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U.S. consumer debt causes financial system jitters

by Anthony K. Wikrent

A series of warnings about U.S. consumers having overextended their credit sent chills of fear down the spines of Wall Street bankers in mid-June. The American Bankers Association announced that U.S. credit card delinquencies hit a 15-year high in the first quarter of this year. And Moody's Investors Service, Inc. reported that the credit quality of the average U.S. credit card holder fell to the lowest level in six years.

Troubling signs were also noted in the area of home financing, when the Mortgage Bankers Association of America released figures for the first quarter of this year, showing that 4.46% of all mortgage loans in the United States were 30 days or more past due, compared to 3.94% in the first quarter of last year. The Federal National Mortgage Association, the nationally chartered and federally sponsored corporation that is the largest buyer of home mortgages in the United States, announced that 0.58% of its loans were seriously overdue at the end of March, compared to 0.48% at the end of March 1995.

The damage that these consumer debt troubles might wreak on quarterly earnings was brought home to Wall Street by the Bank of New York on June 19, which announced that it was increasing its reserve for losses on its credit card business by a whopping $350 million. While the increase brought the Bank of New York's loan-loss reserve generally in line with those of other credit card issuers, at just under 3% of outstanding credit card receivables, all that Wall Street was concerned about, was the prospect of red ink gushing from the bottom line at the quarter's end, and the bank's stock price was sent tumbling.

Indeed, the loan-loss reserve announcement caused such great consternation, that the Bank of New York issued a statement a few days later saying that it had "mismanaged" the announcement, and that the increased loan-loss reserves would be paid for out of the proceeds of a previous sale of a subsidiary, so there should be a negligible impact on the bank's earnings for the quarter.

The post-industrial shift

Nonetheless, the episode serves to underscore just how jittery the financial markets in the United States have become, which in turn is a result of the dangerous fragility of the U.S. economy in general. The great irony is that this fragility is an inevitable result of the policy shift to a post-industrial society, which has been imposed on the United States for the past three decades, and which Wall Street has not just applauded, but enforced through its "shareholder rights" movement.

Before this shift to a post-industrial economy, the major impetus to economic growth came from capital-intensive advances in technology, and the construction of major infrastructure projects, such as the Interstate Highway System. Now, however, technological advances are increasingly viewed as "bad" or too costly, while any and all government involvement in the economy has become a favorite whipping boy for the crowd of "neo-conservative" free marketeers, typified by Speaker of the House Newt Gingrich (R-Ga.). Any instrumentality of national purpose is thus prohibited from giving direction to the U.S. economy. Instead, this crucial role devolves upon "consumer spending."

The pyrrhic importance won by consumer spending in the post-industrial economy is graphically captured by looking at spending on infrastructure, and on producers' equipment, in relation to Gross Domestic Product. U.S. spending on construction of infrastructure, both public and private (such as hospitals, public utilities, and colleges), was 3.87% of GDP in 1960, and 4.17% in 1970. By 1980, it had declined to 3.21%, and by 1990, had fallen to 2.66%.

Even more dramatic is the collapse in capital expenditures

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for the physical economy: manufacturing, mining, transportation, and utilities. Capital expenditures in these sectors are a key indicator of the capital intensity of the real economy. As a percentage of gross domestic product, they had fallen to 4.47% in 1994, the lowest level since the end of World War II. Through most of the 1960s and 1970s, capital expenditures in the physical economy were in the range of 5 to 6% of GDP.

Thus, Wall Street's preoccupation with the spending of the U.S. consumer, as being the motor for the rest of the economy. And a key marker for consumer spending is credit card debt, which is why U.S. financial markets nearly swooned upon hearing the Bank of New York's announcement. Because if credit card loan losses are suddenly spiking upwards, then a similarly sudden collapse in consumer spending may be in the works. Which means, in the view of some Wall Street gurus, that the "smart" thing to do is to begin edging closer to the "investment" exits.

Personal bankruptcies set record

But, most denizens of the financial markets still refuse to see the economic collapse underlying their own case of jitters. Symptomatic was the report by *Barron's* on the massive wave of personal bankruptcies, which is expected to set a new record this year, reaching over 1 million for the first time ever. That will be one out of every hundred U.S. households declaring bankruptcy this year. According to *Barron's,* the reason for this wave of bankruptcies is that the social stigma attached to bankruptcy has been undermined by the reform of the bankruptcy laws, and that there is simply too much easy credit being given out by the banks and credit card issuers.

Barron's is especially upset that 25% of new bankrupts, and up to 50% in some areas of the country, "showed no signs of distress before the debtor ducked out: The accounts were in good standing and were considered high quality. That's never been seen before."

Stephen Roach, the chief economist of Morgan Stanley, advised his clients that the "recent announcement by the Bank of New York gave pause for thought." But, Roach wrote reassuringly, "the story of the overextended consumer" is "more of a bank-specific problem that should not be generalized as a macro event for the economy at large." Roach pointed to a Conference Board survey of around 5,000 U.S. households, which reportedly indicated that only 19% of households were paying more each month for installment credit than they had paid last year.

Roach was especially comforted by the survey's finding that the average monthly debt payment, for households earning $25,000 a year or less, was $550 to $575.

It evidently did not occur to Roach that a household with only $25,000 in annual income is netting around $1,600 a month after local, state, and federal taxes. Which means that a monthly debt burden of $550, on these households, is one-third of their take-home pay. If anything, this is a discomfitting, not comforting, level of debt. It bears out the warnings of those "Cassandras," such as Lyndon LaRouche, that U.S. households are teetering on the edge: With the collapse of earning power of the lowest four-fifths of the U.S. population, many households are now at the point that they are using credit cards to buy essentials, such as groceries.

The plight of such households would also explain the phenomenon that so troubles *Barron's.* These are not profligate households. For years, they have silently watched their earnings shrink. Incurring credit card debt was intended only as a temporary means to help make ends meet; when better times came along, and more income was flowing into the household, then the credit card debt would be paid off. In 1992, the hope was that replacing George Bush with William Clinton result in those better times. By 1994, it seemed Clinton as little about economics as Bush, and voting for the 1994 Conservative Revolutionaries became the new hope. Now, it is clear that Newt Gingrich and his fellow Revolutionaries also don't know what to do about the economy, and households are throwing in the towel—right in the face of their creditors.

Collapse erodes hope

The hopelessness of America's working families has been captured in a slew of recent statistical profiles documenting the growing disparities in income, and wealth, between rich and poor. The University of Michigan's Institute for Social Research, which compiles widely followed monthly numbers on "consumer confidence," released such a study on June 21. Based on a survey of close to 7,000 families, some of which have been in the survey since 1968, the study showed that the richest 10% of U.S. households held 61.92% of the nation's wealth in 1984; by 1994, this had increased to 66.76%. The poorest one-fifth of U.S. households were an average of $3,282 in hock (that is, they had less assets than liabilities; i.e., they had no net wealth). Ten years later, their situation had worsened, with their indebtedness more than doubling to $7,075.

In a cover story on "The Forces Making for an Economic Collapse," in the July issue of the *Atlantic Monthly,* Thomas I. Palley, a professor of economics at the New School for Social Research, noted that Americans' real average weekly earnings peaked at $308.03 in 1973, and have fallen 15.5% to $260.37 in 1991 (in 1982 dollars). The U.S. economy has shifted, Palley wrote, from "Main Street capitalism of the Golden Age to the *Mean* Street capitalism of the Leaden Age. The hallmark of the former was that it generally worked for the benefit of the average citizen by sharing the fruits of growth among all. The hallmark of the latter is an economic environment that pits citizen against citizen for the benefit of those who own most of America." Palley calls the decline in earnings a "silent depression," echoing the term used by Sen. Edward Kennedy (D-Mass.) earlier this year, and warns that once shrinking incomes can no longer meet debt payments, demand will collapse, causing huge layoffs, and plunging the U.S. economy into a depression.