



**The Northern Trust Company**  
**Economic Research Department**  
**Positive Economic Commentary**

*"The economics of what is, rather than what you might like it to be."*

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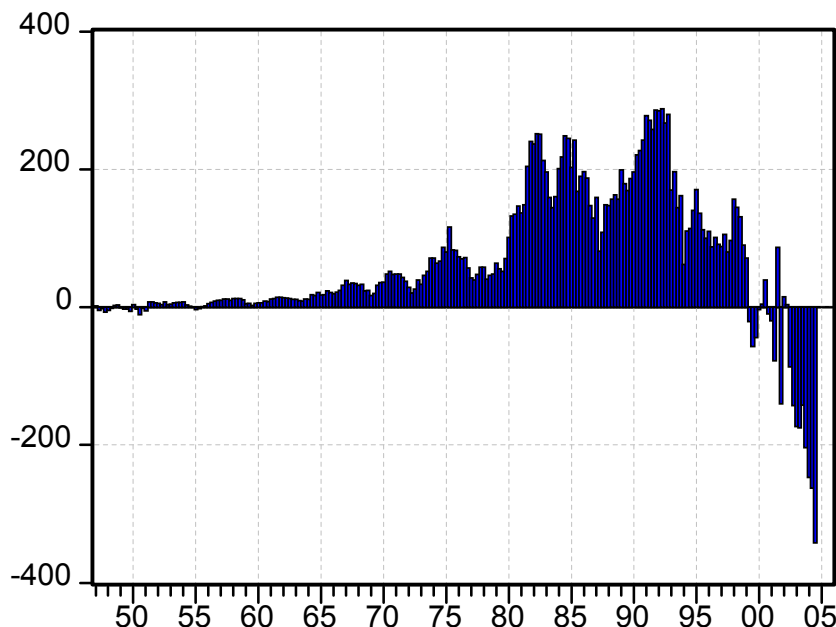
October 29, 2004

***Households Run Record \$342 Billion Deficit!***

With today's release of third quarter GDP data, we see that households outdid themselves by spending a record \$342 billion at an annual rate on consumer goods and services and residential investment more than they received in disposable (after-tax) income. The history of household surpluses, now deficits, is shown in Chart 1.

Chart 1

Household Surplus (+) or Deficit (-)  
\$ Bil. SAAR

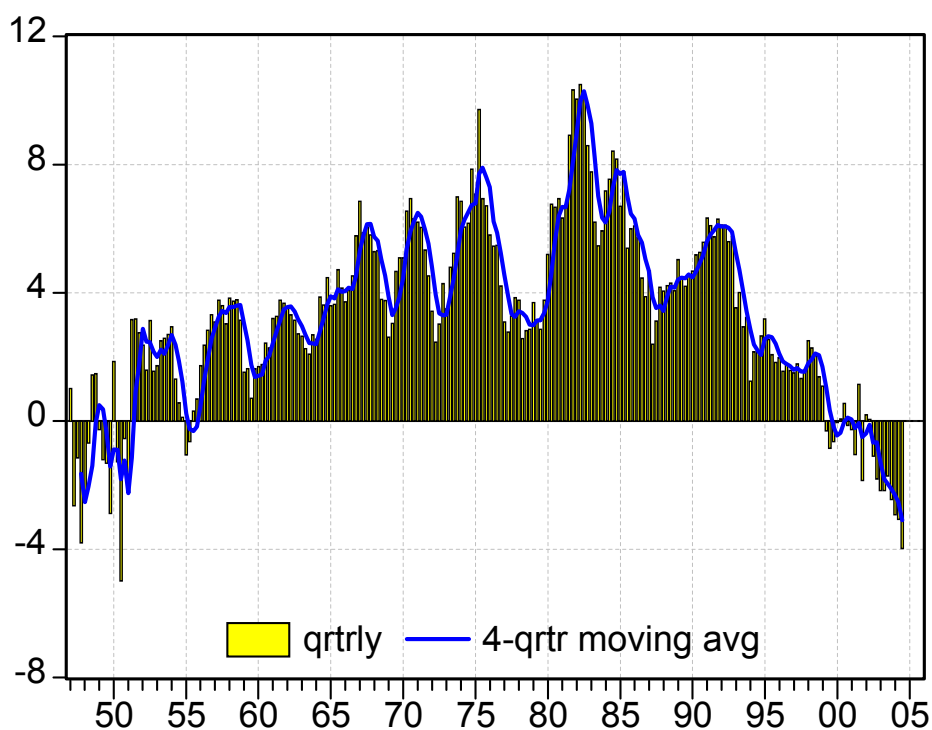


Note: Surplus/Deficit = Disposable Pers. Income minus sum of Personal Consumption and Residential Investment Expenditures

Now, of course, this is a little “yellow” journalism on my part. To be more forthright, this \$342 billion household deficit should be scaled against something – something like Disposable Personal Income (DPI). So, that’s what is shown in Chart 2 – the household surplus or deficit as a percent of DPI. Both the quarterly as well as the 4-quarter moving average observations of this percentage are presented in Chart 2. As a percent of DPI, the household deficit in this past third quarter was 4.0%. So, for every dollar of after-tax income received by households, they spend a dollar and 4 cents. For a given quarter, this is not a record relative deficit. The record was set in third quarter of 1950 when folks spent \$1.05 for every dollar of after-tax income received. But on a 4-quarter moving average basis, we American households did set a post-WWII relative deficit record of 3.1%.

Chart 2

Household Surplus (+) or Deficit (-)  
% of Disposable Personal Income



Prior to 1999, the last time households ran net deficits of any consequence was right after World War II. At that time, it made a lot of sense to run deficits. During World War II, we did not produce much in the way of consumer durables or private housing. A disproportionate amount of US output was devoted to the war effort. And because there was little for households to legally purchase, the household saving rate skyrocketed. So, during the war, household balance sheets got put into great shape and the capital stock of consumer durables and housing fell. It was quite natural, then, for households to run deficits for a few years after the end of World War II.

But is it natural now? Is it natural that a population laden with aging Baby Boomers who have entered their prime saving years would be running record budget deficits? Well, we are

just doing what Alan Greenspan is encouraging us to do. With the CPI up 2.5% vs. year-ago and with the fed funds rate at 1.75%, the *before-tax* inflation-adjusted return on saving is negative. *After taxes*, the return is even more negative.

Herb Stein, one of President Nixon's economic advisers said something along the lines as follows: Something that can't go on won't. Households cannot continue to run deficits. So they won't. Over the next three to five years, households will move back into surplus positions. Now, if exports and business capital spending offset the slowdown in consumer spending and residential investment, GDP growth need not slump. Odds are that GDP *will* slump. But regardless, those industries dedicated to discretionary consumer spending and housing are going to experience weak demand going forward. Adjust your stock portfolios accordingly.

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