

Decline in Cash Available for Consumption Provides Early Warning of Recession

By Madeline Schnapp, Director of Macroeconomic Research
TrimTabs Investment Research

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The recent U.S. economic slump caught many investors flat-footed. As the Bureau of Labor Statistics estimated that the U.S. economy shed 17,000 jobs in January, the ISM Non-Manufacturing Survey Index fell to a five-year low in January, and the Philadelphia Fed Manufacturing Survey Index plummeted to a seven-year low in February, panicked investors yanked massive amounts of cash out of U.S. equities in January and February.

But the economic downturn came as no surprise to us. Since late October 2007, we have been reporting that the economy was heading into a consumer recession. How did we know what flawed, lagged data from the Bureau of Economic Analysis (BEA) and the Bureau of Labor Statistics (BLS) long failed to reveal? We knew because the amount of cash American consumers have available for consumption has been growing at a lethargic rate for more than a year, and we expect it to decline this quarter on a year-over-year basis for the first time since late 2003.

The TrimTabs Consumer Spendables Indicator (TTCSI) measures the three most important sources of consumption cash in the economy:

1. *After-tax wages.* We obtain data on after-tax wages from daily deposits of withheld income and employment taxes to the U.S. Treasury.
2. *After-tax income from non-wage sources.* Non-wage income includes income from a variety of sources, including capital gains, dividends, interest, partnerships, pensions, rentals, self-employment, and S-corporations. We obtain data on after-tax income from non-wage sources from daily payments of “Other Income Tax Not Withheld” to the U.S. Treasury.
3. *Net equity extraction.* This cash is generated when individuals extract equity from homes either through home sales or mortgage refinancing. We obtain data on net equity extraction from the Federal Reserve and Freddie Mac.

The table below shows TTCSI and its three components on a quarterly basis from Q1 2002 through Q1 2008 (data for Q1 2008 is a projection). The graph below shows year-over-year percentage changes in TTCSI from Q1 2002 through Q1 2008.

What is immediately apparent from the data is that growth in TTCSI was tremendous from Q3 2004 through Q2 2006. Specifically, growth exceeded 10% year-over-year in four of those eight quarters. Growth was surging not because wages and salaries were skyrocketing but because consumers were extracting massive amounts of equity from their homes. Specifically, consumers extracted \$565 billion in equity in 2004 and \$535 billion in equity in 2005, which is why the economy confounded the chicken littles who were constantly predicting an economic slump. It is also why economic growth was much stronger than the initial figures the BEA and the BLS reported at that time.

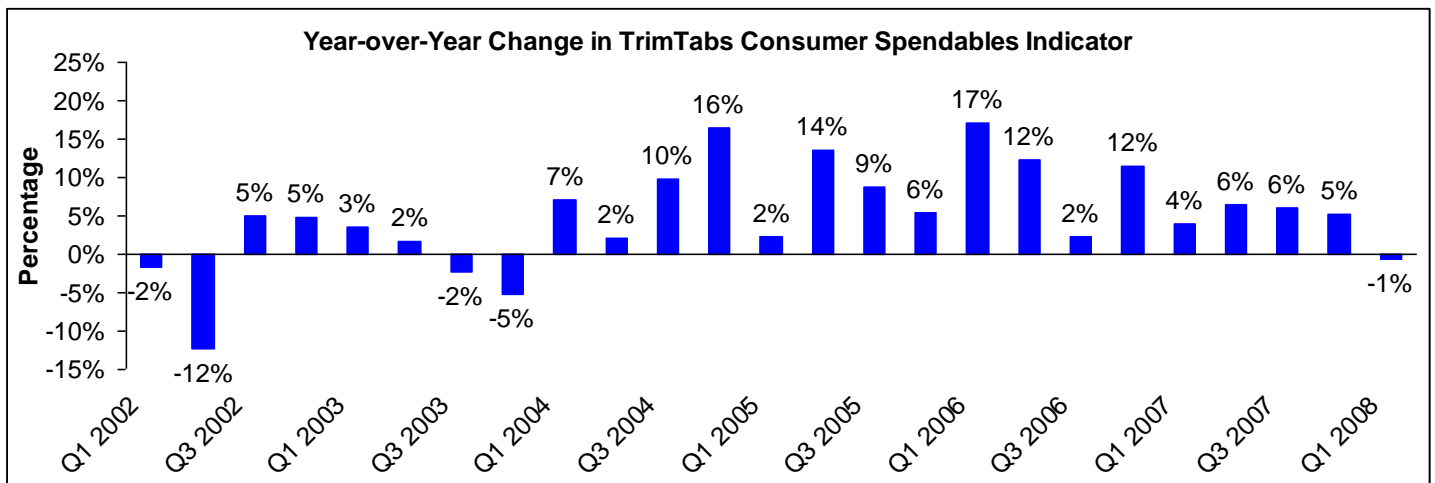
The economic landscape changed starting in late 2006. As the housing slump deepened, consumers extracted less equity from their homes, and the slowdown in real estate activity began to weigh on overall economic activity. From Q3 2006 through Q4 2007, growth was below 7% year-over-year in all but one quarter.

In Q1 2008, we estimate that TTCSI will be \$1.749 trillion, down 0.6% from \$1.760 trillion in Q1 2007. In other words, consumers will have substantially less money to spend this quarter in real terms than in the same quarter last year. The main reason for the drop is that net equity extraction will be an estimated \$60 billion lower in Q1 2008 than it was in Q1 2007. Due in large part to the inability of consumers to extract huge amounts of equity from their homes, the economy has already fallen into a consumer-led recession even though data from the BEA and the BLS does not fully reflect the economic slump.

TrimTabs Consumer Spendables Indicator, Q1 2002-Q1 2008

\$ U.S. Billions Quarter	(1)	(2)	(3)	(1) + (2) + (3)	Year-over-Year
	After-Tax Income from Wages and Salaries	After-Tax Income from Other Sources	Net Equity Extraction	TrimTabs Consumer Spendables Indicator	% Change in TrimTabs Consumer Spendables Indicator
Q1 2002	990.9	199.6	87.3	1,277.8	-1.7%
Q2 2002	915.4	545.5	108.1	1,569.0	-12.3%
Q3 2002	914.8	170.0	135.7	1,220.5	4.9%
Q4 2002	964.1	52.4	145.0	1,161.5	4.8%
Q1 2003	1,049.9	180.2	91.7	1,321.9	3.4%
Q2 2003	965.8	480.2	148.9	1,594.9	1.6%
Q3 2003	920.1	160.2	111.6	1,191.8	-2.4%
Q4 2003	996.6	57.2	46.2	1,100.1	-5.3%
Q1 2004	1,106.4	168.5	139.4	1,414.3	7.0%
Q2 2004	1,015.9	465.7	146.2	1,627.8	2.1%
Q3 2004	1,002.5	154.9	150.4	1,307.8	9.7%
Q4 2004	1,088.4	62.5	129.4	1,280.3	16.4%
Q1 2005	1,169.9	182.4	94.8	1,447.1	2.3%
Q2 2005	1,076.6	624.3	148.3	1,849.3	13.6%
Q3 2005	1,075.5	184.0	162.3	1,421.8	8.7%
Q4 2005	1,155.3	65.7	129.8	1,350.8	5.5%
Q1 2006	1,285.0	217.6	191.2	1,693.8	17.1%
Q2 2006	1,156.2	761.0	159.2	2,076.5	12.3%
Q3 2006	1,129.2	209.0	116.7	1,454.9	2.3%
Q4 2006	#1,325.8	89.1	91.3	1,506.2	11.5%
Q1 2007	1,384.0	246.7	129.1	1,759.8	3.9%
Q2 2007	1,233.0	841.5	136.8	2,211.4	6.5%
Q3 2007	1,199.8	230.6	111.5	1,542.0	6.0%
Q4 2007	#1,410.5	86.2	*86.5	1,583.3	5.1%
Q1 2008	*1,425.5	*254.1	*69.2	1,748.8	-0.6%

* = TrimTabs estimate. # = Adjusted for year-end calendar quirk. Note: Data on after-tax income from wages and salaries is based on withheld income and employment taxes; data on after-tax income from other sources is based on "Other Income Tax Not Withheld" taxes. We assume net average tax rates for income tax withholdings of 27.0% in 2001, 26.5% in 2002, 26.0% in 2003, and 25.5% from 2004 through 2008. We assume net average tax rates for "Other than withheld" taxes of 26.0% in 2001 and 25.0% from 2002 through 2008. Sources: Daily Treasury Statement, Freddie Mac, and updated estimates provided by James Kennedy of the mortgage system presented in Alan Greenspan and James Kennedy, "Estimates of Home Mortgage Originations, Repayments, and Debt on One-to-Four-Family Residences," Federal Reserve Board FEDS working paper no. 2005-41.



The eventual outcome of the housing bubble that peaked in the summer of 2005 was obvious even to the most casual observers. But what few investors could know was exactly when tight credit and the housing slump would spill over into the broader economy and negatively impact income growth and job growth.

We believe that time arrived in October 2007. Both wage growth and non-wage income growth began to decelerate due to the sharp tightening of credit and the deepening slide in home prices. While declining growth in wage and non-wage income were not enough to tip the economy into a recession, it signaled that consumers were on shaky ground. In addition, our real-time employment indicators measured a job loss in October 2007 for the first time since May 2003. At that point, we determined that the economy had slid into a consumer-led recession.

What does the future hold for consumers? The outlook is bleak over the next couple of quarters because the job market and the housing market are deteriorating. Our real-time employment indicators show that the economy is currently shedding jobs, and we expect job losses to continue well into the second quarter. Also, the bottom of the housing market is at least several quarters away. Home prices are a function of liquidity. When it is possible to buy a home with no money down at below market interest rates, home prices will rise to almost infinite levels. When down payments are required from creditworthy borrowers who must borrow at market interest rates, home prices will plummet until buyers deem them cheap given current credit conditions and inventories of unsold homes reach reasonable levels. Neither of those conditions exists now, so we expect further house price declines to limit net equity extraction over the near term.

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