THE US DEFICIT

by Steve Brown

There is rarely a day that goes by that we don't hear a Congressperson, pundit or person-on-the-street interview that frames our current budget deficit against the backdrop comparing the government's balance sheet with the common household budget. The implication is that if any household treated their finances as irresponsibly as the Federal Government, they would be bankrupt and in jail. While this logic makes for a good hysteria-whipped sound byte, it is ridiculous down to its core. We are not fans of the current deficit as it should be incumbent on our industry to make sound fiscal and economic arguments. Hence, we wanted to shed some light on this topic.

For starters, despite any puritanical sensibilities, debt is neither bad nor good. That is to say there is nothing "evil" or conceptually wrong with debt. In fact, it can be expected to be beneficial almost half the time. Debt is nothing more than a shifting of cashflow from one period to another. The interest that is paid makes the lender indifferent as to when those cash flows are given. Issuing $5B in US Treasuries means that the Gov't has $5B to spend now, instead of 5Ys from now. If rates go up, the country is better off and if rates go down, the opposite is true.

The Federal Gov't is 221Ys old and has the power to make laws, enter into trade agreements, issue debt, create money, set monetary value and levy taxes. In short, the Gov't is a going concern, with an undefined, but vast balance sheet that has a wide array of tools at its disposal to control deficit and future budget. A household has no such power and has a finite life. This isn't even apples-to-oranges comparison, but apples-to-Florida comparison. The extra power that the Gov't enjoys makes running a deficit not only manageable, but desirable.

Except for a brief period around 1835, we have had a deficit for every year since 1776. Since that time there has been 7 periods (keep this number in mind, as it will be important later) totaling 40ys where the US has run a surplus enough to pay down outstanding debt. In other words, the US is largely able to accumulate debt almost non-stop, despite calls at each point of a new debt level (some 185x) pundits have degreed that we are taking on too much debt and will ruin the country, like a household declaring bankruptcy.

The 7 periods where we paid down the were 1817 to 1819; 1823 to 1836; 1852 to 1857; 1867 to 1873; 1880 to 1893; 1920 to 1930; and, 1998 to 2001. Oddly the US has experienced 6 depressions, which came in 1819, 1837, 1857, 1873, 1893 and 1929. If you compare the dates, it is no coincidence that in all but the Clinton years, a major budget surplus and budget reduction was followed by a depression. We would make the argument that we were headed for a depression in 2001, when 9/11 happened. At that point, rates were dramatically cut and Gov't intervention provided enough stimuli to turn the recession into a boom. We are not saying surpluses and depressions are linked, but 7 surpluses followed by 6Ã‚Â½ depressions should raise some eyebrows. Our point here is that debt and the repayment of such plays a part in economic evolution and contributes to cycles.

Unlike household and state deficits, the US deficit is self-stabilizing. Issue too much debt and the Dollar drops, making our goods cheaper and the repayment of the debt less expensive. Pay down the deficit and the opposite happens.

The deficit vs. household budget analogy is invoked so often that it is almost taken as fact. A sovereign government bears little resemblance to a household. Allowing such comparisons leads to a faulty assumption that debt is bad. The decision to spend the money now (and accumulate debt), or spend it in the future, is irrelevant. The better question is whether we spending our money wisely.

BANK NEWS

Higher Rates

The Treasury reported foreign demand fell for its securities in Dec by the largest amount in history (down $53B), as China reduced its holdings by $34B and Japan followed suit with an $11B reduction.

Foreclosures

A study by S&P and John Burns Real Estate Consulting predicts nearly 80% of home/condo loans currently delinquent will end up in foreclosure.

TARP and Loans

According to the Treasury, in December banks that received taxpayer funding originated $178.1B in new business and consumer loans, up 13% MoM, though total dollars outstanding dropped 1%. Credit card balances dropped 7% Yoy and new originations fell 17%.

Bank Issues

The latest Grant Thornton LLP Bank Executive Survey finds 52% of banks plan to increase their focus on risk management in 2010; 21% plan to shrink the balance sheet to increase capital ratios and 13% will reduce overhead.

Bank Hiring

A study by the ABA finds banks hire 60% of their employees from within the organization, but 40% of CEOs do not think they are doing enough to help employees grow.

Trust

A study by NewGround finds 82% of consumers say they trust community banks.