

MARCH '04

IMPACT OF HIGHER RATES ON CREDIT+ MORTGAGE BUBBLE IS A MAJOR UNCERTAINTY



- Top News
- Business
- Entertainment
- Sports

Updated: 10:16 AM EST

Consumer Debt Loads at Record

USATODAY.com

By Barbara Hagenbaugh, USA TODAY

WASHINGTON (March 18) - U.S. consumers have taken on record levels of debt as low interest rates have lured them to buy bigger houses and fancier cars and to charge more on credit cards than ever before.

Talk About It But while historically low interest rates make the higher debt levels manageable now, the big unknown is what will happen when interest rates rise.

Weighing in on the increasingly heated debate, some economists warn consumers might be in over their heads when their payments increase. Others, including those at the Federal Reserve, say interest rates won't rise until economic growth - and incomes - are also gaining strongly, making the higher payments possible. Plus, much of the increase in debt in recent years has been for mortgages, and millions of Americans have low rates locked in for 30 years.

It's a debate that's central to the outlook for the U.S. economy. Consumer spending accounts for more than two-thirds of U.S. economic activity. If households are forced to pare spending to pay debts, that could hamper the economy's ability to grow and create jobs.

"I don't think it will be what does in the expansion any time this year or next," says Mark Zandi, chief economist at Economy.com in West Chester, Pa. "I am concerned about it (in the) longer run, however. I can see scenarios where household debt is the problem that undoes the economy some five, 10 years down the road."

Credit Card Debt

Region	Avg. per cardholder
New England	\$6,121
Middle Atlantic	\$5,451
Pacific	\$5,005
East North Central	\$4,915
South Atlantic	\$4,790
Mountain	\$4,505
West North Central	\$4,171

But Chicago Fed senior economist François Velde says fears about consumer debt are overblown. Although debt is growing, so are household assets.

"Over the past 50 years, we've been reaching (debt) records almost every quarter," Velde says. "It's not a sign that there's an impending catastrophe."

Velde points to people such as Laura Gross, whose overall debt rose last year. Gross, 31, increased the amount of her mortgage when she refinanced her Washington D.C., condo. But her payments fell because of the



If you die . . . Love continues

Protect your family pennies a day. Peace of mind is not only affordable, but price

\$100,000 Monthly P
10 Year Non-Instanc
Term Life Insurance

Age	Male	Female
30	\$7.09	\$8
40	\$8.40	\$7
50	\$16.19	\$12
60	\$33.25	\$22

Click for a FREE Qu
All rates are subject to underwriting
State availability by the insurance
Copyright © 2004 CIGI Direct In
Services, Inc. All rights reserved

NEWS HEADLINES:

- Hard-Liner Chosen to Replace Slain Hamas Leader
- Space Shuttle Gears Were Installed Backward, NASA Says
- HMO 'Horror Story' Goes Before Supreme Court
- Credit Card Delinquency Surges to Record High
- Hiker With Bionic Leg Begins 2,168-Mile Trek

News Alerts

Search for Top News:

Search

CREDIT CARD BUBBLE

L7

WALS

MORTGAGE RE-FI BINGE IS LIKELY OVER: PERHAPS FOR THE BEST!

Mortgage party's ending; lenders brace for cutbacks

By John Handley

Tribune Staff Reporter

10-22-03

SAN DIEGO—For mortgage lenders, a two-year party is ending, raising worries about the hangover to come.

Bankers gathered here for an annual convention predict their business will fall by 50 percent next year, with an accompanying loss of industry jobs and smaller brokers.

"We think 100 to 200 mortgage companies will disappear in the next 2 to 2½ years," Douglas Duncan, chief economist for the Mortgage Bankers Association, said Tuesday.

Low interest rates have powered a record-setting home refinancing boom in the last two years, with lenders adding up-

wards of 150,000 new workers to help process paper, work with customers and arrange financing. But as mortgage interest rates have risen to more than 6 percent from a low of 5.2 percent for 30-year fixed-rate loans in early summer, refinancing has become less attractive.

Duncan estimates that mortgage originations will total \$3.3 trillion this year, with about 18 million to 20 million loans—a level he calls "not sustainable."

Next year, originations are expected to fall to \$1.6 trillion, with fewer than 10 million loans.

The result will be branch closings and job losses, up to 100,000 of the new positions added during the boom, Duncan said.

PLEASE SEE MORTGAGE, PAGE 2

CONTINUED FROM PAGE 1

"Not necessarily all the disappearing companies will go out of business. Many will be absorbed by mergers and acquisitions. You may even see some big guys go," Duncan said.

Duncan's comments come at a particularly sensitive time for U.S. economic policymakers. Since the late 1990s, the housing industry has been one of the few bright spots in an otherwise unenthusiastic economy where unemployment now hovers at 6.1 percent.

Refinancing and low interest rates are credited for much of the buoyant consumer spending in recent years, spending that propped up economic activity when business investment was slack and the stock market was falling.

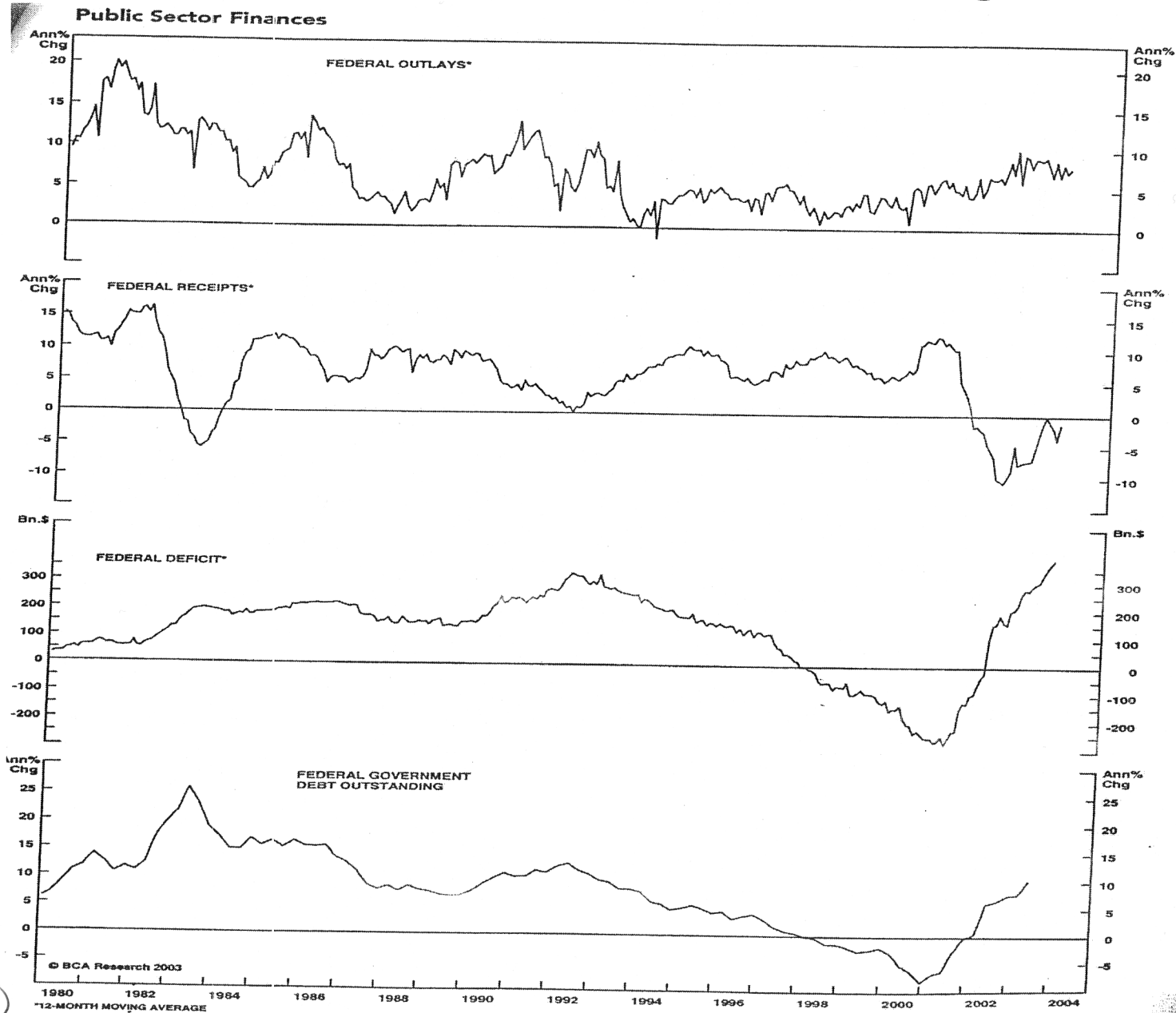
Scott Anderson, senior economist with Wells Fargo and Co., said he has little doubt that refinancing will fall as interest

50

OCT '03

103

Huge Tax Stimulus = Spiraling Debt



Deficit

Total Debt

19

HOW MUCH BUYING POWER DOES THE CONSUMER REALLY HAVE ?

They Spent the Tax Rebate. Now What W

If you send it, they will spend it.

NYT 10-5-03

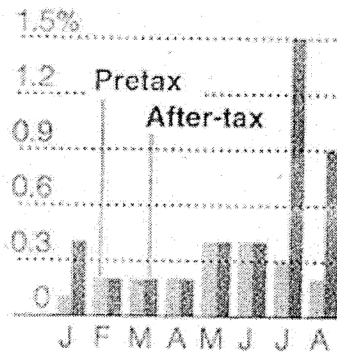
The third quarter was a phenomenal one for the American economy, which probably grew at an annual rate of above 5 percent. Corporate profits soared.

As that growth occurred, economic optimism grew both in this country and overseas. There was talk that the American engine was again pulling the world back into acceptable growth patterns. Even American business leaders began to seem a little more optimistic, with capital spending plans starting to edge up. Only the negative job market outlook put a shadow on the sunny picture.

Overlooked in some of the analysis at the time was the most obvious fact of all: checks totaling \$13.7 billion were being mailed out by Uncle Sam to millions of families. The checks, for the child tax credit, did not go to the poorest Americans, a fact that outraged liberal legislators who learned of the details only after the bill passed. And they did not go to wealthier Americans, who would have been more likely to save the money anyway. They went to the parents in between the two groups.

Now comes the aftermath. The checks were in the hands of Americans in July and August, and clearly lifted spending in the back-to-school season. We don't have September numbers yet, but there was probably some stimulative effect then. But it's over now.

Monthly change in personal income



Source: Bridgewater Associates

The New York Times

It was fun while it lasted. Personal income was growing slowly on a pretax basis, but after-tax disposable income rose more rapidly in July and August than at any time since early 2002, when tax cuts were also helping the economy along.

For business, that created a bonanza. Revenues leaped, but payrolls, the biggest part of most companies' expenses, stayed the same. A result was a surge in profits.

It would be nice to think the profit surge would lead to more investment and more hiring. There has been a gradual increase in capital spending, which was cut after the 1990's bubble burst. And there are reports of retailers stepping up Christmas orders after being favorably impressed by the back-to-school season. But hiring continues to lag and a big increase in Christmas orders could lead to a blue Christmas as retailers deal with excess inventory.

710

102

Are the Republicans on their way to offering up a tax inc

You heard it here second. A tax increase is coming in America—and Republicans will be among those who preside over that increase.

The first place you might have heard about it was, of all places, Reaganite Web chat rooms. There, economists have been muttering for a good six months about the prospect of Republican-supervised tax increases. Especially clear has been Bruce Bartlett of the National Center for Policy Analysis, a think-tank in President Bush's own Texas.

It is not that the less-government types desire tax increases. Far from it. It is just that they toted up the numbers. Taken together, the nation's new Medicare program and Social Security, its old unreformed pension system, make a tax increase just about inevitable. Since tax increases are to Republican voters as SARS is to tourism, you have to wonder how Republicans got themselves into this position.

Here's the short version. Back in the 1970s and 1980s,



Amity Shlaes

free-market thinkers in England and the U.S. decided good fiscal policy was about one thing: providing incentives for growth or, put another way, reducing disincentives to it. Taxes were high, so British Prime Minister Margaret Thatcher and President Ronald Reagan slashed rates. In this philosophy, also known as supply-side economics, deficits and budgets mattered less. If you made your economy competitive through tax cuts, your deficits would, eventually, narrow. If you look at the 1980s and 1990s together, you can see that this worked.

Sometimes, tax cuts paid for themselves through increased growth and revenue. Cutting spending, a traditional conservative goal, was less important.

The philosophy allowed Republicans to distinguish themselves from their conservative forerunners.

No Scrooges they.

Sidelined in the 1990s, the Republicans watched as President Bill Clinton put a second philosophy into action: "triangulation." The idea was to marginalize your opponent by stealing his ideas. This lesson stuck as well.

By President Bush's inauguration, the old supply-side theory had shifted a bit.

What had been matters of emphasis became absolutes. Tax cuts always paid for themselves.

They always offset spending. And generous spending was necessary, so that the Republicans might triangulate and snatch the mantle of compassion from the Democrats.

The new administration applied those lessons. It encouraged growth by cutting taxes and staying out of the way of business; this administration gets an "A-" when it comes to growth.

The administration and its

congressional friends, however, also spent like crazy. There was defense spending after Sept. 11, 2001, of course. And Social Security went unchanged. But there were also the outlays of triangulation, "compassionate conservatism."

The biggest such commitment was the Medicare drug program for seniors. This new entitlement will cost billions. It would be hard for lower tax rates alone to offset it.

With the winter have come some second thoughts. In December, the Congressional Budget Office warned that "unless taxation reaches levels that are unprecedented in the U.S., current spending policies will probably be financially unsustainable over the next 50 years." The report went on to note that "an ever-growing burden of federal debt held by the public would have a corrosive and potentially contractionary effect on the economy."

So much for not playing Scrooge. You have to wonder what Douglas Holtz-Eakin, director of the CBO, felt as he signed off on these words.

But in any case: As the CBO points out, you do not need a new law to widen the federal government's tax take. Wages are increasing, pushing citizens into higher brackets. A quirk in the system, the Alternative Minimum Tax, will force many households to pay extra taxes. Some Bush tax cuts are scheduled to be phased out.

What now? If you ask the various Democratic presidential candidates, Washington must undo some or all of the Bush income tax and capital gains tax cuts. There is also talk—although mostly from think tanks—of raising Social Security taxes. Currently, the amount of income subject to Social Security is capped at under \$100,000. Some Democratic thinkers would eliminate that cap.

This would amount to a wicked marginal tax rate increase.

What about the Republicans? The Office of Management and Budget is already wildly promising budget cuts for 2005. There is speculation that Presi-

dent Bush will rate cuts per State of the Union there needs to increases. He paign year to free-market c Medicare law significant. F a social secu plan that wot ton's "ending know it." Bus ing at govern a share of grc uct, instead o deficit-GDP r in methodolo him to confrc plan.

In short, Re turn themself party of smal however untr sounds. But i all balloons a conservatism will come. It i when.

Amity Shla columnist for Times. E-mail .com

TAX CUTS PROBABLY HISTORY.



Two Trillion in Ten Years

By Kevin Hassett

An economic platform can offer a glimpse into the ideological soul of a candidate and provide crucial information to swing voters. Bill Clinton signaled his "New Democrat" credentials in 1992 when he advocated a generous business tax break, and signaled many events to come when he immediately dropped the idea after his election. President Bush sought swing voters with an aggressive federal expansion in education spending—and then lived up to his promise. What does John Kerry's economic platform tell us? Very little about his ideology, but a great deal about the man himself.

Mr. Kerry promises higher spending, higher taxes and overall deficit reduction. But the details do not add up.

The centerpiece of his campaign is a proposal that would increase the proportion of Americans with health insurance. But succumbing to the tendency for presidential candidates with long experience in the Senate to include almost everything they ever voted for in their campaign platform, Mr. Kerry has added an astonishingly broad grab bag of other spending proposals—70 in all.

How much would all of these promises cost? Let's begin with the biggest proposal. The only existing score for the health plan was provided by Kenneth Thorpe, a former Clinton official and Emory University professor. He at first placed the cost of Mr. Kerry's health plan alone at about \$1 trillion. Mr. Thorpe subsequently revised the figure downward to \$653 billion to account for some rather mysterious "savings," apparently because the health plan's vague statements concerning prevention will yield miraculously precise lower expenses in later years.

The higher number is more reasonable. But starting with the lower number, the National Taxpayers' Union Foundation recently estimated that Mr. Kerry's proposals would increase government spending by \$226 billion in his first year in office. That's about \$2,000 per American family, or 10% of the federal budget. While the report did not include a 10-year score, the construction of one is hardly rocket science. My own calculations suggest that the total costs of Mr. Kerry's proposals would be at least \$2 trillion from 2005 to 2014.

Mr. Kerry's tax proposal is to renew the cuts that were provided in recent years to the so-called "middle class," to reverse reductions provided to those with incomes above \$200,000, and

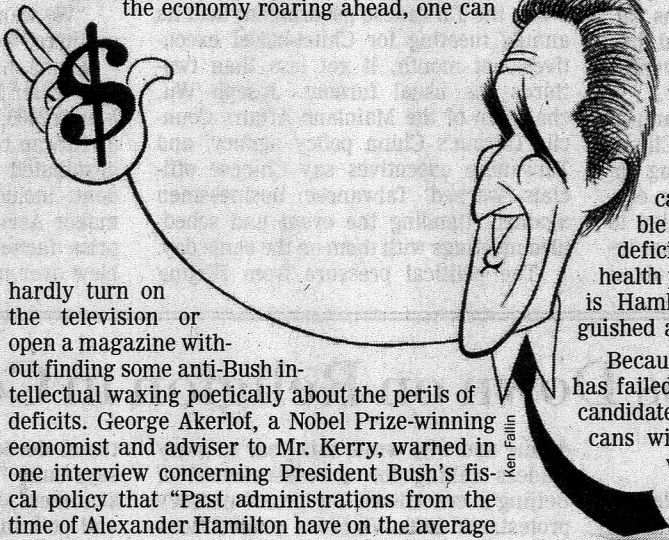
to introduce a new tax credit for higher education. All of the tax cuts enacted by Congress and President Bush are currently scheduled to expire, so Mr. Kerry's tax plan actually *reduces* tax revenue by more than \$400 billion over 10 years. If Congress extends President Bush's tax cuts before departing this year—something only Mr.

That's how much John Kerry would increase America's spending if elected.

Kerry's campaign thinks will happen—then the Kerry plan would increase revenue by approximately \$800 billion.

If we put the spending and tax sides together, the first budget that Mr. Kerry will submit would increase the deficit over 10 years by a minimum of about \$1.2 trillion and, more likely, by well over \$2 trillion. While a few smaller proposals from Mr. Kerry raise a little more revenue, they do not go anywhere near the level necessary to close the enormous gap between spending and taxes.

This is a strange result for a party that clucks like a nest of saintly deficit hawks. Even with the economy roaring ahead, one can



hardly turn on the television or open a magazine without finding some anti-Bush intellectual waxing poetically about the perils of deficits. George Akerlof, a Nobel Prize-winning economist and adviser to Mr. Kerry, warned in one interview concerning President Bush's fiscal policy that "Past administrations from the time of Alexander Hamilton have on the average run responsible budgetary policies. What we have here is a form of looting," adding that "now is the time for people to engage in civil disobedience."

The Kerry plan increases the deficit a great deal more than the dividend tax reduction that

aroused so much inflammatory rhetoric last year. In order to provide his army of virtuous talking heads with virtuous talking points, Mr. Kerry has proposed budget rules that, on the surface, limit the growth of government spending. But he has walled off many of his proposals. In a debate during the primaries, John Edwards, now Mr. Kerry's running mate, said quite accurately that the Kerry plan would "drive us deeper and deeper into deficit." Even Mr. Akerlof, no political opportunist, complained openly in the Washington Post that the Kerry message is muddled. The candidate talks about deficit reduction but protects his pet programs.

How could such an internally inconsistent plan have been constructed? One explanation may be that there are too many cooks; Mr. Kerry's current advisory team includes 200 economists. But a more plausible explanation is that the economic platform is merely another manifestation of Mr. Kerry's own contradictions and confusions.

In economics, at least, Mr. Kerry is not a "flip-flopper," as the Bush campaign likes to say. If he were, his relationship to policy would be like that of Elizabeth Taylor to Richard Burton.

But he does not hold a position passionately one day and then drop it for the opposite position the next day. The truth is that, right from the start, Mr. Kerry cannot make up his mind whether he is a free-spending liberal or a deficit hawk. He could not possibly reverse course on his economic plan because the current course is impossible to discern. If he backtracks on deficit reduction, he advances his health plan. His relationship to the deficit is Hamlet's toward King Claudius: anguished and indecisive.

Because of this indecision, Mr. Kerry has failed where almost every presidential candidate before him has succeeded. Americans will depart this week's convention with no idea what will happen to economic policy if the Democrats sweep into office in November.

That may be acceptable to a Democratic base that has apparently been hypnotized by Michael Moore, but it will surely leave swing voters scratching their heads.

Mr. Hassett is director of economic policy studies at the American Enterprise Institute.

... SPENDING PROMISES CONTINUE
L12

Op-Chart

GEORGE P. SHULTZ

A Record of Recovery

JUST
AN
ASIDE

Over the course of last week, we heard a lot from the Democrats about their record of economic achievement. So let's take the advice of a Democrat of yesteryear, Al Smith, the former governor of New York. His trademark phrase was, "Let's look at the record."

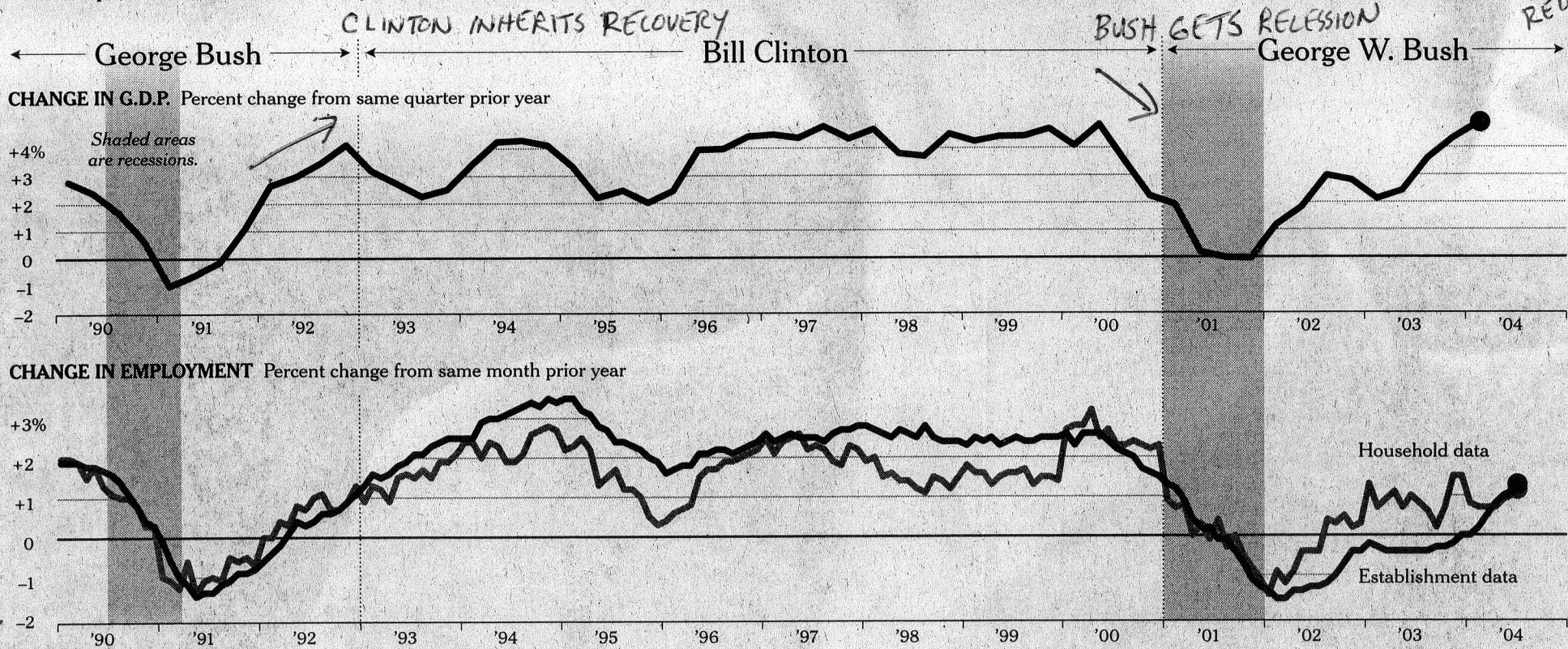
These charts show the rate of change in real gross domestic product and in employment from 1990 to last June. The shaded areas show recessions. The vertical lines show when President Bill Clinton took office and when he left. Because the economy has momentum, it's useful to look carefully at the trends in evidence at the time of presidential transitions. When you look at the record, a quick summary is this:

President Clinton inherited prosperity; President Clinton bequeathed recession.

The 2001 recession was short and shallow, with employment — always a lagging indicator — the last part of the economy to rebound. The employment picture has been a little puzzling since the two main surveys — one asks existing establishments how many people are on their payrolls, and the other asks people in a large sample of households whether they have jobs — show slightly different patterns. In any case, by now a third piece of the record appears clear: the recession President Clinton left behind has turned into prosperity under George W. Bush.

Thanks, Al Smith, for your good advice.

MILD
RECOVERY
NOW



Sources: Bureau of Labor Statistics, Commerce Department, National Bureau of Economic Research, Haver Analytics.

George P. Shultz, secretary of the Treasury from 1972 to 1974 and secretary of state from 1982 to 1989, is a distinguished fellow at the Hoover Institution at Stanford University.

STOCK MARKET BECOMES A PRIMARY DRIVING FORCE OF THE ECONOMY

From 2002 Outlook: "...Because the average American household is very heavily in debt and low on cash, the performance of the stock market (as it ebbs and flows) will have a pronounced effect on Consumer Confidence, buying habits, etc...Thus the "linkage" between the market and the economy is more acute than ever..."

MARKET / ECONOMY LINKAGES

- 1) Wealth Effect
- 2) Consumer Confidence
- 3) Corporate Financial Strength / Weakness

7/4

3-5-04

U.S. Household Wealth Hits Record

Net Worth of \$44.41 Trillion Reflects Market's Rebound, Increase in Home Values

By JAMES R. HAGERTY
And DEBORAH LAGOMARSINO

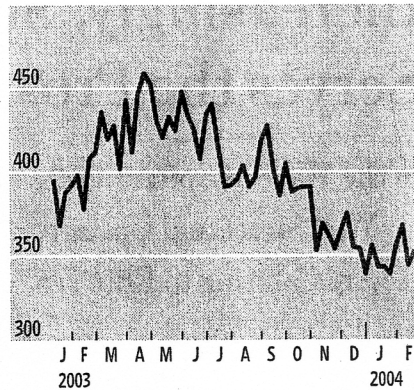
WASHINGTON—Rising house and stock prices pushed the total net worth of U.S. households to a record \$44.41 trillion at the end of 2003, the Federal Reserve reported.

That measure of household wealth surpassed the peak of \$43.58 trillion reached in the first quarter of 2000, just before the bursting of the stock-market bubble began to put cracks in many Americans' nest eggs. The recovery in wealth reflects a rebound in the stock market as well as the rapid appreciation in home values in the past few years. The figures aren't adjusted for inflation.

Today, the Labor Department will release data on employment levels in February, providing the latest evidence of whether the economy is starting to create jobs on a large scale. The Wall Street consensus calls for a rise of about 125,000 in nonfarm pay-

Back to Work?

Weekly initial jobless claims, seasonally adjusted, in thousands



Source: Labor Department

rolls, but those monthly numbers are notoriously unpredictable.

The Fed's quarterly "flow of funds" report also showed a slight slowing in the pace at which Americans are piling on debt. Total household borrowing increased at an annual rate of 8.3% in the fourth quarter, down from a revised 9.9% rate in the previous three months. Mortgage debt rose at a 10.5% rate in the fourth quarter, down from 11.5% in the third quarter.

So-called nonfinancial debt—borrowing by all sectors of the economy except banks, thrifts, finance company and other financial-service providers—increased at a 6.6% pace in the fourth quarter, down from a revised 7% rate in the third quarter.

Household net worth at the end of 2003 was up 5.1% from the third quarter, marking the fifth consecutive quarterly increase. Household net worth is a measure of assets, such as houses and pensions, minus liabili-

ties, such as mortgages and credit-card debt.

Rising house prices have allowed Americans to use their homes as piggy banks. Economists at Bear Stearns estimate that Americans extracted \$491 billion of equity from their homes last year through such means as refinancing them with bigger loans or keeping some of the cash when they sell one house and buy another. Even so, because housing prices jumped, the total amount of equity Americans have in their homes rose \$656 billion to \$8.4 trillion last year.

The Commerce Department reported that U.S. factory orders slid 0.5% to \$343.17 billion in January, mainly because of a decline in aircraft and other transportation orders. Excluding transportation orders, factory orders rose 1.4%. The government also said January orders for durable goods—items expected to last three years or longer, such as cars and appliances—fell 2.3%, more steeply than an earlier estimated decline of 1.8%. A barometer of business investment moved higher: Nondefense capital goods, excluding aircraft, increased 1.3%.

The Labor Department reported a decline in the number of people filing new applications for unemployment benefits for the workweek ended Feb. 28. New filings declined by a seasonally adjusted 7,000 to 345,000.

The department revised its estimate of productivity growth in the fourth quarter to an annual rate of 2.6% from the 2.7% reported a month ago. Productivity measures the amount workers produce per hour. Productivity increased 4.4% in all of 2003 and 5% in 2002. The gradual slowing in productivity suggests that employers are running out of ways to milk their workers for more output and may be inclined to hire more in the months ahead.

FACTORY ORDERS

Here are the Commerce Department's latest figures for manufacturing output in billions of dollars, seasonally adjusted.

	Jan. 2004-p	Dec. 2003-r	% Chg.
All Industries.....	\$343.17	\$344.87	-0.5
Durable goods.....	180.15	184.36	-2.3
Nondurable goods.....	163.02	160.51	1.6
Capital goods industries....	67.97	69.85	-2.7
Nondefense.....	59.79	60.22	-0.7
Defense.....	8.18	9.63	-15.0
Total shipments.....	350.09	348.49	0.5
Inventories.....	439.41	438.58	0.2
Backlog of orders.....	505.82	506.30	-0.1

p-Preliminary. r-Revised.



Journal Link: WSJ.com subscribers can see the latest economic reports, at WSJ.com/Economy.

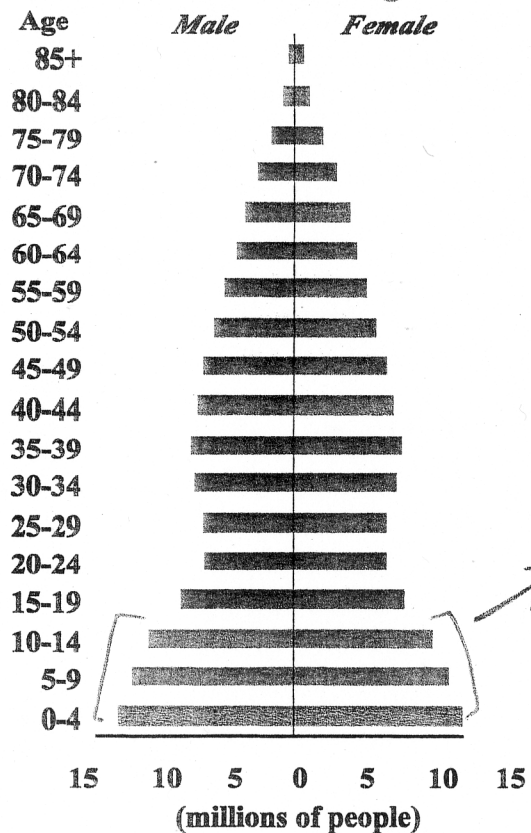
① Provides fuel for economy & markets

② Creates vulnerability to stock selloff.

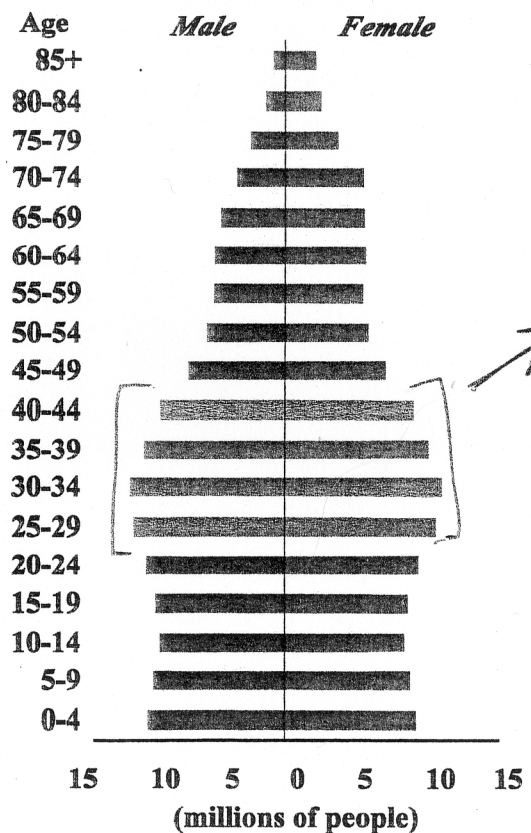
L15

THE BABY BOOMERS AND THE U.S. POPULATION IN 1960, 1990, 2030

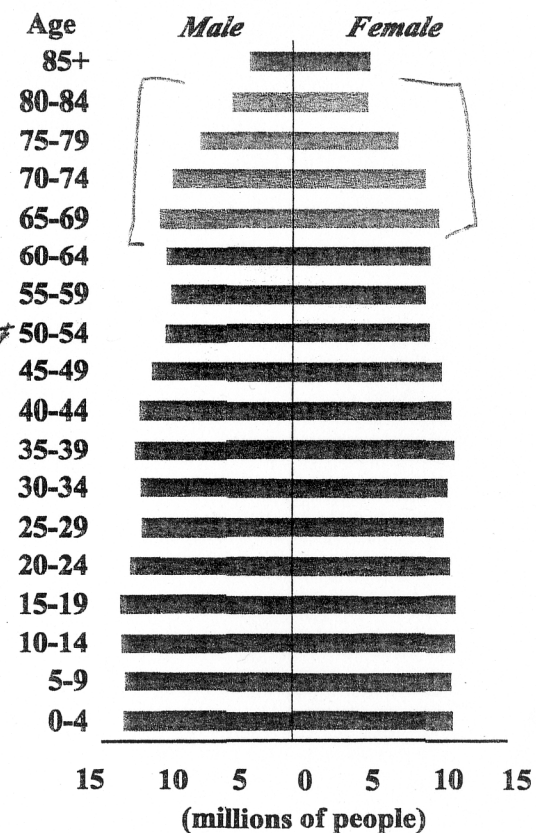
United States Population in 1960:
Boomers (in red) Arrive
76 Million Strong



United States Population in 1990:
Boomers (in red) Dominate the Workforce



United States Population in 2030:
Boomers (in red) in Retirement



7/16

Source: U.S. Census Bureau

THE CONCORD
COALITION

