

## **CONSUMER SPENDING MUST SLOW**

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Another economic research source we use is The Levy Economics Institute of Bard College. They are very Keynesian-oriented; therefore, we use them as somewhat of a counterbalance to the Austrian model. They by in large give us the demand side of the economic equation, whereas the Austrian economic model presents the supply side. Recently they published a public policy brief entitled U.S. Household Deficit Spending: A Rendezvous with Reality. We would urge all to visit their web site at [www.levy.org](http://www.levy.org) and read, and then reread this piece. The author of this study is Robert W. Parenteau, chief economist at RCM, an investment management company of Allianz Global Investors.

We have written time and time again about the dire financial condition of the consumer. Frankly, we were beginning to believe that we were the only ones who saw this as a problem. With that in mind, note the following quote: “Even as many economists decry government deficit spending, they turn a blind eye toward deficit spending in the private sector. Contemporary economists are trained to view household spending as the aggregation of millions of individual budgeting decisions based on intertemporal utility calculations; by definition, these calculations must produce rational consumption paths over time. The dramatic deepening of household deficit spending suggests that this view may be too complacent.”

Ah-ha! Now we understand. Due to the fact that there are 300 million consumers in the United States, those at the fringes of consumption (i.e. the spendthrifts and the misers) cancel themselves out, whereas the rest of us in the middle—being of a rational mind—do about what is right in light of our resources.

This economic axiom is, of course, flawed—just like the efficient market theory is flawed. Rationality and the real world are two separate things. Human behavior must be taken into account, and when that is done, all bets are off. However, due to the fact that Wall

Street chooses to disregard human nature, markets are not likely to reflect what is going on until it's way too late.

The summary and conclusion by the author are as follows; we agree:

**Summary and Conclusion**

*U.S. household deficit spending has achieved an alarming trajectory. So, too, has the ratio of household debt to income. While debt-trap equations are frequently employed to analyze the sustainability of European fiscal deficits or Latin American external deficits, rarely are such analytical tools applied to deficit spending in the private sector.*

*When a conventional debt-trap equation is applied to the U.S. household sector, we find an explosive trajectory of household debt to income. The primary financial surplus is nearly exhausted, and long-run household income growth remains below the prevailing interest rate on household debt. Accordingly, continued household deficit spending has become increasingly dependent upon sustained asset-price appreciation in a Ponzi-like fashion. Under this dynamic, an explosive household debt-to-income trajectory can be sustained only by an equally explosive asset-price appreciation that lifts asset prices far from fundamentals. Central bankers may feel compelled to allow serial asset bubbles in order to avoid violating the lower threshold of their inflation target zones.*

*Even under optimistic assumptions, the trajectory of U.S. household spending growth is likely to slow further. With the end of the housing boom, various major lines of household credit have already slowed dramatically, and a credit crunch could sharply curtail household credit growth. These events would force a dramatic reversal of household deficit spending.*