# Thomas Jefferson: ‘Never spend your money before you have earned it.’

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Over 200 years ago, Thomas Jefferson, the third US president, offered this sage advice: ‘*Never spend your money before you have*

Jefferson lived in a different era.

An era that didn’t have the temptation of credit cards, investment loans, home-equity loans, mezzanine financing, payday lending, in

Today there are multitudes of ways to spend money years before it is ever earned.

We’ve borrowed so much — in excess of US$220 trillion — from future earnings, it’s almost inconceivable to see how we could poss

However, if recent history is a guide, this ‘minor detail’ certainly won’t stop us from trying.

Simple maths dictates the expansion or contraction of the private sector’s debt-girth is a function of earning capacity. Debt cannot ou

We saw this expansion-and-contraction dynamic at play during and after the mining boom.

Workers, who previously earned $40,000 per annum, upped stumps and went to the mines to earn $100,000 or more.

The increased earnings translated into an expansion in spending and borrowing. Property values rose. ‘Toys’ were bought.

But what happens when the boom ‘busts’ and those six-figure incomes are no longer on offer? This, from Flight Safety Australia (em

> ‘*Just a few short years ago the boarding lounges of Perth Airport were a riot of fluorescent colour as thousands of fly-in-fly-out (F*

> ‘*In Perth, there’s a sense that the easy money has gone.* ***Weekend newspaper features about the end of the boom speak of***

Reduced earnings means households have to make adjustments to their budgets. Spending and borrowing levels are reined in. Eco

The point of the exercise is this: Earnings matter.

What’s happening to earnings in Australia? Reuters reports (emphasis mine):

> ‘***Australian wages growth had languished at record lows for an entire year by the end of June quarter****, official data showe*

> ‘*“With households’ real wages having been unchanged over the last year, consumption growth will surely slow soon.”* [Said Paul

> ‘***The RBA is worried about the impact on the A$1.7 trillion (US$1.3 trillion) economy from surging household debt****, which*

And it’s not only wage earners that are suffering stagnating incomes.

Low interest rates are restricting the earning capacity of your average retiree.

Without meaningful wage growth, households (with debts to service and rising energy bills) must be very close to ‘red lining’ their bu

In April 2017, *The Australian* reported that Aussie households have been doing it tough for six years:

‘*There has been no improvement in living standards since 2011, with record low wage increases only just matching the subdued*

‘*There has not been such an extended period of stagnation in household incomes for 25 years, since the depths of Australia’s la*

This is bad news for an economic model that’s completely dependent upon debt-funded consumption to generate growth. Without the capacity to borrow more, the model fails.

The only solutions to this bind for policymakers are:

1. Lower interest rates;
2. Increase incomes;
3. Reduce the annual increases to fixed expenditure (government fees, council rates, power costs, insurances and health costs);
4. A combination of all three.

Based on probabilities, the best option is to lower interest rates.

The RBA still has some buffer in lowering the cash rate, which could fall from 1.5% to zero.

The problems with this option are threefold:

1. Your average retiree suffers an even bigger income squeeze. Meaning less money to spend in the economy;
2. A lower deeming rate for the age pension means the government will need to tip the pensioner tin a bit more. Not good news f
3. Based on recent history, the banks may not pass on the full extent of the cuts.

Real wage increases — despite political rhetoric to the contrary — are not coming anytime soon.

Globalisation and automation have sown the seeds for will, at best, be wage suppression and, at worst, job destruction.

It’s highly conceivable that society’s mindset could change from expecting annual wage increases to one of being thankful for having a job…even one that pays a stagnating income.

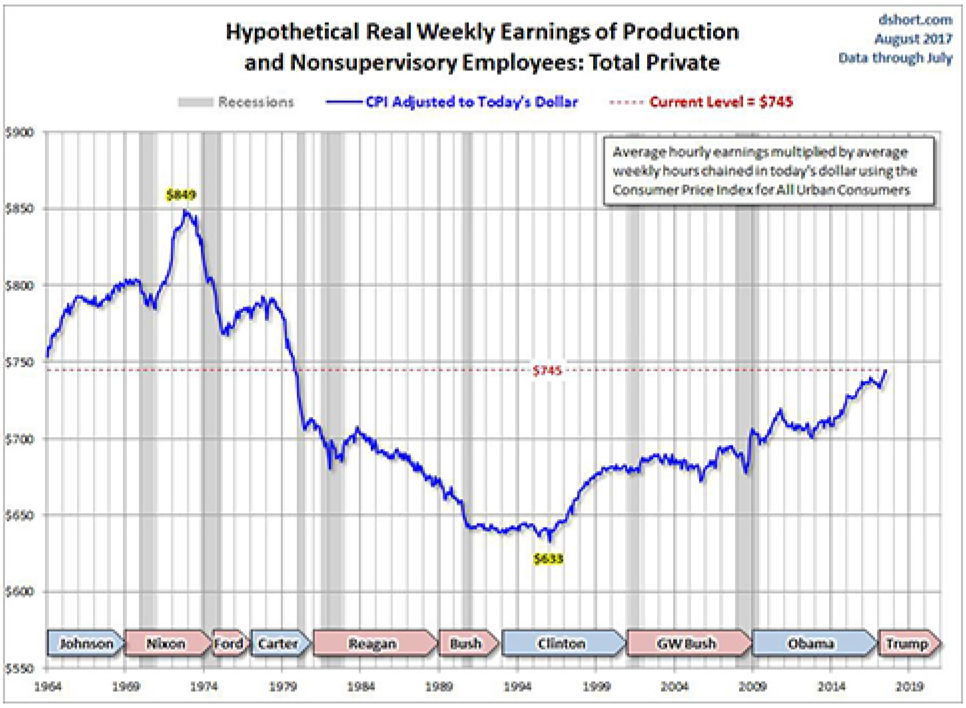
This is not an experience that’s unique to Australia.

The middle class of the world’s largest economy — the United States — has not experienced real wage growth since 1974.

In fact, middle-class income today is no greater than what it was in 1964.


Increased Expenses

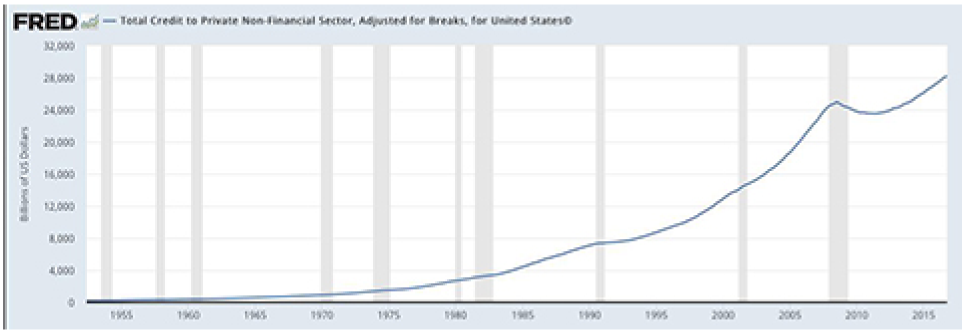
However, on the expense side of the equation, households today pay for cable TV, mobile phones, internet plans and water. These budget items were not in existence in 1964.




Source: Advisor Perspectives
[Click to enlarge]

With cost increases outstripping wage growth, how has the US managed to remain an economic powerhouse?

US household — private non-financial sector — debt was US$600 billion in 1964. Today, it's more than US$28 trillion.




Source: Federal Reserve Economic Data (FRED)
[Click to enlarge]

When adjusted for population growth and inflation, US$600 billion in 1964 is the equivalent of about US$8 trillion in today's money.

In real terms, US households have borrowed US$20 trillion to finance their lifes.

This extraordinary level of indebtedness was only made possible by interest rates going lower and lower.

The problem is that this one-trick pony is old, tired and going lame.

Without the capacity to reduce rates much further, where does future 'growth' come from?

If households are almost 'maxed out', the only way to move the GDP needle into the positive is by governments going deeper and deeper into debt. Running even more generous social welfare programs. Financing infrastructure (so-called 'nation building') projects. Or financing tax cuts to put more dollars back into consumers' hands.

None of this is a productive use of capital.

What about infrastructure spending?

Here’s my two-word answer: school halls. And let’s throw in for good measure that great white elephant…the NBN.

Infrastructure spending is code for lining the pockets of union buddies.

The projects will take longer to complete and cost at least double the original amount, delivering a fraction of the promised outcomes. This doesn’t even qualify as a prediction…it’s a guaranteed outcome.

Governments may well buy themselves some economic growth, but this solution only adds to the problem…more debt does not solve a debt crisis.

There are no good outcomes from a situation as dire and as hopeless as the one we find ourselves in.

We are trapped by a system that failed to heed the words of one of its founding fathers — we have spent far more than we have earned.

The time is fast approaching when we have to pay the price for this recklessness.

How will this play out?

More than any other, this is the question that occupies my thinking. But also what you should be looking out for…the defensive strategies to take to protect yourself…and how you might capitalise on the upheaval that’s in our near future.

**Regards,**

**Vern Gowdie,**
**Editor, *The Gowdie Letter***

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