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TARGET PREDICTS THAT THE U.S. FED WILL LOWER INTEREST RATES

The U.S. Economy Faces Tough Times

The prospects seem to be very strong that the US Federal Reserve will reduce interest rates at its next Open Market Committee Meeting, scheduled for May 9, 2007, the way that things stand, today.

If not at its May 9, Open Market Committee Meeting, then, The Fed's Open Market Committee Meeting, scheduled for June, should see a cut in The Fed Funds' Rate of at least 25 basis points.

This is **TARGET**'s opinion with regard to the overall situation in the economy of the United States of America, taking into account the present, prospective crisis scenario plus the potential for further, more-worrisome financial crises, caused, to a great degree, by the problems in the subprime mortgage-lending market where, it is estimated, $US1,000 million is at risk.

It would appear that The Fed, on the one hand, has to contain inflationary pressures in the country, but, on the other hand, it has to take aggressive and very definitive action in order to contain any and all potential, prospective problems, associated with those corporate mortgage lenders, which between about 1998 and 2005, were very lax in respect of looking at fundamentals, prior to approving certain loan applications from aspiring home-owners and property speculators in the US.

Last Monday, in New York, New Century Financial Corporation filed, what is known in the US as Chapter 11 of the Bankruptcy Laws.

This is a means by which a corporate entity may apply to the Bankruptcy Court in order to be protected from its creditors.

New Century Financial Corporation, of California, founded in 1995, sacked 3,200 of its employees, representing about 54 percent of its entire Establishment Level and announced that, within about 45 days, the company plans to offload all of its assets.

In 2006, New Century Financial Corporation agreed to lend about $US60 billion.

It closed its doors to any further lending operations in February.

This situation is very telling because New Century Financial Corporation was the largest, independent subprime mortgage lender in the US.

New Century Financial Corporation admitted that it owed money to about 100,000 creditors which include:

Bank of America Corporation
Citigroup Incorporated
Countrywide Financial Corporation
Goldman Sachs Group Incorporated
Morgan Stanley
Barclays plc

It appears unlikely that investors, holding the Common Stock of this publicly traded company, will ever see their money after the restructuring of New Century Financial Corporation is completed.

Statistics, compiled in the US by the Authorities (a criminal investigation into potential accounting fraud in certain corporate, subprime lenders, has, already, been launched), claim that 30 other similar (but not as large as New Century Financial Corporation) corporate entities have gone the way of New Century Financial Corporation, but their demise appears to have gone almost unnoticed for the most part.

Some of the known, major US corporate subprime lenders, in deep financial trouble include:

Accredited Home Lenders Holding Company
Fremont General Corporation
NovaStar Financial Incorporated

The Conundrum Of Home-Owners

Many home-owners in the US, today, are facing very tough times because the higher interest rates, imposed by lenders, are straining household budgets to the breaking point.

Delinquency rates are rising.

A full-blown, credit-crunch could be in the offing unless action is taken to ameliorate the situation.

The problems in the subprime mortgage lenders has led to a glut of houses, hitting the marketplace, as home-owners bite the bullet and hoist '*For Sale'* signs.

Today, it is a buyers' market and, to a great extent, buyers are holding off making fresh commitments in the certain knowledge that patience will prove to be a virtue in the course of the next 6 months or so.

The house-wealth effect is being eroded, sharply, with the passing of each day; and, this situation is, in the fullness of time, going to be felt in the High Street.

Unemployment is bound to rise, also, exacerbating the financial restraints that already exist, today, in the largest and most-important economy of the world.

The prices of homes in the US, as with most countries of the developed world, are cyclical, but the value of bricks and mortar is, still, the backbone of an economy.

In the US, between about the middle of 1996 and the end of 2005, according to the database of **TOLFIN** () (The Computerised, Online Financial Intelligence Service and Web-Based, Credit-Checking Provider), the prices of houses in the US rose by about 100 percent.

The increases in the price of homes caused euphoria among consumers; corporate mortgage lenders were only too happy to go along with the flow.

Enter the subprime lenders, such as New Century Financial Corporation, which were anxious to catch the mortgage-lending *'bus'* before it approached its terminus.

But, come the awakening in the latter part of 2005 and things were a little different: Interest rates were on the way up; insufficient numbers of new jobs were being created in The Land of Plenty; mass layoffs were escalating; the automotive industry was facing one crisis after another with no end in sight; the increases in the price of crude oil was being felt at the petrol pumps; the Iraqi War was taking its toll of confidence, both at the consumer level and at the electorate; and, consumers were having to tighten purse strings in order to make ends meet.

Not a very happy state of affairs.

The loose standards of yesteryear in respect of mortgage lending practices in the US are being revamped, today, and, without question, there will be investigations by the US Authorities into a number of companies, with New Century Financial Corporation, high on the list of companies to investigate.

In the event that there is the strong likelihood of a full-blown, credit-crunch, swift and aggressive action will have to be taken, but, by that time, substantial damage could have been done to the US economy.

Some of that damage will, no doubt, be exported to other parts of the world, directly or indirectly.

In order to survive, one may imagine that certain, corporate mortgage lenders will try to steal from Peter in order to pay Paul.

In the hurry to reduce further portfolio risks, it could well mean that many qualified consumer loans and loans, normally reserved for small businesses, will be curtailed, the reaction to the credit crisis, being overdone.

Much more voluntary conservative credit practices will be put in place by US institutions in the mortgage-lending industry because, if they do not heed *'advice'*, such a modus operandi could become compulsory by statute.

But, for the vendors of the High Street, they will suffer because lower consumption is not far off whenever there is a smell of a credit crunch: It is the natural outcome of such a situation.

While this is taking place, lower house prices will lead to further disinvestment and/or disinclination by former, prospective home-owners.

This will add to the general financial problems, facing the economy of the US.

In the coming 2 quarters, all this and more will become only too apparent.

Such a scenario is likely to continue for the remainder of this year and into 2008, according to current estimates.

Could this lead to a recession?

As **TARGET** () has stated in the past, there is a 20-percent chance that the US will enter a period of a technical economic recession before the year is out.

Having said that, a prolonged and material, housing-market slump – which, today, appears to be a guarantee – could be a sufficient drag on the US economy as to stymie economic growth in The Land of The Free and The Home of The Brave.

And, in the interim, investor sentiment will be adversely affected and this, no doubt, will be apparent by the volatility in equity markets, around the world.

Force majeure situations are bound to arise from hereon in as corporate investors will be forced to sell equities in order to meet creditors' demands because the alternative is unacceptable.

The Federal Reserve Board, without question, will try to allay the fears of investors as will the Government of the US, but, as the erosion of wealth effect continues and US investors see the value of their nest eggs depleted, proportional to the falls of key indices of equity markets as well as the falls in the prices of bricks and mortar, it may not be a pretty sight.

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