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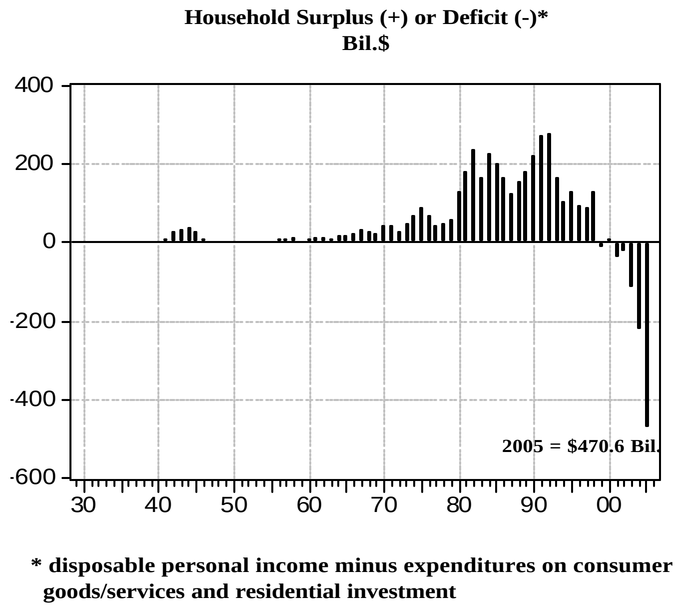
It's Different This Time

As the chart below indicates, it *is* different this time. With rare exceptions like the Great Depression and in the years right after WWII, households have run surpluses. That is, households usually spend less than they earn after taxes. But in recent years, thanks largely to cheap mortgage credit, households have started to run deficits. In dollar terms, households ran a record deficit of $470.6 billion in 2005. Relative to their after tax income, households ran a record deficit of 5.2% in 2005. Households in 2005 ran a bigger deficit than did the federal government! Yep, it sure *is* different this time. I can't wait to see how this imbalance is resolved.

Chart 1



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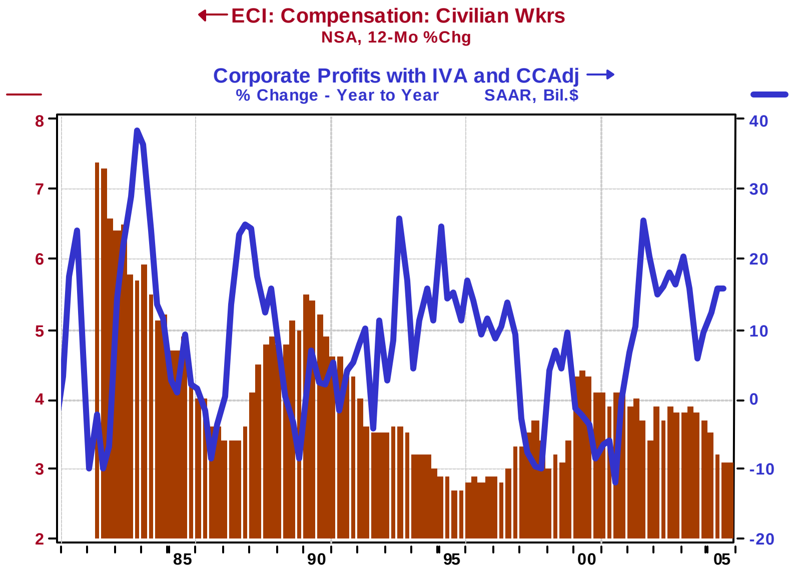
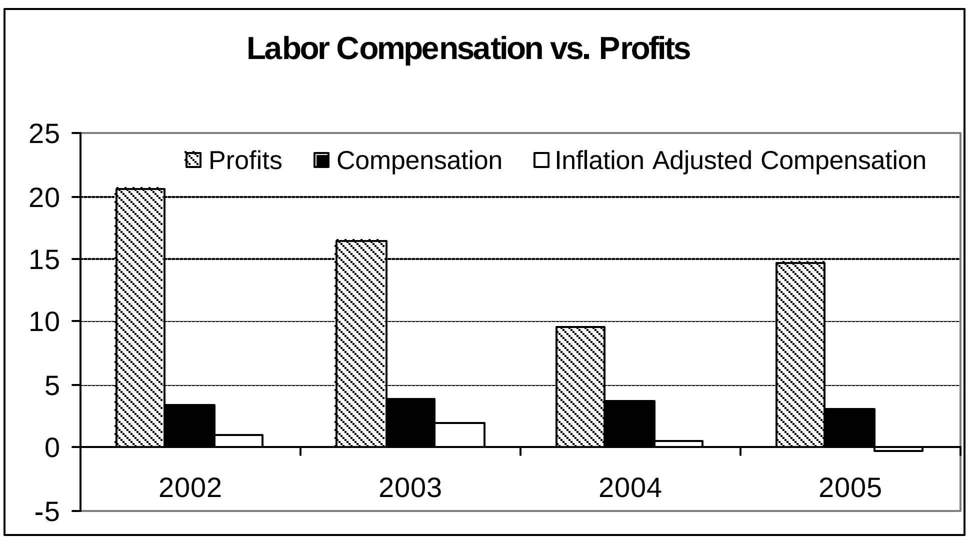
Labor Compensation Is Far Short of Profit Growth

The Employment Cost Index (ECI), an overall measure of labor costs inclusive of wages and benefits, grew 3.1% in the fourth quarter of 2005 (year-to-year basis), down from 3.8% and 3.7% gains in 2003 and 2004, respectively. The unemployment rate has marched steadily down to 4.7% in January from 5.7% in January 2003 and 5.2% in January 2004, implying tightening of labor market conditions. Contrary to expectations, employee compensation has decelerated as the unemployment rate has declined. As mentioned in earlier commentaries, the unemployment rate overstates the extent of tightness in labor markets.



Sources: BLS, BEA /Haver

During 2002-2005, corporate profits have grown between 9.6% and 20.6% (average year-to-year growth in the first three quarters in 2005 in 14.7%). By contrast, labor compensation shows slower growth in 2005 (+3.1%) vs. 2004 (+3.7%) and inflation adjusted labor compensation dropped 0.3% in 2005, after advancing 0.5% in the prior year. In other words, labor costs are unlikely to be a worrisome problem in the near term.



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