

November 12, 2003

The Liscio Report

On the Economy

For John Liscio 1949-2000

Mood at State Budget Offices Continues to Improve

Our October Sales Tax Diffusion Index climbed to 80% from September's 70%, and the number of states reporting positive year-over-year growth rose from September's 80% to 85%. The three-month moving averages, graphed on p. 2, also rose. But year-ago comparisons are important to consider. The same months in 2002 were mirror images of this year: September's level of 67% slipped to 37%, and the states reporting positive growth fell from 100% in September to 51% in October. And September 2002's strength was largely about September 2001's weakness.

Looking below the surface, we note that positive growth reported in October fell into two patterns. One, the majority of states that have recently reported the largest sales tax gains saw moderation in October, slipping from the 4-5% range to 2-3%. The other group saw negative and/or flat growth turn weakly positive. ("Growth, if not grand growth.") This is good news, but suggests some cross-currents, and an overall moderation in spending patterns.

Perhaps the best news was no mention of another round of downward revisions to budget projections. A few contacts mentioned that recent braying about the end of the states' fiscal crises is premature, but meeting expectations and not being forced to revise budgets downward could signal the beginning of real improvement. And this time last year our state contacts were voicing concern that the recovery was faltering, which it in fact did.

- ***an end to downward budget revisions?***
- ***time for business to get on the stick***

A number of states have tax amnesty programs in place for October. Some of our contacts believe they have adjusted for this quite well, and still show growth. Others aren't so sure and caution that strength in collections was probably boosted

by amnesty, which might rob future months. And, speaking of future months, it makes sense that the warm weather in October probably pushed cool weather purchases into November, as has been widely reported by retailers. (The current weather pattern also was reversed in 2002; last October was plagued by sleet and freezing rain.)

fidarsi é bene; non fidarsi é meglio

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Tax cuts and confidence

The contribution of the tax cuts to consumption is hard to overstate. Shown on p. 3 is a chart of the effective tax rate on personal income—the difference, that is, between total and disposable personal income. In fact, it's almost without historical precedent. The

first round of Reagan tax cuts in the early 1980s took about two percentage points off the tax bite, lowering it from 13.7% in 1981 to 11.7% in 1984. The rate rose gently as the decade progressed, and then rather sharply through the 1990s, peaking at 15.5% in early 2001. Successive rounds of tax cutting and rebate checks have brought it down nearly four percentage points, to 11.8% in the third

quarter of this year. The tax cuts have added about \$338 billion to disposable income, roughly equal to a full month's worth of retail sales. Add to that another \$600 billion in home equity withdrawals (HEW) this year, and you've financed about three full months of retail sales. These stimuli are both running out of steam; further tax cuts of this magnitude are unlikely, and HEW is likely to yield half as much cash next year as this. Consumer incomes have gotten lots of outside assistance while the labor market has

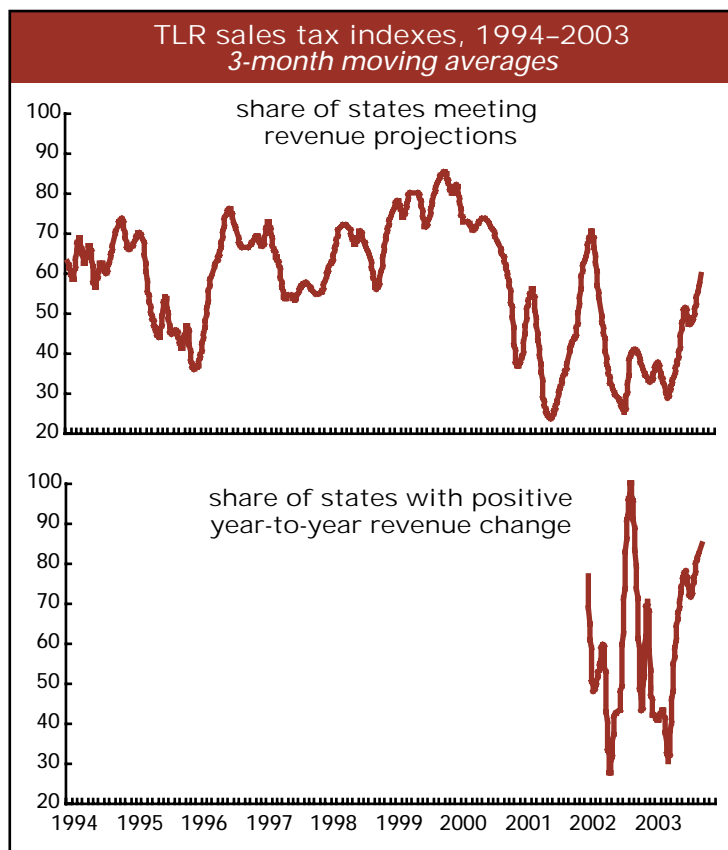
been dormant, a fact our contacts often comment on.

Attitude problems?

Is the mild pickup in the labor market over the last three months enough to keep things going? To help answer that, the

various consumer attitude measures bear close watching over the next few months.

Graphed on p. 4 are the most prominent surveys—Michigan, the Conference Board, the ABC/Money, and Gallup's—since 1970 along with retail sales. It's comforting to see that the four measures do track each other pretty closely, though their relation to retail sales is a bit less intimate. A couple of points: retail



spending has been pretty strong lately, and it's hard to imagine much of an acceleration from here. Periods of stronger retail sales growth, like those around 1976, 1984, and 1993, were, unlike recent experience, preceded by deep declines. Periods of acceleration, like those leading into those peak years, were also accompanied by strong rises in the attitude measures. And periods of deceleration or decline, like those following those peaks, were accompanied by stagnation or decline in attitudes.

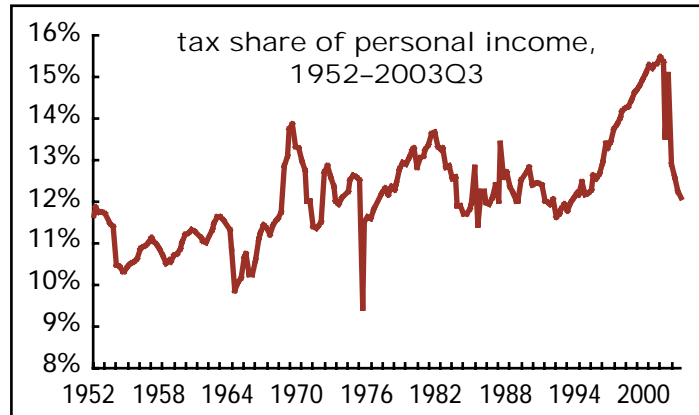
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Lately, we've been watching the sentiment measures stumble a bit after their postwar bounce. The ABC/Money measure has been stuck at -18 for three consecutive weeks, and has gone essentially nowhere since August. The Michigan and Conference Board indexes have been stronger, but they're still not in the kind of strong uptrend we'd see in a retail acceleration. It's really time for business to take up the baton from the consumer if this recovery is going to turn into something more exciting than it's been.

Friday's numbers

Our sales tax survey covers both September and early October activity, so missed the effects of the fires and transit strike in Southern California, which affected a substantial percent of the metropolitan population. Also, state sales taxes are collected on building materials that are not necessarily included in the Census retail sales reports, so that's another reason for caution. Our model, which includes prices and reported sales (and excludes the survey because of its short history), suggests Friday's Advance Retail Sales Report should come in on the weak side, with the headline at -0.4% and the ex-auto number at +0.1%. This is not out of line with our survey considering year-over-year comparisons, which should still look good on the national level even if October retail sales activity comes in a bit weaker than expected. Gas prices fell, which should be

a drag on the headline number; ex-auto and gas, we should see a somewhat healthier +0.3%. Apparel sales were held back by early October's warm weather, though housing-related sales probably extended their strong run. Auto unit sales fell again in October, and are off almost three million (at an annual rate) since August.



One several occasions when our sales tax survey was strong but other evidence weak, we've seen upward revisions to the past month. We

were on the high side of consensus for the September retail sales print, but the strength turned out to be the full percentage point upward revision to August. Although we expect the overall number to come in on the weak side this Friday, it seems likely there will be a strong point—an upward revision, a surprisingly strong sector (based on our contacts' comments, that would be building materials), or an ex-auto figure that surprises to the upside.

by Philippa Dunne and Doug Henwood

consumer surveys & retail sales



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RETAIL SALES AND THE MAJOR CONSUMER ATTITUDE MEASURES

