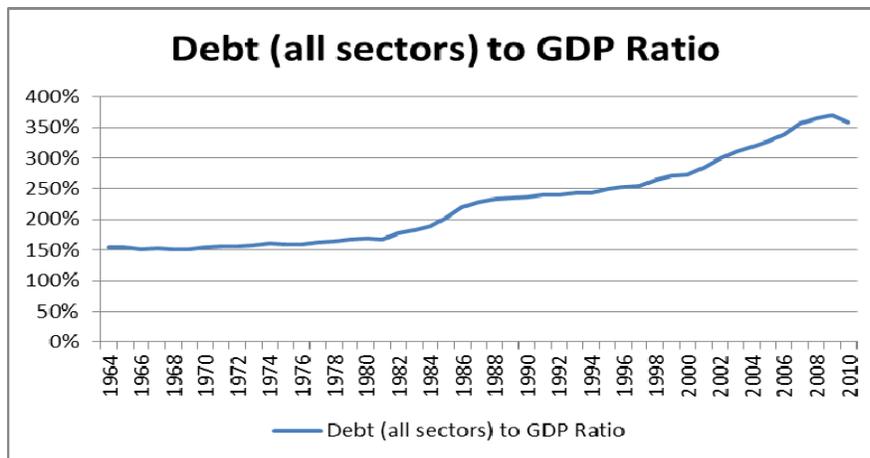


**This is Your Debt.....This is Your Income Distribution on Debt  
Not your Grandfather's Economy**

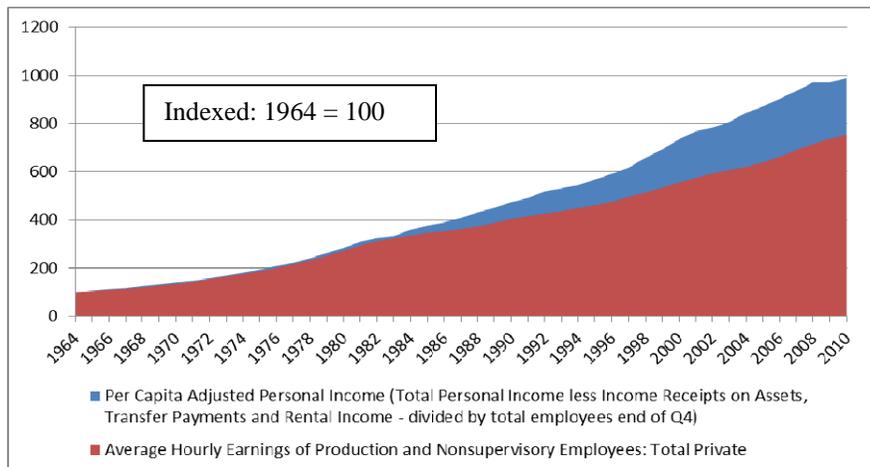
Let's keep this relatively simple. Apropos of the Republican/Democratic tussle that finally went to the mat yesterday with the President's speech at George Washington University: We offer two charts to illustrate where we are, and why "where we are" is not sustainable. The graphs below speak for themselves – but we've nevertheless thrown in a few comments following them for extra measure.

This is how we have been financing the past three decades of ephemeral growth (with the exception of the growth of the late 90's which was mostly bought and paid for with real productivity):



Source: Federal Reserve Board z.1 and BEA NIPA data

And this is the income allocation that the above leverage has enabled and fostered:



Source: BEA NIPA data and BLS CES and CPS data

We've cleaned up the Personal Income data, to be fair (as the inequity would look more extreme if we hadn't), to eliminate returns on assets and transfer payments, in order to get down to brass tacks. Good data on this series only goes back to 1964, but prior to the "Reagan Recovery," the hourly earnings of the folks on the factory floors, and manning the desks in the offices, of the U.S. private sector were nearly perfectly tracking overall personal income growth. Beginning in 1983 – and sustained throughout the past nearly-30 years – personal income grew substantially faster than hourly wages. Where did all the excess go?

Well, the hourly wage data above included production and non-supervisory workers only. So we will leave it to you to figure out who are the lucky members of that blue zone above.

Two things happened yesterday that are of note. In a more public venue, as mentioned above, President Obama finally woke up to the fact that the Republicans have long been "graciously" ceding to him a populist argument he's avoided since the day after his inaugural, and daring him to take it up. The President heretofore hasn't done so, in part because he's been listening to the wrong people for too long, and, to a greater extent, because he has, in general, proven to be extremely uncomfortable with the exercise of the presidential prerogative of laying out to the people exactly what he wants and using the bully pulpit to get it. Sort of a Keynesian Calvin Coolidge (although not silent, he has been saying little).

A few hours after the President's speech - in a an intimate, unabashedly wonkish forum organized by the Levy Economics Institute of Bard College at the Ford Foundation, to celebrate the Institute's 20<sup>th</sup> Annual Hyman P. Minsky Conference, Bill Gross's former PIMCO partner, Paul McCulley, gave a passionate lecture on the state of the developed world's economies. Paul was interestingly unperturbed with the process of financial institution reform and the prospect for the financial sector's (and the U.S. economy's) double dip (we may not be in total agreement, but give him his due respect). He was very concerned about the fracturing of the Eurozone and the implications or the global economy. But if anything keeps Mr. McCulley – a man who has no-doubt benefitted enormously from the events of the past three decades – up at night, it is the unsustainable levels of income and wealth distribution that have materialized in the U.S. It was a most impressive speech – far more so than the President's.

While we have been engaged in a bacchanalia of borrowing – taking debt by any measure (nominally or relative to GDP) to stratospheric levels – the U.S. has engineered a winner-take-all economy and indebted both the majority of its people and its government to keep a "don't tax, but spend anyway" and consumerist fantasy alive.

And now we are met on a field of battle we never expected to be fighting on in those Cold War days of the 80's when this all began. Now we are facing unprecedented competition from the 3.3 billion people of the BRICS nations, massive wage and trade imbalances, and underemployment levels unseen since the great depression. And we are trying desperately to avoid nominal wage deflation (real wage deflation is already well underway).

Paul McCulley is right – the status quo is unsustainable.

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