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Why Consumers Aren't Spending

A weak housing market continues to weigh down the economy

By [MEG HANDLEY](#)

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Politicians are putting a lot of stock in plans and legislation designed to resuscitate the economy, proposing everything from tax credits for businesses that hire to expanding and expediting trade agreements with other nations.

But will passing another stimulus bill restore consumer confidence, the absence of which has severely hampered economic growth and progress toward recovery?

Experts aren't so sure. Despite the fact that the economy is growing—albeit, extremely slowly—and the economy hasn't begun to shed jobs yet, consumer sentiment remains in the dumps. Americans feel slightly more secure in the workplace, but on the whole they feel "worse off" financially than last year, according to a recent survey by Absolute Strategy Research (ASR). Consumers are also more pessimistic about the coming year, largely due to worries about the rising cost of living.

[In Pictures: [6 Numbers Every Investor Should Follow.](#)]

"The issue is 'Why aren't people spending?' and 'Why aren't they confident of their ability to spend more?'" says Robert Shapiro, fellow at the Georgetown Center for Business and Public Policy at the McDonough School of Business and chairman of Sonecon, LLC. "We've had a modest recovery, including in employment."

But that hasn't been enough. According to experts, the ASR survey underscores the deep scars of the Great Recession, in particular how the credit crunch and housing meltdown have fundamentally changed Americans' opinions about debt and housing as a foolproof investment.

"People still feel very insecure, they're worried, and it's changing their attitude about debt," says David Bowers, global strategist and managing director of Absolute Strategy Research. "Although jobs initiatives are to be welcomed, this is a reminder of just how severe a headwind housing has become."

[See [Will Obama's Jobs Plan Help Small Business Hire More?](#)]

Household worth fell about \$16 trillion from peak to trough, but only about half of that loss has been made up, which helps explain why Americans feel less wealthy and more insecure. Moreover, a third of all homeowners in the ASR survey believe their home is worth less than they paid for it, and 27 percent believe they have an underwater mortgage.

Why do housing values really matter? According to the Fed, the bottom 80 percent of American households hold only 7 percent of the total value of all financial assets in the economy. But that same 80 percent holds about 40 percent of all residential real estate assets, which means more Americans rely on and perceive their wealth from the value of their home.

"Home equity is the only widely held asset in America, and home equity is very sensitive to shifts in housing values," Shapiro says. "You have a very powerful negative wealth effect going on."

[See [What the Debt Ceiling Deal Means for Consumers.](#)]

In previous recoveries, a run-up in housing values made Americans feel wealthier and more apt to spend, even though wages had stagnated. This time around, the reverse has happened. Wages have stayed flat, but housing values have plummeted.

When housing takes a hit, so does Americans' perception of wealth. If they feel less wealthy, they're likely to spend less, which feeds into a vicious cycle of less spending, less economic growth, and less confidence.

"It's a feedback loop where weakness of growth, unemployment, household wealth not doing well, and the political uncertainty surrounding future regulatory policy all make for low consumer confidence," says Greg Daco, principal economist at IHS Global Insight. "Consumer confidence feeds into lower consumer spending, which leads to lower sales for businesses, which then have less means to reduce costs in other ways, so they might end up reducing payrolls."

[See [Has the Housing Market Finally Found Its Footing?](#)]

But while Americans remain pessimistic about the prospects for dramatic improvement, most don't feel the economy is destined to take a nosedive either, perhaps one slightly comforting nugget in all the dismal data. A recent survey of financial professionals revealed that based on interactions with clients, more than 54 percent believe the economy will remain lodged in its current state of limbo.

"We're mired in a lot of uncertainty across the board and the results speak loudly to the fact that people feel like [the economy] is going to be the same, we're spinning our wheels," says Tim McPeak, senior analyst at Sageworks, Inc., which provides financial analysis on privately held companies. "Uncertainty breeds paralysis and until people have a clearer picture of where we are going, they're going to be less likely to make big decisions whether that's hiring, making capital investments in business, or making larger purchases."

So how do we break the cycle? One of the major criticisms leveled at President Obama's much-anticipated American Jobs Act is that it overlooks the housing crisis. While Obama floated the idea of working more closely with the Federal Housing Financing Agency (Fannie Mae and Freddie Mac's regulator) to facilitate more mortgage refinancing for struggling homeowners, some experts say the measures don't directly address the foreclosure and housing slump, which is often blamed for the drawn-out downturn in real estate.

[See [Refinancing Out of Reach for Many Americans.](#)]

A push for better access to refinancing options could give the housing market and the economy a small boost by potentially stemming the flow of new foreclosures, but with more than 3.5 million first-mortgage loans in or near foreclosure and more price declines likely, the outlook is grim.

"Most worrisome is the risk that housing will resume the vicious cycle seen at the depths of the last recession, when falling prices pushed more homeowners under water causing more defaults, more distress sales, and even lower prices," Mark Zandi, chief economist at Moody's Analytics, wrote in a recent report. "That cycle was broken only by unprecedented monetary and fiscal policy support."

While the Fed has promised to keep interest rates low for the next few years, more intervention from the central bank is uncertain. That leaves fiscal policy to pick up the slack, the specifics of which Congress and the President haven't been able to agree on. What is certain, experts say, is that further partisan bickering and backbiting will do nothing to improve consumer confidence, and may actually further undermine it.

[See [Could QE3 Help the Economy?](#)]

That's a frightening possibility, especially in light of Americans' reduced spending and increased savings rates. Americans are pulling back and becoming increasingly risk-averse, according to ASR's survey—50 percent of respondents said they would not take any risks with their savings, compared with 40 percent two years ago.

"People have been up against this headwind for two years and it's starting to darken the whole mood," Bowers says. "America is known for being a great entrepreneurial society, the land of opportunity. This is about people going back into their cabin, shutting the door, and hunkering down. This is about survival mode."

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