

From Tax Cuts to "Tax Increases"

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We are all well aware that the consumer is suffering from headwinds that should put a damper on his spending. The operative word, of course, is should. To date there has not been a sharp cut in spending although a gradual decline in the rate of growth has been taking place over the last several quarters. The headwinds are well known i.e. lack of additional tax cuts, lack of acceleration in government spending and most serious of all a lack in income. All of this has been offset by additional borrowing, which in many cases has come from refinancing of homes and other mortgage related new forms of financing. Buying automobiles below cost with 100% financing has also been a major "help" in spending.

All of the above continues, however, we are inclined to believe the following will cause the "tipping point," which leads to lower economic activity. Our friend John Mauldin in his most recent e-mail newsletter reported these interesting numbers, which will (should) cut into discretionary spending. In the first place energy costs which were running 4 1/2% of personal disposal income (\$9 Trillion) is estimated to be 6% in 2006 – that's an increase of 1 1/2 % or better said 33 1/3% or \$130 Billion+. It is also estimated that higher interest rates on adjustable mortgages will cost an additional \$20 billion. Also, unless tax provisions on Alternative Minimum Tax (AMT) are made permanent another \$30 Billion in taxes will come into play. What about Katrina? It looks as if there will be at least \$110 Billion new debt created by the tragedy. Putting it altogether the 1 1/2% increase could become 3%. No one knows for sure the correct increase, but it's sure to be large. Many have asked what makes the difference? They say total spending has not changed, which is true, but the devil is in details. Increase costs come primarily from necessities – gasoline and housing. What suffers is postponable items – autos, new clothes, entertainment etc. The increased costs come not from additional units of supply, but the same units at a higher price. Necessity cost increases are a tax and regardless of what some politicians say increased taxes cause much economic harm.