

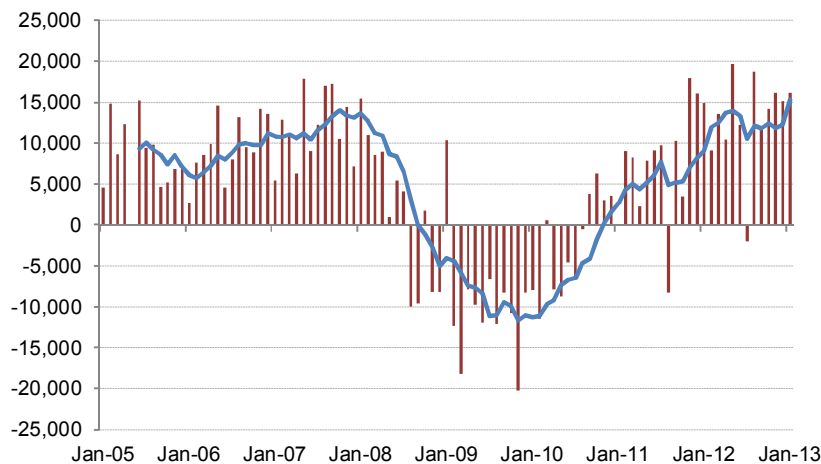
Further to the US recovery

Households' position continues to improve

Today sees the publication of the most meaningless – and yet most market-moving – of monthly data, the US non-farm payroll numbers. Yesterday's US numbers – consumer credit data for January and Q4 Flow of Funds – are far more important. These numbers confirm the positive story for the US.

On the monetary side, the Flow of Funds data means that we now have 'correct' (as opposed to 'estimated') broad money and credit data up to the end of 2012. The adjustments show both series growing somewhat faster than previously estimated, with broad money at the end of January up 6.7% from a year earlier (a six-month annualised rate of 13.2%) and total private sector credit up 3.9% year on year (7.3% on a six-month annualised basis). Moreover, the trend remains up. Consumer credit rose by \$16.2bn in January, slightly faster than the \$15.1bn in January and the sixth consecutive month of double-digit billion dollar increases. Applying a six-month moving average (the blue line in the chart below) shows that consumer credit growth in dollar terms is now stronger than it was in the years leading up to the crisis.

Total consumer credit, monthly change, \$bn s/a

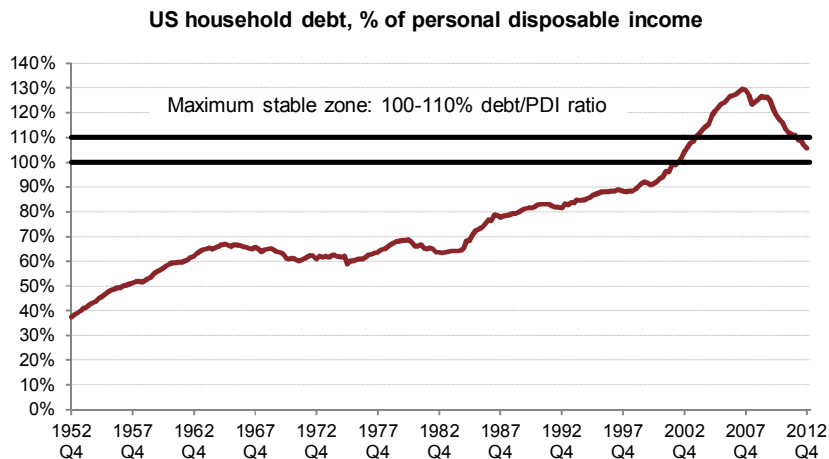


There's further good news from the Flow of Funds. Although households are borrowing more, household debt relative to disposable income continues to ease, falling to 106% in Q4, well within the maximum stable zone of 100-110%. However, this does not mean that the deleveraging process is over; the maximum stable zone is the *highest* debt burden that households could comfortably carry. It has to be assumed that, in the aftermath of a debt-induced crisis, there will be a remaining aversion to debt,

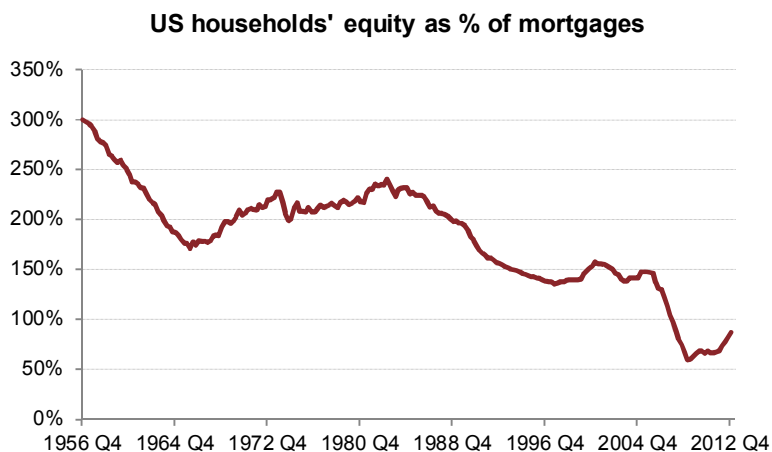
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meaning households will want to get their debt down further; and also that banks will remain unwilling to lend to the same extent as pre-crisis. Most likely, the household debt/PDI ratio will fall below 100% before this process is finished. However, it should be noted that this is consistent with households borrowing more; it merely means that household disposable income will rise faster than borrowing.



A key issue for households remains the negative equity in houses. As detailed in past Comments, real US house prices remain well below pre-crisis peaks. However, over the past five quarters, US households' equity relative to total mortgages has risen to 87% from a low of 61% in Q2 2009. Obviously, this is an aggregate figure and the number remains below 100% and below most of post-war history. Nevertheless, this is further good news in that, with continued debt repayment and rising house prices, US households should – at least on aggregate – move above water in 2013 or 2014. Set against this, the impact of the payroll tax reversion earlier this year becomes even less significant.

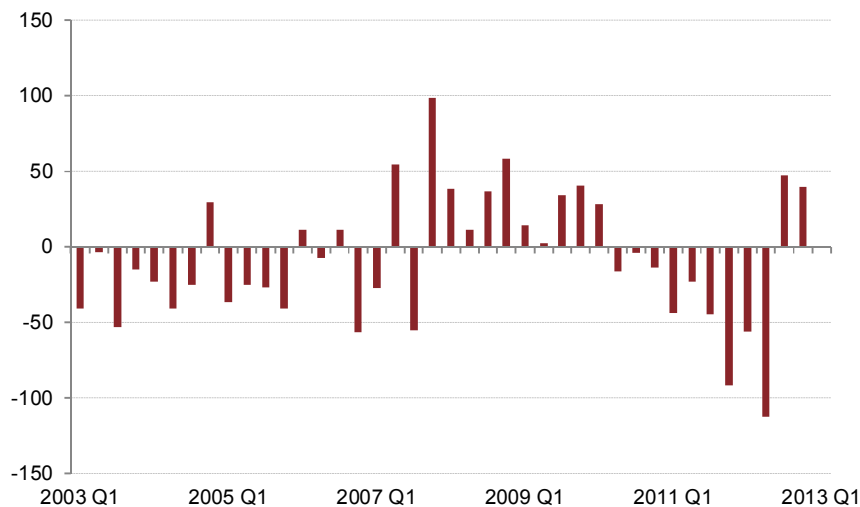


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The Flow of Funds data also show that foreigners are once again piling into US equities. On a quarterly basis, net buying of US equities by foreigners (less sales of foreign equities to Americans) rose by \$40bn in Q4 2012, the second quarterly rise after nine quarters of net sales. Continued healthy US output growth and attractive equity markets mean that this trend is likely to continue in 2013, further boosting the prices of US risk assets and the dollar in a virtuous circle

Net equity flows Rest of the World vs US



While there are likely to be hiccups on the recovery road, the outlook for the US continues to look relatively bright, an impression reinforced by other data published in recent weeks. However, there is one potential cloud on the horizon. This is the possible (likely?) appointment of Janet Yellen as new Chairman of the Board of Governors of the Fed once Ben Bernanke's term ends. Dr Yellen has in recent weeks repeatedly made it clear that she would want monetary policy to remain ultra-loose even after the various Fed triggers – mainly 6½% unemployment – have been reached. Short term, that would obviously be supportive of fixed income. Long term it does raise the very real risk of a bad bond bubble. My forecast remains that the Fed will end QE in 2013 and begin to raise interest rates in H2 2014. But a Yellen Fed would probably make me change this view.

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