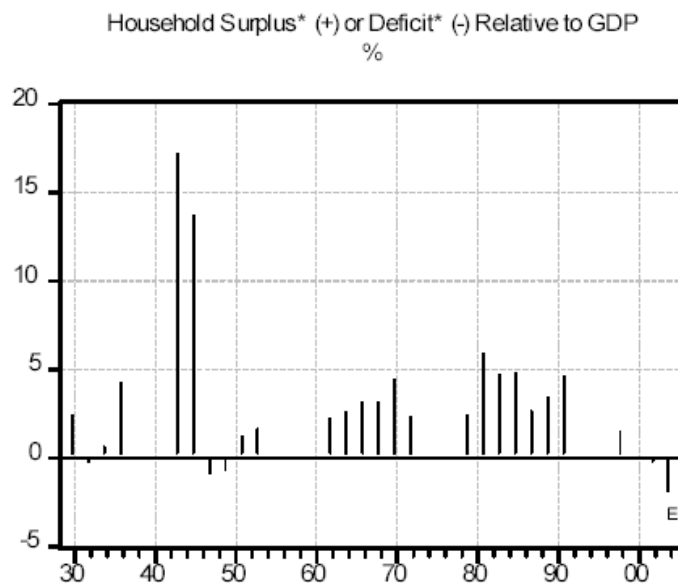


# Consumer Showdown Ahead

November 8, 2004

The US Economy continues to be plagued by a lack of income growth, which is sure to result in lower economic activity as we go forward. The 3<sup>rd</sup> Quarter GDP of 3.7% was considered a disappointment in that it was less than the 4.5% projected by most economists. On the other hand it was an up tick from the 3.3% of the 2<sup>nd</sup> Quarter. As you know the GDP numbers broadly based and one needs to dissect the contents in order to have some idea of the future. The most disturbing item within the numbers was the growth of disposable income. It plunged from \$116 B to \$53 B in the 3<sup>rd</sup> Quarter. A year ago the 3<sup>rd</sup> Quarter GDP was originally announced at 9% and then later reduced to 7.2%. At that time, we opined that this would mark the peak in growth magnitude for this recovery. And so it has. By the way, another measure of the entire country's income is nominal GDP (real growth + inflation). For the 3<sup>rd</sup> Quarter, it was 5.5% as compared to 6.8% in the 2<sup>nd</sup>.

If income growth is slowing, then how can the consumer continue to buy and consume? You've got it – taking on more debt. At some point it should become apparent to those who lend that maybe the risk has become too great. As you know from our previous comments, the most under appreciated financial number is the size of consumer debt. It is huge and it appears as if its size is finally beginning to bite. Please note the following chart depicting some 70 years of personal income amounts minus spending. The last 5 years look similar to only two other periods of time: (1) The Great Depression and (2) After WW II pent up demand. Does that cause you any concern?



\* Disposable Personal Income minus sum of expenditures on Consumption and Residential Investment

E= average of Q1 and Q2 in 2004