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Millennials – They Are Coming

Demographics (the statistical data of a population, especially those showing average age, income and education) provide a certain amount of validity to the “science” side of economic forecasting. For example, if four million people in the United States are currently 40-years old, we can rather accurately determine the number of 50-year olds there will be in 10 years (given death rates and immigration data). Typically, people who are 40 (or 50 for that matter) are productive at a certain

rate and have other consumption preferences.



This is the raw “stuff” of economic forecasting. According to philosopher, Augustine Comte, “Demographics is destiny.” I recently read a very interesting report from our friends at Ned Davis Research (NDR) outlining some of the economic challenges the “millennial” generation faces. It’s in the spirit of this research, that I write this week’s

commentary.

Variable Economic Factors

Consumption represents approximately 70 percent of economic activity (Gross Domestic Product) in the United States. And, approximately 70 percent of consumption is “non-discretionary,” meaning that 70 percent of what we, as Americans, spend is for items which many consider necessities (i.e. food, utilities, housing and transportation). Consequently, a large portion of GDP activity is somewhat non-volatile and non-voluntary. The remaining variables, other than non-discretionary spending, provide either lift or drag to overall economic growth.

Enter demographics to this discussion. In the 1980s, the U.S. economy grew rapidly – the average annual-growth rate in GDP during the decade was 3.2 percent. Comparatively, over the last 10 years, the GDP growth rate was 1.7 percent.

We can point to many factors which have contributed to the overall slow growth of the GDP. One factor, which has been different until now, is demographics. It is a demographic fact that the peak of the baby boomer generation’s births occurred in 1957 with 4.3 million new babies. Twenty three

years later, in 1980, this wave of young people started an acceleration in “household formation,” which continued for quite some time. Household formation includes not only the potential purchase of a home, but also the purchase of furniture, appliances and white-goods. Household formation rates are a major contributor to “discretionary” consumer spending. The household formation surge in the 1980’s significantly contributed to overall economic growth for that period of time.

The Echo Boom

The baby boomers’ children, (generation x and millennials) have exhibited a similar pattern. Let’s call this population surge the “echo boom.” The echo boom birth rate troughed in 1983 at 3.6 million births. ***And by 1990, the echo boom birth rate spiked to 4.15 million births per year, matching the birth rate of their parents’ generation in 1957.***

People tend to establish their own households in their mid-20s, but so far, the millennial generation has not participated in this traditional household formation rate. ***Why has the millennial generation not yet formed new households, and what needs to happen to spur this activity?***

Broadly speaking, the millennial generation describes individuals born between 1982 and 2000. If the millennial generation is similar to other generations, we should expect to see an upward push in household formations occurring in the near future. As noted above, the baby boomer generation birth rate peaked in 1957, and 23 years later, there was a sharp escalation of household formations. This helped drive overall economic activity during those boom years. The millennial generation reached its birth-rate peak in 1990, but our economy did not witness a strong surge of new household formations 23 years following that birth-rate peak (2013). Therefore, purely from a demographic standpoint, ***the U.S. economy is due to experience a sharp upward increase in household formations as the millennial generation reaches maturity.***

Household Formations Aren’t Accelerating Yet - Why?

Why have household formation growth rates been stuck in slow motion? Reasons given include the following:

- **Student loans**: The lack of household formation has been blamed directly on the amount of debt millennials are carrying. The outstanding student loan data *is stunning*. As of the end of 2013, 41.7 percent of households, in which the head of the household was less than 35 years of age, owed money for student loans, the median value of which was \$17,200. Outstanding student loan balances have jumped by 23.7 percent over the last three years! It’s no wonder millennials can’t establish their own households – they owe too much on student loans. Is this the end of the story? The median value of all debt outstanding for the millennials is \$31,700 - the lowest for that age bracket in 20 years. In other words, while earlier generations owed less than millennials for student loans, they tended to owe much more for other types of “installment” debt, including credit card and auto debts. So while student loan balances truly are an issue, the average Millennial isn’t as financially leveraged as earlier generations.
- **Attending college**: According to Pew Research, college students (18- to 24-year olds) are much more likely to live at home with their parents as compared to those who are not in college (66 percent versus 50 percent). Roughly 27 percent of all baby boomers attended college between the ages of 18 to 24. Now, 41 percent of millennials have/are

attending college and this leads to a reduced level of household formation by the millennial generation. At the very least, it leads to a delay in household formation.

- **Delayed marriage:** Marriage has typically been a key driver of household formation levels. Approximately 25 percent of all millennials are married. Over the last seven years, the average age of women marrying for the first time has risen from 25.6 years of age to 26.6 years. The average age of men marrying for the first time has also risen from 27.5 years of age to 29.0 years over the same time frame. Unmarried millennials are much more likely to be living with their parents (47 percent versus 3 percent), which again leads to a delay in household formation.
- **Lack of housing supply:** It's true, vacancy rates are at their lowest level in 13 years. This lack of supply has been pushing rents higher in many markets, but this situation appears to be changing. The National Association of Home Builders (NAHB) Multifamily Production Index is back to the 2004-2005 peak levels. Additionally, the Multifamily Vacancy Index bottomed three years ago and has started to rise. In other words, the "market" is correcting the lack of apartments available for rent.

All the factors for delayed household creation contribute to the ultimate problem millennials face: **A lack of income.** College attendance and living at home and not getting married can all be directly correlated to millennials having trouble finding decent paying jobs. In 2014, the Federal Reserve released data about young households under the age of 35, (millennials), and perhaps one of the most striking data points was the low level of income.

The **median pre-tax income level for heads-of-household below the age of 35 was \$35,300 per year.** Comparable levels of income for previous years of the same demographic were \$38,900 in 1995 and \$43,900 in 2001 (all priced in 2013 dollars so we are looking at an apples-to-apples analysis). Over the last 13 years, the pre-tax income of our youngest workers has declined by almost 20 percent when compared to previous generations. It is no wonder, given the above mentioned hurdles, that millennials have had a hard row to hoe when it comes to household formation.

Turnaround Ahead

According to the work of the individuals at NDR, it appears household formations from the millennials is about 3 million formations behind previous generations' rate-of-structure. If this formation deficit were reversed, the implications on overall economic growth would be significant.

What is it going to take to unleash this pent-up demand for household formation? Better employment trends. In 2013, Andrew Paciorek, of the Federal Reserve, wrote a research paper titled "The Long and Short of Household Formation." In this work, he outlines the core cause of the household formation deficit to be a bad labor market. **The good news, however, is this needed improvement appears to be slowly occurring.**

When studying the "employment-population ratio," you will see the millennials (age 25 – 34 in this study by the Bureau of Labor Statistics) have recovered half of their job losses (as a percent of the population base) since December 2007, a much higher "recovery" rate since the last recession as compared to the population in total. Additionally, it is important to highlight that many millennials have had jobs for three straight years, which increases the likelihood of household formation.

Latest Data

A few weeks ago, the Housing Vacancy Survey was released for data, (as of the end of December 2014), and the results of the report were stunning. ***During the fourth quarter of 2014, 1.337 million new households were formed – the most in one quarter in over 30 years. Over the last year, 1.7 million new households were formed, the highest level of annual household formation in 10 years.***

Has the rate of household formation turned the corner? One quarter, and even one year of data, does not make a trend or provide any solid predictions; but the latest data is nonetheless heartening. As we move forward, if this trend continues, it could add significantly to overall economic growth.

A personal note – all three of my daughters are “millennials.” They are all highly educated, hard-working and smart. I only wish they didn’t live their lives through their cell phones! Stay tuned for further developments.

We will be back next week.



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