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Structural Impacts on Cyclical Changes in the U.S. Economy

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Abstract

The problems in the U.S. economy are structural, not cyclical. This is not to say that the economy will avoid the impacts of cyclical change. Rather, the impact of cyclical change will be exacerbated by the underlying structural problem. Long-term overall output growth has slowed due to restructuring that goes back to the 1970s and which has been accelerated by accompanying technology transformation. The U.S. economy has become increasingly dependent on infusions of cash, the overexpansion of which led to increasing inflation through the pandemic period. The U.S. economy is no longer driven by manufacturing, even though it is the second largest manufacturing country in the world. Rising interest rates intended to curb inflation are currently threatening to reduce investment and output levels which had already been subject to slow long-term growth. These factors have combined to change the structure of the labor markets, as there are fewer jobs in manufacturing and technology has reduced the demand for labor to accomplish many traditional business processing tasks. Government and overall indebtedness are reaching unsustainable levels, creating an additional drag on economic growth potential and increasing systemic economic risk. As of today, the U.S. economy is most likely headed for a recession

in which the landing will be hard. Trade credit managers can expect increasing DSO, delinquency and bankruptcy activity.

Introduction

What you are about to read is not another piece on the impact of the COVID pandemic on the current state of the U.S. economy and its opportunities for making a “full recovery” from the disruption that it caused. While we cannot ignore the impact of COVID, the monetary creation that led to the inflation that it caused, and the effect of the Fed’s interest rate increases in response, there is a much longer-term trend at work, and we need to understand it if we are going to be able to see where the economy is headed and what to do about it. In fact, if we had to assign the label “key event” to a particular point in time, it might better be given over to the 9/11 attacks, which coincidentally corresponded to the end of the technology market boom of the late 1990s. This was then accentuated by the advent of the monetization of the economy that followed the financial market meltdown of 2008. It appears, however, that structural changes had been underway prior to the meltdown. The major force behind the change has been technology transformation and the restructuring that has accompanied it.

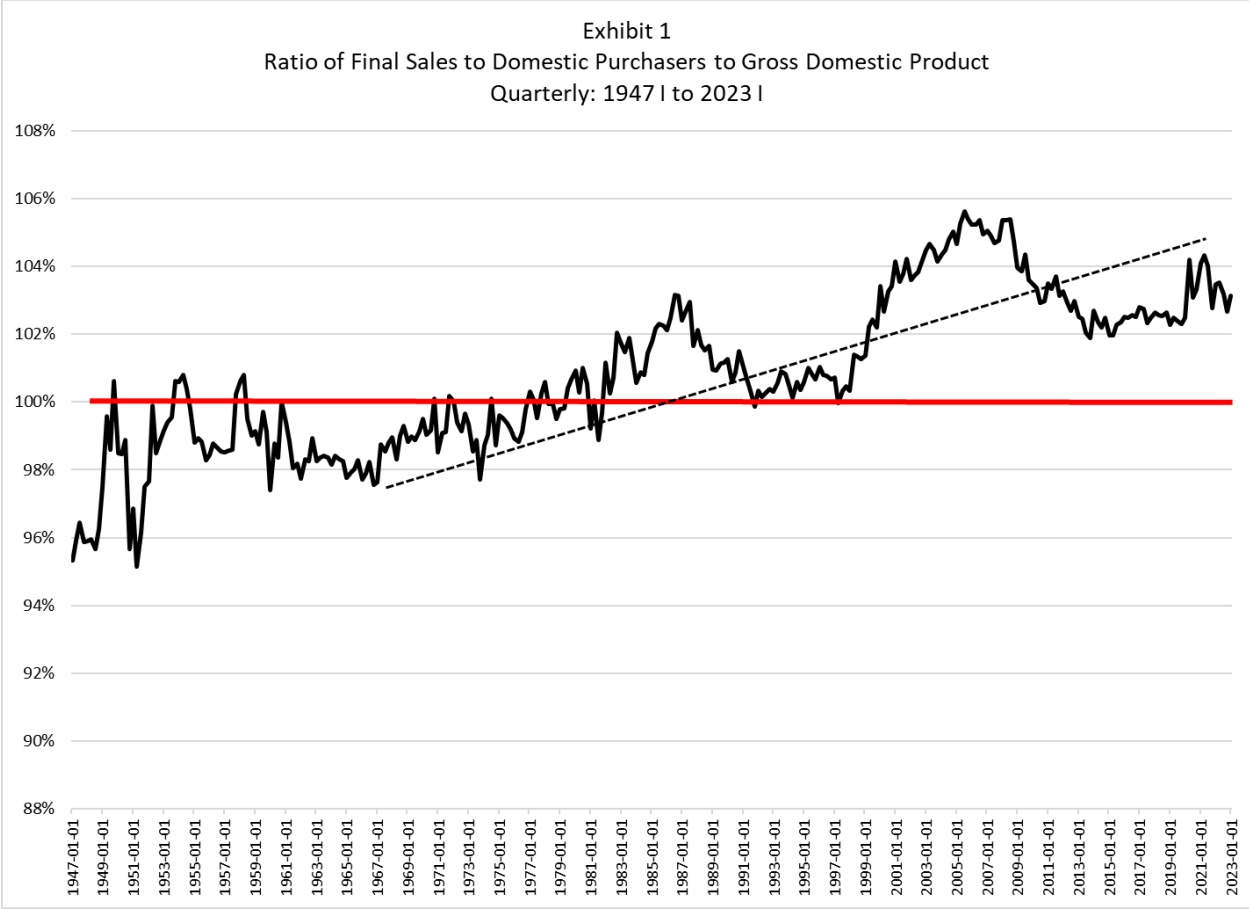
Aggregate Demand and Gross Domestic Product

Aggregate demand is a measure of the total value of purchases of final goods and services within an economy. Its measure includes personal consumption expenditures, gross private fixed investment and consumption expenditures, and gross investment by the government. This also amounts to gross purchases less the change in private inventories.

Aggregate demand tracks the gross domestic product very closely, but the major difference is captured by the propensity of the economy to consume imported goods. GDP is an output measure, while purchases is a more accurate measure of consumption in the household, business and government sectors. Over time, it is apparent that the relationship between the two measures has been subtly changing.

The major point of change in the behavior of final purchases relative to the GDP is apparent in the early 1980s. As can be seen in Exhibit 1, the ratio of final purchases to GDP went above 100% in 1981. Although it has risen and fallen over two cycles, it remains consistently above 100%, meaning that the U.S. economy has had a propensity to consume more than it produces. The rising elements of the cycles correspond to the periods 1981-1987 and 1997-2008. It is interesting to note that the two points at which the trend turned down corresponded to the financial market disruption of 1987 and the collapse of 2008. There is also within the pattern a noticeable change corresponding to the COVID pandemic. Overall, the ratio has been trending up since the late 1960s.¹

¹ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

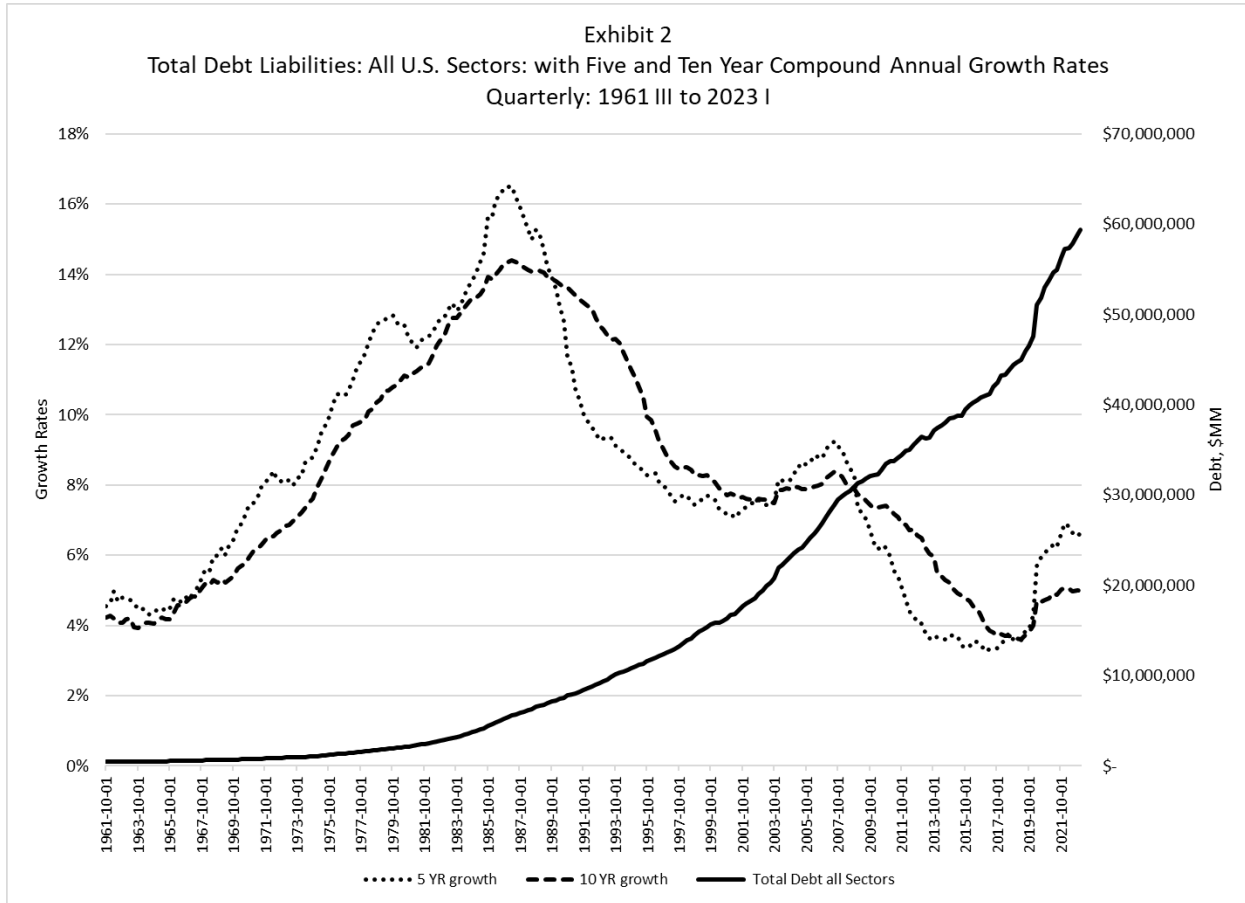


The increase in the ratio of purchases to output takes place over a period in which the U.S. economy has been continuously restructuring. The 1970s were a period in which the obsolescence of the manufacturing infrastructure was accelerated by rising energy costs. This led to the offshoring movement of the 1980s that was driven by changes in financial market liquidity and a wave of leveraged M&A transactions in which the business sector began its long-term trend of consolidation. The 1990s brought about a wave of business process reengineering driven by the technology transformation occurring in that decade. The 2000s saw the subsequent offshoring of business processes enabled by growth in the sophistication and capabilities of those same technologies. All along the way, the U.S. economy demonstrated an increasing propensity to consume more than it produced. A sustained period of monetary expansion and low interest rates was yet another factor enabling this trend.

Total Indebtedness

Of course, it is impossible for any economic entity to consistently consume more than it produces without going into debt. The U.S. economy has not been an exception to that rule. As can be seen in Exhibit 2, which shows the total debt securities for all sectors of the U.S. economy, overall indebtedness has been steadily increasing. The growth rate in these debt levels, however, rose through 1987, falling until 2001 and then rising again until 2008, at which

point it fell again until about 2017, rising significantly during the pandemic and then beginning to fall again in 2022. Each point at which the growth rates begin to slow down correspond to disruptions in the financial markets, including the crash of 1987, the collapse of 2008, and the commencement of interest rate increases by the Federal Reserve in 2022.²



Further, the fact that the growth rates reverse indicates that the economy may be hitting limits in its ability to carry additional debt.

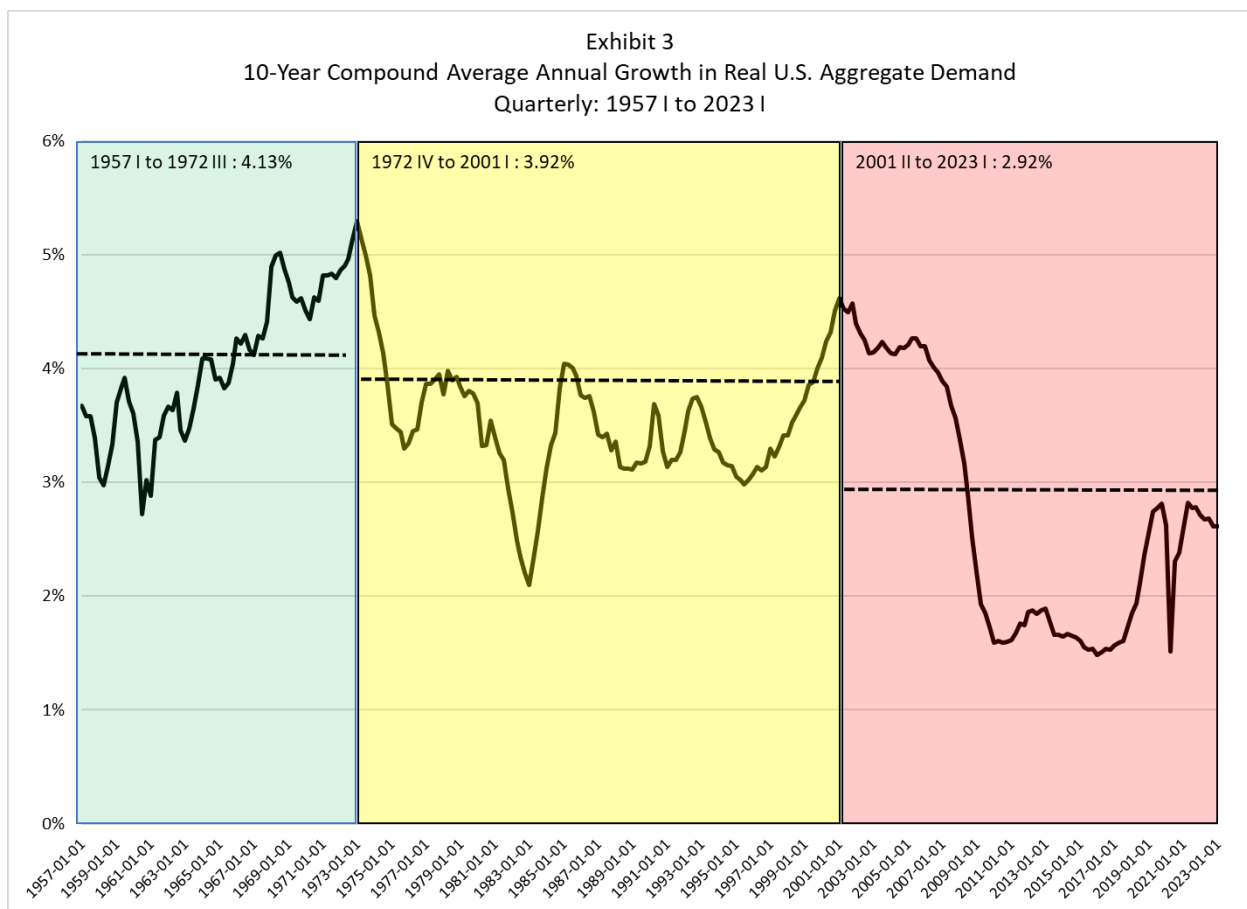
Changing Growth in Real Aggregate Demand

The impact of the structural changes on the U.S. economy and the significance of the turn of the century as a point of change are evident in the analysis of long-term growth in real aggregate demand. As can be seen in Exhibit 3, the pattern of long-term growth as measured by the ten-year average annual growth in aggregate demand falls into three distinct periods. The first, spanning between 1957 and 1972 was characterized by rising long-term growth rates with an

² Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

overall average of 4.13%. The second sub-period, between 1972 and 2001, saw a flattening of that growth trend. Even with the cyclicality evident in the trend, the overall average growth was at 3.92%.³

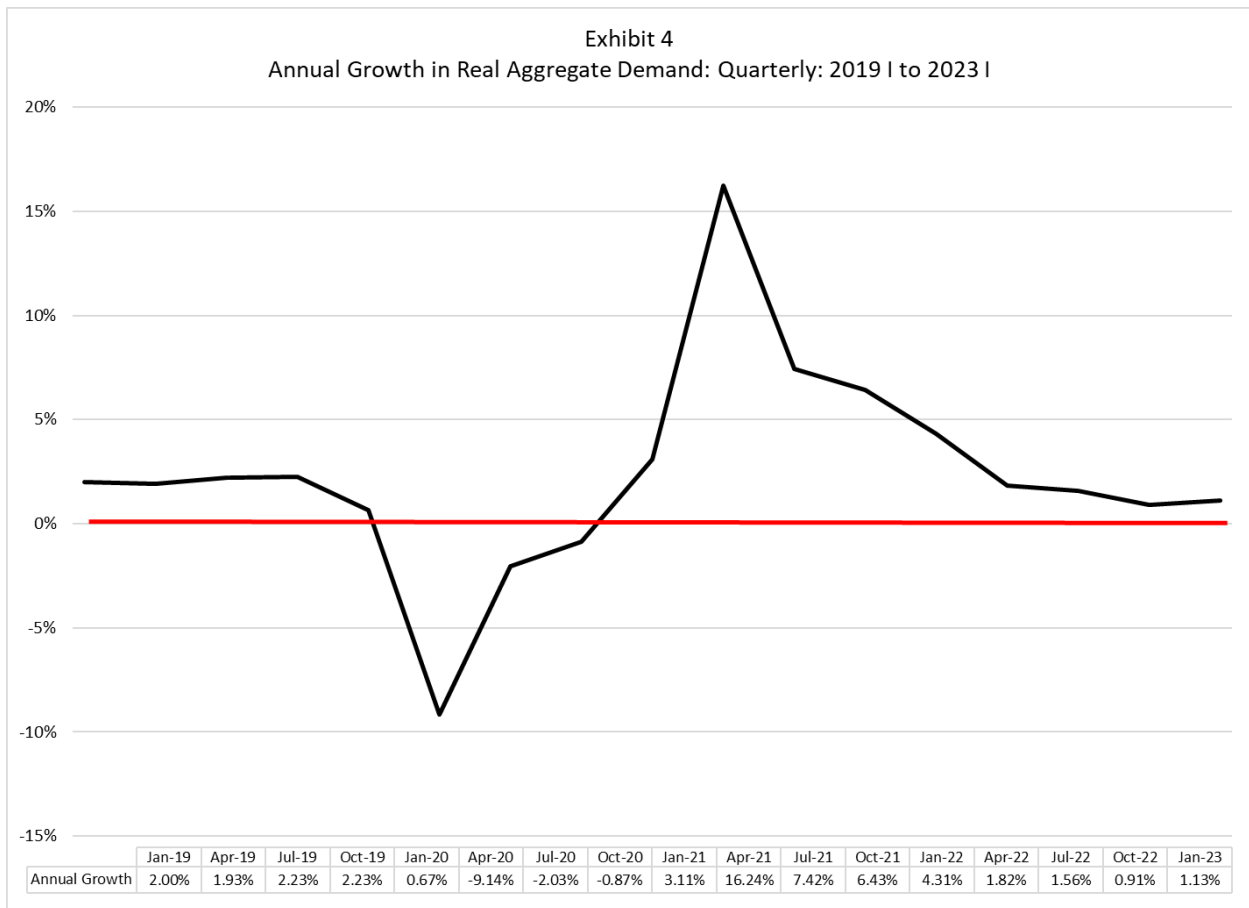
The greatest shift in aggregate demand growth occurs in the period following 2001, during which long-term aggregate demand growth plummeted leading up to the financial market collapse, recovering somewhat until the pandemic, since which time it has flattened out. The overall average growth has fallen by 100 basis points, down to 2.92% for that time interval. The most recent rate has been falling since it peaked in second quarter 2021 and is currently down to a 10-year growth rate of 2.61%.



³ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

The Pandemic Bump

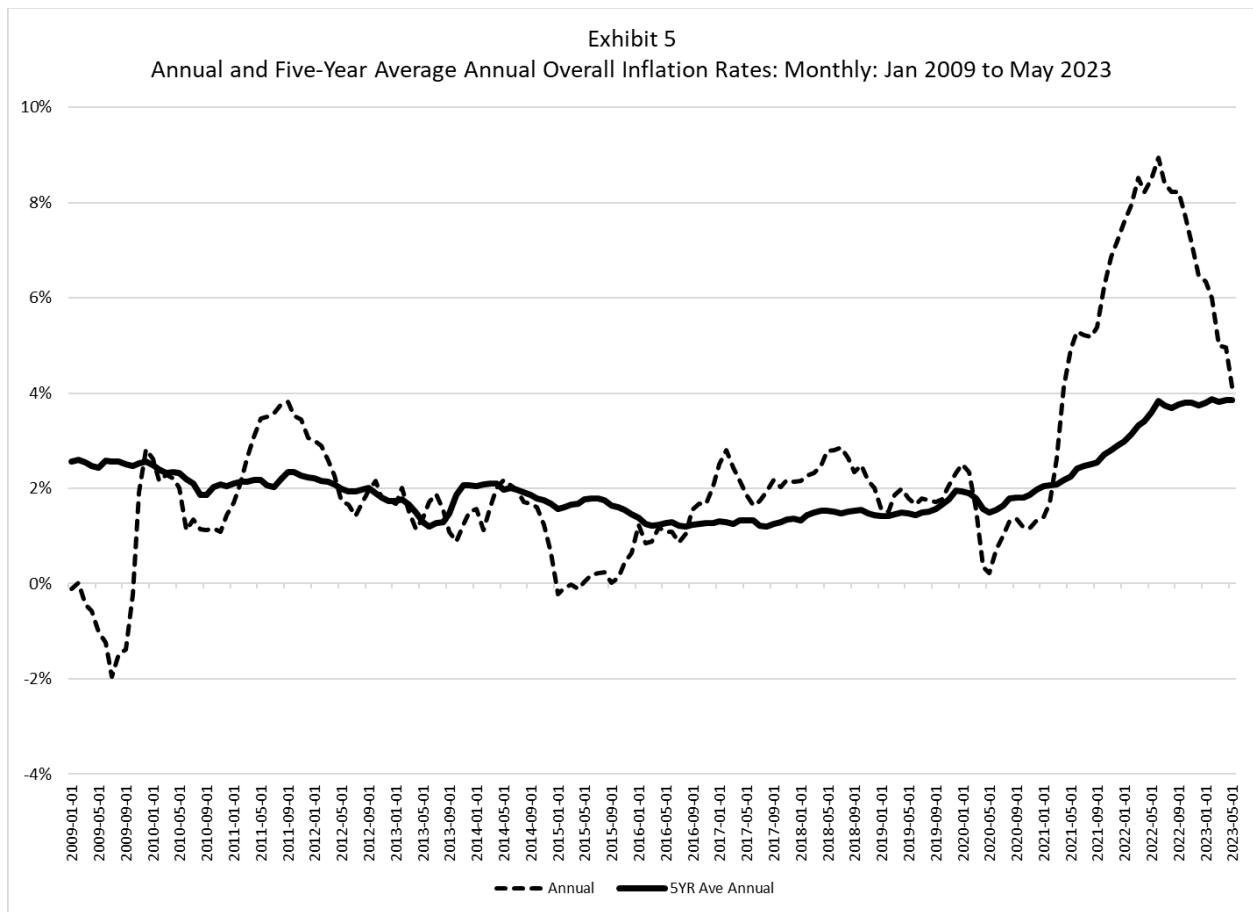
As insignificant as the pandemic in the long-term outcome of the systemic restructuring of the U.S. economy, it is clear to see that the government’s response created additional disruptive factors. As can be seen in Exhibit 4, real growth in aggregate demand was running close to 2.0% in the year preceding the pandemic. The onset of the shutdown brought that down, but it had recovered by early 2021, in part because of the safety nets put in place during that year. The second infusion of pandemic assistance, however, seems to have launched the economy into a brief period of false growth, which eventually led to the onset of double-digit inflation and the Federal Reserve’s response by raising interest rates. As can be seen in both Exhibits 3 and 4, the interest rate increases have put the brakes on growth in real aggregate demand.⁴



⁴ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

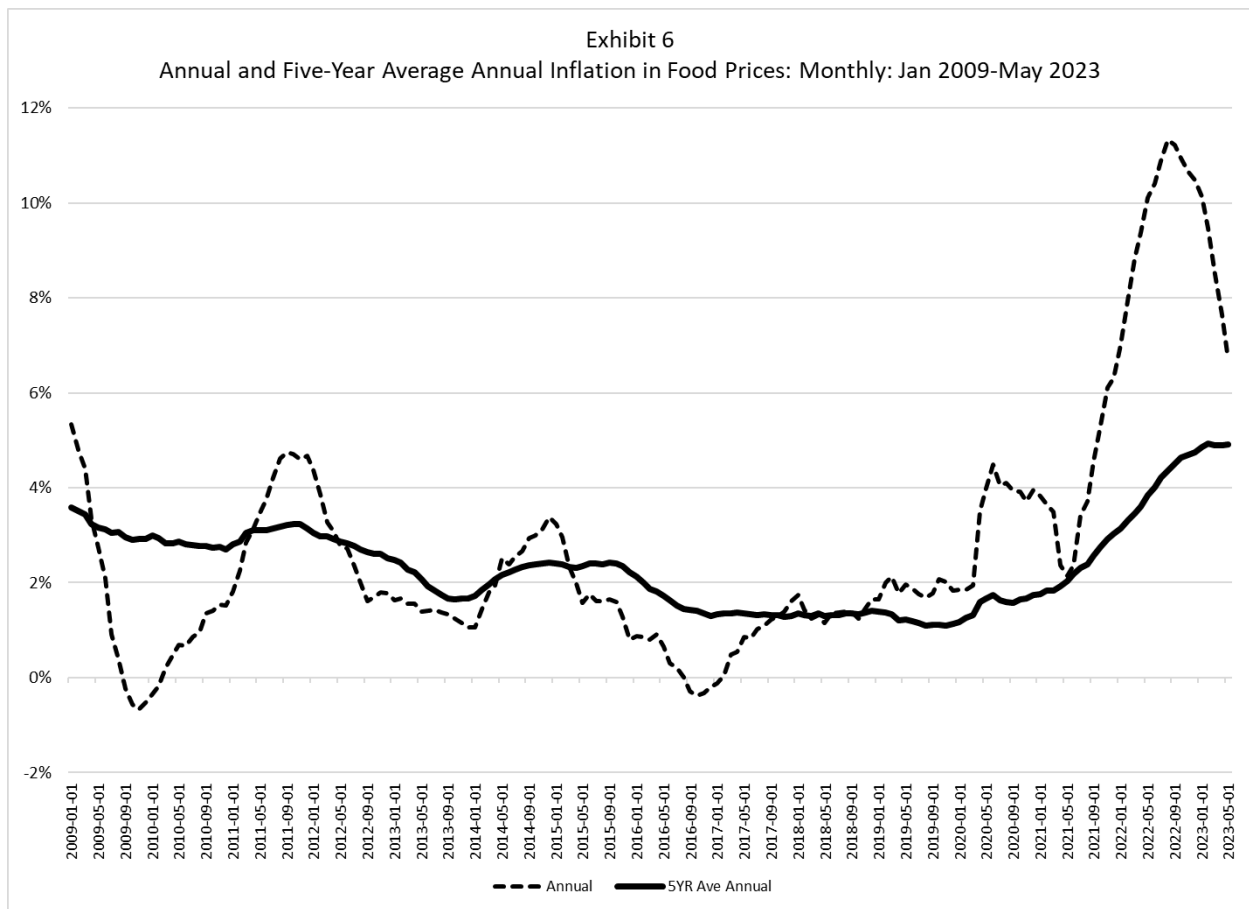
Inflation

Prior to the pandemic, concerns over deflation were more pressing than those related to inflation. As can be seen in Exhibit 5, the economy experienced a deflation following the market collapse in 2008. The economy re-inflated as the Federal Reserve engaged in a massive initial bailout (TARP) followed by three rounds of quantitative easing through the end of 2014, after which time the annual rate settled right around the target of 2.0%. As can also be seen in Exhibit 5, the onset of the pandemic and infusion of government financial support, along with slowdowns in the supply chain, combined to drive up prices by as much as 9.0% annually by June 2022. The Federal Reserve's interest rate increases, initiated in early 2022, have helped bring the annual inflation rate back down to close to 4.0%, but the five-year rate continues to remain over 200 basis points higher than it was prior to the pandemic.⁵



⁵ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

Inflation, however, has not spread evenly through all sectors of the economy, particularly, it has been much more severe regarding food prices. As can be seen in Exhibit 6, food price inflation topped out at an annual rate of 11.22% in September 2022 and has fallen only to 6.69% in May 2023. The five-year average annual rate is at 4.91%. This has meant that food is now become a much bigger element of the typical American family’s budget, and this is beginning to cut into expenditures on other consumer products. A study by McKinsey holds that: “Around 40% of US consumers have reduced spending in general, and they expect to continue to cut back on nonessentials specifically. This reality reflects profound discomfort about the state of the economy.” The study goes on to say that: “Even with overall spending declining, intent to spend in essential categories is increasing. Even among those with higher incomes, we see that while essentials show spending momentum, intent to buy discretionary products still lags significantly.”⁶ As a consequence, additional recessionary pressure will be put on industries engaged in providing non-essential goods and services to the economy.⁷



⁶ Charm, Tamara, et. al.; “The Great Consumer Shift: Ten Charts that Show How US Shopping Behavior is Changing,” McKinsey and Company, 2023; <https://www.mckinsey.com/capabilities/growth-marketing-and-sales/our-insights/the-great-consumer-shift-ten-charts-that-show-how-us-shopping-behavior-is-changing>

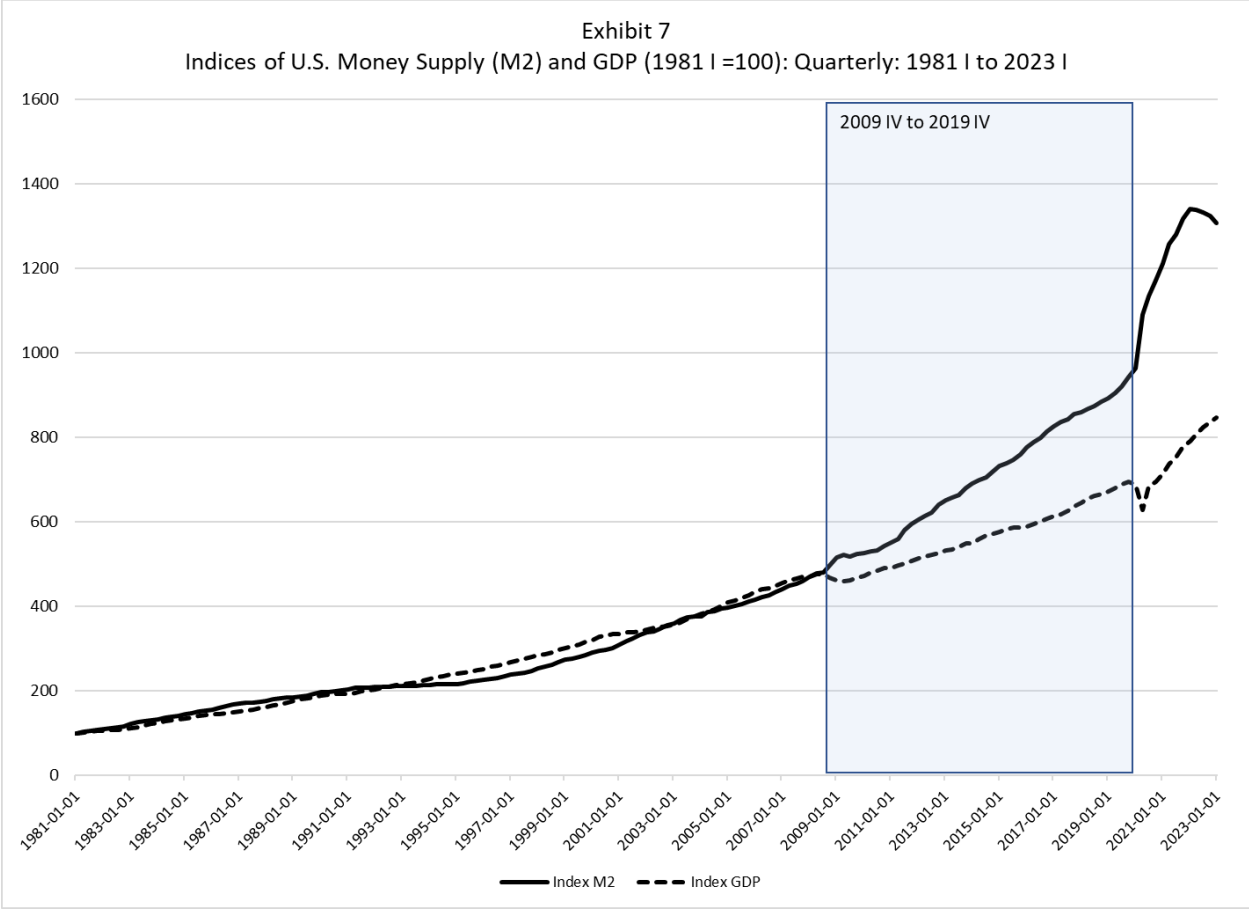
⁷ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

Inflation Persistence and Recession?

Even as the Federal Reserve's interest rate increases have slowed the rate of inflation, it continues to persist at over twice the target level. In the meantime, the economy is showing signs of recessionary pressure, causing the Fed to reconsider the continuation of its rate increases. This brings important questions to bear: 1) Why is it that inflation rates have not come further down after interest rate increases of almost 500 basis points? 2) For how long can we expect inflation to persist at such high levels?

To understand the answers to these questions, it is first helpful to see the change in the relationship between U.S. GDP and its money supply (M2) over time. As shown in Exhibit 7, which displays indices of the money supply (M2) and GDP beginning the first quarter of 1981, the two grew at the same rates up until the financial markets collapsed in 2008. Beginning in 2008, the money supply started to grow at a higher rate, implying that the U.S. economy required greater infusions of money to sustain growth at previous rates. As can be seen, the gap between the money supply and GDP continued to widen through the beginning of the pandemic. It is important to note here that the average annual inflation rate during that period (January 2009 to January 2020) ran at 1.85%, even below the Fed's target rate of 2.0%.⁸

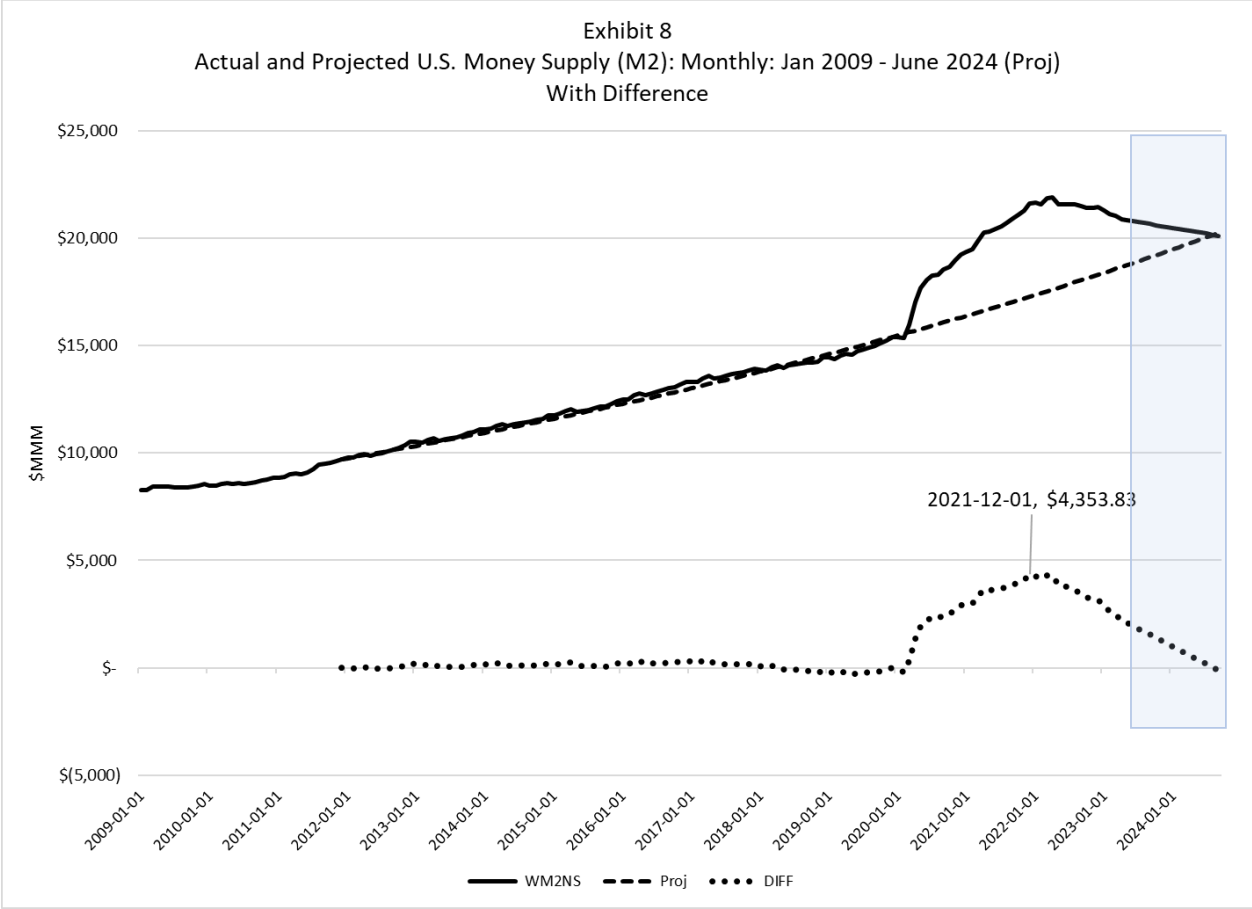
⁸ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)



It is also clear to see the impact of the government’s pandemic response on both the money supply and GDP. The index of M2 increased by 340 points between the first quarters of 2020 and 2022, while the index of GDP increased by 102 points at the same time. The excess money in the system combined with slowdowns in the supply chain accentuated inflation in the overall economy to the point where the monetary authorities had to reduce the money supply.

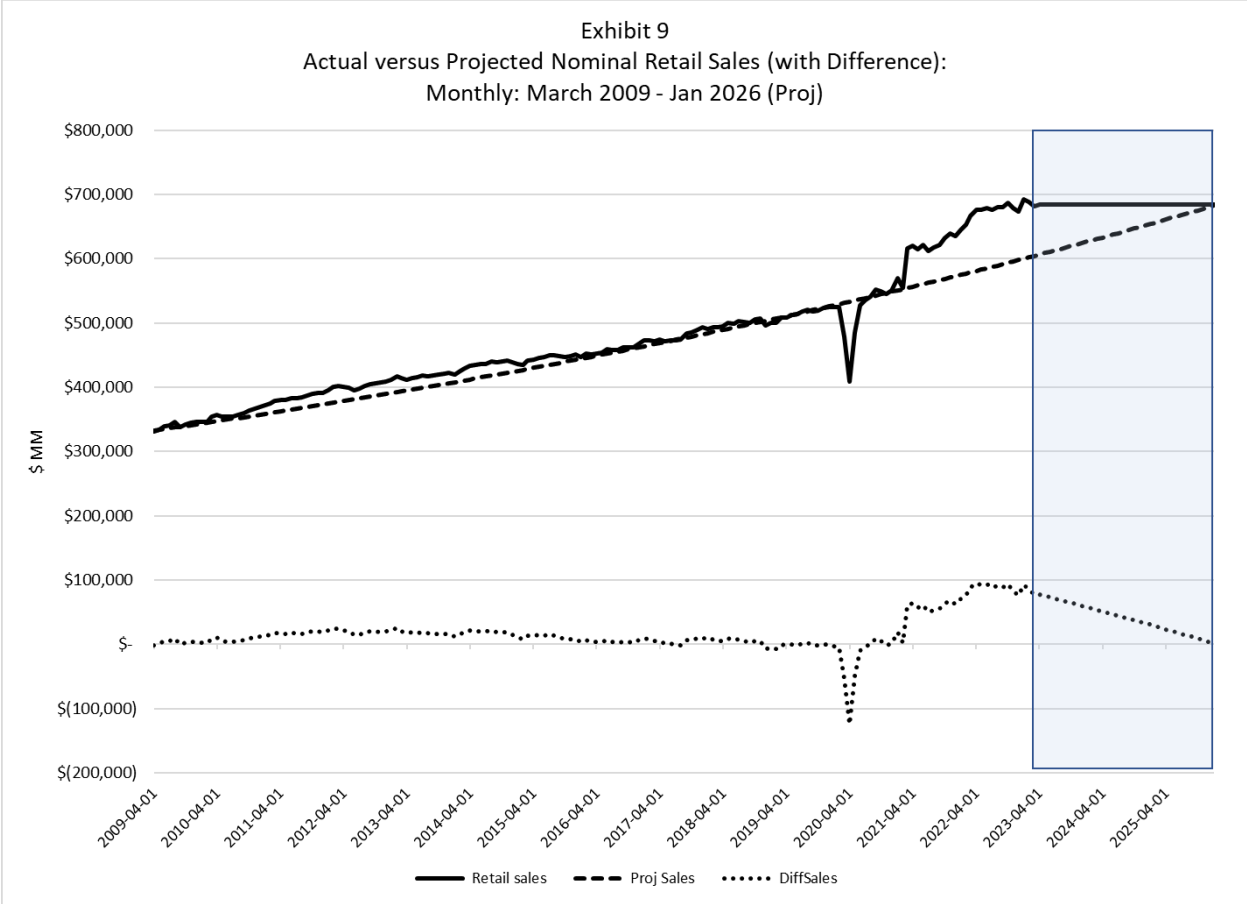
Between first quarter 2009 and first quarter 2020, the money supply and GDP grew at average annual rates of 5.86% and 3.71% respectively. By December 2021, the pandemic policy response resulted in the creation of over \$4.3 trillion above the amount that would have existed had the established growth trend continued. The Fed then commenced its anti-inflation strategy of increasing rates and pulling reserves out of the financial system, which has since caused the money supply to decrease. At this current rate of decline, however, the money supply will not return to its pre-pandemic trendline value until mid-2024. This is shown in Exhibit 8, which compares the actual money supply to a projection based on the period January 2009 to January 2020. As can be seen, the actual departs from the projected at the beginning of the pandemic, and it has been coming down since early 2022. The shaded area in the exhibit shows the projection of the two trends if the Fed policies continue to reduce the money supply at the current rate. If so, the excess money will be out of the system in mid-2024.⁹

⁹ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)



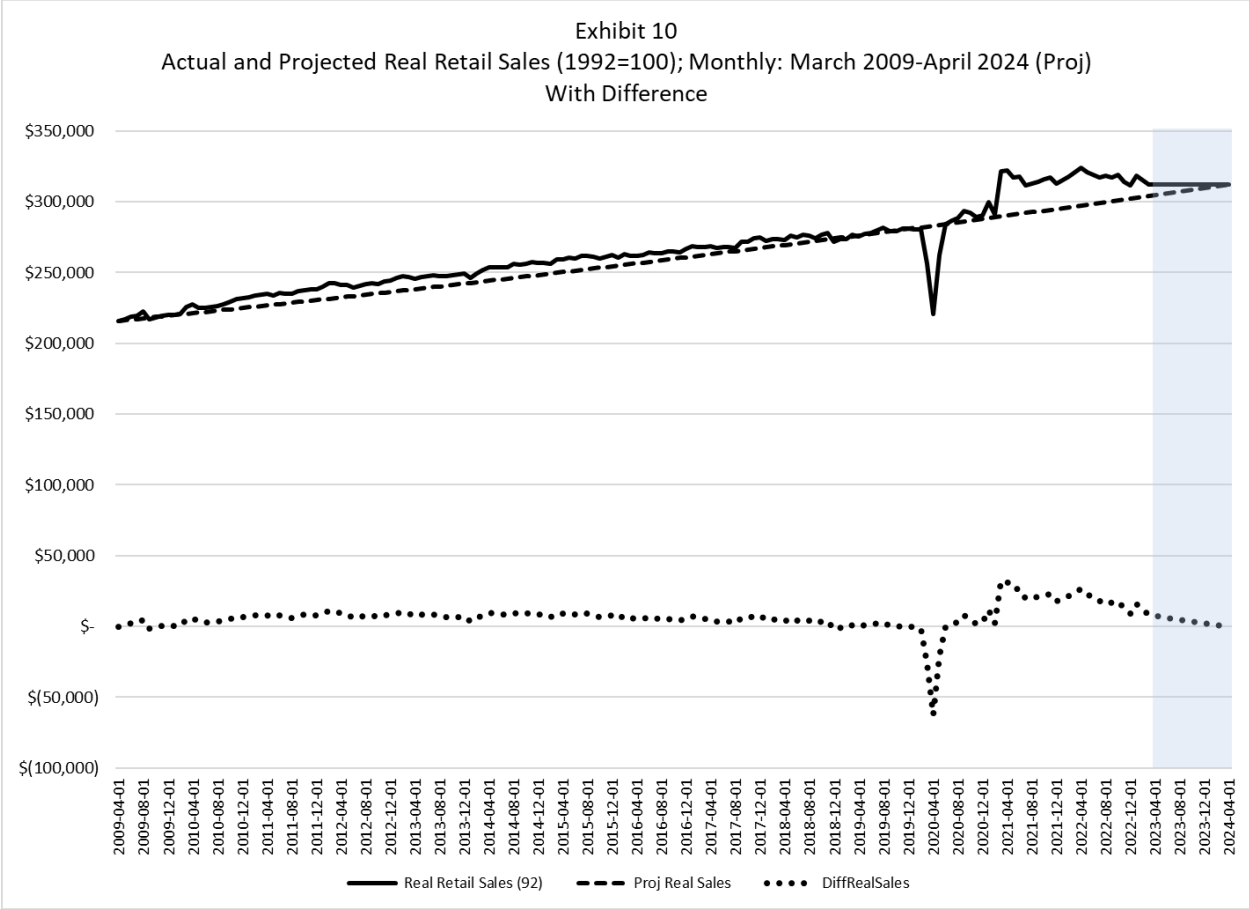
The massive infusion of money into the economy also caused a significant change in the growth of both nominal and real retail spending on the part of consumers. Between first quarter 2009 and first quarter 2020, nominal and real retail sales grew steadily at rates of 4.39% and 2.50%, respectively. As can be seen in Exhibit 9, which provides an analysis of actual and projected nominal retail sales for the period January 2009 – January 2026, retail sales first fell below the trend at the beginning of the pandemic, and then grew well past the trend beginning about mid-2021. As of May 2023, the cumulative value of retail sales above the trendline is just about \$2.0 trillion, representing almost half of the above-trend money created by the pandemic response. If the level of nominal retail sales remains constant, they will return to the trendline at about January 2026.¹⁰

¹⁰ IBID.



The story is different when you factor in the impact of inflation on the analysis. As can be seen in Exhibit 10, the retail sales bubble is not as large when we factor in the rate of inflation. If real retail sales continue at the current level, they will return to the trendline by around April 2024.¹¹

¹¹ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

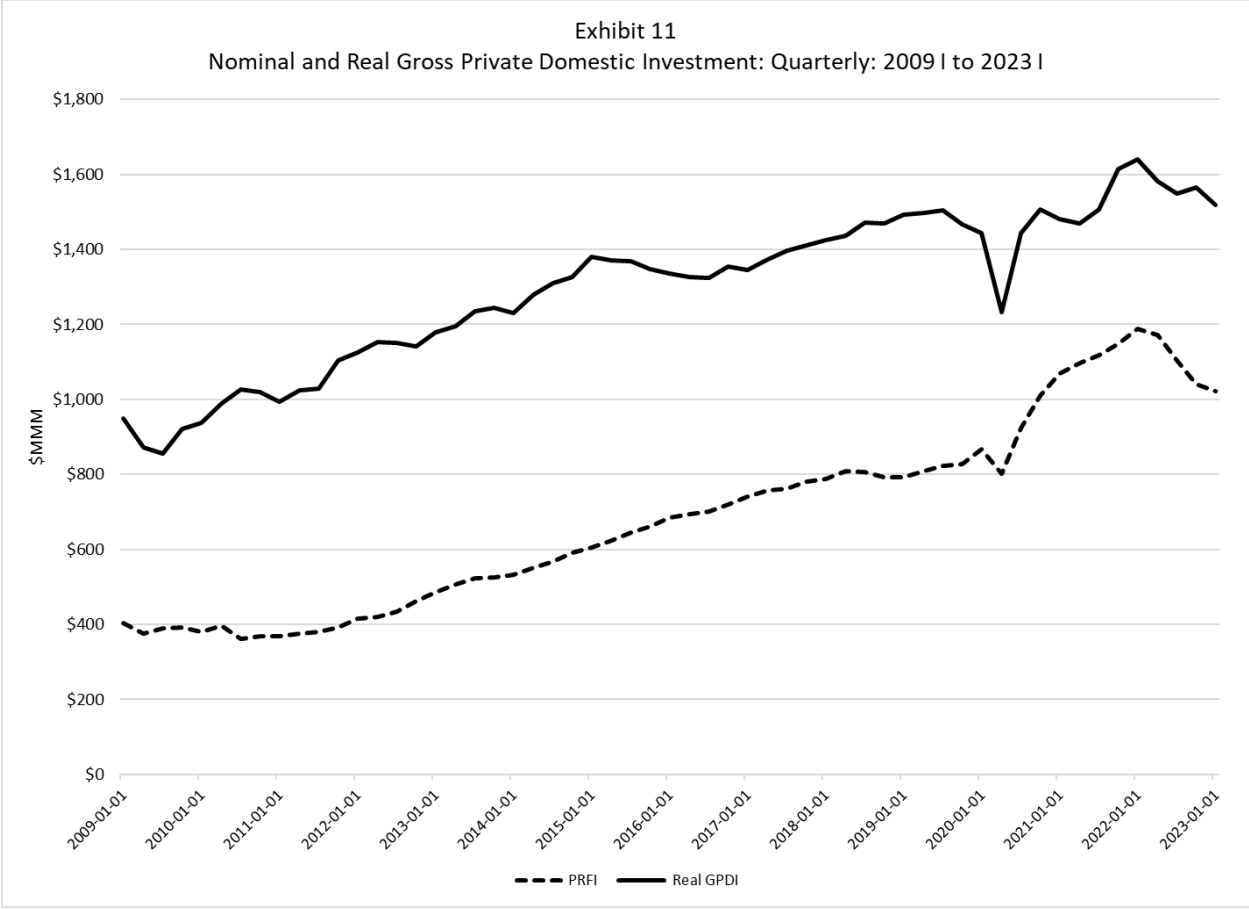


What this implies is that inflationary trends in the economy may persist until at least mid-2024. This assumes, however, that the Fed will continue with its current monetary policies. As we saw in Exhibit 7, the U.S. economy has required higher rates of money growth to maintain consistent nominal GDP growth now than in the past. As the Fed continues to draw down on the money supply, GDP growth will be choked off. This can already be seen in an analysis of private investment spending, a key driver of economic growth.

Private Investment Spending

Both nominal and real gross private domestic spending have been declining since the Fed began increasing interest rates in January 2022. This is not surprising given that higher interest rates mean higher required returns on investment (and hence, higher hurdle rates for investment spending) and that the higher rates have affected home mortgage and housing markets. As can be seen in Exhibit 11, nominal private investment was returning to the pre-pandemic trend rates until the interest rate increases drove it back down. The same is true for real private investment spending, which had begun to trend up until inflation and high interest rates knocked it down.¹²

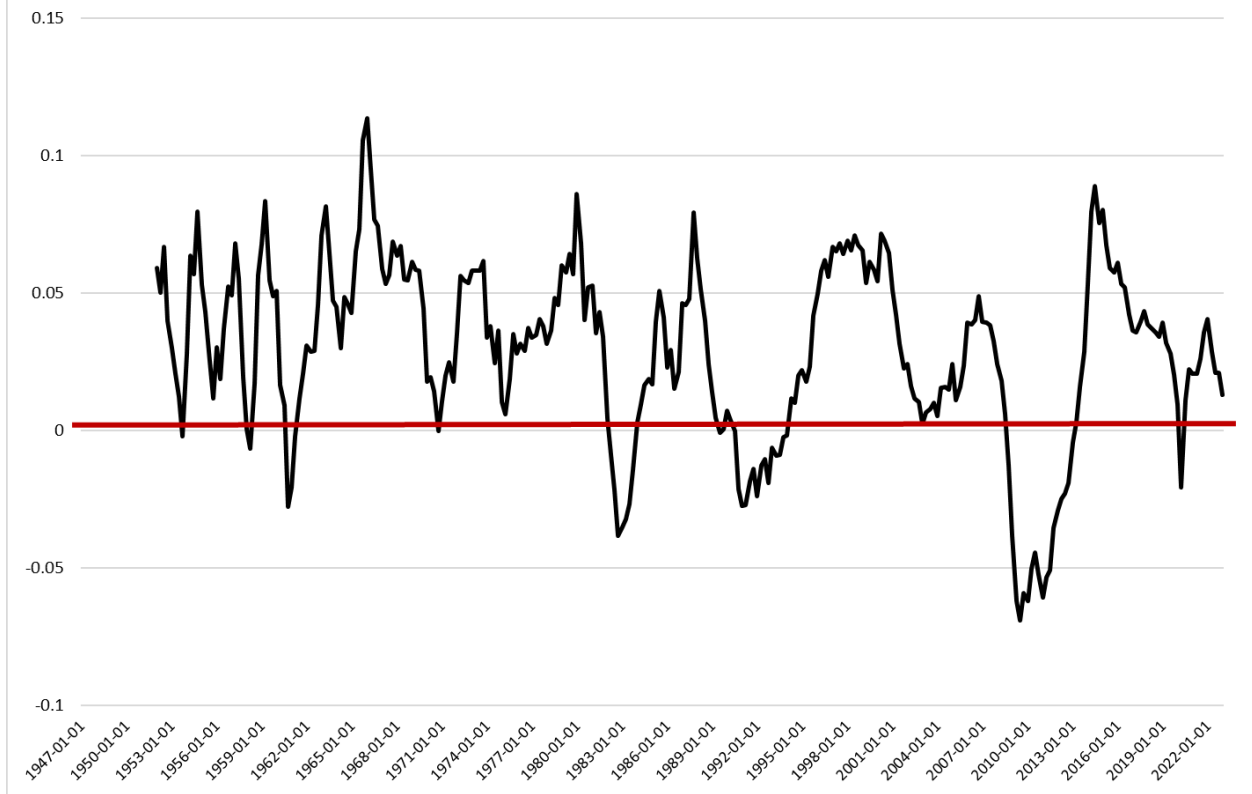
¹² Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)



The current behavior of private investment spending represents a return to the declining growth patterns in effect prior to the pandemic. As can be seen in Exhibit 12, the five-year average annual rate of growth in real gross private investment spending is in decline. As investment spending is a key driver of future economic growth, this trend confirms that we can expect slow growth out of the U.S. economy in the future.¹³

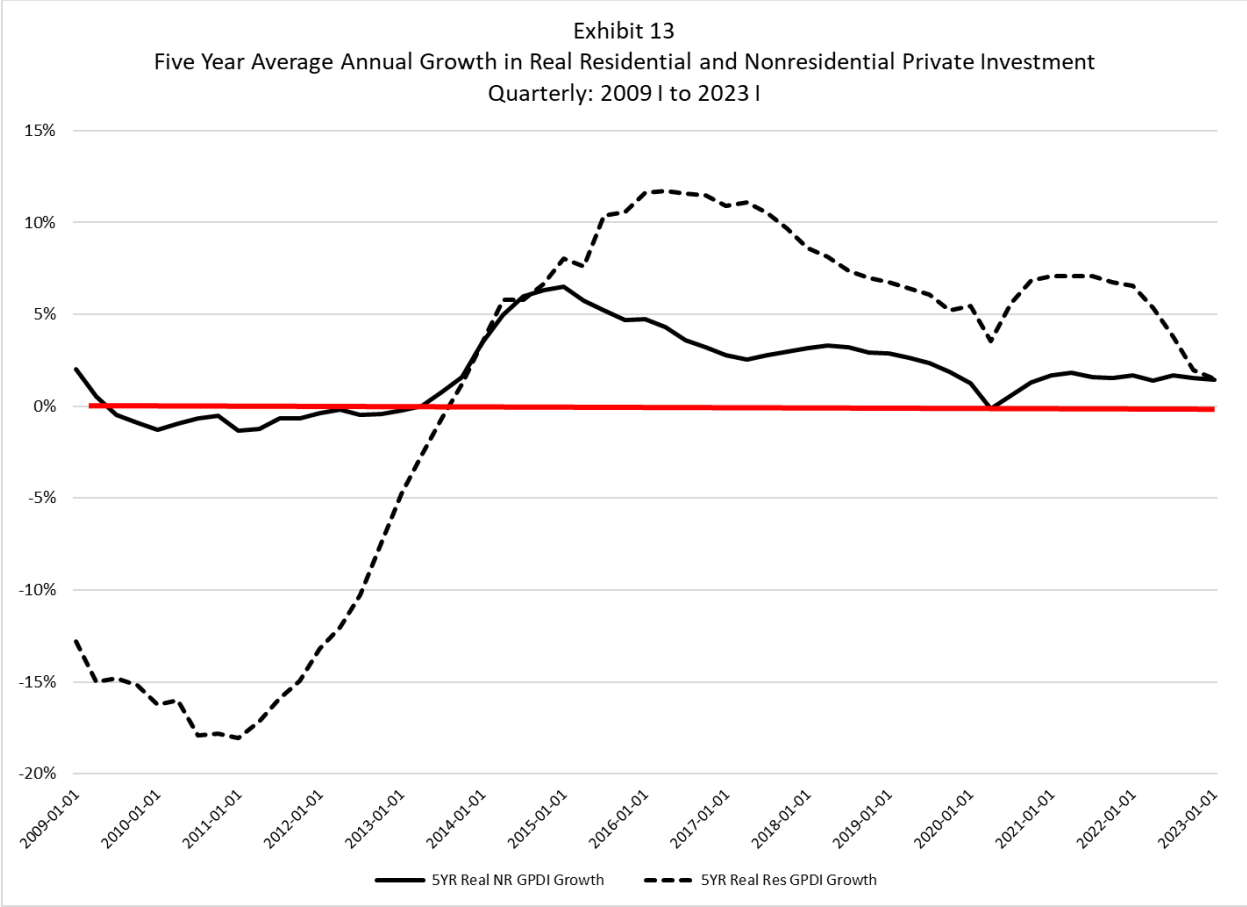
¹³ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

Exhibit 12
Five-year Average Annual Growth in Real Gross Private Domestic Investment
Quarterly: 1947 I to 2023 I



There are, however, differences notable in breaking down private investment spending into its residential and non-residential components. As can be seen in Exhibit 13, growth in residential private investment led overall investment during the recovery from the 2009 recession, and it is now falling more rapidly than private non-residential investment. Even so, overall real private investment spending is growing at less than a 2.0% rate, which would signal low growth in the foreseeable future. Continued interest rate increases will only serve to bring this further down.¹⁴

¹⁴ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)



There has been recent news of increasing investments in U.S. manufacturing capacity. Unfortunately, this surge may be the result of making up for investment spending that was delayed by the pandemic. The index of industrial capacity for the U.S. was at about 131.00 as of April 2020. It hit a low of 127.18 in January 2022, and is now currently at 129.44, still below its pre-pandemic level. Capacity utilization, which was at 77.18% at the beginning of the pandemic, immediately fell to 62% in the first two months of the shutdown yet recovered quickly and now sits at a value of 78.41%. Hence, the slight decline in overall capacity has been offset by a slight increase in utilization.

Employment and the Declining Influence of Manufacturing

The employment situation in the U.S. is subject to several different dynamic factors. The level of the U.S. labor force at the beginning of 2000 was just over 142 million, at which time the labor force participation rate was 67.3%. That point in time represented the peak of labor force participation, which had grown steadily from its level of 58.7% in 1965. The growth was due primarily to the entry of women into the labor force, but it also occurred as the participation rate among men declined from over 80% to below 75%.¹⁵

¹⁵ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

The restructuring of the economy and the availability of retirement income has changed the participation of those over age 55. From 1965 to 1993, the labor force participation rate for that cohort fell from 40% to 29%. It then increased back to 40% by 2013, where it was at the beginning of the pandemic. Since then, it has fallen to 38.4%. As the economy has restructured, a greater percentage of jobs no longer require physical labor, and hence, people can work longer in those jobs, contributing to the rising participation rate from 1993 to now. As access to social security and retirement income increased in the late 1960s and 1970s, laborers engaged in jobs requiring more physical effort were able to retire earlier, thus reducing the participation rate over the period 1965-1993.¹⁶

The current size of the labor force is just under 167 million, and the current participation rate is 62.6%. There are several reasons for the declining participation rate, including the aging of the U.S. population and the match between job availability and job skills. The median age of the U.S. population has increased over the years. In 1970, it was 28.1 years. By the year 2000, it had increased to 35.3 years, and is now at 38.8 years. As the population ages, labor force participation will decline. Many studies also cite a mismatch between job availability and job skills as a factor influencing the decline in labor force participation.¹⁷

Economists at the Federal Reserve continue to point to employment growth and a low unemployment rate as sources of inflation in the economy, and hence, have justified interest rate increases as a result. Even so, high inflation rates have eliminated the value of wage and salary increases that accrued during the pandemic. As shown above, consumer/laborers are seeing a decline in their real income, and the high interest rates are exerting recessionary pressure on the economy.

One of the outcomes of long-term restructuring and the technology transformation that has both accompanied and driven it is the decline of the influence of manufacturing on the U.S. economy. The value of U.S. manufacturing output grew from \$1.5 trillion to \$2.5 trillion between 2000 and 2021. It fell, however, from 15.1% to 10.7% of the GDP over the same time period. From 2004 to 2021, however, manufacturing output for China increased from \$625 billion to almost \$4.9 trillion, making it the fastest growing economy in the world. China's manufacturing output currently represents about 27.5% of its GDP.¹⁸

The decline of the influence of manufacturing is also evident in U.S. employment demographics. As can be seen in Exhibit 14, employment growth in manufacturing went negative from the early 1980s and has been positive only in the past three years, albeit at a rate of less than 1.0%. As manufacturing output has declined as a percent of overall GDP, the level of manufacturing employment has also declined as a percentage of total employment, as can be seen in Exhibit 15.¹⁹

¹⁶ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

¹⁷ Levesque, Elizabeth; Understanding the Skills Gap—and What Employers Can Do About It, Brookings Institution, 6 December 2019; <https://www.brookings.edu/research/understanding-the-skills-gap-and-what-employers-can-do-about-it/>

¹⁸ Macrotrends; <https://www.macrotrends.net/countries/ranking/manufacturing-output>

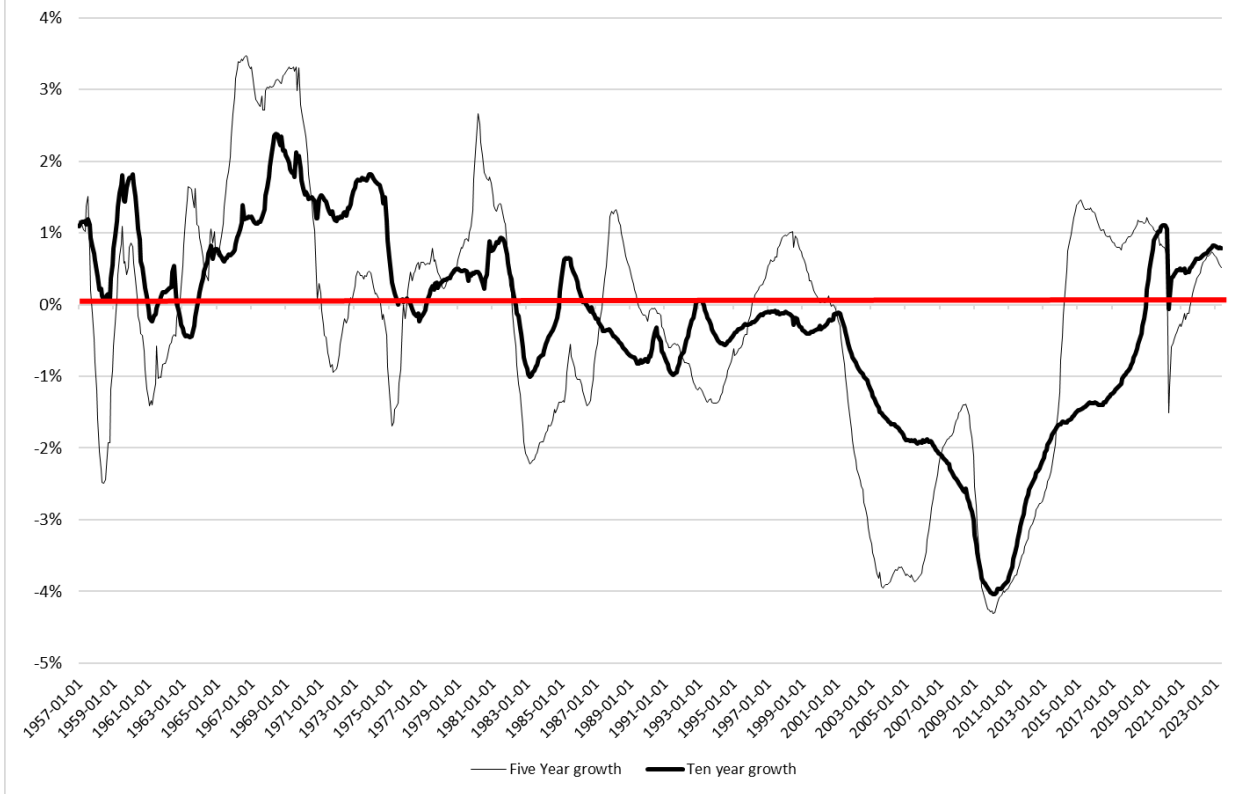
¹⁹ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

This is important because manufacturing activity invigorates the economy and will create greater growth opportunities than activity in other economic sectors. China's economic growth since the mid-1980s is because it has been the primary beneficiary of the restructuring of global manufacturing due to its low labor costs and the impact of technology on manufacturing processes.

As technology reengineered the way non-manufacturing business processes are completed, that work has migrated to regions where there are lower costs. Within the U.S. technology has eliminated the need for human capital to complete business processes, forcing labor force participants into other jobs in both high- and lower-skill areas. All these factors have contributed to a slowing of the growth potential of the U.S. economy and to a redistribution of income and wealth within its society.

Regarding employment, therefore, what ends up being important is less a matter of how many jobs are available and more a matter of what kind of jobs are available. To generate healthy economic growth, jobs need to provide compensation levels, including wages, salaries and benefits, at which laborers can afford more than just the basics and provide a means for real growth over time. Jobs must also be available in industries that are going to contribute greater growth opportunities within the economy. Of these sectors, manufacturing provides the best of these opportunities.

Exhibit 14
Five and Ten-Year Average Annual Growth in Manufacturing Employment
Monthly: Jan 1957-April 2023





Monetization and Debt

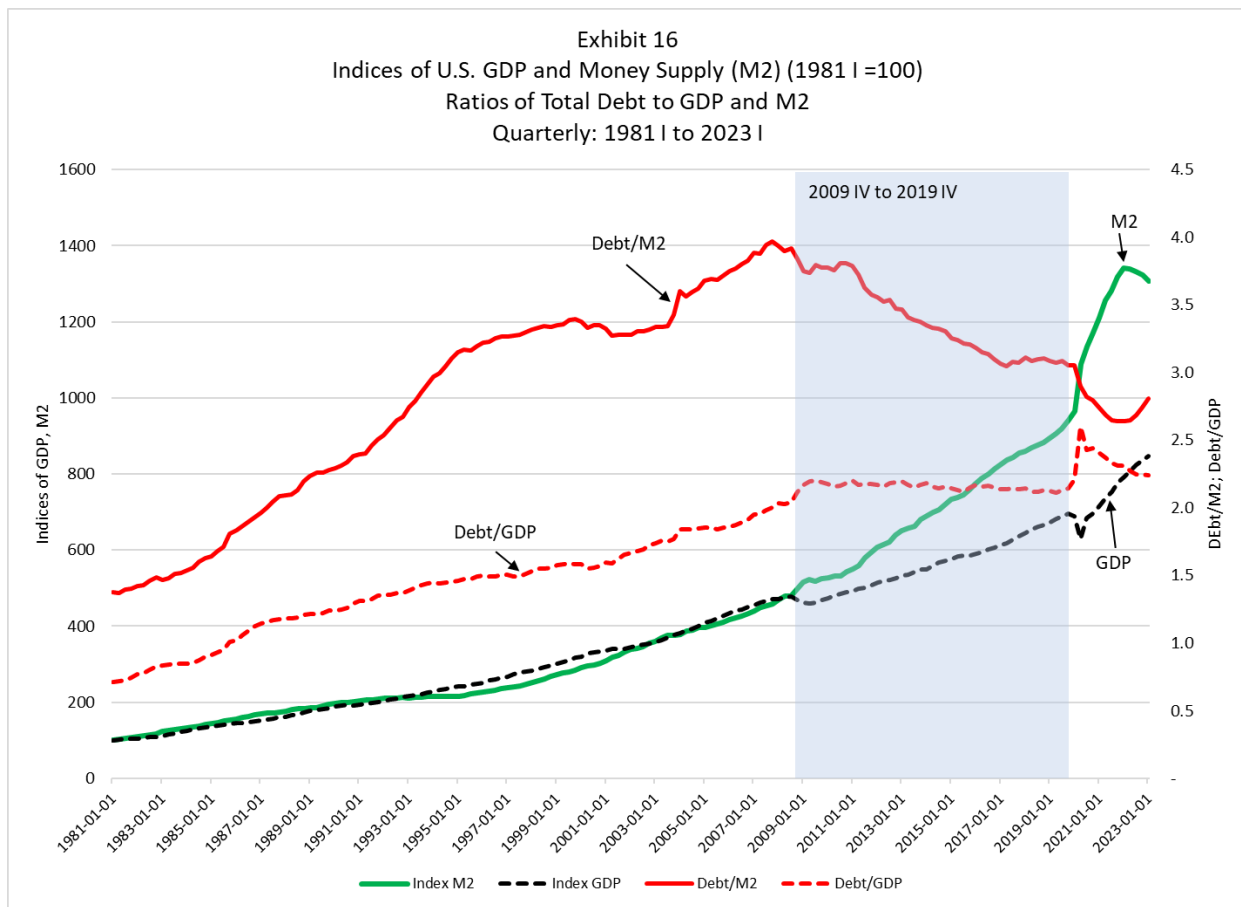
The collapse of the financial markets in 2008 has had a massive impact on the U.S. economy, resulting in significant structural changes in its overall behavior. The most significant of these relate to money creation and the use of debt financing. As can be seen in Exhibit 16, which includes indices of the money supply (M2) and GDP (scaled on the left axis), and ratios of total indebtedness to both the money supply and GDP (scaled on the right axis). Going back to 1981, it is clear to see that GDP growth followed money supply growth almost exactly. Since 2008, however, the U.S. economy has required increasing infusions of money to sustain its growth. As can be seen in the shaded area of Exhibit 16, money supply growth increased relative to GDP growth over the entire period following the market collapse to the beginning of the pandemic. The huge infusions of money during the pandemic basically maintained but did not increase GDP growth.²⁰

The behavior of debt relative to money and GDP also appears to have changed because of the financial market collapse in 2008. As can be seen in Exhibit 16, the level of debt relative to the money supply steadily increased to 2008, since which time it has steadily fallen. It has only

²⁰ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

turned up in the past year because the money supply has, for the first time, been reduced by Federal Reserve policies. The level of debt relative to the GDP can also be seen as rising from 1981 until 2008. Following the market collapse, that ratio leveled off and began to decline, suggesting that the U.S. economy had hit its debt limit.²¹

What is important about these findings is that, theoretically, money creation is supposed to accommodate economic growth. Quantitative easing policies pursued by the Federal Reserve following the market collapse in 2008 were designed to increase the availability of money for business borrowing and investment in job-creating ventures. As the money poured into the economy after 2008, however, the rates at which it was borrowed and at which it created GDP growth both declined. In fact, increasing amounts of money were necessary to accommodate relatively constant GDP growth. The U.S. economy has become addicted to cash and requires bigger and bigger hits to function.



²¹ Data: Federal Reserve Bank of St. Louis, Economic Data (FRED)

How it All Fits

The problems in the U.S. economy are structural, not cyclical. This is not to say that the economy will avoid the impacts of cyclical change. Rather, the impact of cyclical change will be exacerbated by the underlying structural problem. For a medical patient with a bacterial infection, it is possible to address the fever symptoms by administering doses aspirin, but the patient will continue to deteriorate if the infection is not treated. Likewise, when the U.S. economy begins to suffer from the effects of cyclical changes and external events such as the pandemic, it is possible to alleviate the symptoms on a short-term basis by using traditional economic policies that include money creation and borrowing. The following structural changes, however, have made permanent solutions much more elusive. These structural changes include:

- The decline of the relative size and influence of manufacturing activity on the U.S. economy. Less manufacturing will mean lower growth rates.
- The transformation of work resulting from advances in technology. Fewer people are now required to perform basic work tasks, resulting in a restructuring of the employment markets and reduction in the number of jobs involving manual processing and other functions.
- The mismatch of job skills and interests to job availability. There are over 9.5 million unfilled job vacancies in the U.S. today. This is up from 7.2 million just prior to the pandemic. Many of these jobs are unfilled due to lack of either qualified or interested potential employees. Others are unfilled because people have left the workforce. Real wages have not increased to the point where additional labor resources are being drawn into these areas.
- Deterioration in the academic training and performance of U.S. school students will reduce the competitiveness of the U.S. economy and may force additional migration of jobs to other regions across the globe. This relocation will be enabled by technology transformation.
- The increase in indebtedness across the U.S. economy. It appears that the U.S. economy may have reached or exceeded its acceptable debt limit. Heavy borrowing and now rising interest rates will increase the drag on the economy due to the need to service those debt payments. Rising interest rates will reduce the number of economically feasible investment projects and reduce investment spending. Rising rates will also force consumers out of the home buying markets and further reduce investment spending in that sector of the economy.
- The income and wealth redistribution that began in the late 1970s will continue to contribute to a lopsided economic market. As debt levels have risen, income and wealth are redistributed from borrowers to lenders, and from consumers to investors. Wealth gaps increase as a result. Falling real income levels beginning in the lower economic classes, but now moving higher up, will reduce consumer spending on all but the

essential items, reducing demand for other consumer goods and services and having a negative impact on output and employment in those sectors of the economy.

Short Term Prospects

There are several key factors suggesting that the U.S. economy is headed for a recession, and that the landing will be both hard and not evenly spread across all sectors. Those factors include:

- Inflationary pressure will continue to be exerted on the economy resulting from the additional money created during the pandemic. Even with the current tightening, inflation will most likely persist for an additional 12 to 18 months. This will cause consumers to continue to reallocate their budget expenditures and some economic sectors, particularly those of a non-essential nature, to experience recessionary outcomes.
- Should the Federal Reserve continue to increase rates to reduce inflation more rapidly, there will be additional significant negative consequences on investment spending, primarily in the housing market, but also in relation to private business investing. This will reduce opportunities for employment and output growth and could lead to a hard recession. The Federal Reserve is now stuck between the proverbial rock and a hard place. Rate increases and/or money supply reduction are going to be necessary to reduce inflation, but such increases can very well tip the economy into a deep recession.
- As current debt matures, it will require either payoff or refinancing at higher interest rates. Debt servicing costs will increase and further reduce opportunities for investment and economic growth. Companies relying on short term debt will be more heavily impacted by this action. ***For business credit, we can expect to see additional upward pressure on DSO and an increase in delinquency and bankruptcy activity due to this and the above-mentioned factors.***
- The government debt “can” has been kicked down the road yet again: this time until after the next presidential election. Both sides are most likely thinking that they can sweep the election and implement their own solution to that problem. Regardless of which party wins (or a split), the plain fact is that the U.S. federal government cannot continue to sustain or increase its current level of indebtedness in a slow-growth economy. Higher debt levels and servicing costs will put downward pressure on government spending in other areas and additional pressure to raise revenue (i.e., taxes) to keep the government out of a financial distress scenario. Dealing with the debt level in this way will also put recessionary pressure on an economy that is weakly positioned to handle it.

The ultimate reality behind this analysis is simply that the U.S. is no longer a high-growth economy. Further, steady increases in its overall level of indebtedness will continue to stunt its ability to restore any semblance of high growth, as debt-servicing costs will consume a greater portion of its output and income. Debt-service expenditures, however, constitute a transfer of wealth from borrowers to lenders. To a degree, this muddles interpretation of the meaning of

aggregate economic outcomes. To understand the meaning of economic changes, we will need to understand the impact of those changes on the distribution of economic income and wealth within society. What we have seen over the past 50 years and will see into the future is a continuation of this reallocation of that wealth, which will have a significant impact on our health not only as an economy, but as a society.

About the author:

Dr. Steven Isberg is currently Senior Fellow at the Credit Research Foundation and Associate Professor and Chair of the Department of Accounting at Towson University in Towson, Maryland. Steve has been working with CRF since 1994 in his capacity as research fellow and in the development and delivery of a wide variety of our professional training and education programs. Steve has been a part of a number of key CRF research initiatives over the years, including The Future of Credit Studies; the Compensation Studies; Shared Services; and now CECL. Steve has almost 40 years of experience teaching at the college level, where he specializes in the areas of accounting, financial statements analysis and valuation, and financial economic history.