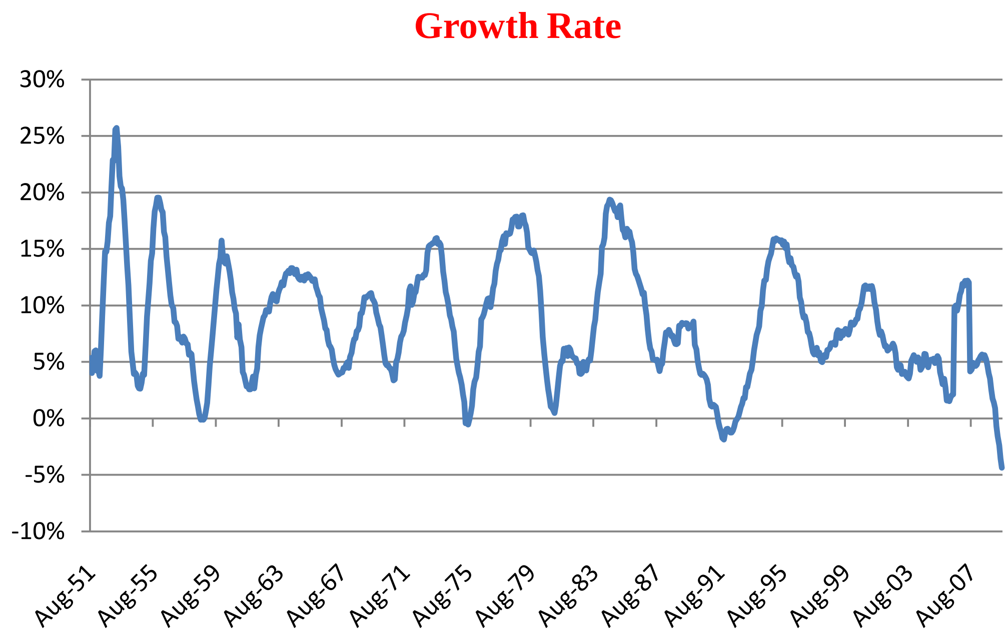
The Long History of Household Debt

Data and Analysis by Logistic Research & Trading Co., September 17, 2009

The chart below depicts the history of total household debt since 1951. The data actually go back to 1944, but for understandable reasons – the data is scaled in terms of the annual growth rate – the numbers before 1951 are quite off the scale. Before 1950, household debt was insignificant, and the growth rate from virtually zero was correspondingly very high.



Source: Federal Reserve Board and Logistic Research & Trading Co.

Simple inspection of the chart shows how remarkable the recent years have been in terms of household borrowing, and how comparable they are to the notorious 1930s. Since 1990, the growth rate has averaged a modest 5%, including the two periods of meaningful negative growth rates. The recent negative growth rate however stands out sharply even in comparison to this history. The latest month – July, 2009 – came in at a growth rate of -4.6%, more than double the bottom of the recession of 1991. This slide was preceded by a startling surge in 2007 associated with the election of 2008, as the federal government poured on the credit stimulus in an attempt to head off a Crash before the election.

Historically, the growth rate of household debt has been a reliable indicator of public confidence in their financial prospects. The implication of this chart is therefore self-explanatory. The contrast with this decade and the preceding one – the "Gay Nineties" – is especially stark. How much of this is attributable to the contrast between the victorious end of the Cold War and the grim onset of the Next War is only a matter for conjecture. An equally important question can however be answered definitively: the public has by no means been launched on a wild borrowing binge for the last ten or fifteen years. Because of the law of compound interest, even a fairly moderate growth rate of household debt after 1990 corresponds to a large growth of debt in dollars, but the public has if anything been trying to kick the debt habit for a long time. It is the growth of the national debt – debt of the Treasury and of government agencies – that has driven the explosion in total dollar debt outstanding.

The growth of Treasury debt has been driven by the federal deficit, of course, and made possible by the strong dollar. The relative frugality of the Reagan years and the strong-dollar policy pursued so vigorously by the Greenspan Federal Reserve opened the floodgates to federal borrowing from abroad. It would be a mistake however to view this history in isolation without regard to what was happening around the world.

The remarkable growth rates of total debt around the world – the worldwide credit explosion – conspired in combination with our federal government in a leveraging of the world economy, and it is the hangover from that leverage that is visible in the worldwide financial collapse. We do not have very good data on household borrowing around the world – that would be OECD data that we don't have at hand at the moment – but one would assume that the experience around the world has been more similar to American experience in the hayday of the 1950s and '60s. We will follow up on this topic.

Implications for the Near Future

Limiting our focus to the American economy, it seems highly likely that the recession will run for a period of many quarters before the public has sufficiently restored its liquidity and starts to shop again. In the meanwhile, the only sources of prosperity will be further federal borrowing and exports. Both of these imply a weaker dollar and higher price inflation. While tax increases would be deflationary and would offset the inflationary implications, they would also risk turning a recession into a depression. The Obama administration's attempts to pass stealth tax increases under the guise of healthcare "reform" and environmentalism are probably doomed in the Congress and with them, probably dooming any prospect of meaningful tax increase.