Aggregate Economic Activity – End of 2010

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Overview

National Income Accounts can be used to display a wide variety of aggregate activities. Not only can Gross National and Domestic Product be monitored, but many other macro-economic endeavors can be analyzed.

The following graphs and items show that aggregate activity has picked up considerably in the last four quarters. At the household level, personal consumption has modestly increased. But the real change has been a dramatic increase in the personal savings rate, which has enabled households to pare down their very large consumer debt loads.

At the business level, aggregate national income and business profits are up. But that has not resulted in increased business investment / expansion, as businesses are generally hording their cash reserves unable to find attractive business opportunities. Additionally, after being stung twice in a decade, many surviving companies are more conservative in the deployment of their reserves, never straying too far from familiar and otherwise profitable areas.

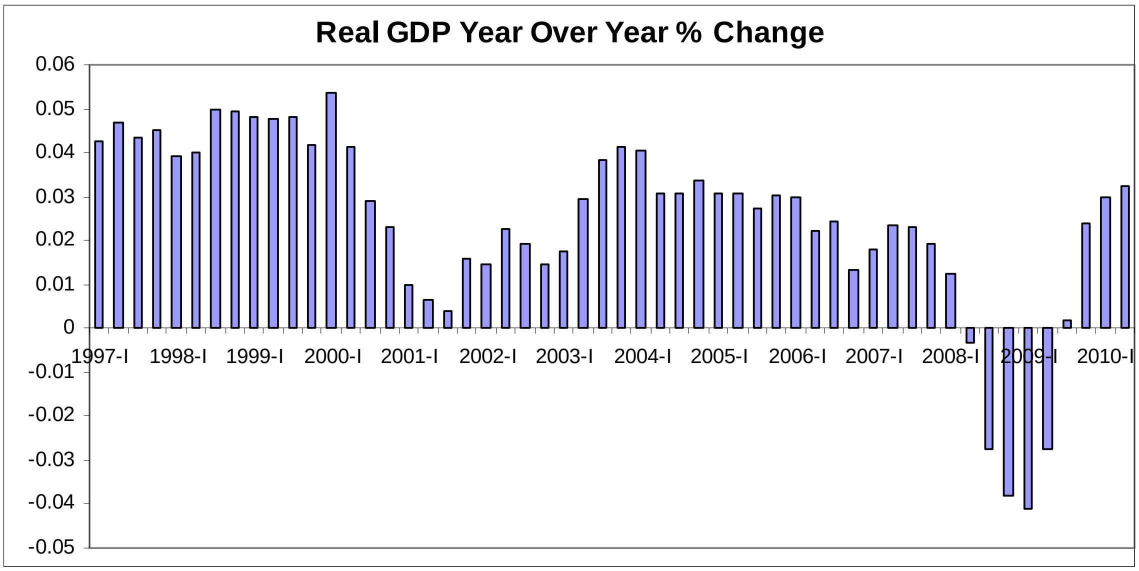
Even through aggregate levels are improving, the real question for many households and businesses alike is still very simple - “when will all of this be over?” One merely can refer to the graph on Potential vs Real GDP (below) for the short answer - it is going to take a while.

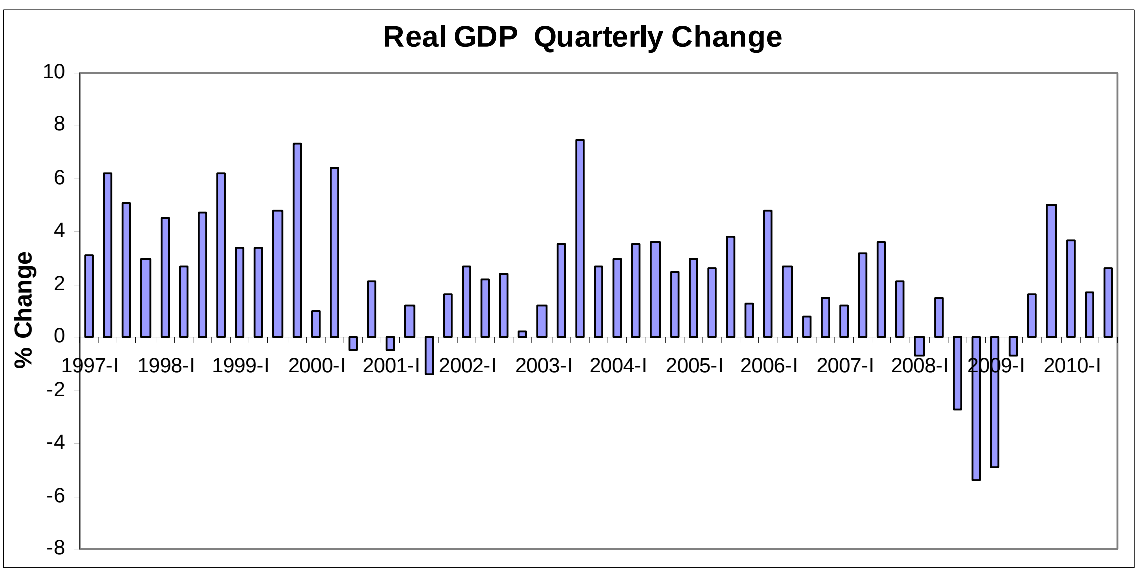
The more involved reasoning for the continued malaise is that the various underlying problems in the economy did not pop up all at once. Instead, structural difficulties developed over a long time frame, and it may simply take a corresponding length of time to wring these weaknesses out of the economy. Until the almost complete collapse of the real estate sector as well as heavy consumer debt loads are worked through, aggregate consumption is likely to be mildly positive to muted, personal and business investment may be at reduced levels, employment at stubbornly high rates, and commercial credit still very tight. It all makes for a very slow and lengthy recovery to all concerned, especially for those without significant asset reserves to have weathered the storm.

Fortunately, inflation is non-existent for the time being while manufacturing and other industrial activities are on the rise. Forward aggregate projections are quite promising, with a real expansion beyond pre-recession levels probably occurring sometime in 2011. Now, for the wonderful graphs that are made possible via a large depository of data and interactive web resources located at the St. Louis Federal Reserve Board.

Gross Product

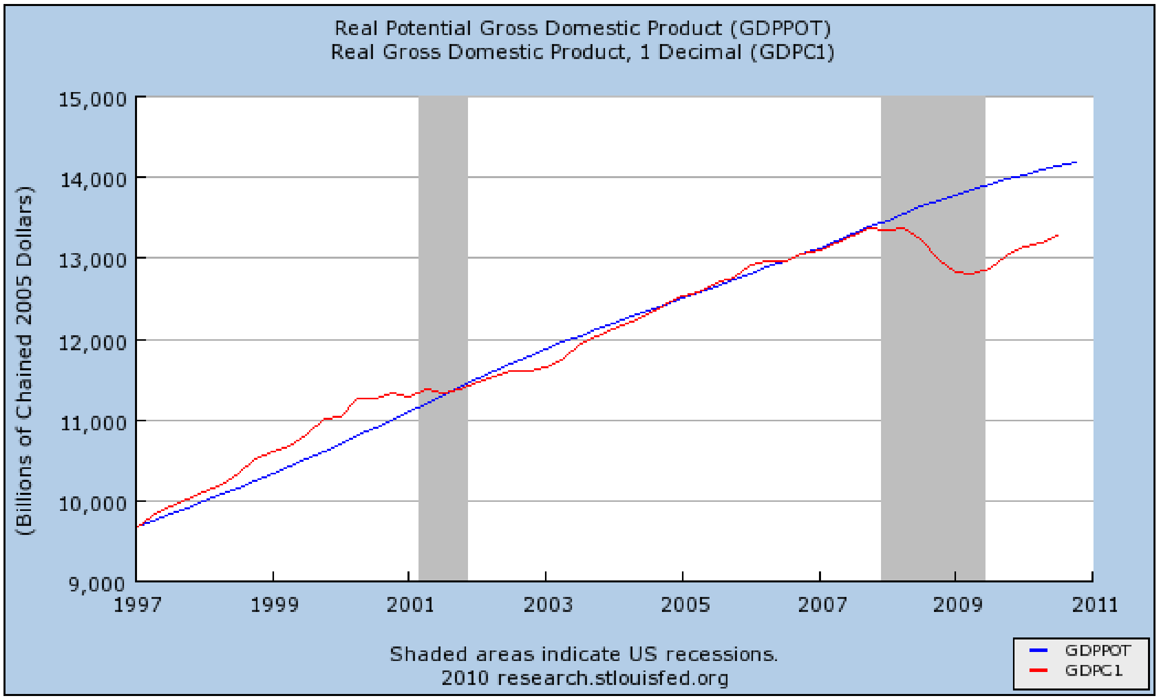
Real Gross Domestic Product shows solid improvement over the disastrous period of 2008-2009, both on year-over-year and on a quarterly basis. *Source: Dept of Commerce, BEA.*





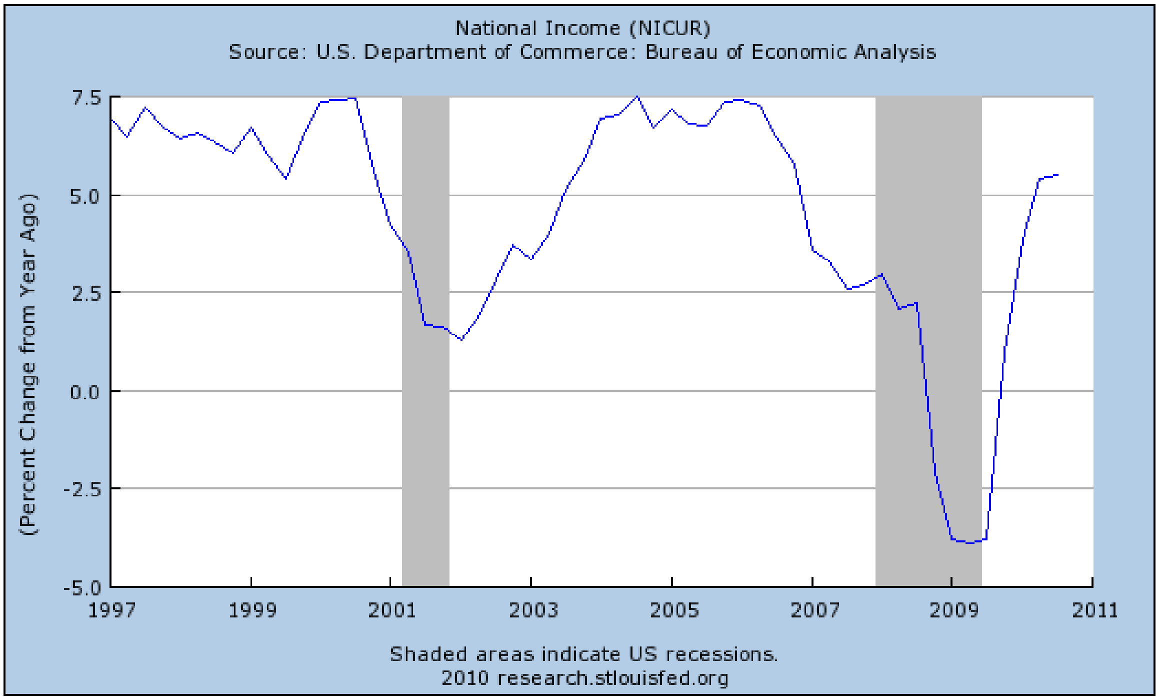
Real Potential GDP. Actual GDP has fallen considerably below potential GDP since the recession began, as shown in the following graph. *Source for Potential GDP, US CBO; Source for real GDP, Dept of Commerce, BEA.* Note how Real GDP was significantly above potential GDP in the late 1990's and into the early 2000's and then again in late

2006. The graph implies vast amounts of unused industrial capacity, and vividly demonstrates how far below the trend-line the economy is at present.

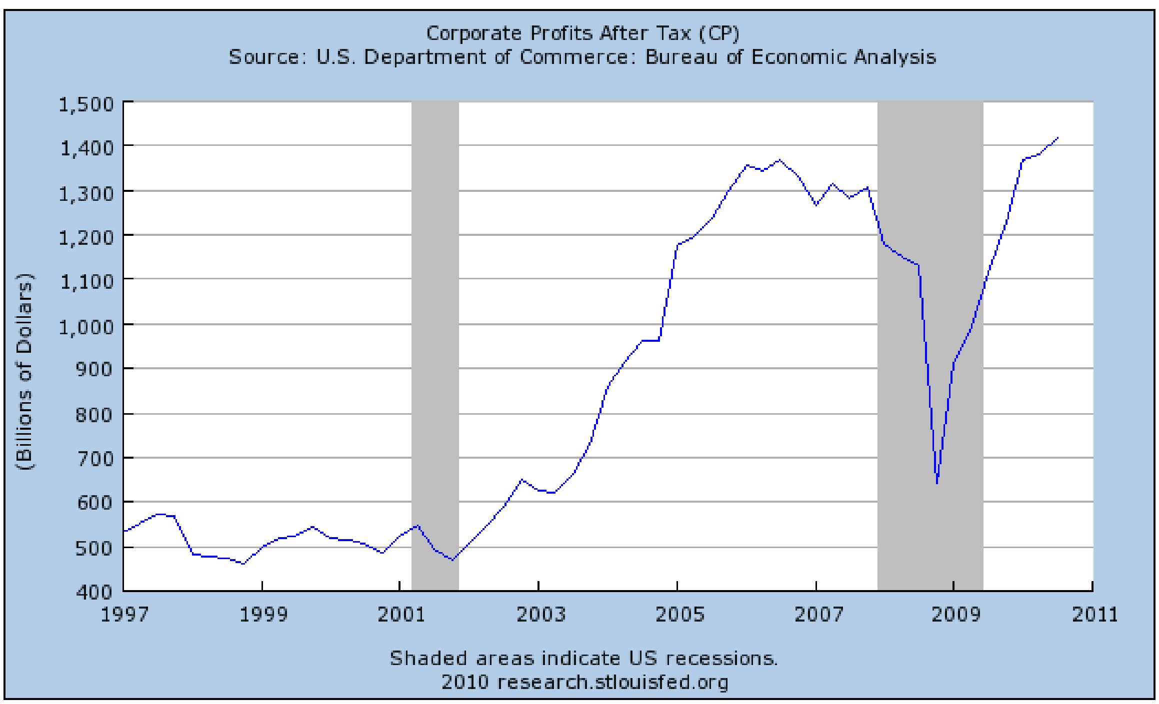


Income

National Income has rebounded nicely from the recession, with healthy percentage changes occurring year-over-year. Aggregate national income of $12.8 Trillion is now exceeding pre-recession aggregate highs, as well. *Source: Dept of Commerce, BEA.*



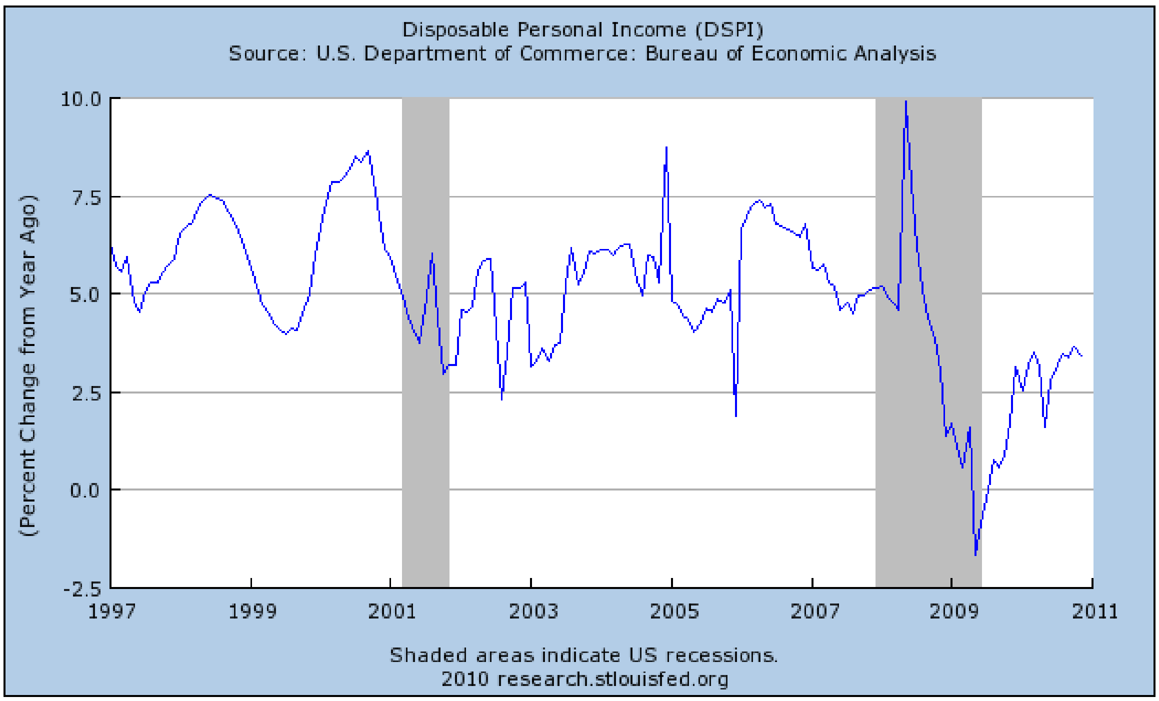
Corporate Profits. Aggregate business earnings have recovered to pre-recession levels, after massive losses were incurred throughout the recession. *Source: Dept of Commerce, BEA.*



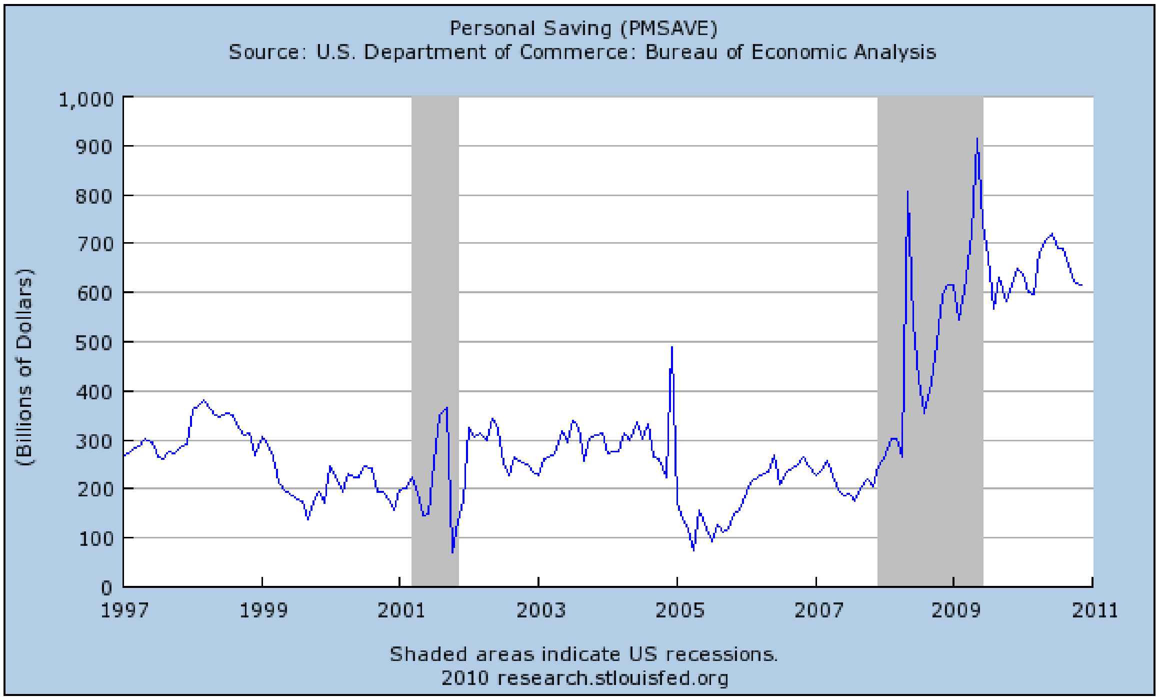
Savings and Investment

Personal savings and business investment involve both economic activity and behavioral patterns. Both savings and investment are critically necessary for economic growth to occur, since industrial production, employment, and personal and business income levels are all dependent upon a continual flow of investment funds. The following graphs therefore show the movement of accumulated assets from the personal, household level through aggregate consumption, and then into the business level.

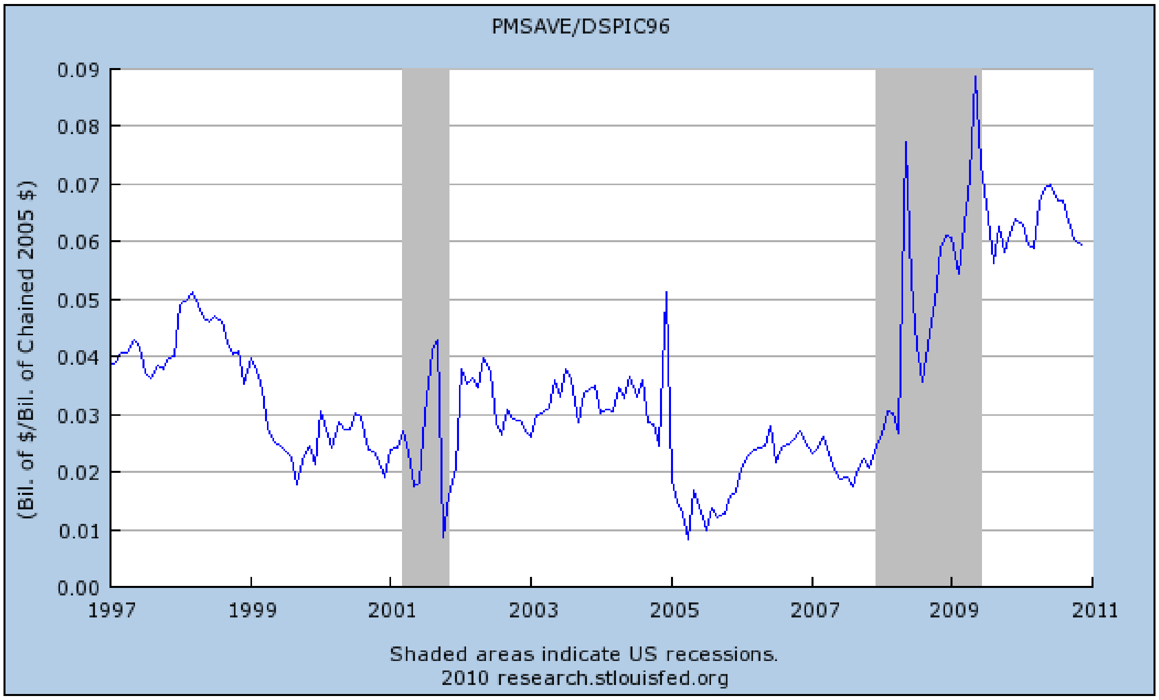
Personal Income has been increasing since the depths of the recession, with the change year-over-year recently stabilizing at 2.5% to 3.0%. *Source: Dept of Commerce, BEA.*



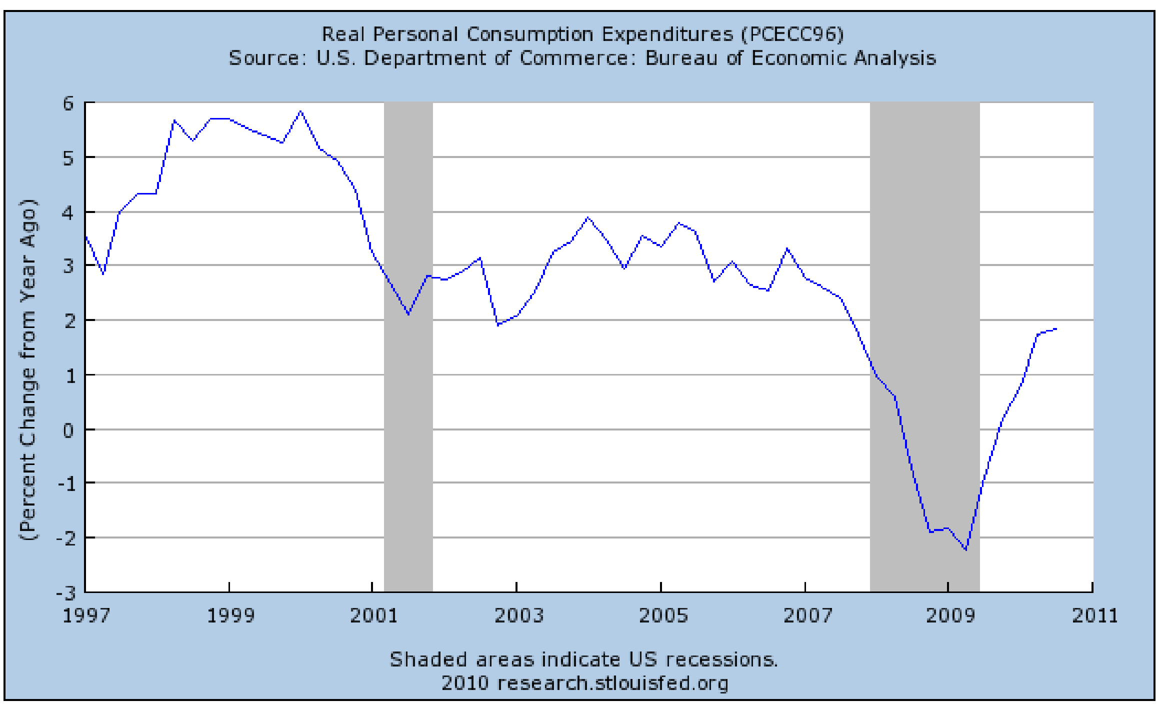
Personal Savings has been markedly increasing since the recession began. *Source: Dept of Commerce, BEA.*



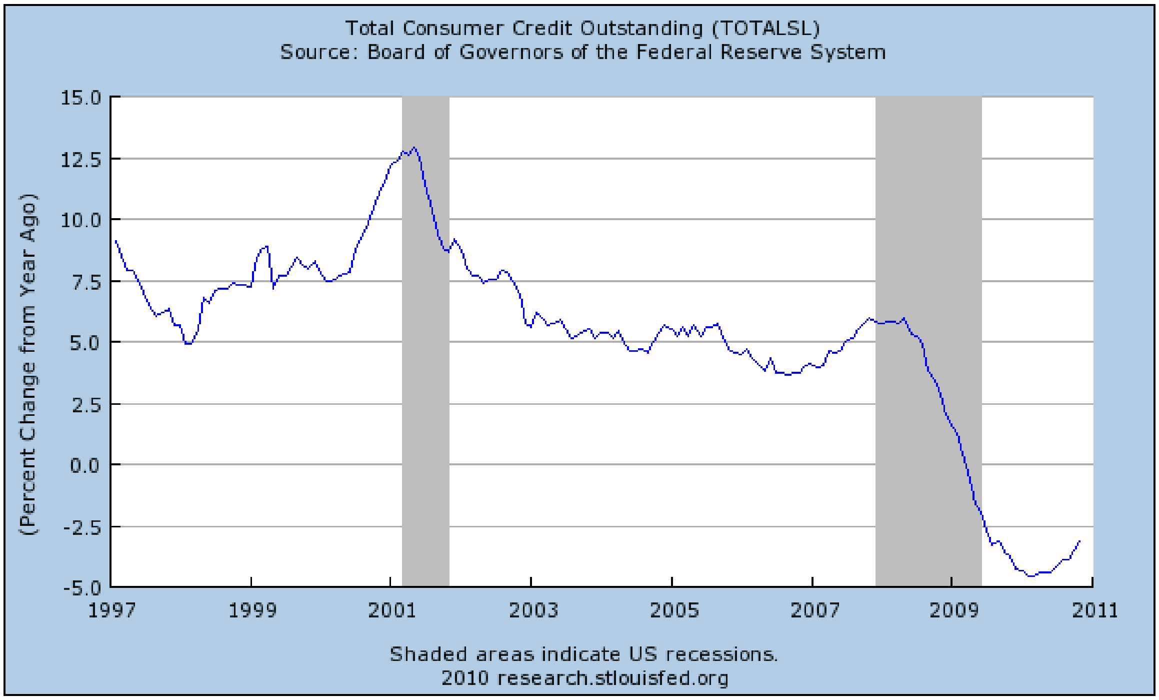
The Personal Savings Rate. The two above data series can be combined to show personal savings as a percentage of disposable personal income. This is an important aggregate ratio, as savings ultimately ends up as either investment or as available cash to spend in some fashion. The savings to income ratio has increased from 1% in 2005 to a 6 to 7% range more recently. This has been a far higher savings rate than through the expansion years of the 1990's and 2000's as well as the recession of 2001. This amounts to a remarkable change in individual economic behavior.



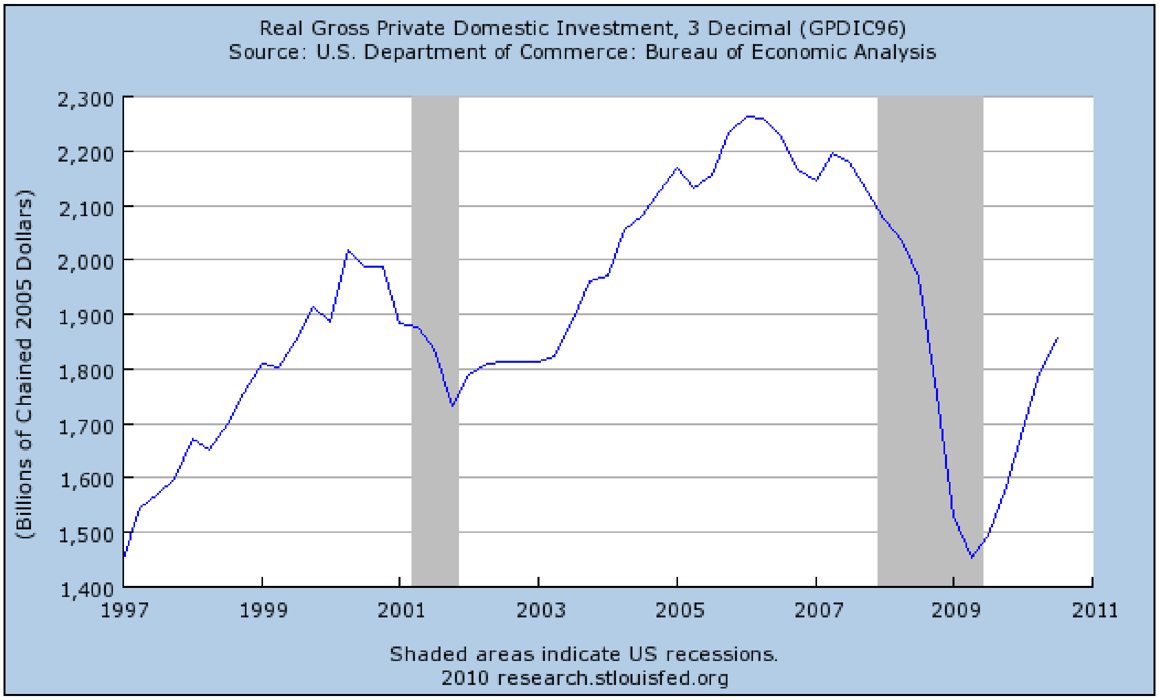
Personal Consumption Expenditures (PCE) are mildly positive year-over-year after drastic reductions during the recession. Even now however, this measure of consumption is only increasing by 2% in the trailing twelve months. It has been as high as 4% in the early 2000's and even higher in the 1990's, at 6%. This suggests that the heightened savings since the recession has not been re-spent along the way in large amounts of consumption expenditures. *Source: Dept of Commerce, BEA.*



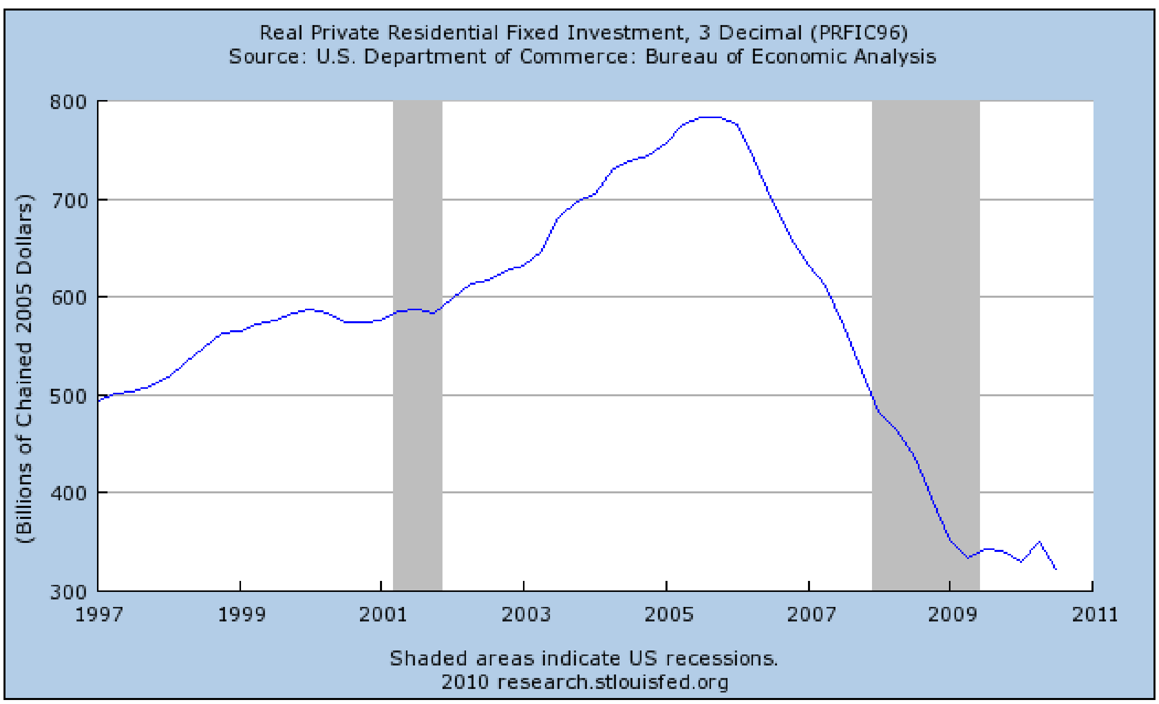
Consumer Debt. Rather than going on a renewed spending spree, households have used their enhanced savings to pay down massive amounts of consumer debt, as shown in the following graph. Only very recently has total outstanding credit begun to turn positive again. *Source: Federal Reserve.*



Investment. With a higher savings rate and only modestly increased consumption, the inference is that business investment may be underway. That is only partially the case however, as private domestic investment dropped precipitously during the recession, and has not yet rebounded to prior, healthy levels. *Source: Dept of Commerce, BEA.*



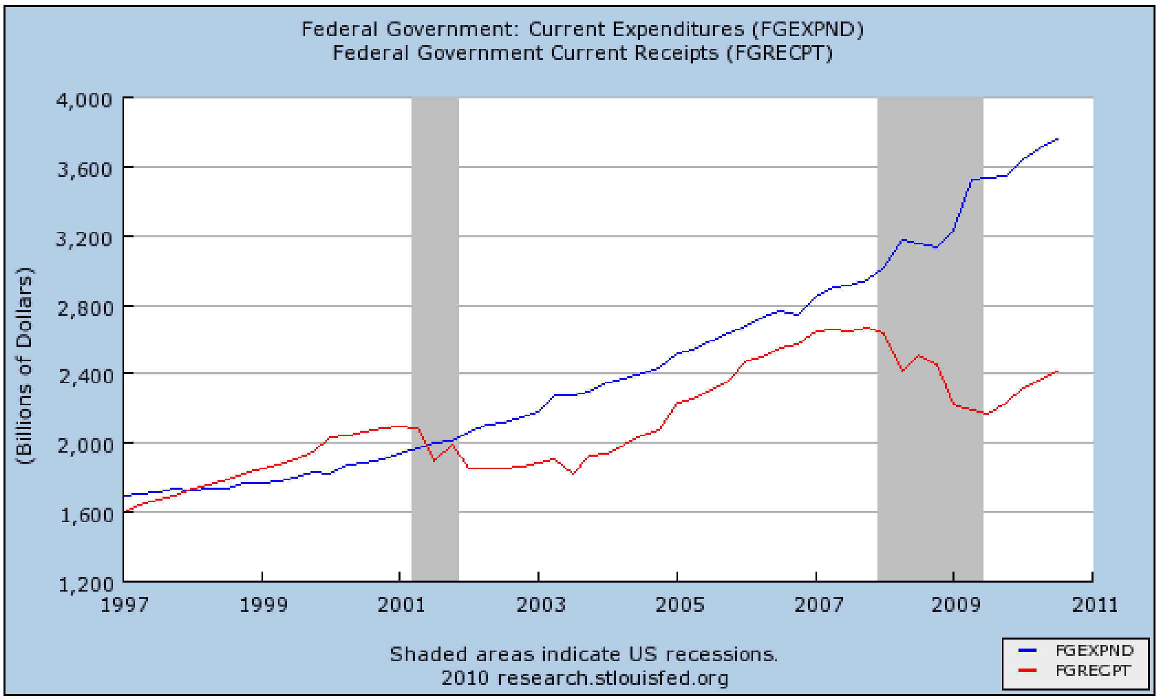
The residential markets have been especially hard hit, with fixed investments being a small fraction of the peak years. *Source: Dept of Commerce, BEA.*



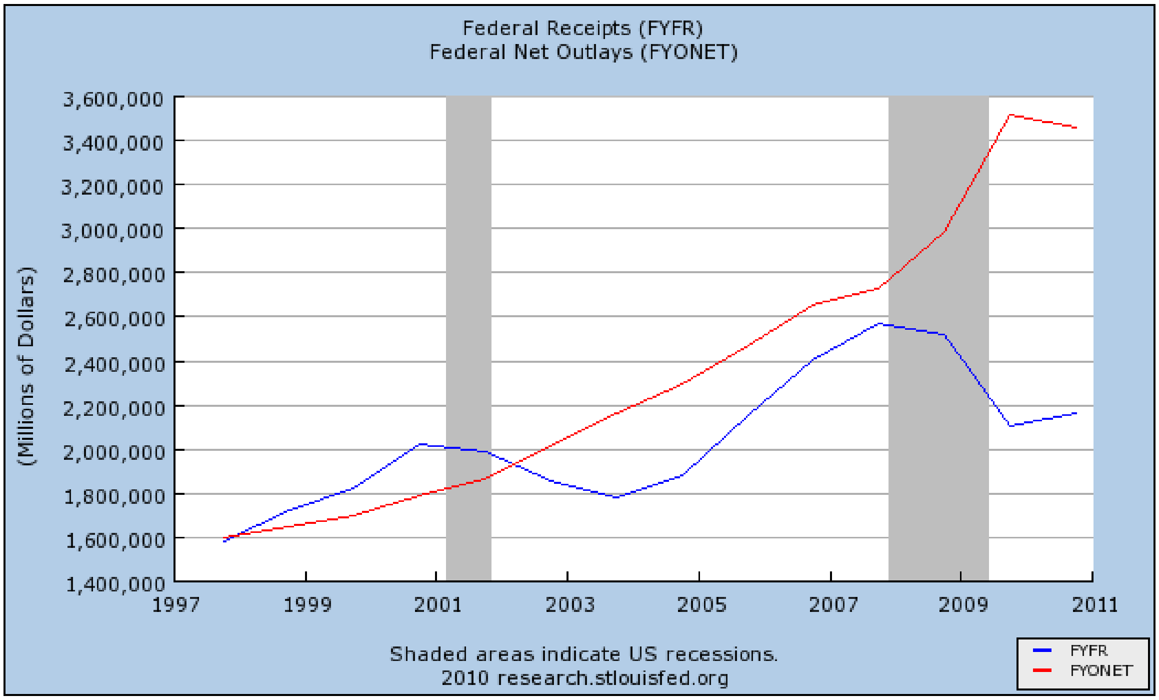
Without higher levels of investment, the cash generated from the re-bound in national income and corporate profits, is being accumulated by businesses as cash reserve holdings. Eventually, the cash will be used for mergers and acquisitions, equipment purchases, creation of new facilities, or even as shareholder dividends or share buybacks. But, for the time being, $1.93 Trillion in business cash reserves is sitting relatively idle, waiting for eventual deployment. For a recent blog posting discussing this cash build-up, see, http://kaufholdco.com/blog/2010/12/28/the-anticipation-of-growth/.

Governmental Debt Issues

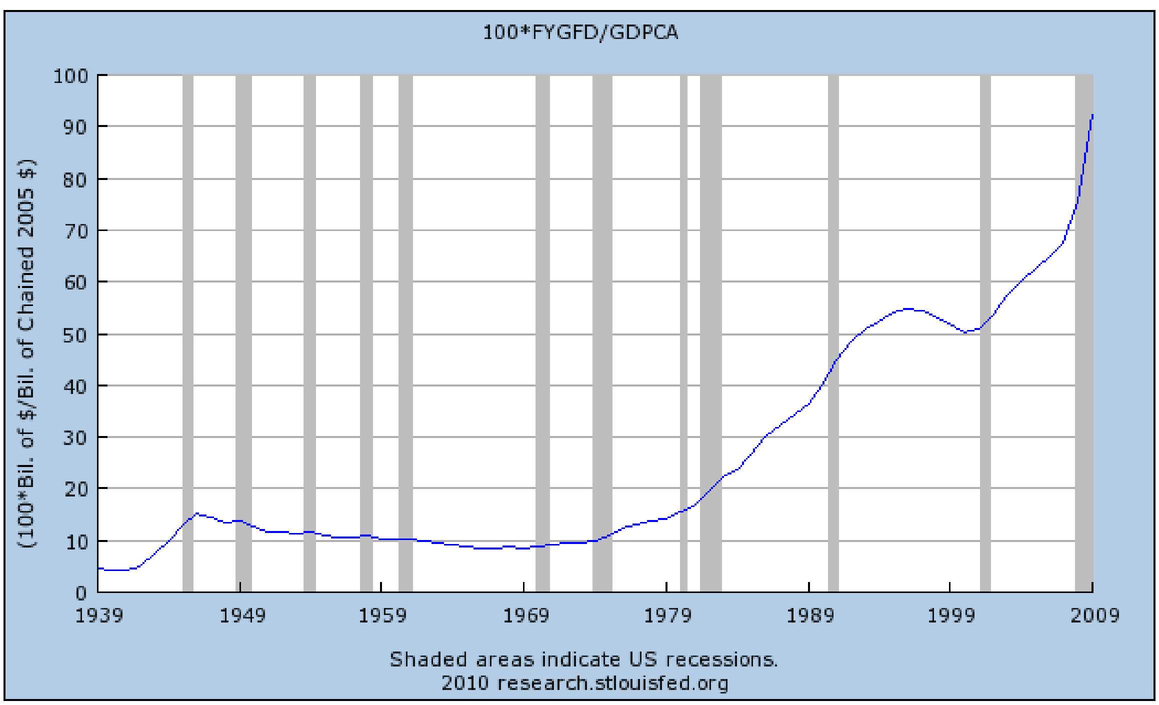
The Federal Deficit has ballooned since the start of the recession, as federal receipts have plummeted even as vast amounts of spending has occurred for fiscal stimulus and counter-cyclical programs. The following shows in and out-flows on a “current” basis. *Source: Dept of Commerce, BEA*



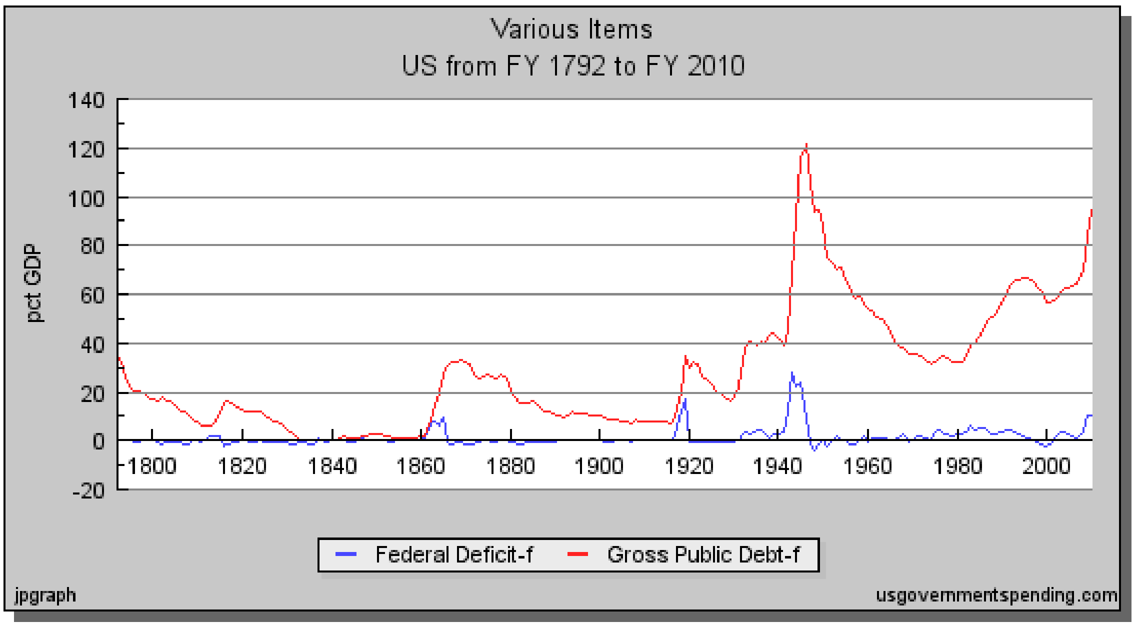
A similar way to measure the budget deficit is to compare cash flows using receipts and outlays, see below. *Source: Dept of Commerce, BEA.* Either method shows the same basic pattern of relatively small deficits through most of the last decade, followed by huge changes in both revenues and expenditures as the recession unfolded. Revenues have actually been hit far harder than expenditures have expanded.



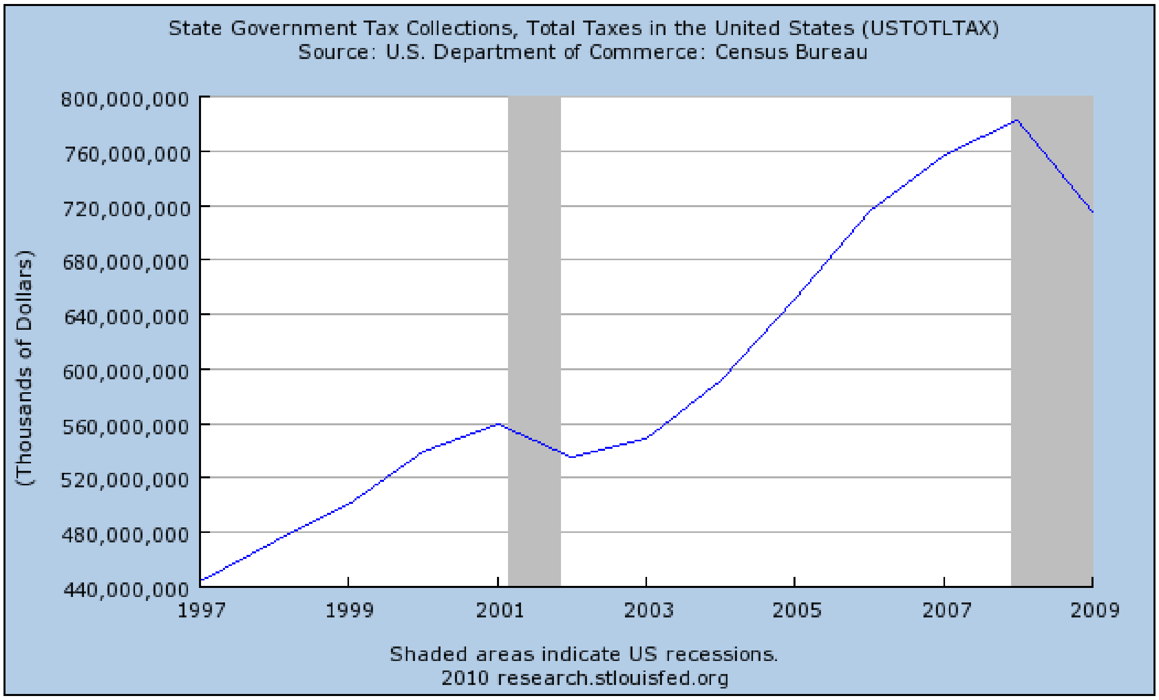
Debt to GDP. The federal debt is financed by government securities being issued to private investors and to other sovereign entities. As the debt increases relative to the ability to pay, confidence in government debt issues may shrink. The graph below shows the total federal debt as a percentage of US Real GDP. Currently, the debt-to-GDP ratio is at 94% for the US. *Source for debt figures, Council of Economic Advisors; Source for GDP, Source: Dept of Commerce, BEA.*



A graph containing similar debt-to-GDP ratios (but evidently with somewhat different data panels) was developed via web-access to *usgovernmentspending.com*. The following graph contains an historical focus. To emphasis to the severity of the most recent recession, note that the last time the US experienced high percentages of debt-to-GDP was in the Great Depression.



State Debt. The federal government is not the only entity experiencing deficits. Nearly all of the state governments have seen their revenue streams sharply curtailed. *Source: Dept of Commerce, Census Bureau.*



State and local tax expenditures at all levels of non-federal government initially decreased somewhat during the recession, but more recently has increased beyond pre-recession amounts. *Source: Dept of Commerce, BEA.*