

## **SMICK: Money in our mattresses**

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DAVID M. SMICK

There is a reason people say to beware what you wish for because you may get it.

For years, the world has wanted Americans to consume less and to save more. They are getting their wish. The U.S. savings rate, near zero less than a year ago, has soared to nearly 5 percent of income and could go higher. Total personal savings jumped from \$20 billion in the first quarter of 2008 to a whopping \$453 billion during the same period of 2009. The real danger is if the savings rate goes to 7 or 8 percent. If that happens, economic recovery could be seriously delayed.

When financial markets are working efficiently, saving is a good thing. At this point, however, with major U.S. industries at risk of complete meltdown, Americans desperately need to consume. Yet households are in a totally defensive mode because the meltdown to date has destroyed \$14 trillion of their wealth. They have been saving like never before.

Consumption comprises 70 percent of our economy. While the reckless, overleveraged consumption habits of the past hardly made sense, the fear now is that American consumption patterns are on a long-term decline. That means potential economic growth in years ahead could be stunningly low (unless the financial system miraculously recovers and business investment picks up the slack).

The role of upper-income earners has become crucial to savings.

There is an undeniable “trickle down” aspect to the workings of our economy. Like it or not, those making more than \$100,000 a year are responsible for half of retail sales and 70 percent of the profit margins at retail, according to a study by American Express Publishing and the Harrison Group marketing and research firm. Suddenly, because of the economic meltdown, this group has become highly cautious about spending. Their savings rate has soared, the study reported.

The question is whether Washington is politically demonizing the very folks capable of leading us out of the recession. Affluent Americans have become the new political whipping boy. They are perceived as the illegitimate recipients of the ill-gotten proceeds of financial liberalization and are about to face stiff increases in taxation.

Nobody likes the rich, yet there are serious policy questions about whether Washington’s latest political fad of class warfare is on a collision course with the goal of economic recovery. The annual affluence study by Ipsos Mendelsohn found that while the economy and climate change are of primary importance to average-income earners, taxes have become a major concern to suddenly cautious high-income earners. Moreover, this group, according to the data, is ironically finding pleasure in their new “be more like my neighbors” mentality as they draw their purse strings tighter.

A related question centers on the degree to which upper-income earners are worried about today's ballooning national debt. Federal spending next year will reach 28 percent of gross domestic product. It has exceeded 25 percent of GDP only four times in U.S. history. When economic historians look back at this period, it will be enlightening to see whether today's debt explosion was responsible for high-income earners significantly increasing their saving in anticipation of potential tax and inflationary changes resulting from the debt.

American consumers are retrenching and saving frantically, with high-income earners leading the way. The banks are barely lending and exports have collapsed. That leaves one option for stimulating demand in the event that the economy fails to fully recover: more fiscal stimulus. With congressional midterm elections less than a year away, a second fiscal stimulus in early 2010 hardly seems out of the question.

This is where our policy-makers could face a tough choice. Would even a \$1 trillion additional stimulus package be enough to impress consumers who have lost 14 times as much? Moreover, would a serious negative wealth effect result among high-income earners if the national debt rises to even higher levels?

Policymakers need to ask themselves which development over the past few months enjoys the greater potential to revive the economy: (a) the \$800 billion stimulus package that produced millions of rebate checks worth several hundred dollars; or (b) the \$3 trillion stock market jump (since the March 9 low), which has relatively cash-rich, traditionally big-spending Americans looking at their 401(k) retirement accounts with some relief for the first time in a while.

Ultimately, the factor determining the success of the Obama economy will be the level of private demand for durable goods by the end of 2010. Success will require a lot of spending by a lot of high-income earners the president probably doesn't like and who probably don't like him.

*David M. Smick is a global financial strategist and the author, most recently, of "The World Is Curved: Hidden Dangers to the Global Economy." From the Washington Post.*