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Debt Reduction Slows the Recovery

In spite of above normal unemployment, American households are reducing debt; primarily consumer credit. While this may be a good way for individuals to become more responsible, it is reducing aggregate demand for goods and services; thereby limiting the economic recovery. Consumer demand for credit has been falling since January 2008. The graph below illustrates the unsustainable growth in credit since 1940.

Corporations have also reduced debt in recent years, while obtaining more favorable borrowing rates. In fact, corporations are so flush with cash, it is possible to self-finance sales, thereby eliminating traditional bank financing.

Declines in consumer and corporate debt in recent years have been off-set by increased Federal government debt. The Federal Reserve has temporarily managed the cost of this debt with a near zero interest rate policy.

Following typical recessions, demand for credit increases, as the Federal Reserve intervenes with lower interest rate policies. Credit spurs demand, which ultimately creates jobs and increased real income. This recovery has been radically different, as years of accumulated consumer debt have stalled the economy.

As America's manufacturing base has moved off-shore during the past 30 years, local consumption has grown in importance, representing nearly 70 percent of gross domestic product. In contrast, Germany and China have economies which are more dependent upon manufacturing and the resultant income derived from exports of products.

