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OFF THE NEWS

Ugly Facts and Troubling Statistics

1 Had Americans not been able to take out cheap home equity loans and refinancings to engage in hyper-consumption, the U.S. economy for the entire George W. Bush Administration would have grown each year by an average of only 1 percent, according to economist Niall Ferguson.

2 From 1946 to 2000, U.S. GDP grew at an average annual rate of 3.2 percent. Since 2000, the U.S. economy has grown at an average yearly rate of 2.4 percent. The 0.8 percent difference sounds modest, but may have cost the economy ten million jobs, according to many economists.

3 Just prior to the outbreak of the Great Financial Crisis, the extraordinarily leveraged U.S. financial services industry represented 40 percent of U.S. corporate profits and nearly one-third of the stock markets' gains. Not anymore. The question is how long it will take for innovative breakthroughs and new industries to fill the gap. Many analysts suggest a decade.

4 Meanwhile, many U.S. public and private pension fund managers still talk in terms of asset returns averaging 8 percent a year or more. If the U.S. economy experiences subpar economic growth over the next decade, with the financial services industry re-regulated with reduced leverage, is an 8 percent return realistic, short of some miraculous overnight transformation of the U.S. economy? Has the U.S. retirement system, in other words, become an illusion of false expectations?

5 With the world's baby boomers aging rapidly and consumption habits changing, the entire world seems determined to become a net seller—not buyer—of goods and services. Everyone wants to be an exporter. President Obama is calling for a doubling of U.S. exports. A recent IMF study concluded that for export-dependent China to maintain 8 percent GDP growth over the next decade, the minimum necessary for social stability, its share of world trade would need to double. The key question for G-20 policymakers: If everybody becomes a net exporter, who will buy the world's stuff?

6 A nation's sense of optimism toward the future is a key to long-term prosperity. Today, the Chinese seem to possess the optimism that once defined Americans. For example, 86 percent of Chinese believe their country is headed in the right direction, compared with only 37 percent of Americans. A majority of Chinese believe China will produce the next society-changing innovation. By contrast, only one-third of Americans believe that about their own country.

7 Today, the Federal Reserve is battling the fear of deflation, not inflation, and is poised to blast the sluggish U.S. economy with a fire hose of quantitative easing. The idea is to keep the Fed's target inflation rate at or near 2 percent, while keeping long bond yields down. Once the economy begins to recover, can Fed officials adjust rates upward enough despite the initial lack of movement in market interest rates? Bond yields don't always immediately reflect trouble ahead. For example, in July 1977, the yield on a ten-year Treasury bond was the same as in July 1970, even though the 1970s were known as the decade of high inflation and soaring interest rates. Only in late 1977 did market interest rates suddenly begin to skip higher, catching up with the economy's stealth-like rising of inflationary expectations. In the future, will Fed officials have the will to raise short-term rates even though market interest rates initially remain stable?

8 The stakes couldn't be higher. The relatively short-term three-year maturity of most of America's public debt means that a large share has to be rolled over each year. Thus, any rise in interest rates several years from now will feed poison throughout the U.S. economy with frightening speed. The level of the federal government's interest payments will quickly jump, as will deficits and debt. The danger is development of a vicious cycle that proves difficult to stop.

9 America's public debt amounts to more than $40,000 for every living American, or more than $160,000 per family. And the price-tag is likely to rise. An increasing number of economists are revisiting the "Riccardo Equivalence Theorem," the nineteenth-century economist David Riccardo's idea that simply the fear of rising debt can potentially inhibit consumer confidence, particularly among affluent consumers who are responsible for half of retail sales. In addition to public debt, Americans face a mountain of personal household debt that will likely take years to work off.

10 Here's more: Earlier this year, Federal Reserve Chairman Ben Bernanke gave a speech suggesting that Americans collectively could eventually be writing an interest payment check on their collective public debt amounting to a trillion dollars a year. Half of this interest payment will go to China. Half a trillion dollars is roughly the size of the U.S. defense budget. Therefore, Americans will be handing the Chinese a dollar amount equivalent to one U.S. defense budget every year. Key question: How long will it take for the balance of power and trade in the Pacific Rim to fully shift away from the United States?

11 Such an interest payment scenario, however, may be too benign. Recently, former Federal Reserve Chairman Paul Volcker went so far as to predict a U.S. monetary collapse sometime in the next five years.

—David Smick

U.S. Real Estate: Still Overvalued?

The value of real estate as of the first quarter of 2010 was $18.1 trillion. The value of mortgage debt was $10.2 trillion. The current ratio of mortgage debt to real estate value is 56.5 percent. To compare, the peak value of real estate, during the fourth quarter of 2006, was $25.3 trillion. Thus, the current $18.1 trillion is a loss of $7.13 trillion. The peak in mortgage debt did not happen until the first quarter of 2008 at $10.6 trillion, and from that peak it is only down by $0.37 trillion.

As a ratio, mortgage debt/real estate value is now at 56.4 percent after hitting a peak in the first quarter of 2009 of 59.6 percent. From 1960 through the 1980s, this ratio had ranged between 27 percent and 29 percent. By 1997, before the acceleration in home values, it inched up to 38 percent. The current ratio of 56.4 percent is 18.4 percentage points higher than the 1990s average and that which prevailed in 1997. If current real values stay at $18.1 trillion (assuming stable prices forward), a 38 percent mortgage debt means that households must carry only $6.89 trillion debt instead of the current $10.24 trillion. This means a deleveraging of $3.35 trillion is required.

—George Saghir

The Human Filter

More than a few White House economic officials have expressed private concern about the vacuum that will be left after National Economic Council Director Lawrence Summers leaves office in mid-December. At least 30 percent of Summers' job, they note, has been as a kind of a financial market safety filter for the Democratic Administration. On a regular basis, he has been forced to point out the ugly, unintended market consequences of various policy proposals coming from political appointees, often with an inadvertent anti-market bent. "Larry's had to rain on a number of parades by pointing out the potential financial market consequences. It's been a thankless task," a colleague said. He added: "There have even been times when the President himself has been annoyed at the messenger. But God bless Larry. He has short-circuited some really crazy stuff around here."

Larry Summers