

No Credit When Credit Is Due

Recent statistics have been published that indicate (1) US payrolls increased by 2.2 million in 2004, representing a 5-year high; (2) bank consumer loan delinquencies have fallen to multi-year lows and (3) outstanding consumer credit fell almost \$9 billion in November, largely offsetting a \$10 billion rise in October.

On the surface, these data threads indicate not only that the American economy is on the mend, but that the average American consumer is in increasingly good shape.

Beneath the surface, I detect that the following has occurred:

1. The increase in US payrolls has been largely within the low-paying service sector (e.g., Wal-Marts and fast-food restaurants paying minimum wage with poor benefits), the low interest rate-dependent housing and mortgage sectors, and the Government sector, and that the growth in jobs is not keeping pace with the growth in worker populations. Also, the payrolls number comes from the US Dept of Labor, so we can assume that they have been inflated by various adjustment mechanisms underpinned by political agendas.
2. Continued low long-term interest rates (i.e., courtesy of the Asian governments that are willing to purchase US Treasury debt at loss-leading rates in order to finance our purchases of their goods) have enabled consumers to continue their raid on home equity in order to service their non-mortgage debt load, thereby delaying the inevitable day of reckoning when rising interest rates create great hardships for the huge number of adjustable-rate mortgage borrowers.
3. An important inflection point may have been reached with US consumer debt, whereby the loan levels are now so high that lenders are denying additional consumer credit.

Somewhere in between the rosy reports and my tempered cynicism lies the truth, and as always I'll be looking for clues. However, the fact remains that the consumer is teetering on the edge of all-time high debt levels, and that continued pressures on disposable income (e.g., rising short-term interest rates, high energy prices, shrinking health care benefits) will push many consumers over the edge. Due to the huge amount of adjustable-rate mortgage debt being carried by the American consumer, I believe that long-term interest rates are the proverbial trump card in the game of preventing the onerous debt situation from causing major damage to the US and world economy.

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