PART II

THE U.S. ECONOMY : WHERE IT IS HEADED
Cheap Things Can Be Too Expensive

Cheap things may, in the long run, turn out to be the most expensive – because, more often than not, they have to be replaced, very frequently.

Quality has no competitor: It is; or, it is not.

Over the past few years, US households have been seduced by low mortgage rates and attractive refinancing packages.

In fact, refinancing has become, very much, a growth industry in the US.

Refinancing in the US has come to mean that Mr and Mrs US Consumer have been able to have more disposable income at hand as mortgage rates continue to plumb for new lows.

Some of this freed-up money has gone to pay off the butcher, the baker, the candlestick maker, no doubt, but not all of the money went to pay off accrued debts.

Some of the freed-up cash has gone into purchases of other items, the effects of which have increased the total debts of Mr and Mrs US Consumer although, at the time of the new acquisitions, it may not have been obvious.

The end result of the situation, of Mr and Mrs US Consumer, being lulled into a sense of security, that such-and-such was, now, affordable and within easy reach, has resulted in a record number of delinquencies in the US.

Credit-card companies are getting tough on late payers; many banks are starting to show increasing signs of nervousness; and, it is becoming more and more apparent that false economic principles, employed by many households, have predicated purchases, which cannot be matched by sources of steady, or fresh, income.

This situation would appear, clearly, to be unsustainable, long term.

Like a young child in a candy store, Mr and Mrs US Consumer have gone a little bonkers.

Unless they can be restrained, the proverbial bubble will burst – and down will fall humpty, dumpty, and all.

Many US households' incomes are being stretched, very thinly, today.

One is reminded of Gracie Allen (Died: 1964) in the television comedy of the early 1950s and 1960s when she played opposite her husband George Burns (Died: 1996), and her logic:

'George!'
'Yes, Gracie.'
'I've just saved us thousands of dollars!'
'How?'
'Well, there was this sale at The May Company on furs and shoes. So I bought 3 new coats and

shoes to match.'
'For how much, Gracie?'
'Don't be rude, George! I've saved us money. That's all there is to it. I charged everything, anyway. So you won't even feel it. Anyway, you don't have to pay anything for the next month.'

This type of logic is quite prevalent in the US, today, with many families, finding it increasingly difficult to pass up what they perceive to be today's wonderful bargains.

They fear that the bargains may not be available, tomorrow: So catch the bus while it is at the corner stop.

Meanwhile, jobs are being lost by the tens of thousands.

The Ratio of Household- Debt- to-Income is rising quickly, approaching, in many cases, more than One:One.

Since 1952, the Ratio of Household-Debt-to-Income has risen from about One:0.30 to the present average level of about One:0.90.

Translated into simple terms, it means that, in 1952, the majority of US households' income was earmarked to repay debts to the extent of about 30 percent; or, put another way, for every dollar earned, 30 cents was reserved for debt service and the repayment of principal.

Today, about 90 percent of households' income goes to pay the mounting debt levels.

And the debts are growing at an unprecedented, and somewhat, frightening level.

Special service companies proliferate in most parts of the US, all promising Mr and Mrs US Consumer that their debts can be consolidated and that, at the end of the exercise, they will be paying monthly installments on their mountains of debt that are less than they are paying, today.

Further, promises are being made to the effect that these service companies have the ability to renegotiate forgiveness for part of the accumulated debts and to establish a schedule of repayments that will be comfortable for all concerned – with no penalty for the delinquent borrower(s).

In spite of equity markets, being shaved down to hitherto unexpected low levels, resulting in a loss of wealth for most Americans, invested in stocks and shares, low interest rates, tax cuts and discounting by retailers have resulted in the US economy being, seemingly, buoyant.

But the Day of Judgment is close at hand, according to many economists – including TARGET's.

<u>The Housing Market</u>

The US housing market is a good example of consumer excesses because it is unlikely that the current boom in new housing starts can be sustained for much longer.

Mortgage rates, at the present, historic low levels, have had the effect of enticing Mr and Mrs US Consumer to re-enter the housing market, or upgrade existing domiciles, or, in some cases, even to go up-market, selling existing homes and replacing them with newer and more expensive ones.

Some of the more adventurous consumers have invested in mortgage-backed securities in order to obtain a higher yield than is presently being offered by gilt-edged investments, such as US Treasury Notes, and bonds, being issued by the Big Three Motors – General Motors, Ford and Daimler-Chrysler – just to name 3, well-known issuers of Short-term Notes.

The perception that such mortgaged-back investments are safer than, say, US Government Treasuries, or other blue-chip, note-issuing entities, is quite likely to come home to haunt many a US household in the very near future.

Low mortgage rates have driven house prices to new highs because it appears to many that a new house is, now, quite affordable.

The second-hand market for homes is, also, booming.

Newly inflated home values have resulted in Mr and Mrs US Consumer, being able to borrow more money, of course, as lenders look at the current replacement cost of homes, or the market value of homes, and open their doors a little wider to home-owners or prospective, new home-owners.

As soon as the penny drops, it will be too late for most, however.

Subsidisation of a lifestyle by drawing down on available credit, *'secured'* by inflated values of bricks and mortar, is likely to be the undoing of many a family.

And aggressive (and, perhaps, irresponsible) banks and refinancing entities are continuing to fan the flames: *'Buy! Buy! Buy! Refinance, now, at cheaper mortgage levels!'*

Household budgets are being stretched to levels of breaking.

As with a rubber band, it can only be stretched to a certain extent before its snaps.

The concept of the frugal management of income has been forgotten by many a US family of today.

Mortgage foreclosures in the second quarter of this year reached record highs.

They will reach for even higher levels by the first quarter of 2003, no doubt.

Ignorant and/or innocent home-owners in the US are opting for short-term loans to finance long-term commitments since they think, mistakenly, that interest rates will continue to fall so that there is no reason to consider fixing the interest rate on their homes, at this juncture.

This is quite likely to prove painful for many people in the fullness of time.

One may imagine many a US bank/financial entity, having to make Provisions for Non-Performing loans by this time, next year.

The American Bankers Association has, already, sounded the alarm bells by producing delinquency rates for direct motor-car loans.

The requirement to move stocks of motor vehicles before the new models hit the showrooms has, in many cases, been at the expense of the credit records of those, seeking to acquire a new family motor car.

Consumers are fast approaching the limits of their power to spend.

Consumers are the engines of the US economy.

Irresponsible lending, spurred on by refinancing entities and by large, multinational banks, will lead, eventually, to undermining the entire US economy unless the brakes are applied in time.

Already, one has seen chain-stores sales fall, as with retail sales, generally.

The worst is yet to come, it would appear.

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