Economic Snapshot for January 2012

Christian Weller on the State of the Economy

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The economy is gradually gaining strength, creating more jobs and reducing the unemployment rate. Economic pain for American families, though, remains significant with relatively high unemployment, persistent long-term unemployment, lingering household wealth losses, and crushing debt burdens. The economy will have to grow much faster for much longer to restore economic security for America's middle class.

The private sector drives growth and job creation, but the current economic recovery would be weaker and delayed had policymakers not taken steps in the past few years to invest in infrastructure and help the most vulnerable.

Smart economic policy can continue to strengthen the economic recovery and help accelerate private-sector job creation. The right steps can strengthen the economy, such as by increasing infrastructure spending on schools, roads, bridges, and more, and by extending key middle-class tax cuts, such as the temporary payroll tax cuts for an additional year. And policymakers can lend a helping hand to millions of unemployed workers who cannot find a job and need extended unemployment insurance benefits until the economy and the labor market improve significantly further.

1. **Economic growth remains low.** Gross domestic product, or GDP, grew at an annual rate of 2.8 percent in the fourth quarter of 2011. Business investment dropped sharply by 14 percentage points from the third quarter 2011 to 1.7 percent,[1] while export growth remained unchanged at 4.7 percent. Consumption grew at 2.0 percent, and government spending fell by 4.6 percent, the second largest drop since the start of the recession. Economic growth is relatively weak because of low consumer demand, due to high unemployment and households' crushing debt burden, but also because of slow demand for U.S. exports in the wake of European economic turmoil and the fiscal struggles of federal, state, and local governments.

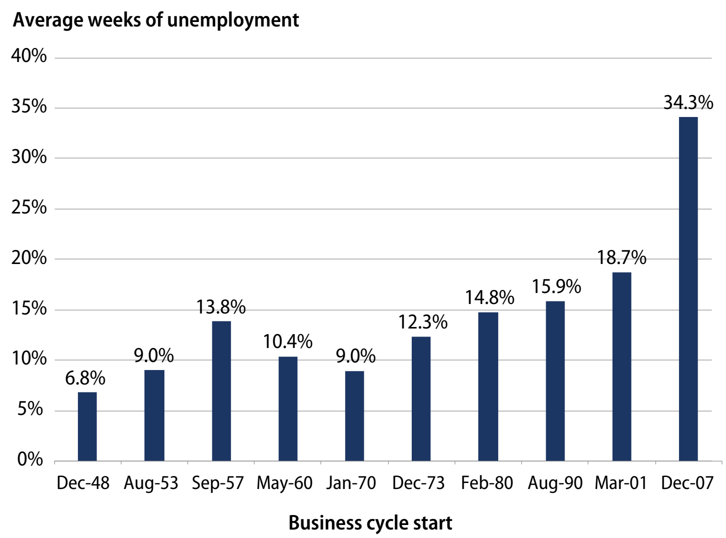
2. **The trade deficit stays high.** The U.S. trade deficit stood at 3.8 percent of GDP in the fourth quarter of 2011, slightly above the 3.7 percent recorded in the third quarter of 2011, and still substantially up from its last trough of 2.4 percent of GDP in the second quarter of 2009.[2] U.S. export growth, even when it was strong in recent years, has not been enough to overcome even larger import increases, following in part higher oil prices and thus larger oil imports. The crisis in Europe could slow U.S. export growth, while turmoil in the Middle East has kept oil prices high—two trends that could result in expanding U.S. trade deficits in the near future.

3. **The labor market recovery is slow.** The economy has added jobs continuously since October 2010. There were more than 100,000 jobs each month for six months in a row, from July to December 2011, marking the first such six-month period since late 2005 to early 2006. And the private sector continuously added jobs from March 2010 to December 2011 for a total of 3.2 million jobs.[3] But state and local governments are cutting jobs for teachers, bus drivers, firefighters, and police officers, among others, reflecting governments' budget troubles. A total of 447,000 state and local government jobs were lost between March 2010 and December 2011.[4] The bottom line is that job creation is a top policy priority since private-sector job growth is still too weak to overcome other job losses and to improve the economic fortunes of America's middle class.

4. **Unemployment stays high amid weak job growth.** The unemployment rate stood at 8.5 percent in December 2011. And long-term unemployment has ballooned in recent years as the unemployment rate stayed high. In December 2011, 42.7 percent of the unemployed have been out of and looking for a job for more than six months. The average length of unemployment stayed near new record highs with 40.8 weeks in December 2011.[5] The long-term unemployed are struggling due to a weak economy, making extended unemployment benefits necessary until the economy and the labor market substantially improve. (see Figure 1)

FIGURE 1

Share of long-term unemployment, business cycle averages



Source: Bureau of Labor Statistics, Current Population Survey (Department of Labor, 2011).

5. **Labor market pressures fall especially on communities of color, young workers, and those with less education.** The African American unemployment rate in December 2011 stayed well above average with a high 15.8 percent, and the Hispanic unemployment rate stayed high with 11 percent, while the white unemployment rate was 7.5 percent. Youth unemploy-

ment stood at a high 23.1 percent. Meanwhile, the unemployment rate for people without a high school diploma stayed high with 13.8 percent, compared to 8.7 percent for those with a high school degree and 4.1 percent for those with a college degree.[6] Vulnerable groups have struggled disproportionately more amid the weak labor market of the past few years than white workers, older workers, and workers with more education. But even those groups that fare better than their counterparts in the weak labor market suffer tremendously from high and long-term unemployment.

6. **Household incomes continue to drop amid prolonged labor market weaknesses.** Median inflation-adjusted household income—half of all households have more and the other half has less—stood at $49,445 in 2010, its lowest level in inflation-adjusted dollars since 1996. It fell by 2.3 percent in 2010, an accelerated decline after median income dropped by 0.7 percent in 2009. American families saw few gains during the recovery before the crisis hit in 2008 and experienced no income gains during the current economic recovery after 2009.[7]

7. **Income inequality on the rise.** Households at the 95th percentile, with incomes of $180,810 in 2010, had incomes that were more than nine times—9.04 times, to be exact—the incomes of households at the 20th percentile, with incomes of $20,000. This is the largest gap between the top 5 percent and the bottom 20 percent of households since the U.S. Census Bureau kept record in 1967.[8]

8. **Poverty continues to rise across a wide spectrum.** The poverty rate rose to 15.1 percent in 2010—its highest rate since 1993. The African American poverty rate was 27.4 percent, the Hispanic rate was 26.6 percent, and the white rate was 9.9 percent in 2010. The poverty rate for children under the age of 18 stood at 22 percent. More than one-third of African American children (39.1 percent) lived in poverty in 2010, compared to 35 percent of Hispanic children and 12.4 percent of white children.[9] The prolonged economic slump, following an exceptionally weak labor market before the crisis, has taken a massive toll on the most vulnerable populations.

9. **Employer-provided health insurance benefits continue to disappear.** The share of people with employer-provided health insurance dropped from 65.1 percent in 2000 to 55.3 percent in 2010. This is the lowest share since 1987 when the Census started to track these data.[10] Families thus face further income woes because of less access to affordable health insurance. They will have to save more than in the past to prepare for eventual economic emergencies.

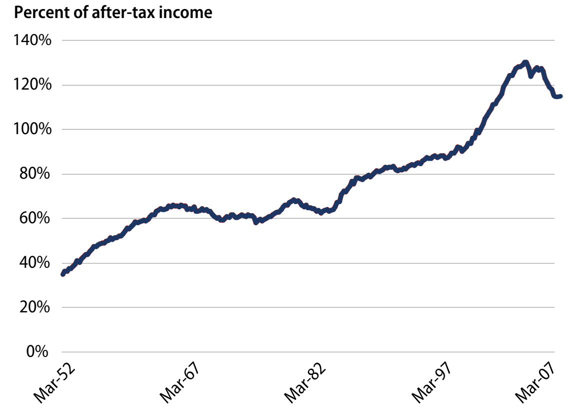
10. **Family wealth losses linger.** Total family wealth is down $15.1 trillion (in 2011 dollars) from June 2007—its last peak—to September 2011. Home equity stays low, such that homeowners on average still own only 38.7 percent of their homes,

with the rest owed to banks.[11] Households, already struggling with low incomes in a weak labor market, consequently feel growing pressures to save more and consume less. The dual burden of low income and decimated household wealth puts the breaks on consumer spending, holding back economic and job growth.

11. **Households are burdened by large debt levels.** Total household debt equaled 114.2 percent of after-tax income in September 2011. This is down from a record high of 130.2 percent in September 2007, but still higher than at any point before September 2004.[12] The unprecedented decrease in household indebtedness since the crisis began resulted from a combination of factors—tight lending standards, falling interest rates, and massive foreclosures—that are slowly abating, suggesting that further decreases in household indebtedness—deleveraging—will also slow, unless incomes rise faster than they have in the past. High household debt will hence continue to slow economic growth in the future as households focus on saving more, rather than on spending more. (see Figure 2)

FIGURE 2

Household debt to after-tax income, 1952 to 2011

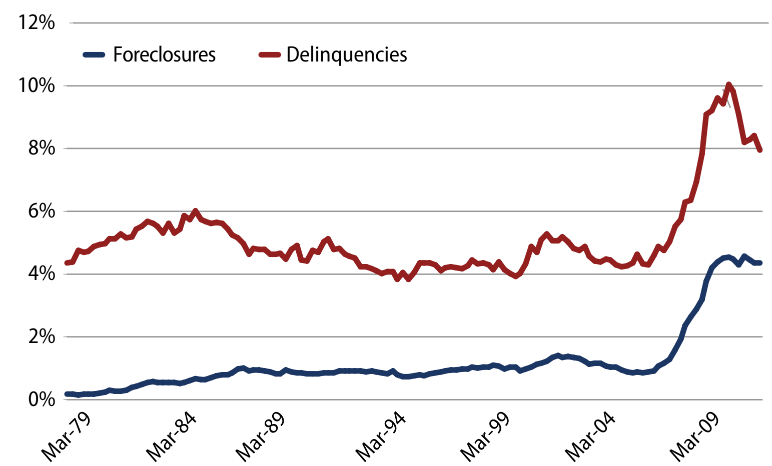


Source: Calculations based on Board of Governors, Federal Reserve, 2011, Flow of Funds Accounts of the United States, Washington, D.C.: BOG.

12. **Financial distress is widespread among families.** One in eight mortgages is still delinquent or in foreclosure, even though mortgage market troubles are slowly easing. The share of mortgages that were delinquent was 8 percent in the third quarter of 2011, and the share of mortgages that were in foreclosure was 4.4 percent at the same time.[13] A weak job market coupled with massive wealth losses has pushed comparatively large shares of families into a desperate situation, reflected in delayed mortgage payments and very high foreclosure rates for several years now. This household economic distress reverberates across the economy as banks are nervous about extending new credit, thus prolonging the economic slump. (see Figure 3)

FIGURE 3

Share of mortgages that are delinquent or in foreclosure



Source: Mortgage Bankers Association, 2011, National Delinquency Survey, Washington, DC: MBAA.

13. **Profitable corporations prioritize cash holdings and other activities over hiring.** After tax profits of nonfinancial corporations increased by 77.3 percent in inflation-adjusted terms from December 2008, the most recent low point in profitability, to September 2011.[14] Cash holdings rose to 14.2 percent of financial assets in September 2011, its highest share since September 1977. Nonfinancial corporations built up more cash holdings since December 2007, when the Great Recession started, even as they spent on average more than all of their after-tax profits—107.6 percent—buying back their own shares and paying out dividends. These nonfinancial corporations needed to borrow money to keep shareholders happy, even as they built up an ever larger trove of cash. The weak labor market is thus not a reflection of employers not having the money to hire more workers, but rather employers focusing on other priorities, such as hoarding cash and keeping shareholders happy.

Endnotes

1 All GDP data are from the Bureau of Economic Analysis, 2011, National Income and Product Accounts, Washington, DC: BEA. Investment growth is expressed as year-over-year change, rather than the most recent quarterly change by itself, as quarterly investment data can be more volatile than consumption data.

2 Trade deficit as share of GDP are calculated as share of net exports out of nominal GDP, based on Bureau of Economic Analysis, 2011, National Income and Product Accounts, Washington, DC: BEA.

3 The discussion here focuses on private sector job creation since private sector employment is vastly larger than public sector employment and since public sector employment fluctuated widely in 2010 due to temporary hiring associated with the 2010 Census. The private sector employment numbers thus offer a more accurate picture of the health of the labor market than the total non-farm payroll numbers.

4 Employment growth data are calculated based on Bureau of Labor Statistics, 2011, Current Employment Statistics, Washington, DC: BLS. The Current Employment Statistics are also known as the payroll survey.

5 Unemployment numbers are taken from the Bureau of Labor Statistics, 2011, Current Population Survey, Washington, DC: BLS. The Current Population Survey is also known as the household survey.

6 Unemployment rates by demographic characteristics are taken from the Bureau of Labor Statistics, 2011, Current Population Survey, Washington, DC: BLS. The Current Population Survey is also known as the household survey.

7 Data for family incomes are from the U.S. Census, 2011, Income, Poverty, and Health Insurance Coverage in the United States: 2010, Washington, DC: Census. This report is occasionally referred to as the poverty report.

8 Other measures of income dispersion also show a growing gap between families in the top 5 percent, top 10 percent, and top 20 percent, relative to families in the bottom 20 percent and bottom 50 percent. See U.S. Census Bureau. (2011). Income, Poverty, and Health Insurance Coverage in the United States: 2010. Washington, DC: Census.

9 Data for poverty rates are from the U.S. Census, 2011, Income, Poverty, and Health Insurance Coverage in the United States: 2010, Washington, DC: Census. This report is occasionally referred to as the poverty report.

10 Data for health insurance are from the U.S. Census, 2011, Income, Poverty, and Health Insurance Coverage in the United States: 2010, Washington, DC: Census. This report is occasionally referred to as the poverty report.

11 Wealth calculations are based on the Board of Governors, Federal Reserve System, 2011, Release Z.1 Flow of Funds Accounts of the United States, Washington, DC: BOG. Real wealth is the nominal wealth deflated by the price index for the Personal Consumption Expenditure index. The Personal Consumption Expenditure index is from the Bureau of Economic Analysis, 2011, National Income and Product Accounts, Washington, DC: BEA.

12 Debt calculations are based on the Board of Governors, Federal Reserve System, 2011, Release Z.1 Flow of Funds Accounts of the United States, Washington, DC: BOG. Debt levels are the ratio of the nominal debt levels divided by the nominal disposable personal income. Debt refers to total credit instruments.

13 Data are taken from the Mortgage Bankers Association, 2011, National Delinquency Survey, Washington, DC: MBAA.

14 Calculations are based on the Board of Governors, Federal Reserve System, 2011, Release Z.1 Flow of Funds Accounts of the United States, Washington, DC: BOG.