

At Last, Good Speak From Greenspan

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Everybody and his dog comments about Greenspan speeches and testimony. Most of the time, his double speak is such that whatever one's position happen to be, it can be validated, sort of. This time however, he actually has something to say that was quite dear, and according to what we believe, is absolutely true. Please read carefully the following quote:

“The sizable gains of consumer spending of recent years have been accompanied by a drop in the personal savings rate to an average of only 1 percent over 2004—a very low figure relative to the nearly 7 percent rate averaged over the previous three decades. Among the factors contributing to the strength of spending and the decline in saving have been developments in housing markets and home finance that have spurred rising household wealth and allowed greater access to that wealth. The rapid rise in home prices over the past several years has provided households with considerable capital gains...consumers have been able to realize gains from the sale of their homes...In addition, low mortgage rates have encouraged significant growth of home equity loan advances and cash-out refinancings, which are another channel for the extraction of previously unrealized capital gains on homes...To be sure, such capital gains, largely realized through an increase in mortgage debt on the home, do NOT (emphasis ours) increase the pool of national savings available to finance new capital investment...”

“All told, home mortgage debt, driven largely by equity extraction, has grown much more rapidly in the last five years than during the previous five years. Surveys suggest that approximately half of equity extractions show up in additional household expenditures, reducing savings commensurately and thereby presumably contributing to the current account deficit. Interestingly, the change in home mortgage debt over the past half-century correlates significantly with our current account deficit...International trade has been expanding as a share of world gross domestic since the end of World War II...yet...only in the past decade has expanding trade been associated with the emergence of ever-larger U.S. current account deficits, lesser deficits elsewhere, matched by a corresponding widening of external surpluses in a majority of trading nations.

“The increased dispersion of these external imbalances is mirrored in a decline in the tight association between national savings rates and domestic investment rates. The correlation between the two, for countries representing four-fifths of the world GDP, declined from a correlation of around 0.96 in 1992, where it had hovered for a half-century, to an estimated low of 0.8 last year...”

“...Of course, household net worth may not continue to rise relative to income, and some reversal in that ratio is not out of the question. If that were to occur, households would probably perceive the need to save more out of current income; the personal saving rate would accordingly rise, and consumer spending would slow...Although capital spending has been advancing at a reasonably good pace, it has nonetheless lagged the exceptional rise in profits and cash flow. This is most unusual; it took a deep recession to produce the last such configuration in 1975. The lingering caution evident in capital spending decisions has also been manifest in less-aggressive hiring by businesses. In contrast to the typical pattern

early in previous business-cycle recoveries, firms have appeared reluctant to take on new workers and have remained focused on cost containment...

"...Over the past two decades, the industrial world has fended off two severe stock market corrections, a major financial crisis in developing nations, corporate scandals, and, of course, the tragedy of September 11, 2001. Yet overall economic activity experienced only modest difficulties. In the United States, only five quarters in the past twenty years exhibited declines in GDP, and those declines were small. Thus, it is not altogether unexpected or irrational that participants in the world market place would project more of the same going forward. Yet history cautions that people experiencing long periods of relative stability are prone to excess."

To summarize in our more simple language: A housing bubble has allowed the consumer to spend more than he earns. This cannot go on forever. In addition, a lack of saving has resulted in less than vigorous capital spending, which we must have in order to grow this economy at a reasonable rate. We are eating our seed corn and the economy's future is not good. And what he didn't say that is most important is that DEBT IS DEFLATIONARY.