

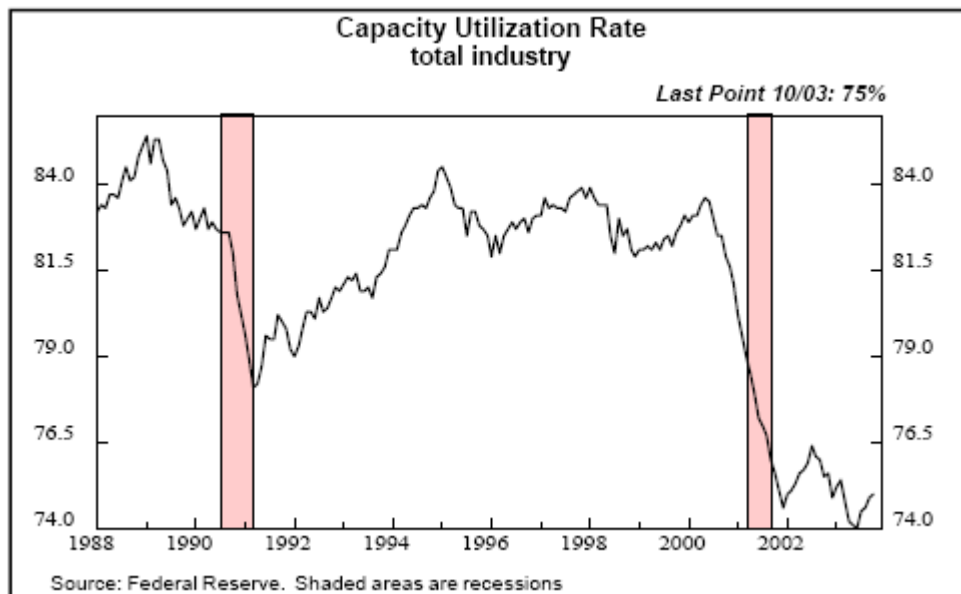
Too much Consumer and Not Enough Business

December 1, 2003

The excitement over the 8.2% increase in real GDP for the 3rd quarter continues to build steam in the financial markets. Wall Street and its minions are all a buzz with tidings of great joy. Let there be no mistake, no one among us can dispute this good number, but we can quarrel with its sustainability under current financial conditions. Those conditions being huge increases in debt and small increases in income.

Before we discuss that in more detail, let's adjust a bit an important 3rd quarter number, which may be not quite as good as the "real" number suggest. For example, the 3rd quarter increase over the 2nd quarter in capital spending was \$39.8 billion. Of this, almost \$43.2 billion was in a category called equipment and software (note – larger than the \$39.8 billion). Of the \$39.8 billion, \$36.1 billion was in computer and peripheral equipment. If one were to measure this amount in current dollars as opposed to quality increased real dollars the increase goes from \$36.1 billion to \$6.0 billion. Some call this productivity; others might say "voodoo economics." The point of this is that in the critical area of capital spending, which is counted on to take the place of the consumer when he hits the wall, is not (and we emphasize NOT) showing any strength of significance.

We believe this is the overlooked trend, which will not allow sustainability. Consumer spending (70% of real GDP) does not have a multiplier effect. Capital spending does. Why should capital-spending increase domestically when only 1/3 of the goods purchased since the recession end has come from our own factories. Please note the chart entitled Capacity Utilization Rate – Total Industry. If one could make a chart on foreign capacity utilization, it would probably look about the same.



Without multipliers at work, the consumer has to stay in the game. How long can this last? Please note the charts on debt service and income gains. As you know, we thought long ago that the consumer would fall back, but plentiful financing on the part of financial institutions continues to keep him alive. A financial accident is in the works, but when? We don't know, but we have never heard of anyone "making it" when spending more than one makes forever.

