Economist-Bloggers Offer Perspectives on Recent Consumer Spending Trends

In practically every news report on the economy, we hear about the rise—or fall—of consumer spending. Accounting for about 70 percent of U.S. economic activity, consumer spending is widely hailed as the main engine of economic growth. When Americans buy more goods and services, businesses generate higher sales and profits and can afford to hire workers. Less consumer spending generally results in slower economic growth.

To inform the public and policymakers, the Liberty Street Economics blog recently examined two topics related to consumer spending: how consumers have reacted to the expiration of the payroll tax cut of 2011-12 and how they are coping with unprecedented levels of student loan debt.

In My Two (Per)cents: How Are American Workers Dealing with the Payroll Tax Hike? Basit Zafar, Max Livingston, and Wilbert van der Klaauw explore the implications of the payroll tax cut—and its subsequent expiration—for U.S. workers.

The tax cut, which was in place during all of 2011 and 2012, reduced Social Security and Medicare taxes withheld from workers’ paychecks by 2 percent. This tax cut affected nearly 155 million workers in the United States, and put an additional $1,000 a year in the pocket of an average household earning $50,000. As part of the “fiscal cliff” negotiations, Congress allowed the 2011-12 payroll tax cut to expire at the end of 2012, and the higher income that workers had grown accustomed to was gone.

The authors find that the tax cut led to a substantial increase in consumer spending and facilitated the pay-down of debt. In addition, they point to a recent consumer survey that suggests that the expiration of the payroll tax cut is likely to lead to a substantial reduction in spending and contribute to a slowdown, or possibly a reversal, in the debt pay-down. However, given other concurrent changes in the macroeconomy, such as the increase in housing wealth of U.S. consumers over the last year, it may be difficult to detect the response to the tax hike in aggregate statistics.
Another obstacle to economic growth may be consumers’ unprecedented levels of student debt. Student loans are considered by economists to be “good debt,” since study after study has shown that college graduates earn more over a lifetime. But an increasing number of borrowers are struggling to pay them off. There are now more consumers with student debt—at higher levels than ever before—and delinquencies have been growing.

In Young Student Loan Borrowers Retreat from Housing and Auto Markets, Meta Brown and Sydnee Caldwell examine trends in homeownership, auto debt, and total borrowing, and find that high levels of student debt may be dampening young workers’ post-schooling economic activity.

The bloggers observe that for the first time in at least ten years, thirty-year-olds with no student loans are more likely to have home-secured debt (mortgages) than those with student loans, and that the same pattern holds for auto market participation for twenty-five-year-olds. By the end of 2012, student loan borrowers were actually less likely to hold mortgage and auto debt than their peers with no student debt.

Brown and Caldwell put forth two reasons why consumers with student loans are withdrawing from the housing and auto debt markets: First, a weakening in the labor markets since 2007 has likely lowered graduates’ expectations of their future income. Declining participation in the housing and auto debt markets may be a result of graduates decreasing their consumption, and thus debt, levels in response to these lower expectations.

A second reason could be more limited access to credit. In response to the recent recession and credit crunch, lenders have tightened underwriting standards in all major consumer debt markets. Consumers with substantial student debt therefore may not be able to meet the stricter debt-to-income ratio standards that are now being applied by lenders. In addition, repayment delinquency has become more prevalent among student borrowers.

Both of these factors—lower expectations of future earnings and more limited access to credit—may have broad implications for the ongoing recovery of the housing and auto markets, and of U.S. consumer spending more generally.

Research Group Publications and Other Media

- Second District Highlights—a regional supplement to Current Issues.
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- Publications and Other Research—an annual catalogue of our research output.
- Liberty Street Economics—a blog that enables our economists to engage with the public on important economic issues quickly and frequently.
Since the onset of the financial crisis, households have reduced their outstanding debt by about $1.3 trillion. [Editor’s note: As of first-quarter 2013, this figure is $1.45 trillion.] While part of this reduction stemmed from a historic increase in consumer defaults and lender charge-offs, particularly on mortgage debt, other factors were also at play. In The Financial Crisis at the Kitchen Table: Trends in Household Debt and Credit (Current Issues in Economics and Finance, vol. 19, no. 2), Meta Brown, Andrew Haughwout, Donghoon Lee, and Wilbert van der Klaauw use a rich new data set on individual credit accounts to investigate the consumer behavior underlying these trends.

This data set—the Federal Reserve Bank of New York Consumer Credit Panel—is an ongoing panel of quarterly data on individual and household debt. It is created from a large sample of U.S. consumer credit reports provided to the New York Fed by Equifax, one of three national credit reporting agencies.

The authors’ analysis of the Consumer Credit Panel reveals that households actively reduced their obligations since 2008 by paying down their current debts and reducing new borrowing. These choices, along with banks’ stricter lending standards, helped drive this deleveraging process.

The authors note that, in light of recent modest improvements in credit availability, an important question is how much further consumers’ voluntary actions will lower aggregate debt before spending resumes. While the pay-down of debt has helped improve household balance sheets, it has also likely contributed to slow consumption growth since the beginning of the recession. Therefore, “the trajectory for consumer indebtedness has important implications for consumption and economic growth going forward.”

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Out of the “Shadows”: A Look at a Critical Banking System

The nature of financial intermediation has changed in step with the rapid growth of the market-based financial system. “Shadow banks” now serve a critical role, yet they are still a mystery to some. A forthcoming study in the Economic Policy Review helps to demystify the banks by describing the institutional features of the shadow banking system.

Authors Zoltan Pozsar, Tobias Adrian, Adam Ashcraft, and Hayley Boesky also consider the system’s economic role and its relation to the traditional banking system as well as offer observations on the future of shadow banks in light of recent reform efforts. They argue that an understanding of the “plumbing” of the shadow banking system is an important underpinning for any study of financial system interlinkages.

Shadow banks are financial intermediaries that conduct maturity, credit, and liquidity transformation without explicit access to central bank liquidity or public sector credit guarantees. They intermediate credit through various securitization and secured funding techniques, including asset-backed commercial paper and securities, collateralized debt obligations, and repos. The banks contributed to asset price appreciation and credit expansion prior to the recent financial crisis. During the crisis, however, the shadow banking system’s vulnerabilities and fragility were exposed, compelling the Federal Reserve and other government agencies to provide emergency support.

Using the Fed’s “Flow of Funds” data, Pozsar and his coauthors calculate that shadow bank liabilities grew to nearly $22 trillion in June 2007, compared with about $14 trillion in traditional banking liabilities. Yet the size of the shadow banking system has contracted substantially since then, while traditional banking liabilities have continued to grow.

As such, the authors contend that despite efforts to address the excesses of credit bubbles, the shadow banking system will likely continue to play a significant role in the financial system for the foreseeable future. Furthermore, higher capital and liquidity standards for traditional banking entities are “likely to increase the returns to shadow banking activity,” partially because reform efforts have done “little to address the tendency of large institutional cash pools to form outside the banking system.”

The study, Shadow Banking, updates a 2010 paper published in the Staff Reports series; it includes a series of online appendixes that depict graphically the processes of the shadow banking system and its many components.
Top Blog Posts of Q2

Our Liberty Street Economics blog publishes on economic topics twice a week—more frequently when there is a post on a newly released report or on a pressing topic.

Listed below are the top five posts in the second quarter.

- **Are Stocks Cheap? A Review of the Evidence**
  Fernando Duarte and Carlo Rosa
  May 8 – 38,985 downloads

- **Young Student Loan Borrowers Retreat from Housing and Auto Markets**
  Meta Brown and Sydnee Caldwell
  April 17 – 9,627 downloads

- **Crisis Chronicles: 300 Years of Financial Crises (1620-1920)**
  James Narron and David Skeie
  June 24 – 5,226 downloads

- **Grading Student Loans**
  Meta Brown, Andrew Haughwout, Donghoon Lee, Maricar Mabutas, and Wilbert van der Klaauw
  March 5 – 4,337 downloads

- **Do Big Cities Help College Graduates Find Better Jobs?**
  Jaison Abel and Richard Deitz
  May 20 – 4,203 downloads

Most Downloaded Publications

Listed below are the most sought-after Research Group articles and papers from the New York Fed’s website and from the Bank’s page on the Social Science Research Network site.

**New York Fed website, second-quarter 2013:**

- **Cash Dollars Abroad**
  Rebecca Hellerstein and William Ryan
  Staff Reports, no. 400, October 2009 – 16,353 downloads

- **Why Are Banks Holding So Many Excess Reserves?**
  Todd Keister and James McAndrews
  Staff Reports, no. 380, July 2009 – 4,197 downloads

- **The Financial Crisis at the Kitchen Table: Trends in Household Debt and Credit**
  Meta Brown, Andrew Haughwout, Donghoon Lee, and Wilbert van der Klaauw

**SSRN website, second-quarter 2013:**

- **The Corporate Governance of Banks**
  Jonathan R. Macey and Maureen O’Hara

- **Transparency, Financial Accounting Information, and Corporate Governance**
  Robert M. Bushman and Abbie J. Smith

- **Determinants and Impact of Sovereign Credit Ratings**
  Richard Cantor and Frank Packer

For lists of the top-ten downloads, visit our website.
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Papers Presented


“The Pre-FOMC Announcement ‘Drift,’” David Lucca and Emanuel Moench. Western Finance Association meetings, Incline Village, Nevada, June 20. Also presented by Moench at a CIRANO (Center for Interuniversity Research and Analysis on Organizations)/Bank of Canada workshop, Montreal, Quebec, Canada, April 11.


“Banking across Borders with Heterogeneous Banks,” Friederike Niepmann. CESifo Annual Area Conference on Global Economy, Munich, Germany, May 17.


“The Effects of the Saving and Banking Glut on the U.S. Economy,” Andrea Tambalotti. Advances in DSGE Models, a workshop at the University of Milan Bicocca, Milan, Italy, June 13. With Alejandro Justiniano and Giorgio Primiceri. Also presented at a University of Padova seminar, Padova, Italy, June 18.


“Credit Constraints, Subjective Expectations, and College Choice in Urban Pakistan,” Basit Zafar. Political Economy of the Muslim World, a conference jointly organized by the Baker Institute of Public Policy at Rice University and the Association for Analytic Learning about Islam and Muslim Societies, Rice University, Houston, Texas, April 6. With Adeline Delavande.


New Titles in the Staff Reports Series

**Macroeconomics and Growth**

No. 613, April 2013  
The Gender Unemployment Gap  
Stefania Albanesi and Ayseş Şahin  
Albanesi and Şahin study the evolution of gender differences in unemployment from a long-run perspective and over the business cycle.

No. 615, May 2013  
Dynamic Effects of Credit Shocks in a Data-Rich Environment  
Jean Boivin, Marc P. Giannoni, and Dalibor Stevanovic  
The authors reexamine the evidence on the propagation mechanism of credit shocks to economic activity. Such shocks are found to have important effects on real activity measures, aggregate prices, leading indicators, and credit spreads.

No. 617, May 2012  
The Impact of Housing Markets on Consumer Debt: Credit Report Evidence from 1999 to 2012  
Meta Brown, Sarah Stein, and Basit Zafar  
The authors investigate the effects of large swings in the housing market on nonmortgage borrowing, including student, credit card, auto, and home equity debts.

No. 618, May 2013  
Inflation in the Great Recession and New Keynesian Models  
Marco Del Negro, Marc P. Giannoni, and Frank Schorfheide  
The authors use a standard DSGE model, available prior to the recent financial crisis and estimated using data up to third-quarter 2008, to explain the behavior of key macroeconomic variables since the crisis.

No. 621, April 2013  
Shared Knowledge and the Coagglomeration of Occupations  
Todd M. Gabe and Jaison R. Abel  
Occupations with similar knowledge requirements tend to coagglomerate, or locate near one another, and the importance of this shared knowledge is greater in metropolitan areas than in states.

**Microeconomics**

No. 610, April 2013  
Up Close It Feels Dangerous: “Anxiety” in the Face of Risk  
Thomas M. Eisenbach and Martin C. Schmalz  
Eisenbach and Schmalz model an “anxious” agent as more risk averse to imminent, rather than distant, risk. They show that costly delegation of investment decisions is a strategy for coping with agent anxiety.

No. 611, April 2013  
A Bargaining Theory of Trade Invoicing and Pricing  
Linda Goldberg and Cédric Tille  
Goldberg and Tille develop a theoretical model of international trade pricing in which individual exporters and importers bargain over the transaction price and exposure to exchange rate fluctuations.

No. 612, April 2013  
Inflation Risk and the Cross Section of Stock Returns  
Fernando M. Duarte  
Duarte argues that the inflation risk premium arises because high inflation lowers expectations of future real consumption growth.

No. 614, May 2013  
Going Global: Markups and Product Quality in the Chinese Art Market  
Jennie Bai, Jia Guo, and Benjamin Mandel  
The authors exploit some special features of the Chinese fine-art market to study the influence of quality and markups on international prices.

No. 619, April 2013  
A Bargaining Theory of Trade Invoicing and Pricing  
Linda Goldberg and Cédric Tille  
Goldberg and Tille develop a theoretical model of international trade pricing in which individual exporters and importers bargain over the transaction price and exposure to exchange rate fluctuations.

No. 609, April 2013  
Banking across Borders with Heterogeneous Banks  
Friederike Niepmann  
Niepmann develops a general equilibrium model of trade and foreign direct investment in banking to explain the heterogeneity in banks’ foreign operations.
Banking and Finance

No. 616, May 2013
The Risk of Fire Sales in the Tri-Party Repo Market
Brian Begalle, Antoine Martin, James McAndrews, and Susan McLaughlin
The authors conclude that limited tools are available to mitigate the risk of pre-default fire sales and that no established tools currently exist to mitigate the risk of post-default sales.

No. 620, May 2013
Trading Partners in the Interbank Lending Market
Gara Afonso, Anna Kovner, and Antoinette Schoar
There is large and persistent heterogeneity in the extent to which some banks concentrate lending and borrowing across counterparties, observe Afonso, Kovner, and Schoar.

No. 622, May 2013
The Microstructure of China’s Government Bond Market
Jennie Bai, Michael Fleming, and Casidhe Horan
The authors describe the history and structure of the Chinese government bond market and assess its liquidity and informational efficiency.

Quantitative Methods

No. 619, May 2013
Time-Varying Structural Vector Autoregressions and Monetary Policy: A Corrigendum
Marco Del Negro and Giorgio Primiceri
Del Negro and Primiceri correct a mistake in the estimation algorithm of Primiceri’s 2005 time-varying structural vector autoregression model and propose a new algorithm for the estimation of VAR or DSGE models with stochastic volatility.

Publications are available at our webpage or may be accessed by clicking on the publication titles below.

**ECONOMIC POLICY REVIEW, VOL. 19, NO. 1**

TBA Trading and Liquidity in the Agency MBS Market
James Vickery and Joshua Wright

Unintended Consequences of School Accountability Policies: Evidence from Florida and Implications for New York
Rajashri Chakrabarti and Noah Schwartz

Trading Activity and Price Transparency in the Inflation Swap Market
Michael J. Fleming and John R. Sporn

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Rajashri Chakrabarti and Sarah Sutherland

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