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UP AND DOWN WALL STREET DAILY

Debtors' Prison for the U.S. Economy

By RANDALL W. FORSYTH

Unwilling or unable to borrow, consumers can't overcome falling incomes and shrinking net worth.

ANNIE LEIBOVITZ HAS WON A REPRIEVE, however temporary, from her debt woes. The celebrity photographer won't lose her real estate and the rights to her work to satisfy a \$24 million loan but will continue to work out a deal with the lender, Art Capital Group, which effectively is a pawn shop for rich artists.

The very rich, it seems, aren't so different from the rest of us in terms of getting into hock. But regular Americans have little choice but to hunker down, cut spending to pay down debt, just as they have done in every recession.

This time, however, they won't be returning to their free-spending ways as they did after every other downturn. Indeed, the deleveraging by consumers probably has just begun.

What's happening is a matter of simple accounting: If spending exceeds income, borrowing has to increase or assets have to be liquidated. That goes for Ms. Leibovitz and the rest of us.

Unlike the richly paid famous photog, the real median income of American households is no higher than in 1973, after inflation, according to Shadow Government Statistics.

"Recent reporting has shown not only that real growth in household income has failed to keep up with inflation, but that consumer debt and net worth are contracting paces previously not seen in the post-World War II era," writes SGS's John Williams.

Indeed, he adds, "the official numbers show households struggling to make ends meet for at least the last decade. Without adequate income growth, consumers met the consumption needs and/or desires through expanded debt.

"Such activity was encouraged openly by Federal Reserve Chairman Alan Greenspan, and the bulk of economic growth in recent years, as a result, was due largely to debt expansion, not to healthy growth in consumer income," Williams concludes.

MacroMavens' Stephanie Pomboy points to another reflection of the same phenomenon. In her current missive, she charts consumer installment debt rising relative to disposable personal income -- even as employment growth fell off sharply -- early in the decade. In that widening gap between debt burdens and employment, she cheekily adds the legend, "Greenspan wuz here."

SGS' Williams shows consumer borrowing is undergoing an unprecedented contraction. "Weak real incomes and contracting consumer credit are not the stuff of which economic booms, let alone recoveries, are made," he observes.

Meanwhile, consumers can liquidate savings, that is, their net worth, to make ends meet, he continues. But the Federal Reserve's Flow of Funds data show a record plunge in households' net worth through the first quarter (the most recent numbers available until second-quarter data are released later this week.)

Since then, of course, the stock market has levitated about 50% in round numbers from its March lows. And the evidence seems to be that at least some lucky people are using the rally to cash in their winnings.

Those would be corporate insiders, according to Trim Tabs' tally. In August, insiders sold \$6.9 billion, the most since May 2008, and bought only \$240 million worth -- a 29-to-1 sell-to-buy ratio -- "exactly what we would expect at a market top," Trim Tabs' Weekly Liquidity Report says.

For everyone else not fortunate enough to have stock holdings to tap, there's little choice but to tighten their belts.

In the latest issue of The Liscio Report, Philippa Dunne and Doug Henwood pose the question, "Penury, self-imposed or inflicted, the new normal?"

Spending on essentials -- in food and beverage and drug stores -- is holding up, rising 0.6% in the year to July, while spending on everything else is off 6.2%. That gap of 6.8% is the widest since data began in 1992, they add.

"A gap this wide looks like a real structural shift in spending behavior, as austerity becomes the new normal," they write. "Though Americans have shaken off bouts of prudence before, like that of the early 1990s, with consumer credit constricted, household balance sheets ravaged and labor income weak, it's probably going to take some time before anything resembling extravagance returns."

And extravagance doesn't fully explain the debt-driven consumption of recent years, TLR's Dunne and Henwood add. Much of the spending has been for medical care, apparently as employers shift more of those expenses to employees. Meanwhile, the cost of benefits are rising more slowly than pay for the first time in 25 years -- not because of any slowing of medical inflation but because of higher co-pays or dropped coverage.

All of which should add a huge chunk of salt to an outsized rise in retail sales for August due to be reported Tuesday morning. Cash-for-clunkers could inflate the gain to an above-consensus 2.5%, TLR estimates. But excluding autos and gasoline sales

swelled by higher prices, the increase is likely to be a "tepid" 0.2%.

If Americans have indeed changed their spendthrift ways, the standard fiscal stimuli will be impotent to spur the economy. Tax cuts will be saved rather than spent.

(Use-it-or-lose-it gimmicks such as cash-for-clunkers or the \$8,000 gift to first-time homebuyers that expires Nov. 1 may accelerate purchases that probably would be made anyway. After the sugar rush fades, sales revert to form.)

Meantime, the American economy is likely to remain mired in its debtors' prison.

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