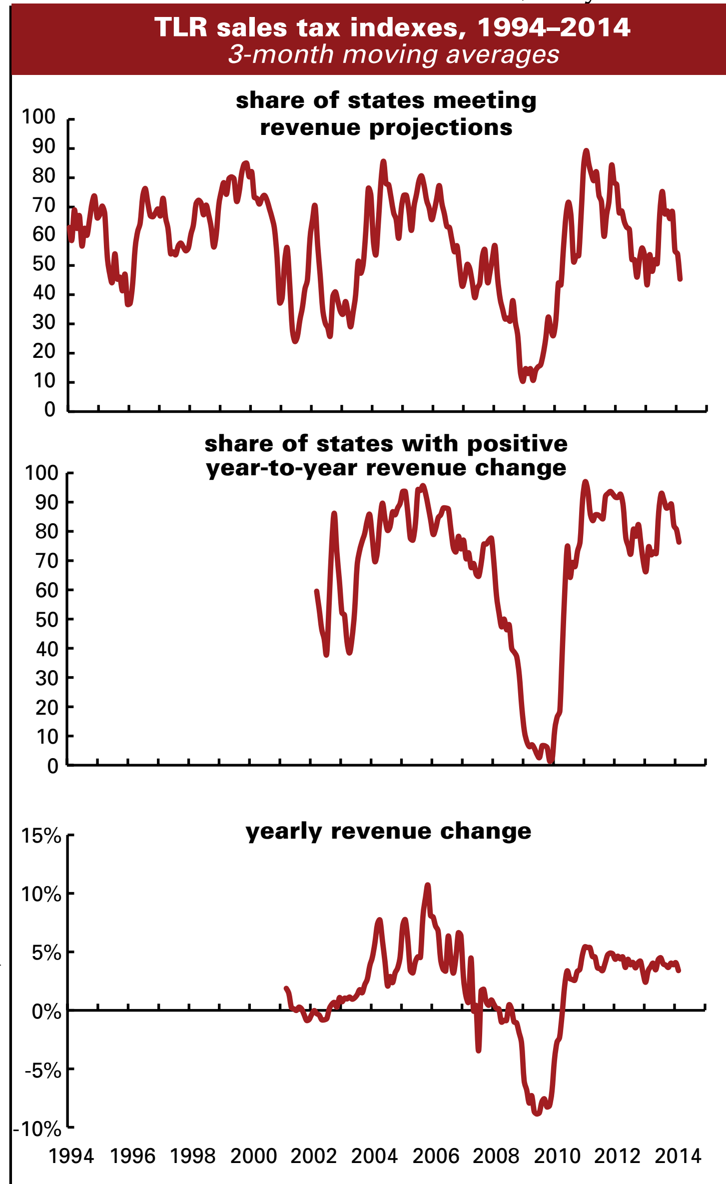
• corporations are borrowing to buy back their stock but not invest so much

• the stock market is looking very rich

• and the U.S. international accounts continue to look rather stable after a long slide into the red.

credit markets

As the graph on the bottom of p. 3 shows, while households continued their long reduction in debt levels relative to GDP—from 95% at the beginning of 2009 to just under 77% at the end of last year—nonfinancial corporations have been increasing their debt ratio at a fairly steady pace. This is a little odd, given that (as we'll see in a bit) they're flush with cash and not really investing it; the most likely explanation is that they're borrowing for takeovers and buybacks. Financial corporations—who borrow to lend mostly—were flat for the quarter, but are way down from their bubble peak.



The public sector turned in a mixed performance, with state and local governments continuing to reduce their debt/GDP ratios, while Uncle Sam reversed two quarters of decline with a small increase. The pace of federal borrowing has slowed dramatically; the debt/GDP ratio doubled in the recession and its aftermath, but has been flattish over the last year. While it's reasonable to be concerned about the state of federal finances over the longer term—assuming the population doesn't stop aging and health care doesn't stop getting more expensive—there looks to be little cause for worry in the short- to medium-term.

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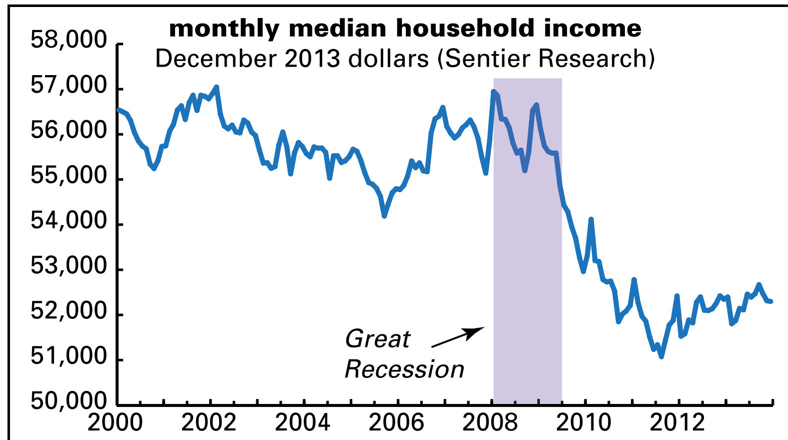
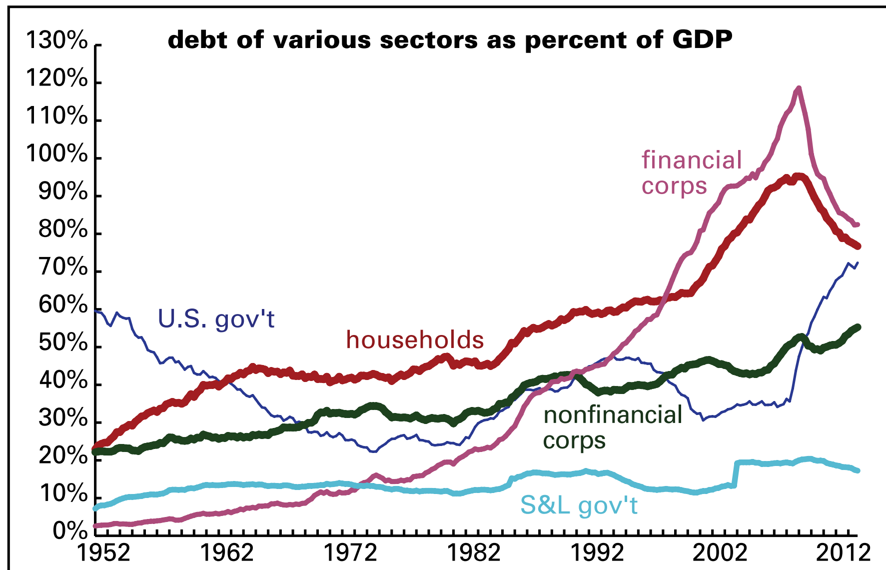
households

Household balance sheets extended their recovery, with net worth rising to 639% of after-tax income, the highest it's been since early 2007. (See graph, p. 4.) The Fed includes consumer durables as assets in their computation of net worth; stripping those out (since they depreciate rapidly, are illiquid, and return no income), and household real estate as well (the light green line on the bottom graph), makes the net worth picture look even better.



Several things caused the improvement in overall net worth: the value of household real estate rose 2.4% in the quarter while mortgage debt rose a mere 0.2%, and the value of stocks and mutual funds rose by 6.6%. Of course, since the ownership of stocks and mutual funds is heavily skewed towards the upper brackets, the more modest improvement in residential net worth (see graph of homeowners' equity, p. 5) is a better picture of what the average household experience at the end of 2013—but that is highly welcome, for sure.



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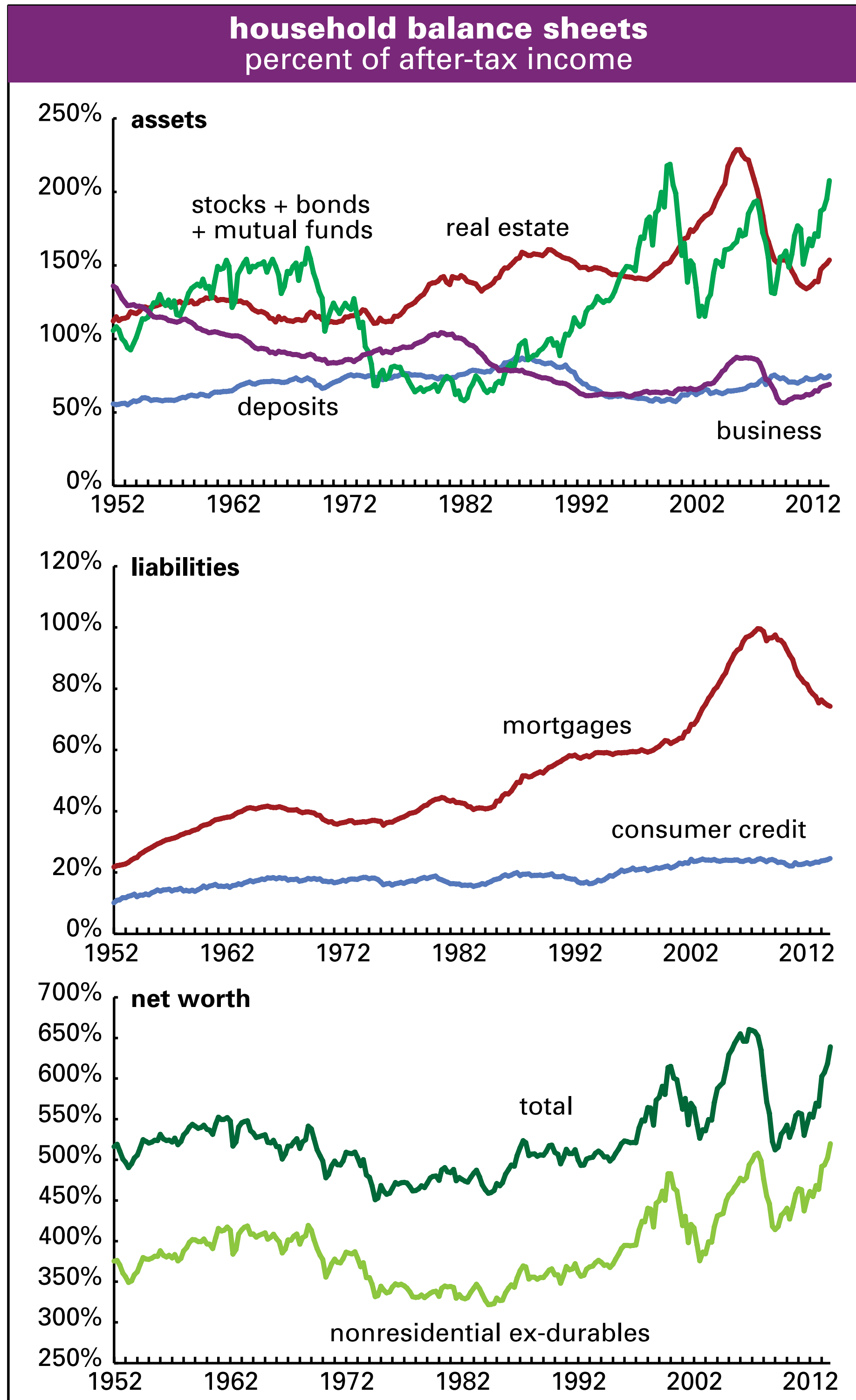

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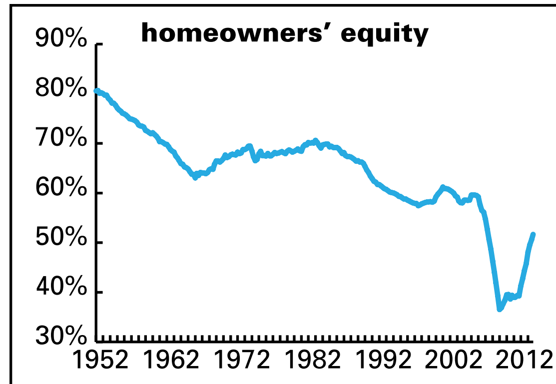
The consumer credit ratio has been impressively flat since 2000; we're going to take a look at what's going on under the aggregate (i.e., education debt up, credit card use not) in the near future.

nonfinancial corporations

We don't have the NIPA profit data for the fourth quarter yet, so we can't present the usual profitability graph; we'll report on that as soon as we can.



But as the graph at the top of p. 6 shows, nonfinancial corporations are still rolling in cash flow, with internal funds as a percent of GDP near an all-time high. And although capital expenditures have recovered substantially from their recession depths, they're still far below the green internal funds line. Much of the difference, known as free cash flow, has been devoted to buying stock, either through takeovers or buybacks. In the fourth quarter, nonfinancial firms retired stock equal to 6.1% of GDP—no match for the 10.1% record set in 2007's fourth quarter, but four times the 1952–82 average, and nearly twice the 1983–2007 average.

This vigorous retirement of stock has been a major support to the market. We've been quiet about sounding valuation alarms, but things are starting to look seriously frothy these days. As the graph on the bottom of p. 6 shows, the ratio of stock market capitalization (both financial and nonfinancial firms are included in this measure) to GDP is well past its 2007 high and closing in on the dot.com level. This is getting worrisome, and we'll be returning to this topic very soon.

rest of world

As the graph on p. 7 shows, the long slide of the U.S. into net foreign debtor status looks to have stabilized. The ratio of net foreign debt to GDP is only slightly higher than what it was five years ago. And if you add in net U.S. holdings of equity and foreign direct investment, the position has improved substantially. Given how much Washington has been borrowing, this is an impressive feat.

So while households are looking to be in better financial health than they've been in some time, the nonfinancial corporate sector is looking less so, and the stock market may be something to start biting nails over.

check it out

In an effort to capture some of the complexities of the labor market beyond the scope of the headlines, the New York Fed has just introduced a new feature on its website: "Eight Different Faces of the Labor Market," in which they group several

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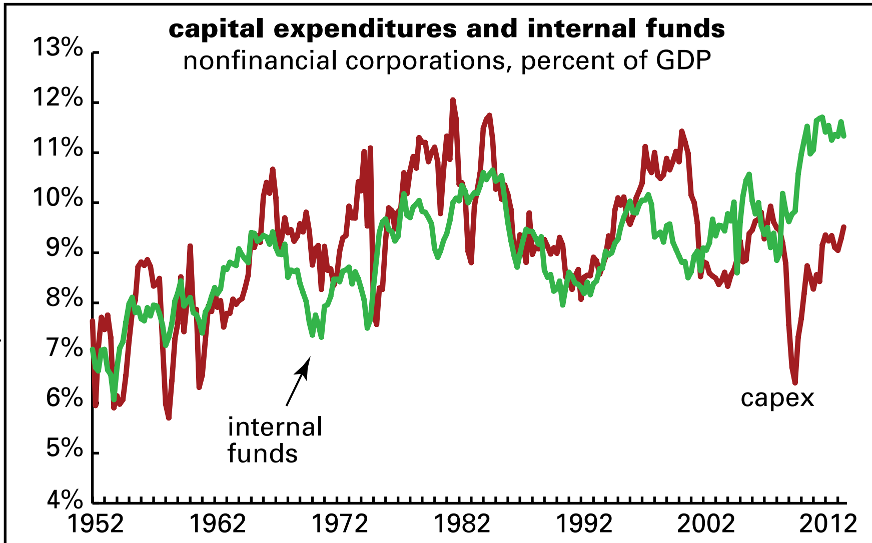
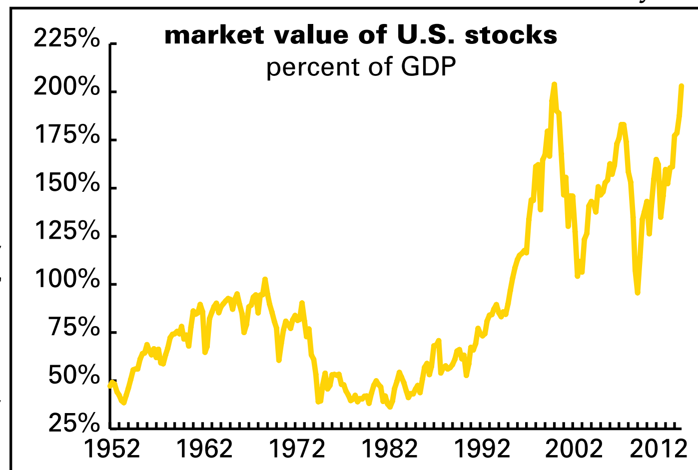
indicators under eight categories. If you visit, you'll see that the job loss and unemployment indicators are the strongest, many of the others are either in decline, flat or moving up at a snail's pace.

The most interesting feature is their own measure of "mismatch"—the degree to which available workers are a poor match for available jobs. Although this theory seems to be enjoying new life lately, as a way of arguing that the labor market is tighter than it looks, it's not supported by the New York Fed indexes: both their occupational and sectoral measures are below their 2006 levels.



Also not supporting the tight labor market thesis: the recently released Job Openings and Labor Turnover Survey (JOLTS) data for January shows the Beveridge Curve, central to the theory, continuing its crawl left toward a more normal range. But the quit rate, a measure of worker confidence, fell by 0.1 point in January. While well up from its recession lows, it's still at the low end of its historical range. Were the labor market seriously tightening, we'd expect to see the quit rate rising.



Elsewhere on the web, State Street has just released a new inflation index generated by scanning online prices. It tracks the monthly CPI quite closely. The "robust" March reading, excluding food and transport, suggests to them that weakness in recent U.S. data is weather-related.

Thursday's retail numbers

And yes, past research by one of our revenue contacts in a state that was among the hardest hit by wintry blasts last month suggests that back-to-back storms can take up to 5% out of monthly sales tax collections. Commentary from the International Council of Shopping Centers was rife with complaints about the weather and although we sometimes snicker about this as an excuse, we believe it right now. Gap alone had 450 stores that had to shut down for some time during the month.

We expect the headline for February sales to come in at 0.0%, with a 0.1% decline

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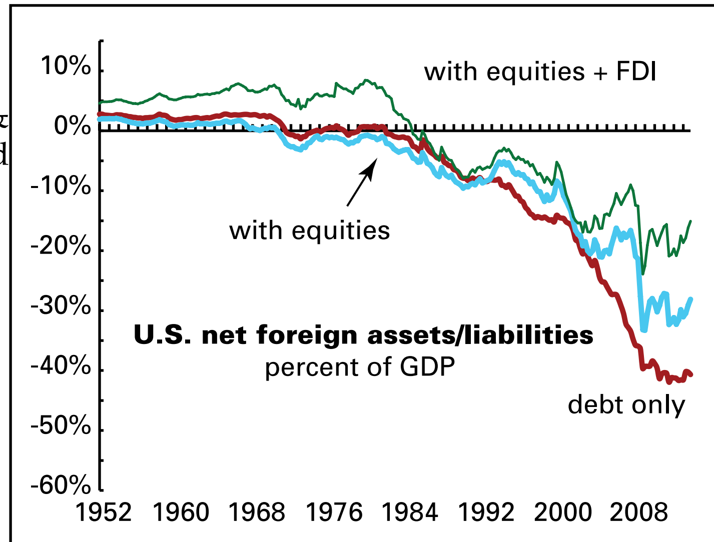
stripping out autos. Some of that spending, on clothes, books, electronics, and the like will likely be recouped in the coming months, but income lost by bars, restaurants and entertainment establishments is probably gone for good.

—Philippa Dunne &
Doug Henwood



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