



Macro Credit Trends

Everything Comes From Somewhere...

Marc Lavoie of the University of Ottawa famously said: “everything that comes from somewhere goes somewhere”. This was his succinct way of describing the double entry bookkeeping system we have in a modern monetary system. In other words, all of our financial wealth is derived from assets which are someone’s liabilities (or contra-assets if you want to include equity on the balance sheet).

One of the great conundrums of the recovery in the USA is that no one seems to be able to pinpoint where the improvement is coming from. In fact, some people think it’s all just a sham. How is the economy expanding without someone’s balance sheet improvement and expansion? This has become increasingly confusing as the government’s deficit has contracted.

As we know from previous notes, as the private sector has de-leveraged the government picked up the baton. The housing bubble and economic contraction put enormous stress on household balance sheets and sent household borrowing into a tailspin. Without the household sector to lever up as it usually does the economy grew increasingly weak until the government stepped in to expand its balance sheet. But that has started to reverse in recent quarters as the household sector has improved, tax receipts have improved and the government’s deficit has contracted.

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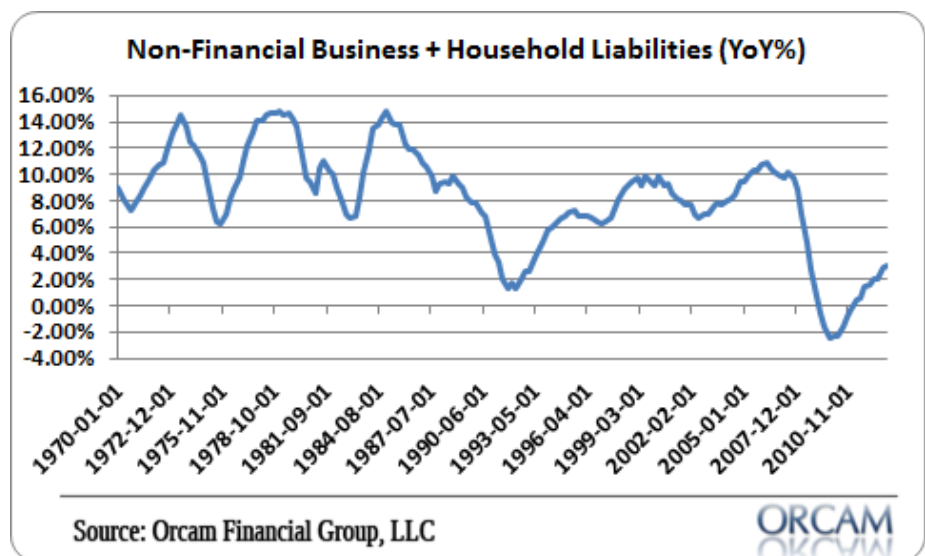
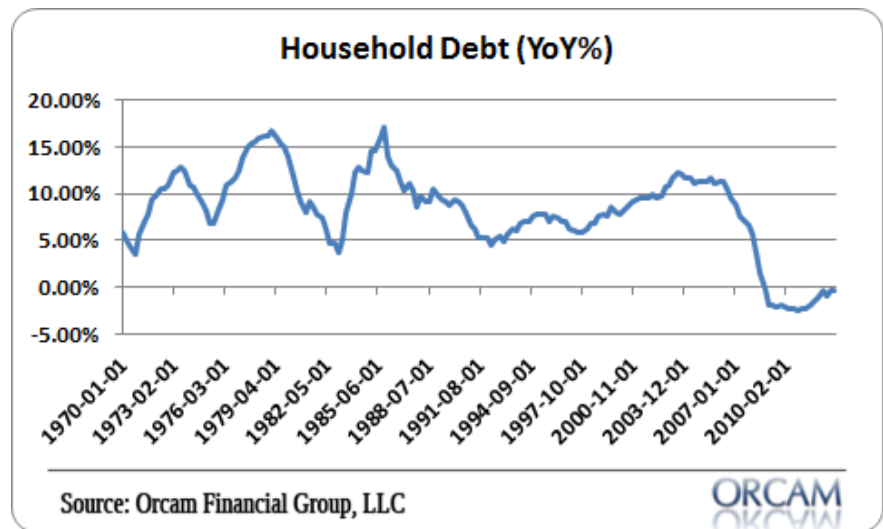
Today's NY Fed Household Quarterly Debt report showed another small contraction in household debt trends:


"The New York Fed released its [Quarterly Report on Household Debt and Credit](#) for the second quarter of 2013 for the second quarter of 2013, which

shows a \$78 billion decline in overall household debt from the previous period. Delinquency rates improved considerably, with the overall ninety-plus day delinquency rate falling to 5.7 percent, the lowest it has been since mid-2008."

So what's going on here? If we look at the long-term trend we're still looking at only marginal improvement in household debt trends. Yes, it's better than it has been and the Balance Sheet Recession has been all about incremental improvement, but if we're going to avoid a recession we're likely going to

need some sector to pick up the slack more so than the household sector is. And that's where a broader 4 sector view of the economy comes into play (the 4 sectors being the household sector, the business sector, the financial sector, the government sector and the foreign sector).





And if we look at the trend in business borrowing we see something dramatically different than the household trend. This is the primary difference between Japan in the 90's and the USA today—the non-financial business sector is extremely healthy. As a result of the clean balance sheets in corporate America businesses have been able to pick up the slack where households have not. And as the deficit declines this expansion in non-financial business liabilities has continued to bolster aggregate demand. The most recent quarter showed a 6.7% expansion year over year in corporate liabilities as households shrank -0.25% . The sum of this is a 3.1% increase year over year which is more than offsetting the decline in the government's deficit. While the government's deficit has fallen \$366B year to date, the household and business sector has levered up by \$775B.

Of course, that doesn't mean businesses are spending all of the funds they've raised, but it's certainly not all sitting in vaults. And that's the kicker here. The de-leveraging might not be completely over in the household sector, but the aggregate private sector is certainly done de-leveraging and that means it's okay for the government to reduce the deficit some. I continue to believe a sharp decline in the deficit poses risks, but we have to look at the aggregate sectors. I don't think the reduced deficit is as alarming as some make it sound. And so far, this story rhymes nicely with my "no recession" view.



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