

Back to the Future...Again

We have advanced [several explanations](#) for the severity of the recession (not the one that may be coming, the last one) and the anemic recovery. Chief among them the global supply shock in labor, capital and productive capacity relative to demand, with respect to the former, and debt deflation with respect to the latter.

But was the proximate cause of the rapid contraction in U.S. economic activity since May - including consumption, manufacturing and confidence? We believe the attached graph illustrates a good deal of the reason behind the contraction.

In short, [consumers maxed out](#) their credit availability again, just as occurred in the quarters leading up to the recession. In fact, the rate of [consumer credit growth](#) at 7.6% (\$15.5 billion) in June (announced last Friday) was stunningly high (it would have gotten a lot more attention if not for the brouhaha over the markets and the jobs report).

With no growth in real salaries and wages (or even nominal salaries wages in Q2) – growing consumer credit means an economy living on both borrowed time as well as borrowed money.

Since [November of last year](#) we have been tracking the rate of consumer credit growth vs. retail sales growth, using a seasonally adjusted three month moving average to smooth out MoM spikes. The most updated version of the chart, through the announcement last Friday, is attached to this note.

Since the recovery commenced, and prior to last fall, consumers were deleveraging – paying down their credit cards and taking on little other additional debt. There were a few micro-cycles during which consumers dipped back into credit with predicable accompanying surges in retail sales (often misinterpreted as part of a cyclical recovery).

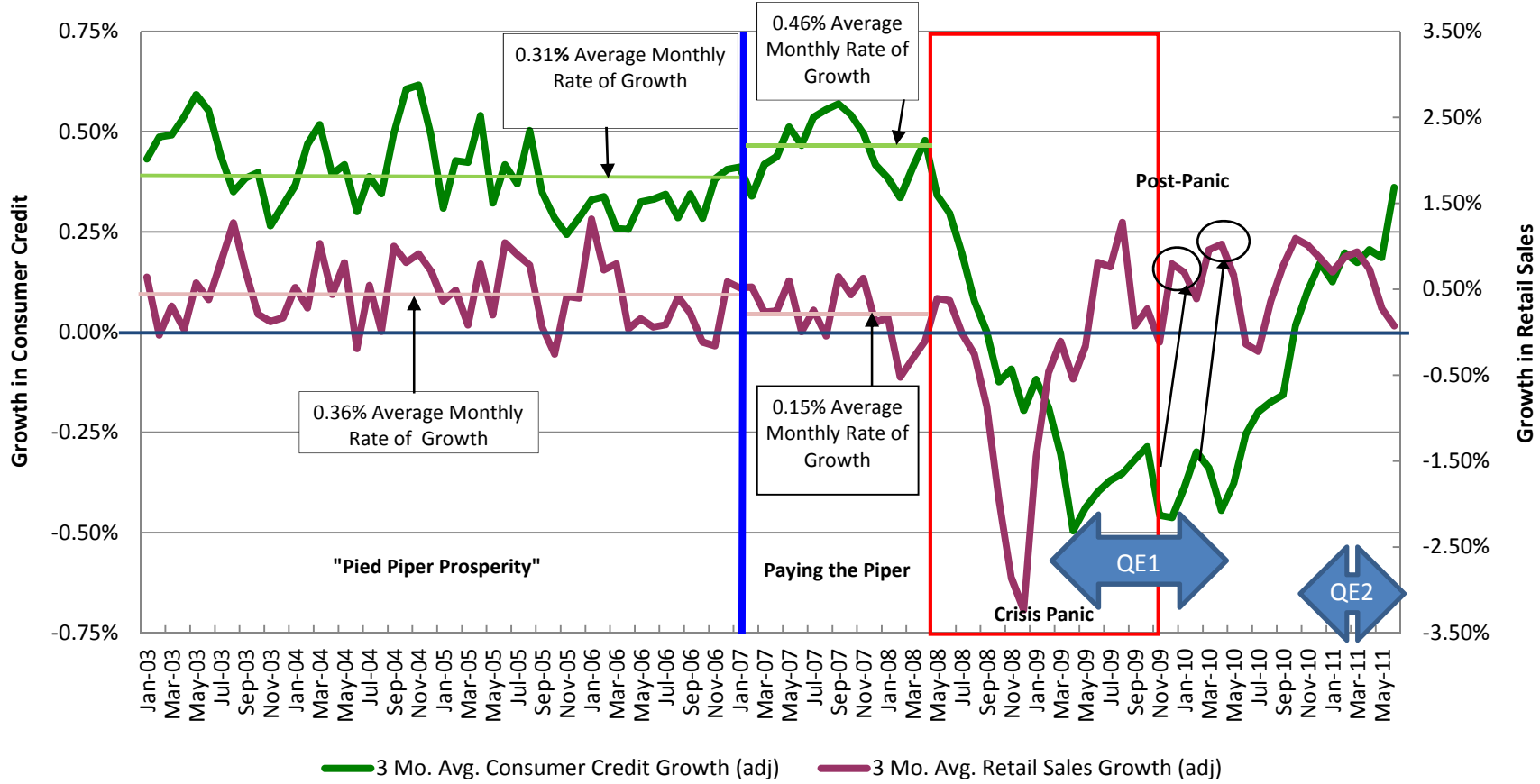
But beginning last fall, consumers actually entered a period of growing credit. The rate of credit growth accelerated steadily, with a brief pause in 2011 Q1, and then shot up to actually exceed the rate of growth in retail sales in Q2. This phenomenon had not occurred since the recession and was much more typical of the period leading into the recession, when consumers began to actually live off credit day to day (see the “Paying the Piper” period in the attached chart).

Our friend, David Rosenberg of Gluskin Sheff noted yesterday that the recent growth in consumer “credit was not being tapped for spending as much as to meet...unpaid bills. In fact, if you look back at the last three recessions, they are actually touched off by ‘get by’ behavior like this.”

We couldn't agree more.

[See graph next page]

Three Month Moving Average Growth in Consumer Credit Outstanding & Retail (Seasonally Adjusted)



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