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Insights

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Middle-Class Earnings Move Forward

A recent release from the Census Department reports that, six years into the economic recovery, the middle class has finally seen household earnings increase. Though the reports are generally viewed to show that the middle class is burgeoning, there are those who believe this to be a false positive. Let's examine the data and what it truly means for the middle class.

Benefiting the Middle Class

The term "middle-class" is used extensively in the media, but the exact parameters of who that applies to may be unclear for some. So first, let's try to define what makes a family "middle-class." First and foremost, because different areas have varying standards of living, there are no exact numbers for determining "middle-class" finances. According to Pew Research Center, a family of four must earn $46,960 to $140,900 annually to be considered "middle-class" in the United States. Alternatively, in terms of net worth, $0 to $401,000 is considered "middle-class," according to NYU Professor Edward Wolff.

Middle-class earnings per household rose by 5.2 percent (inflation-adjusted) from 2014 to 2015. This figure includes increases for families of all ethnic backgrounds and for all major age groups. Last year marked the largest single-year household earnings increase for the middle class in nearly 50 years and is the first annual increase for middle-class families since 2007. Average household income for a middle-class family is now $56,500.

Between 2014 and 2015, the amount of full-time, year-round workers increased by 2.4 million. This is the highest number of total, full-time working adults since the recession began. Together, the information regarding growing wages and increasing employment paints a positive picture of the current state of the middle class's working situation.

In addition to increased earnings and higher employment rates, poverty levels and the number of Americans without health insurance also sharply declined between 2014 and 2015. The official poverty rate dropped by the largest amount in a single year since 1999, from 46.6 million to 43.1 million. Similarly, those without insurance declined from 33 million to just 29 million.

Cautious Optimism

Though tentatively interpreted as the middle class recovering from the recession, there may be need for cautious optimism when considering these statistics. It is important to note that the numbers that are consistently being cited by the media are based on "household" earnings, not individual earnings. Individual earnings are increasing at a much lower rate, at just 1.5 percent for men and 2.7 percent for women.

While the nominal value for household income is the highest it has been in nearly 20 years, purchasing power for the middle class's median income is lower than its peak in 1999. Even given the recent earnings increase, the middle class is still earning less than it was in 1999 when considering inflation.

Though the increase in earnings was significant in relation to 2014 numbers, this is the first time that such an increase has happened since the recession. Therefore, some analysts suggest that 2015 should be considered an outlier and not necessarily indicative of an improving middle class.

While the recent data regarding middle class earnings is generally positive, it is important to take the report with a grain of salt. Though household incomes are on the rise, purchasing power in the middle class has yet to regain the high point set back in 1999. Similarly, while poverty levels are the lowest that they have been since the recession, they are still higher than before the recession began. Whether the increase of earnings will continue to rise remains to be seen, but for now, the recent bump is some of the best news the middle class has gotten in the past decade.

the market at a glance

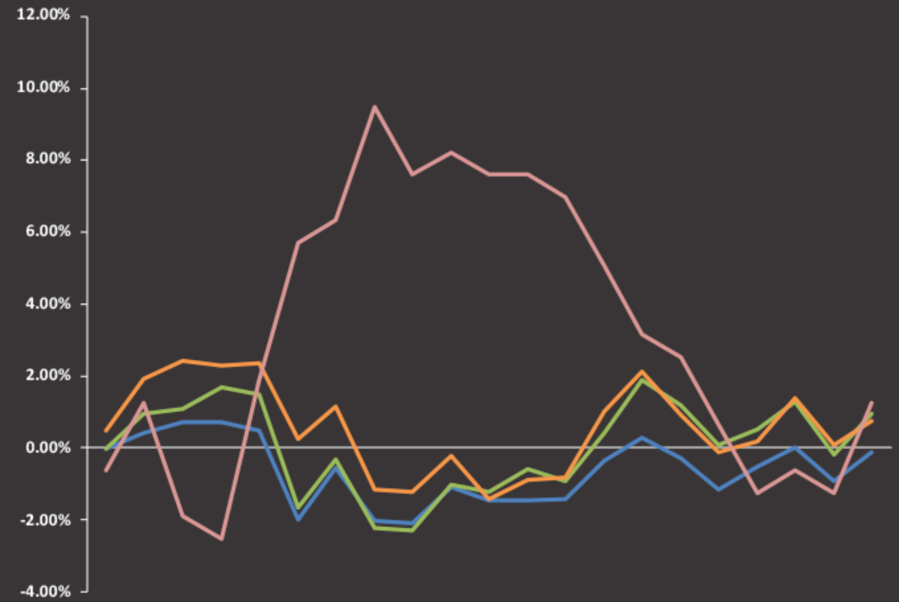
SEPTEMBER

U.S. Large Cap
(S&P 500)
2,168.27 (-0.12%) ▼

U.S. Mid/Small
(Russell 2000)
1,251.65 (0.95%) ▲

International Large
(NYSE International 100)
4,886.26 (0.76%) ▲

U.S. Treasuries
(U.S. 10-Year Treasury Yield Rate)
1.60 (1.27%) ▲



Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly.

The market in action

- Wells Fargo & Co. faces a Senate hearing and a $185M fine after it reveals its employees had created over two million fake customer accounts since 2011. Wells Fargo immediately fired 5,300 people associated with the fraud and suspended the cross-selling programs that had incentivized account falsification.
- After months of discussion, Bayer AG reaches deal to buy Monsanto Co. for $66B. The acquisition, if approved by regulators, will be the largest takeover of a U.S. business by a German corporation.
- The World Trade Organization lowers its forecast of global trade growth in 2016 to 1.7 percent from 2.8 percent. If accurate, it will be the first time in 15 years that international trade grew less than the total world economy—suggesting governments are focusing their attention on growing their domestic economies.
- Yahoo Inc. announces it was the victim of the largest hack in history, stating that as many as 500M of its user accounts may have had their data stolen. The breach is not expected to affect Verizon Communication’s $4.8B acquisition of Yahoo, which began in July.
- Volkswagen AG receives notice of a $9.1B misconduct lawsuit filed by its own investors. The suit claims that Volkswagen’s production of emissions-cheating engines, which led to billions of dollars in government fines, was a fiscally irresponsible decision by management.
- Postal Savings Bank of China Co. debuts on the stock market with the largest initial public offering of 2016. Although the stock remained relatively flat on its first day, the Hong Kong-based bank fetched an initial market valuation of $7.4B.
- The Institute for Supply Management reports that U.S. manufacturing contracted in August for the first time in six months as factory production drops by the most since 2012. Meanwhile, factory production in the United Kingdom jumped to a 10-month high in August despite expectations it would suffer from the “Brexit” vote.
- Canadian fertilizer companies Potash Corporation and Agrium Inc. agree to an all-stock merger that will create a $36B agricultural-chemicals giant.

Structural Struggle

Why has the American economy grown so slowly since the Great Recession? This year, GDP growth will fall somewhere in the 1.5% to 1.8% range, below the 3% growth rate that is considered a sign of robust economic health. Critics have blamed everything from China's slowdown to globally outsourced manufacturing to fiscal fights in Washington. But new research from economists at the Federal Reserve Board points to a different—and much simpler—explanation.

The researchers started with a demographic prediction model. The model recognizes that the economy was destined to grow rapidly when the workforce is heavily weighted toward young accumulators, as it was in the 1960s and 1970s when the Baby Boom generation entered the workforce. The good times continued as the labor force matured and the Boomers reached a high consumption stage of their lives.

But then the Fed economists asked: what happens when the Baby Boomers start to retire, as they did starting in 2005, and in increasing numbers since? The boomer generation had fewer children than their parents did, so the research shows that as the workforce aged and retired, there were fewer people in the workforce. Economic output inevitably declined, no matter what happened in China or the manufacturing sector.

Over the past decade, the research shows that what economists call "capital"—machines, factories, roads, buildings, etc.—has become abundant compared to labor, which has depressed the return that investors receive for investing in capital. This doesn't just mean slower economic growth; it also leads to a decline in interest rates. This helps explain why interest rates rose in the 1960s and 1970s, and have gradually declined in the subsequent decades.

The conclusion? The U.S.—alongside many other developed nations—is experiencing a decline in workers compared with retirees, which happens to coincide with the lingering effects of the financial crisis. The power of demography is like the tide; don't blame the government or the Fed for not intervening, because they don't have the power to overcome the shortage of workers. More babies, and maybe more immigrants, represent better solutions.

-Bob Veres

Sources:

http://www.federalreserve.gov/econresdata/feds/2016/files/2016080pap.pdf

https://www.washingtonpost.com/news/wonk/wp/2016/10/07/theres-a-devastatingly-simple-explanation-for-americas-economic-mess/?tid=sm_tw

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