

Will U.S. consumers be part of the economic rebound? The jump in savings could offset the government's efforts to kick-start the economy

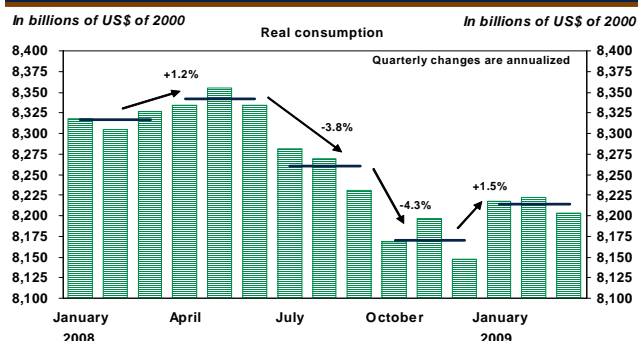
The difficulties in U.S. households, coupled with the housing sector and a fragile banking industry, are at the heart of the recession that has rocked the economy since the start of 2008. That said, some signs point to an uptick in household confidence. In this Economic Viewpoint, we will show that several factors are such that consumers will nevertheless remain cautious. First of all, the financial situation in households is still very fragile due especially to the drop in the value of real estate and financial assets. This deterioration in household balance sheets, in addition to the sharp rise in the jobless rate, should push households to continue to save more, thereby limiting consumption's contribution to economic growth. In these circumstances, the Obama administration's stimulus measures aimed at households may have limited impact, and the economic recovery will most likely be slow.

For the first time since the spring of 2008, real consumption rose in Q1 2009. After posting annualized contractions of 3.8% and 4.3%, the 1.5% rise could be seen as a surprise (graph 1). This gain will be fleeting however and it appears as though the downward trend could resume with vigour as early as Q2 2009.

Where did this gain stem from? The jump in real consumption was a one-month phenomenon in January 2009. Real spending jumped by 0.9% in January, due to a 1.4% increase in real

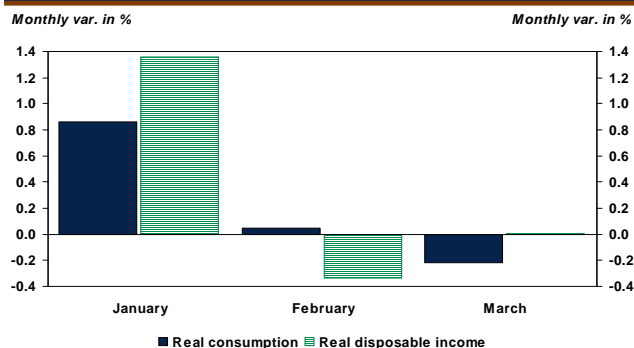
disposable income. This was supported by upward adjustments to the wages of federal employees and military personnel, as well as government transfers to individuals. January's jump in real spending was followed by much weaker growth in February of a scant 0.1%, and a drop of 0.2% in March (graph 2). And yet this was enough for the annual quarterly change to wade into positive territory for the quarter. We do anticipate however that new pullbacks will be posted in Q2.

Graph 1 – Consumption rose in Q1 after sliding for two quarters



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

Graph 2 – Increase in income early in the year supported consumption



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

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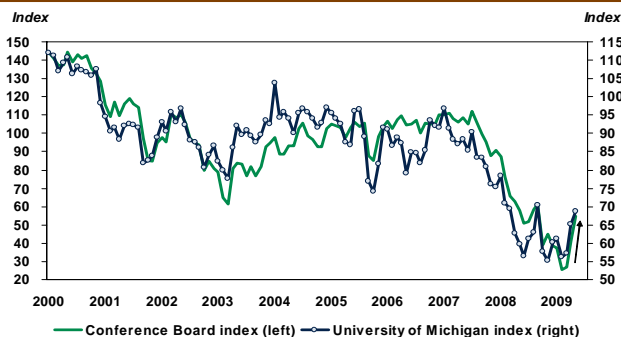
NOTE TO READERS: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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SIGNS OF STABILIZATION

Besides the fluctuations in consumer spending seen at the beginning of the year, some indicators have shown that the gloomy mood in households may be lifting. In fact, consumer confidence indexes seem to have hit their cyclical troughs in February while the stock markets were still reeling from many lower trading days and a succession of grim economic news that trumpeted more historic lows. The most recent statistics on consumer confidence are therefore comparatively upbeat vs. the low levels recorded. As such, the Conference Board and University of Michigan confidence indexes are both advancing since they hit their low points in February. That said, the gains appear to be weak compared to the magnitude of the collapse suffered during previous months (graph 3).

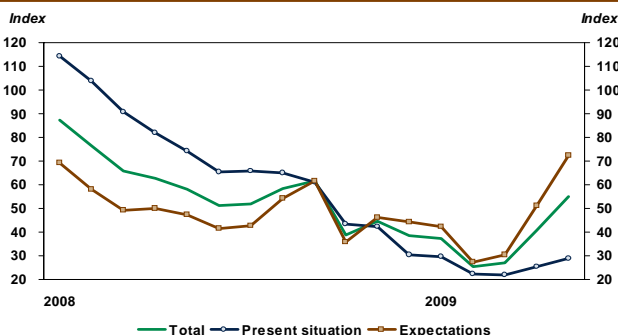
Graph 3 – Consumer confidence shows stabilisation and slight improvement



Sources: Conference Board, University of Michigan and Desjardins, Economic Studies

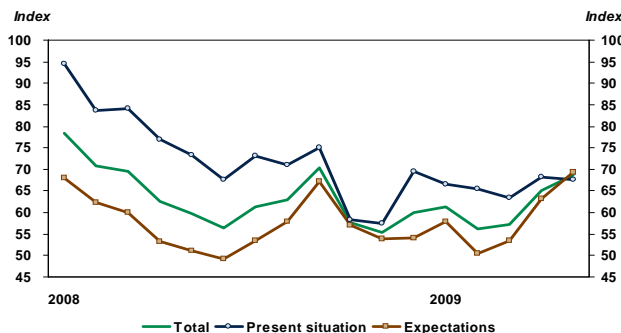
If we analyze the components that make up the confidence indexes, we note that the increase mainly stems from the sub-indexes tied to households' expectations (graphs 4 and 5). Consumers are still very wary of the current situation, which is quite rational given the level of economic uncertainty still in place and especially the sharp deterioration of the job market. On the other hand, households are increasingly confident that the economic situation will improve in the near future.

Graph 4 – Jump in Conference Board index stems mainly from consumer expectations



Sources: Conference Board and Desjardins, Economic Studies

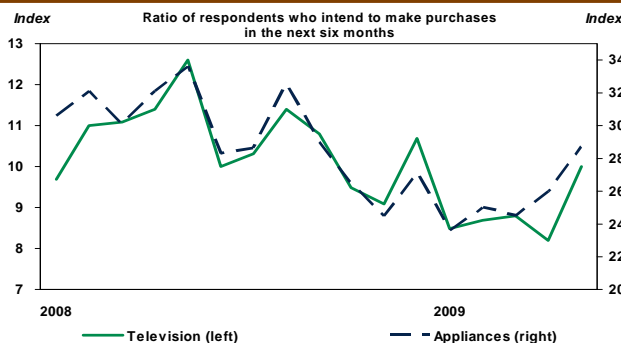
Graph 5 – Increase in University of Michigan index also stems from consumer expectations



Sources: University of Michigan and Desjardins, Economic Studies

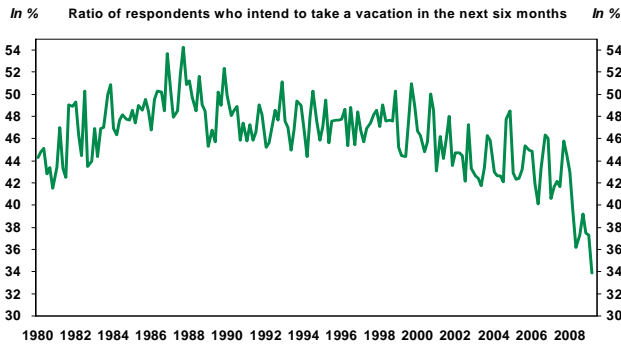
Current levels are still depressed, however, and they remain in line with a continuing recession. According to the Conference Board survey, purchasing intentions show only slight improvements for the months to come (graph 6) in many categories of durable goods. In terms of tourism, for the next six months, vacation intentions have posted new declines (graph 7), and this was before concerns about swine flu started to make headlines at the end of April. If the recent jump in confidence indexes—required for any sustained rebound in household spending—is most welcome and a step in the right direction, we cannot conclude that we are seeing a sustained rebound in consumption (graph 8). The real question is: What is holding back households?

Graph 6 – Purchasing intentions improve, but remain weak



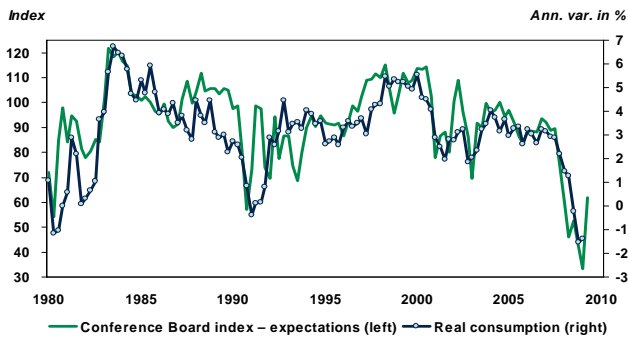
Sources: Conference Board and Desjardins, Economic Studies

Graph 7 – Vacation intentions for the next six months are very weak



Sources: Conference Board and Desjardins, Economic Studies

Graph 8 – Confidence not strong enough to signal any steady increase in consumption

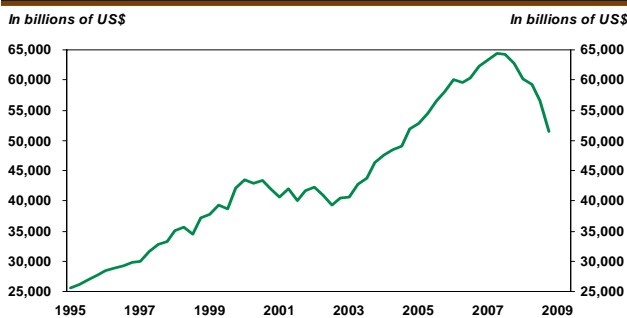


Sources: Conference Board and Desjardins, Economic Studies

DETERIORATION IN U.S. HOUSEHOLD BALANCE SHEETS

One of the pressures that households have been reeling from in this recession is the sharp deterioration in their balance sheets. Net household value—assets minus liabilities—reached a peak of US\$64,361.7B in the spring of 2007. By the end of 2008, this value had shrunk to US\$51,476.9B (graph 9). A decline of 20%, by far the largest drop since the Federal Reserve

Graph 9 – Decline in net household value is considerable



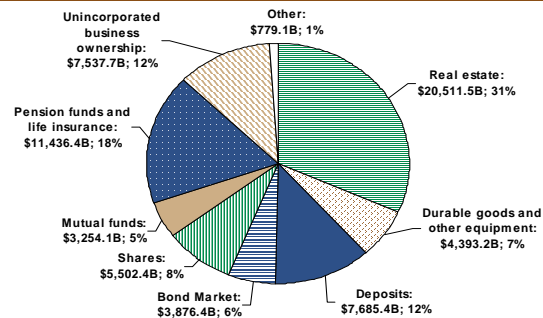
Sources: Federal Reserve Board and Desjardins, Economic Studies

started compiling these statistics. The day after the techno bubble burst at the start of the new millennium, net household value had dropped by 9.7% at best. Falling home prices these past few quarters and plummeting stock markets were clearly behind the drop in household values.

REAL ESTATE

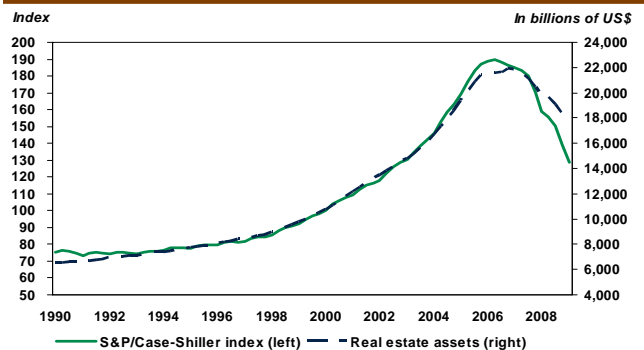
Real estate investments still represent the main asset held by Americans, making up almost a third of all households' worth at the end of 2008 (graph 10). The collapse of the housing market therefore dealt a serious blow to household wealth. Since hitting their peak, the value of real estate assets has dropped by 15.4%, a decline that is still quite moderate compared to other home value indicators, especially existing home price indexes. The S&P/Case-Shiller index instead shows a decline of 32.2% since the peak reached in the summer of 2006, and the relation between this index and household values suggests that household values may fall even further (graph 11).

Graph 10 – Composition of household assets in Q4 2008



Sources: Federal Reserve Board and Desjardins, Economic Studies

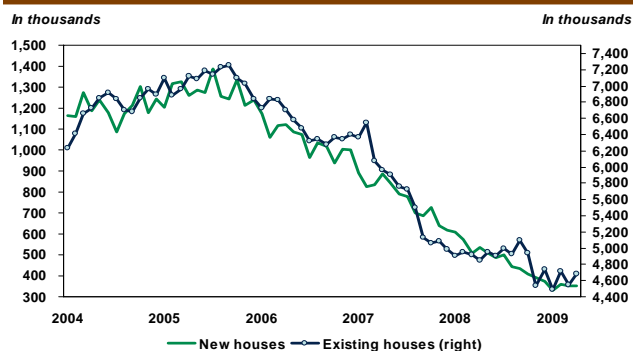
Graph 11 – Households' real estate wealth could post new declines



Sources: Standard & Poor's, Federal Reserve Board and Desjardins, Economic Studies

Moreover, it now appears that home prices will continue to fall. We probably reached a low point in housing market activity at the start of the year when sales of new and existing homes hit their cyclical low points (graph 12). However, this stabilization is taking hold at the expense of home prices while overall activity is becoming increasingly dependent on foreclosures and distress sales. According to the National Association of Realtors, almost half of all existing home sales in April were based on this type of transaction, a situation that exerts downward pressure on prices: usually, distress sales involve prices that are 20% lower than traditional sale).

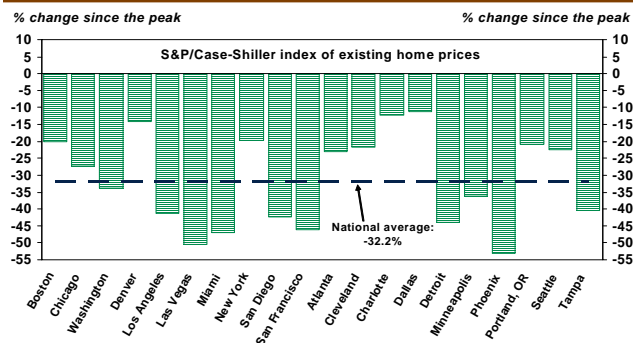
Graph 12 – Home sales stabilizing at very weak levels



Sources: Census Bureau, National Association of Realtors and Desjardins, Economic Studies

It bears noting that in 2008, 3.2 million homes, or 1 in 54, had entered foreclosure proceedings in the U.S., with peak activity in certain states like California, Nevada, Arizona, Florida and Michigan, with the metropolitan regions in these states recording the sharpest drops in home prices (graph 13). Foreclosure proceedings have been initiated on many homes to date in 2009.

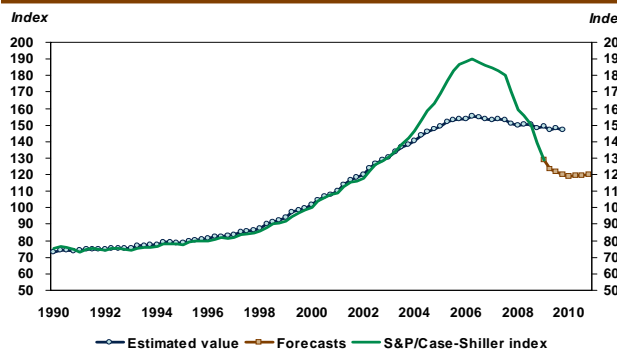
Graph 13 – Home price declines are widespread, with some regions more hard hit than others



Sources: Standard and Poor's and Desjardins, Economic Studies

Can home prices fall even further? This is highly probable despite the fact that the S&P/Case-Shiller index has already fallen below the equilibrium value of our home price model¹. But the size of this overflow, compared to the equilibrium value during the bubble period between 2004-2008, and the scant advances in credit conditions (other than interest rates) are such that prices could very well hover for some time below the level estimated by the model (graph 14). From a drop of 32.2% since reaching the peak in 2006, the index should show a total overall decline of about 36%. Home prices should stabilize at the start of 2010, or at about the same time this recession is expected to end. In these circumstances, and given the lag between both statistics, household real estate wealth could fall further, by approximately 20%, or close to US\$4,000B.

Graph 14 – Home price declines could continue until 2010



Sources: Standard & Poor's and Desjardins, Economic Studies

FINANCIAL INVESTMENTS

Combined, the different items in household balance sheets that fall into the category of financial investments represent close to 50% of all assets held. Among these investments, cash deposits, money market funds and some bond investments fluctuate very little. At best, these investments act as a safety net or safe haven when the stock market is experiencing volatile shifts.

The stock market is by far where financial investments feel the greatest fluctuations. Movements in indexes, like the S&P 500, are largely behind the variations in assets—especially equities—but for other investments like mutual funds and pension funds as well. The value of financial assets held by households reached a peak of US\$50,495.2B by the end of Q3 in 2007, or at the same time the S&P 500 hit its record high. In fact, the S&P 500 reached its highest peak, 1,565.15 points, on

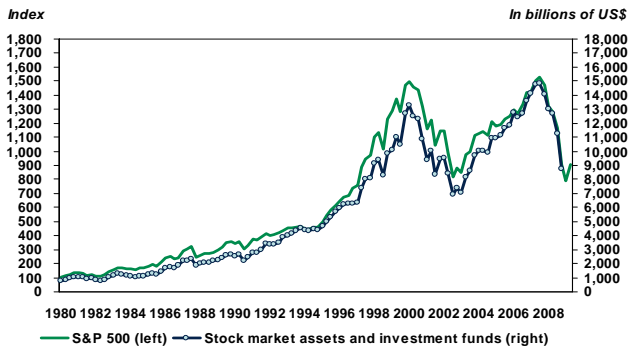
¹ This model is based on the inventory level of available homes, households income and interest rates. See the *Economic Viewpoint* entitled "United States: Are home prices set to bottom out?" dated March 12, 2008.

October 9, 2007. Since then, the value of financial assets has plunged by almost US\$10,000B to US\$40,814B by the end of 2008, representing a decline of 19.2% while the S&P 500 suffered a drop of 40.8% during this same period. It bears noting that some financial assets, like Treasury bills, are much less volatile or they often have a negative correlation with the stock market.

These numbers present a snapshot of the situation at the end of 2008. And what happened to household wealth in Q1 2009? The stock markets have fluctuated wildly since the start of the year. Until the beginning of March, most stock indexes were trending decidedly downwards while bad news on the economic front kept mounting and uncertainty on the health of the markets was at its apex. The S&P 500 hit a low point of 676.83 points on March 9, a 56.8% plunge vs. the peak reached in 2007. The S&P 500 has sprung back to life since those dark days however, rebounding by about 35%.

The U.S. Federal Reserve will not publish Q1 results on household balance sheets until the beginning of June. We can expect to see another decline in the value of financial assets as at March 31. However, if the recent rebound in stock markets proves to be lasting, it will allow us to sidestep this data since the situation has since improved. Our most recent forecasts² on the stock market—a year-end target of 950 points for the S&P 500 for 2009 and 1,075 points for 2010—give hope that the net value of financial assets in household balance sheets has finally stopped falling. The plunge has been particularly painful and households are unlikely to recover any sums lost in the past few years in the short or medium term (graph 15). After the techno bubble had burst, we had to wait almost seven years before the value of financial assets exceeded the peak reached at the start of the year 2000.

Graph 15 – Stock market meltdown rammed households' financial assets



Sources: Datastream, Federal Reserve Board and Desjardins, Economic Studies

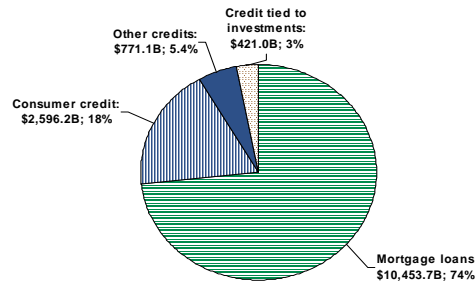
² See the Economic and Financial Outlook dated May 25, 2009.

DEBT

The net value of households is the difference between the value of all assets held and any outstanding debt. If real estate and financial assets have lost a substantial amount of their value in the past few years, thus contributing to the drop in net value, fluctuations in overall debt have been more moderate.

Mortgages are by far the main element in household debt. At the end of 2008, mortgages made up almost three-quarters of all debt (graph 16). Consumer credit, including credit cards, comes in second, representing 18.1% of all household debt.

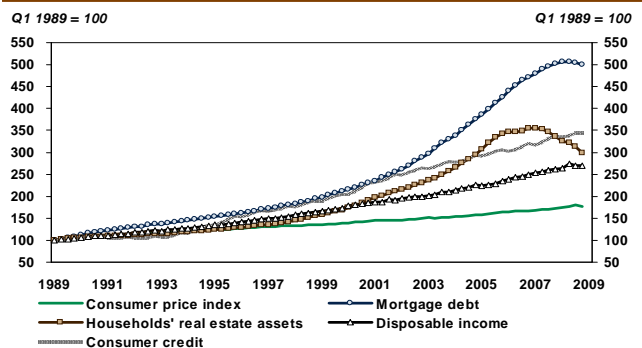
Graph 16 – Composition of household liabilities in Q4 2008



Sources : Federal Reserve Board and Desjardins, Economic Studies

In addition to being the main element in overall indebtedness, mortgage loans are also the reason for the dramatic rise in household debt in the past two decades. In current dollars, mortgage debt has quadrupled in the past 20 years whereas the cost of living, calculated by the consumer price index, has risen by only 80%, and personal disposable income has advanced by 176%, while home values have only doubled, including the declines posted over the past few quarters (graph 17). Consumer credit has also shown weaker growth,

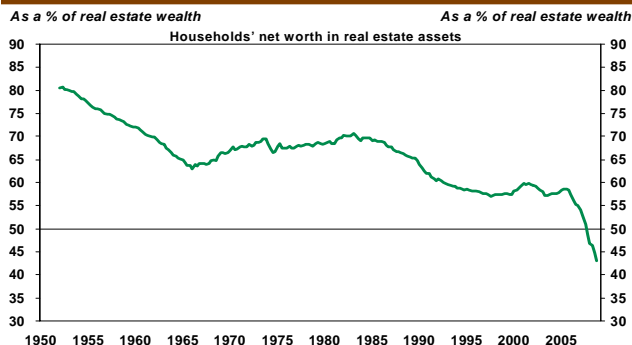
Graph 17 – Increased debt stems mainly from mortgage debt, which has quadrupled in 20 years



Sources: Federal Reserve Board and Desjardins, Economic Studies

rising by 240% since 1988. The fact that mortgage debt has risen faster than home values means lower net values for real estate, such that for the first time since this data has been compiled, this asset now represents less than half of home values (graph 18). The once exuberant housing market, and the debacle that followed, have left many households with negative equity on their homes, with debt outweighing the property's value. We estimate that 20% of households are in this situation.

Graph 18 – Debt takes up large portion of the value of residential real estate assets

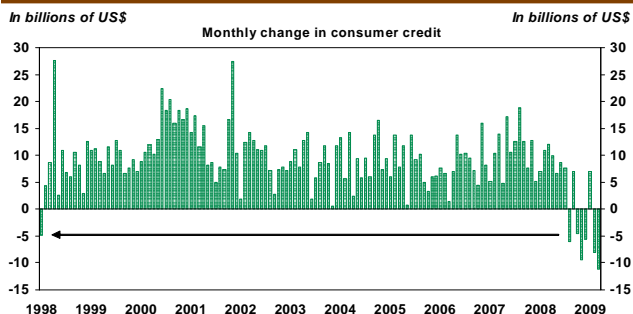


Sources: Federal Reserve Board and Desjardins, Economic Studies

Mortgage debt has nevertheless declined over the past few quarters. Outstanding debt has fallen from US\$10,558.2B at the start of 2008 to US\$10,453.7B by the end of the same year. Increased savings, which can be channelled toward debt repayment, the drop in home sales, the decline in home values for new buyers, the re-assessment and re-financing of some loans with support from government programs, abandoned homes and foreclosures have all contributed to this first drop in the national mortgage debt in 25 years. We expect this recent trend to continue in the coming quarters.

Consumer credit also continued to show an advance until the end of 2008. However, we feel that a decline could be posted in 2009. The monthly data on consumer credit shows that outstanding debt has fallen by US\$32B since it reached its high point in the fall of 2008 (graph 19). This decline can be explained by an increase in savings and the tightening of credit conditions by financial institutions that are making it more difficult to access new credit. Consumption obviously

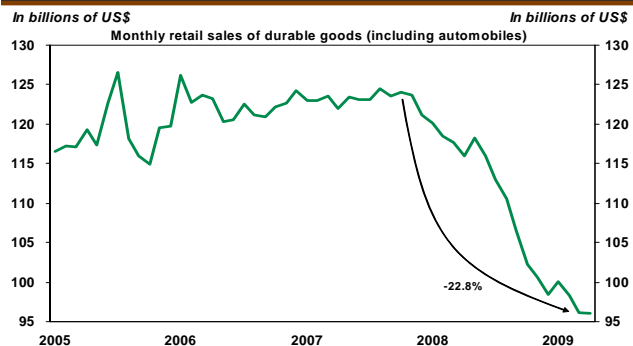
Graph 19 – First decline in consumer credit in 10 years



Sources: Federal Reserve Board and Desjardins, Economic Studies

suffers when borrowing levels fall, a situation we can clearly see in the automobile market where sales have tumbled over the past year. Other than the rebound we saw at the beginning of the year, consumption of durable goods is also being put to the test due to reduced access to debt (graph 20).

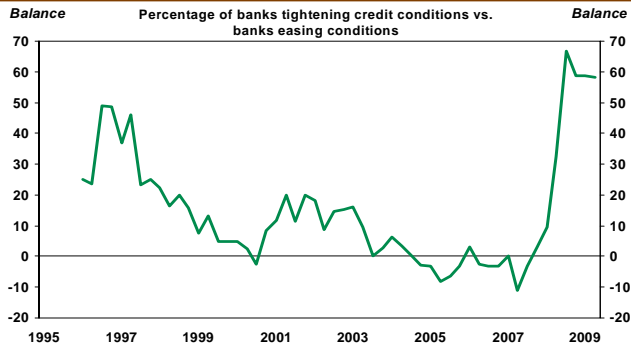
Graph 20 – Retail sales of durable goods down sharply



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

Credit card financing also seems to be struggling these days (graph 21). The drop in outstanding revolving credit debt in the past few months was the first decline in more than ten years. Credit card offers have also declined sharply: Americans received more than \$2B in credit card offers through the mail in each quarter of 2006. Only a quarter of this same volume had been sent out by early 2009³. In addition, in April, 63% of financial institutions surveyed by the Fed for the Senior Loan

³ The Economist, May 7, 2009.

Graph 21 – Credit card conditions have tightened

Sources: Federal Reserve Board and Desjardins, Economic Studies

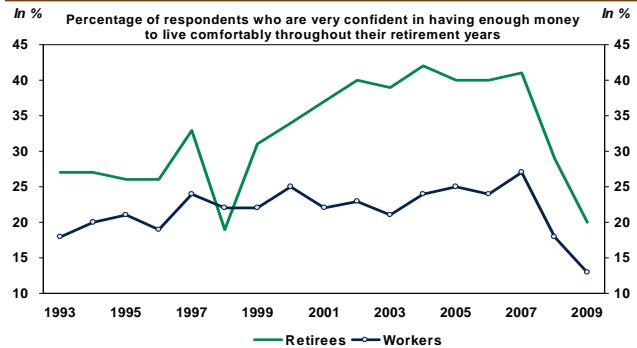
Officers survey indicated that they were reducing credit card limits, which is fairly normal considering that 90% of these institutions expect the quality of credit card loans to deteriorate.

We therefore expect the debt level in U.S. households to continue to fall in the next few years. At its worst, the level of debt should not rise as swiftly as income once the economic recovery is firmly on its way. This situation will somewhat offset the impact of falling assets on net household values, but it will not help consumption accelerate. As long as income remains stable, two conditions are required to pay back debt: increased savings and slower spending.

MOVEMENTS IN NET HOUSEHOLD VALUES, CONSUMPTION AND SAVINGS

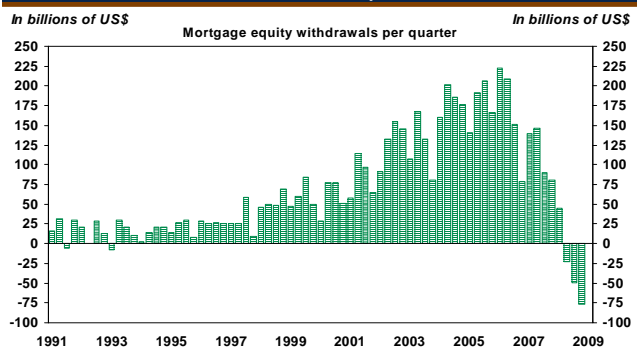
Households feel wealthier when two things take place: when the value of household assets increases or when real income increases. When consumers feel their financial position is improving, they consume more goods and services. This is what we call the wealth effect; a richer population spends more.

The wealth effect implies that any increase in asset values has a positive effect on consumption, but it also has positive impact on the portion of income earmarked for consumption. The deterioration of household balance sheets in almost two years did not bode well for consumption. Households, uncertain of their own financial positions, are compelled to be cautious in their spending habits. The decline in their investments, especially retirement funds, is such that households must put more money aside to prevent any deterioration in their lifestyles over the long term. A recent survey by the Employee Benefit Research Institute showed that only 13% of responding workers were very confident that they will have saved enough money to provide for a comfortable retirement, a historic low. The situation has deteriorated sharply as well for respondents who have already retired (graph 22).

Graph 22 – Workers and retirees concerned about their standard of living in the future

Sources: Employee Benefit Research Institute and Desjardins, Economic Studies

The current context of depreciating values for financial and real estate assets has also removed the option households had to consume part of the value of their assets, by using credit. The wave of mortgage re-financing and home equity loans that rippled through the first half of the decade, mainly through mortgage-secured lines of credit, is now behind us. According to a study published by the Federal Reserve, penned by Alan Greenspan and James Kennedy, households managed to increase their disposable income by about US\$175B per quarter between 2003 and 2006. This situation has since been reversed and equity loans are now in negative territory (-US\$77B by the end of 2008) (graph 23).

Graph 23 – Households can no longer use home values to fuel consumption

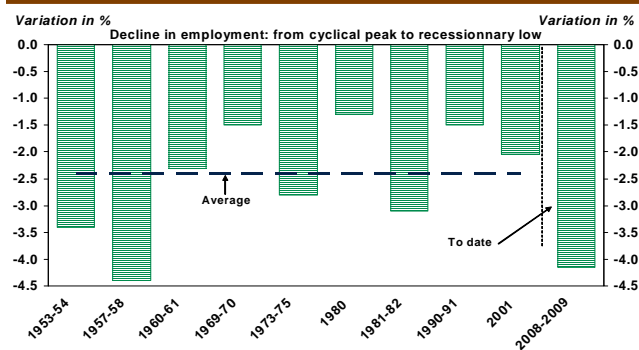
Sources: Federal Reserve Board and Desjardins, Economic Studies

The negative wealth effect—sparked by a decline in household net values—is one of the reasons behind the downtrend in consumption seen since last year. It is certainly one of the main factors behind the weak consumption relative to income that is fuelling a return to savings in households. Other factors, however, are equally important to fully understand recent shifts in consumption and to anticipate upcoming fluctuations.

A DETERIORATING JOB MARKET

The current market conditions are very difficult for American workers. This recession has been one of the most, if not the most severe in terms of employment since the Great Depression. In the 16 months since this recession began, more than 5,738,000 jobs have already been lost or 4.2% of the work force (graph 24). While we held hope that layoffs would not be as brutal in this low cycle due to the slower job growth since the last recession, the depth and breadth of the job market's deterioration was a surprise.

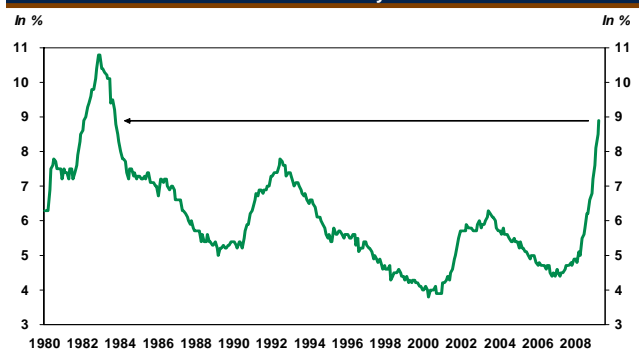
Graph 24 – This recession is tough on the U.S. job market



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

In addition to financial losses and the contraction in the real estate market, we must now add the troubles in the job market as a new cause for concern in U.S. households. In April, the jobless rate reached 8.9%, the highest level since September 1983 (graph 25). Moreover, this jump in the number of people without jobs was very swift: the jobless rate was 4.5% just two short years ago. This deterioration does not only affect those who recently lost their jobs. Those lucky enough to

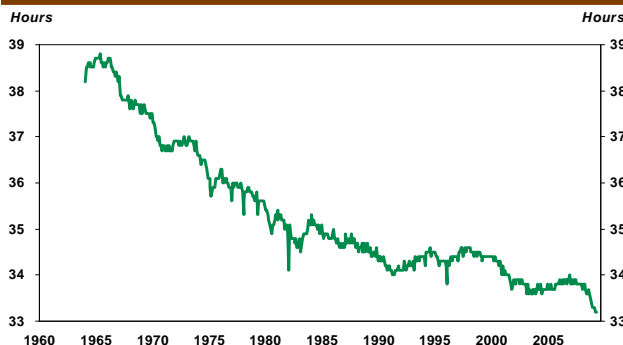
Graph 25 – Jobless rate reached its highest level in more than 25 years



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

have kept their jobs often see their hours cut: the number of hours worked per week fell from 33.9 hours in 2006 to 33.2 hours in April 2009, the lowest number on record (graph 26).

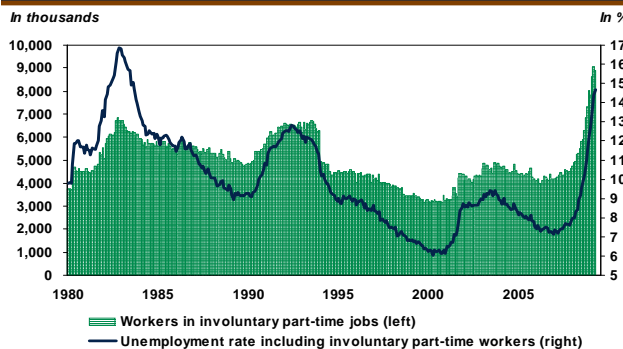
Graph 26 – Weekly hours worked set a new low



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

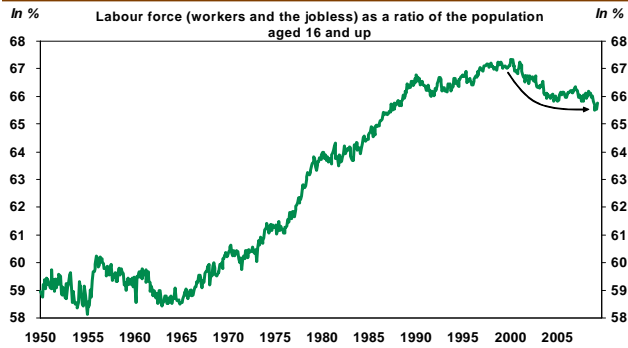
The number of involuntary part-time workers (those who would prefer to work full time) is 8,900,000. If we take these workers into account, the jobless rate climbs to 14.7% (graph 27). The portion of jobless individuals shoots up even higher if we include those who would like to work but are no longer part of the labour force because they are discouraged by the difficulties in the job market. Lastly, the jump in the jobless rate was eased by a drop in the labour force at the end of the 1990s. Between 2000 and 2009, the rate of participation (workers and the jobless as a share of the total population of labour force age) has fallen by more than 1% (graph 28).

Graph 27 – Number of involuntary part-time workers is very high



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

Graph 28 – Rate of activity is falling

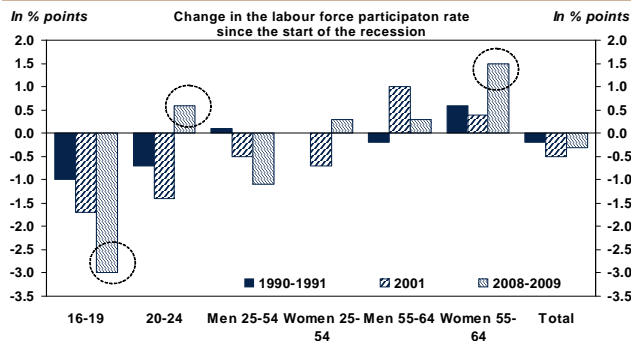


Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

The huge difficulties in today’s job market are not helping households to ramp-up consumption. In fact, personal income from wages has dipped by 1.9% since the peak reached in 2008 (the drop is 2.8% in the private sector).

The drop in the value of household assets, discussed earlier, has its own consequences on the make-up of the job market. During a recession, individuals usually withdraw from the labour force. This trend is especially observable among young workers who would rather go back to school instead of trying their luck in an unwelcoming job market. During the recession of 2001, men aged 55 to 64 went back to work to make up for the drop in the value of their financial assets after the techno bubble burst. This was not the case for women, however. The breadth of the stock market meltdown and falling home values brought on by this recession are prompting individuals aged 55 and up, women included, to jump back into the job market (graph 29). The return of these workers speaks volumes of how fragile personal finances are in households. The lack of opportunities on the job front is such that intentions to preserve a suitable income could fall flat. Yet another sign that consumption will continue to sag.

Graph 29 – Younger people quitting the job market, but students and older women persevering

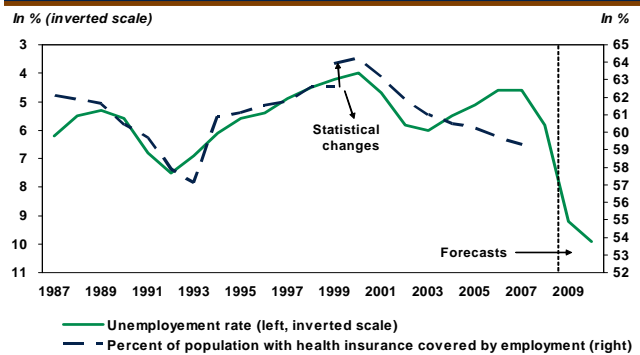


Sources: Bureau of Labor Statistics, Federal reserve of San Francisco and Desjardins, Economic Studies

JOB LOSSES AND HEALTH INSURANCE

Another consequence of job loss on consumption and personal finances stems from the health insurance system in the U.S., where 87.8% of the population has private health insurance coverage through their employers⁴. In these circumstances, the consequences of a layoff extend far beyond the lost income. As such, it is quite probable that millions of people have lost their health care insurance in the past few years (graph 30). If this loss cannot be offset by access to a government program or to coverage provided through another family member’s employer, households may try to save more to remedy this uncertainly.

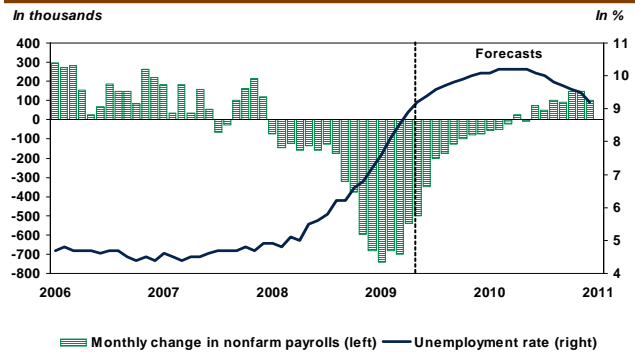
Graph 30 – Rise in unemployment could see further declines in health insurance coverage



Sources: Bureau of Labor Statistics, Census Bureau and Desjardins, Economic Studies

The impact on consumption and savings are taken into account in our forecast models via changes in the jobless rate. We must highlight however that we expect layoffs to continue to mount over the next few months. We expect total job losses since the start of the recession to exceed 7,000,000, implying that close to another two million jobs will be lost by the end of the year. The total jobless rate should exceed 10% in the first quarter of 2010 (graph 31).

Graph 31 – Job losses should continue, and the jobless rate will top 10%

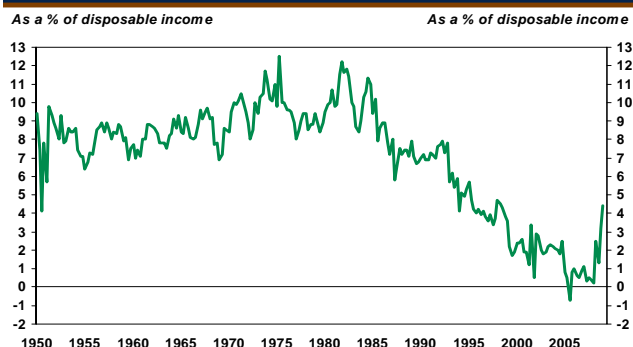


Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

⁴ 15.3% of the U.S. population, or 45.7 million people, did not have health insurance in 2007. The U.S. government provides health insurance to 27.8% of Americans through Medicare and Medicaid.

We have shown how changes in household balance sheets, credit conditions and the job market can influence on the portion of income earmarked for consumption or savings. As such, in this current context, the stock market meltdown, the contraction in home values, the extreme tightening of credit conditions and rising unemployment imply a decline in households' propensity to consume and a jump in the savings rate. When real consumption showed vitality in the first quarter, we noted that the savings rate was rising from 3.2% at the end of 2008 to 4.4% (graph 32) a peak on a quarterly basis since 1998. Despite the 1.5% increase, consumption has clearly declined as a ratio of disposable income, which grew by 6.5%.

Graph 32 – The saving rate is rising



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

ANTICIPATED INCREASES IN DISPOSABLE INCOME

It seems abundantly clear that mounting job losses are having a negative impact on the evolution of household income. In addition, soft stock market returns and even weaker corporate profits are limiting dividend income, much like free-falling interest rates are reducing income earned on loans granted. As such, right now few factors are contributing to an increase in income, expressed in current dollars. The gains made in January and in Q1 2009 stemmed from short-term adjustments made to the wages of federal public servants and military personnel and transfers to individuals (mostly in terms of social security). Income tax returns were also high in the first quarter, probably a delayed reaction to the tax cuts included in the Bush Administration's economic stimulus plan. If not for these exceptional factors, real disposable income in households would have declined by 1% in the first quarter instead of posting substantial gains of 6.5% (annualized).

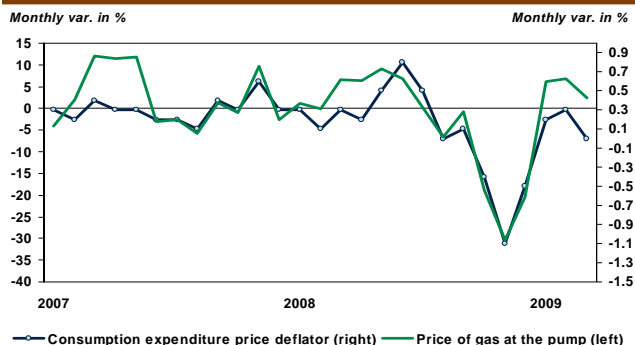
Over the next few quarters, we can expect household income to continue to get support from government efforts to jump start the economy. Certain provisions regarding personal income taxes and adjustments to government transfers entered into effect in April and May 2009. These factors should remedy the pullback in disposable income after the rebound seen at the beginning of the year. Weak income growth should then settle in, as long as the job market begins to stabilize.

In the past three quarters, real income has largely benefited from the sharp drop in energy prices. While gas prices stood at above US\$4 a gallon in mid-2008, nominal consumer spending on gas ate up 4% of disposable income. With prices at the pump at about US\$2 per gallon in March 2009, the ratio fell to 2.3%. This can also be seen in the 1.4% drop in the consumer spending deflator since July 2008 (graph 33). This contribution is already dwindling and gas prices, like oil prices, have started to climb. If this climb continues, rising energy prices will play against movements in real income.

RISING SAVINGS

The combination of the negative wealth effect, credit conditions that are still quite severe, rising unemployment and moderate real income growth are boosting savings at the expense of consumption. The question is: What do the next few quarters have in store?

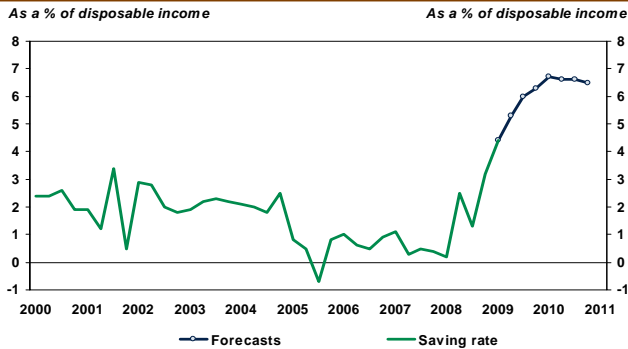
Graph 33 – Drop in gas prices led to a decline in the consumer spending deflator



Sources: Bureau of Economic Analysis, Energy Information Administration and Desjardins, Economic Studies

Our model, which determines the savings rate based on a set of variables including those mentioned above (see box on page 12), calls for an increase relative to the 4.4% rate recorded in Q1 2009. This rate should climb to about 6% in the coming quarters (graph 34). The portion of income earmarked for consumption will therefore continue to decline. The stock market's recovery since March, if it proves lasting, should see the savings rate level off quickly much like improvements in credit conditions (already noted in the Fed's survey of Senior Loan Officers). Relatively weak interest rates are also limiting the possibility of seeing any sharp increase in the savings rate⁵.

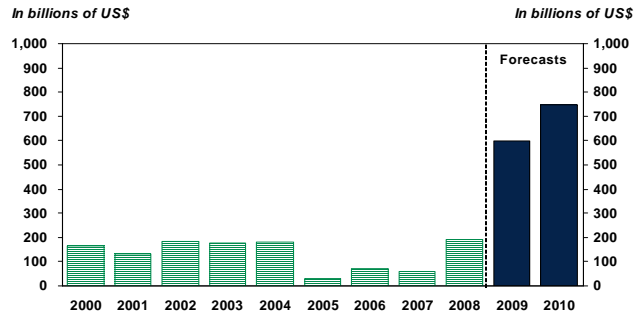
Graph 34 – Increase in the savings rate should continue



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

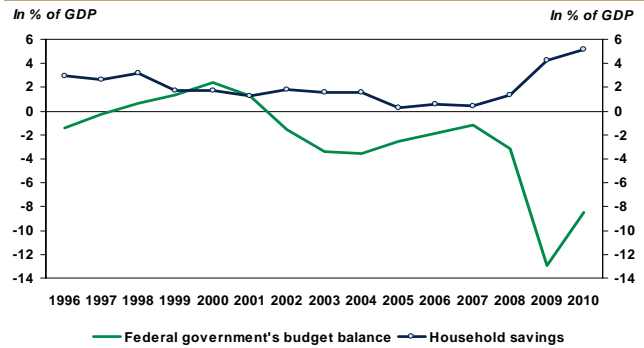
What does this increase in the savings rate really mean for households? Based on our forecasts on real disposable income and the consumer spending deflator, we can track the movements in nominal disposable income, which is the savings rate denominator. According to our model, the savings rate should be 5.5% on average in 2009 and 56.6% in 2010. We can therefore estimate that household savings will total US\$600B in 2009 and US\$750B in 2010. This is in stark contrast with the anaemic numbers posted during earlier years: on average, Americans saved a meagre US\$54B between 2004 and 2007 (graph 35). The jump in savings should help households slash their debt. These funds could be channelled, either directly or indirectly, into reducing the federal government's huge debt (graph 36).

Graph 35 – Amounts socked away in household savings will be much greater



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

Graph 36 – Household savings to help offset a portion of government debt



Sources: Bureau of Economic Analysis, Energy Information Administration and Desjardins, Economic Studies

THE OBAMA ADMINISTRATION'S STIMULUS PLAN AND HOUSEHOLDS

A large part of the government efforts to counter this recession is aimed at restoring confidence in households and stimulating consumption. The American Recovery and Reinvestment Act of 2009, the ambitious recovery plan launched by the Obama administration and adopted by Congress in February 2009 includes a wide range of measures to the tune of US\$787B over ten years. A large part of this government plan, or US\$585B, is set to be implemented during this budget year and next year, in other words, just when the U.S. economy needs a boost (graph 38).

⁵ Updates to our model show less worrisome results than our estimates in our quarterly Economic and Financial Outlook published in March for spring 2009. We had called for a possible increase in the savings rate up to 8%.

SAVINGS RATE FORECAST MODEL

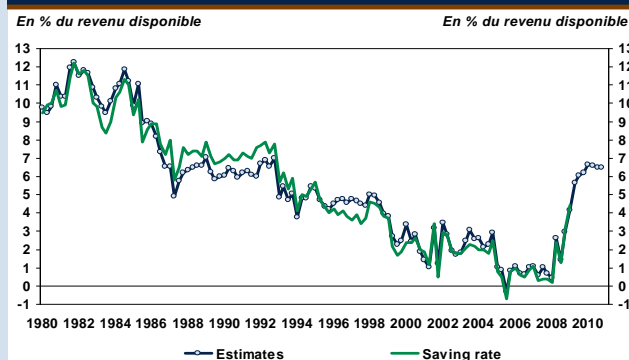
Our forecast model for the savings rate is based on concepts discussed in this Economic Viewpoint. In using this model, we are trying to account for changes in the savings rate brought on through the wealth effect and fluctuating unemployment, credit conditions, interest rates and disposable income. To this we have added elements that could help explain shifts in households' propensity to save, like price fluctuations and the participation of women in the job market.

And since the Federal Reserve is slow to publish its official results on household wealth, we sought to assess this savings determinant directly based on the value of the S&P 500 and the S&P/Case-Shiller house price index.

Like many other macroeconomic variables, the savings rate leads to problems with stationarity which can distort econometric calculations. To alleviate this situation, an single equation error correction model is used. The explanatory variables linked to the stock market and home prices were adjusted to provide a stationary format. The variable represented by credit conditions, drawn from the Fed's survey of Senior Loan Officers, represents the willingness of banks to grant consumer loans with instalment credits. Any increase in this variable means that obtaining credit has just gotten easier.

The estimate is based on data from Q1 in 1980 to Q1 in 2009 (graph 37). The estimated variable is the first difference in the savings rate. The overall regression is significant, like each of the explanatory variables selected. The results are presented in the following table:

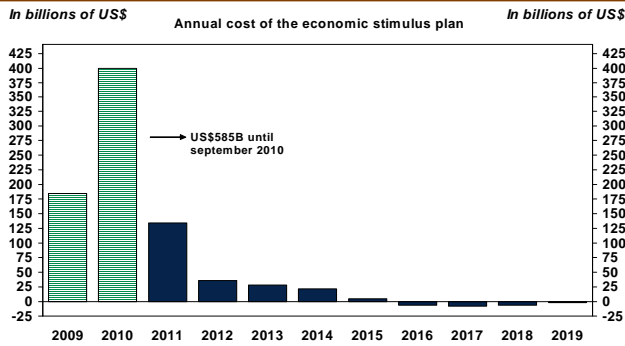
Graph 37 – Savings rate estimates since 1980



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

Variables	Coefficients	p-value
Constant	1.288	0.004
Long-term determinants		
Savings rate (one lag)	-0.076	0.000
S&P 500 index/nominal disposable income (one lag)	-6.737	0.000
S&P/Case-Shiller index/nominal disposable income (one lag)	-53.654	0.009
Credit conditions (one lag)	-0.005	0.032
Short-term determinants		
S&P 500 index/nominal disposable income (first difference, two lags)	-7.422	0.056
S&P/Case-Shiller index/nominal disposable income (first difference)	-209.267	0.026
10-year bond rates (first difference)	0.251	0.000
Jobless rate (first difference)	0.569	0.000
Real disposable income (first difference and in log)	75.464	0.000
Consumer spending deflator (first difference and in log)	31.173	0.003
Rate of women's participation in the job market (first difference)	-0.410	0.026
Savings rate (first difference and one lag)	-0.130	0.003
Other statistics		
R ²	0.8609	
Durbin-Watson statistic	2.1939	

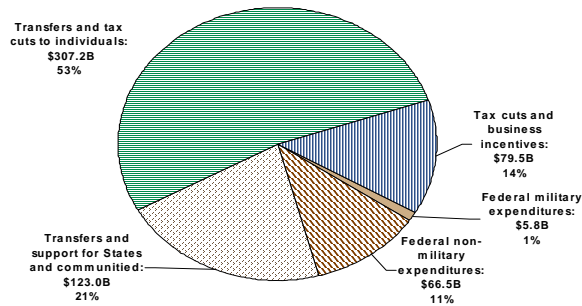
Graph 38 – The US\$787B stimulus plan is mostly for short-term spending



Sources: Congressional Budget Office and Desjardins, Economic Studies

Graph 39 – Most of the stimulus plan targets individuals

Breakdown of the plan's measures to September 2010 (end of 2010 budget year)



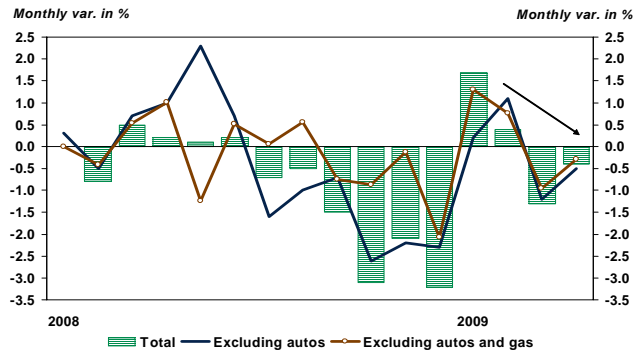
Sources: Congressional Budget Office, Joint Committee on Taxation and Desjardins, Economic Studies

Following a series of negotiations and bargaining sessions that allowed Congress to adopt the plan, some changes were made to President Obama's initial plan. One change involved targeting a bigger part of the package to tax cuts and government transfers to individuals. Graph 39 represents the ratio of different types of measures included in the plan adopted by the Congress. The different measures that target individuals specifically add up to US\$307B, or almost 53% of the plan's total amount.

How will these new government policies for households be implemented? While the basic idea remains the same, this stimulus plan differs from the plan developed by the Bush Administration in spring 2008. The plan does not rely on a single measure like sending tax cuts to individuals directly. This time, the method used is more broad-based. Several tax relief measures have been adopted, including the Make Work Pay Tax Credit for a total of US\$86B over two years and other tax credits for child care, education, first home buyers, etc. The Make Work Pay Tax Credit is an income credit of 6.2% that can reach a maximum of US\$400 per person in 2009 and 2010. Workers should already feel the difference in their paycheques.

We should be able to see the results of some of the changes brought on by the stimulus plan in the next round of monthly statistics on household income for April (at the beginning of June) and May (at the end of June). We can expect however that household disposable income will get a bit of a short-term boost. It remains to be seen whether these gains will be spent or saved, including debt repayment. Up to now, the retail sales statistics published this spring have been fairly disappointing (graph 40).

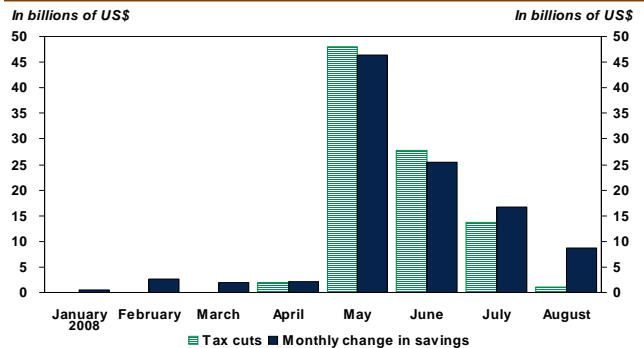
Graph 40 – Jump in retail sales in the U.S. was short-lived



Sources: Census Bureau and Desjardins, Economic Studies

It bears noting that the effectiveness of the tax cuts granted in 2008 to kick-start the economy is still debatable. Of the US\$100B transferred to households, a large portion was socked away in savings (graph 41). In addition, these funds came at a time when gas prices were soaring to peak levels, dragging down family budgets further. The net effect: between April 2008 (when cheques were starting to be sent out) and December 2008, retail sales fell by more than 10%. It is safe to say, however, that without the government's generosity, the contraction in consumption and in the economy could have been much steeper.

Graph 41 – Economic stimulus plan put in motion last summer was ineffective



Sources: Bureau of Economic Analysis and Desjardins, Economic Studies

Our model on the savings rate already provides a good idea of the tax measures that will either be spent or saved. Our savings forecast (which includes the stimulus plan in our estimates on disposable income) calls for a US\$400B increase in savings compared to 2008 and US\$150B in 2010 compared to 2009. This increase of US\$550B in savings exceeds the additional US\$307B injected from the stimulus plan into disposable income for 2009 and 2010. As such, the Obama administration's efforts to stimulate consumption could go unnoticed since they are being offset by opposing headwinds that are pushing households to save more: the contraction in wealth, rising unemployment and tightened credit conditions.

CONSUMERS AND THE ECONOMIC RECOVERY

The recession that started at the very end of 2007 is the first consumption recession since 1990-1991. In 2001, consumption showed no quarterly decline. Consumers contributed to making that recession probably one of the most severe since the end of World War II. It must be said that households were severely tested during that cycle. The bursting of the real estate bubble, the stock market meltdown, the instability of financial institutions and record job losses are all factors that call for caution.

Can consumers be completely removed from any possible rebound in the economy? No, and household spending should start to show a steady climb by the end of 2009, just when the savings rate should level off at around 6.5%.

However, we do not expect the recovery period and the growth cycle that usually follows to be characterized by a sharp growth in consumption. Households will remain the main drivers of the U.S. economy, but economic advances won't be able to depend on any ramp-up in household spending.

First of all, household balance sheets will bear the marks of this recession for a long time to come. We do not expect the savings rate to start dwindling substantially again as happened during the previous recoveries that followed the recessions of 1990 and 2001.

Secondly, the innovative financial products that paved the way toward debt and fuelled the appreciation in household assets will probably never see the light of day again. Investors and financial institutions will be far more distrustful of these types of products going forward.

In the third place, financial institutions should not be so lenient when granting loans. The financial system in the U.S. is still quite fragile and it's still leaning on government crutches to function normally. The stabilization of the banking system is still ongoing, and credit conditions will probably remain relatively tight. The deleveraging, or the dismantling of financial leveraging to healthier levels, will take time.

In the fourth place, international savings that used to be channelled to the United States, and toward U.S. consumption indirectly, could start to dwindle now that governments in several different countries are faced with difficult budget situations that will require a larger portion of source financing.

Lastly, stimulus efforts and the direct cost of the recession for the U.S. government, i.e. the public deficit, are the ball and chain that will weigh down government debt for the next ten years. Sooner or later, someone has to foot the bill and the solution could very well start with an increase in taxes or income taxes, which will translate into a reduction in households' disposable income.

And yet consumption should soon show advances that prove to be lasting, but the advances could be weak compared to what we have seen in the past 30 years. The growth of the U.S. economy will have to start stemming from other sectors. The government has stepped up to the plate during this downward cycle and the federal administration has made laudable efforts to remedy the situation. However, this will prove insufficient in the long run and hopes for a steady increase in real GDP rest mainly on business and foreign trade. Given that economies overseas are also struggling with their own difficulties and given the low level of confidence in the business sector and abnormally high inventories levels, we expect that the economic recovery in the U.S., however imminent, will be very slow indeed.

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