

## Very sluggish US recovery

Global economic update: August 2010

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The US economic recovery is not convincing and the housing market has not shown signs of improvement. However, there is some support for the housing market which should prevent the US moving back into recession.

### US consumer confidence falls

US consumer confidence fell to 66.5 in July from 76.0 in June because of the slow recovery in the job market. This was the lowest confidence reading since August 2009.

### No improvement in the US housing market

US housing activity weakened significantly in May/June 2010, following the expiry of the relatively generous Federal Housing Tax Credit at the end of April 2010. A range of housing indicators are now at, or near, record lows. These include new homes sales, housing permits, housing starts (building) and mortgage applications. There are still a high number of vacant or foreclosed houses in the US, which is weighing on home prices and construction.

Although the housing market is probably the single weakest aspect of the US economy, it is unlikely that the housing market will cause the US economy to move back into recession. With house prices having fallen significantly, housing is now more affordable. Recent evidence suggests that house prices are stabilizing.

### Consumers continue to pay off debt

In May 2010, US consumer credit fell by a significant \$9.1bn. This was a bigger decline than the market expected. US consumer credit (which excludes mortgage finance) has fallen in 19 of the last 22 months. Before January 2009, US consumer credit rose each month for a consecutive 125 months.

US consumers have been trying to get rid of, or avoid, debt since the middle of 2008. This was reflected in a dramatic drop in mortgage advances during 2008/2009 and also in a sharp decline in consumer credit. This decline in consumer credit has been very unusual relative to the history of consumer credit. For example, from 1995 to 2008, US consumer credit rose by a total of \$1.56 trillion or at an average of \$111.7 billion a year. In contrast, during 2009, US consumers reduced their credit (excluding mortgages), by a significant \$112.3 billion.

### Household debt lower but still high

The ratio of US household debt to disposable income is at 125.9% (Q1 2010), having peaked at 135.9% in Q1 2008. However, at 125.9% the indebtedness ratio is still well above the average of 118% over the past ten years. Fortunately, the debt servicing ratio (the monthly cost of debt repayments compared to income) has declined to 12.46% of disposable income due to lower interest rates and reduction in debt levels. This is still relatively high but well below the peak of 13.96% recorded in Q1 2008.

It is also encouraging to see that US personal income has started to rise year-on-year (at least in nominal terms) and that consumer spending has now increased for 8 consecutive months (year-on-year, in nominal terms).

### US needs to grow employment, not credit

Obviously, the lack of growth in consumer credit hurts the economic recovery, at least in the very short-term. Consumer spending has always been a major driver of economic growth. Given that the US consumer remains highly indebted, with modest monthly savings, a significant growth in consumer credit at this stage of the recovery cycle would actually be a concern. Ideally, the US needs to see a combination of modest increases in credit coupled with a healthy and sustained increase in private sector employment.

### Employment recovery to remain slow

Although employment is recovering, the job market is still likely to take a long while to improve, especially when one considers that the previous two employment booms in the US were driven by very specific industry dynamics, namely the growth in the hi-tech sector, which ultimately led to a bubble in technology stocks, and the growth in the housing market, which ultimately led to an oversupply of housing and the credit crisis. Much stronger job gains are needed to repair the damage caused by the financial crisis.

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