KEEP THE CASH AND LET THE CREDIT GO !
STAND BY FOR THE CRUNCH IN 2008 !

One would have to be a complete dimwit not to appreciate the glaring fact that the US Government is running scared.

The Government of the **U**nited **K**ingdom (UK) has, already, made it only too clear that it is very concerned about the current financial situation, worldwide, especially as it affects the UK mortgage industry.

The subprime, mortgage-lending industry is strangling not just the US economy, but its long-reaching tentacles are being felt, internationally.

Last Wednesday, The **F**inancial **S**ervices **A**uthority (FSA) of the Government of the UK said that the difficult situation, globally, could affect the UK mortgage markets, resulting in many more defaults.

The FSA said, inter alia, that arrears and repossessions had increased significantly of late.

The FSA's Managing Director, Mr Clive Briault, warned:

> *'There is a very real prospect that conditions will worsen further into next year in terms of both liquidity and credit risks.'*

At this very moment, senior US Government officials are wrestling with the notion that some red-hot irons must be pulled out of the financial fires at home, saving the country from falling into another recession.

Mr Henry Paulson, US Treasury Secretary, said only last Monday in respect of this problem:

> *'… As we are all aware, the housing and mortgage markets are working through a period of turmoil, as are other credit markets, as risk is being reassessed and re-priced. We expect that this turbulence will take some time to work through, and we expect some penalty on our short-term economic growth. The positive news is that we are confronting and managing these challenges against the backdrop of a strong global economy. And the U.S. economy remains fundamentally sound – core inflation is contained, continued job gains are providing a good foundation for household spending, corporate balance sheets remain healthy overall, and strong growth abroad is supporting U.S. exports. Our economy will continue to grow, but it is facing a number of challenges.*
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> *'And as I have said before, the housing market downturn is the biggest challenge to our economy. When home foreclosures spike, the damage is not limited only to those who lose their homes. Homes in foreclosure can pose costs for whole neighborhoods, as crime goes up and property values decline ...*
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> *'And so, Treasury is aggressively pursuing a comprehensive plan to help as many able homeowners as possible keep their homes. We began by convening a diverse group of market participants, who represent all segments of the mortgage industry. Based on what we have learned, we are implementing a three point plan to avoid preventable foreclosures and to minimize the impact of the housing downturn on the U.S. economy…*
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> *'First, we must reach homeowners who are struggling, reach them early, and reach them with information and hope. The need for this effort became starkly clear when we learned that 50 percent of foreclosures occur without borrowers ever talking to their lender or a mortgage counselor. We knew that if we are to make a difference that number has to be*

reduced ...

'The HOPE NOW effort to streamline refinancings and modifications is a positive step, but it is not a silver bullet. There is no single solution to address all of the issues currently affecting the housing and mortgage markets.

'The government has a role to play, as well. First, we need to draw attention to these letters and urge borrowers who receive them to act on them. Secretary Jackson and I have been doing just that, recently we sent copies of these letters to all Members of Congress so they can alert their constituents. We are asking governors and mayors to do the same. We will also join HOPE NOW's efforts to broaden its public service announcement campaign, to spread the word that hope is but a phone call away…'.

One may well ask when the US Government last opined that it had a role to play in the affairs of private enterprise, that is, when private enterprise was not breaking the law and when the defence of the realm was not imperiled.

What happened to the coveted philosophy of caveat emptor?

The fact remains that the current situation is so worrisome to the Bush Administration that the US Government feels obliged to play a role in attempting to ameliorate the present chaos in view of its gravity and its potential to tip the economic scales, internationally.

The Bush Administration has stated that it would like to freeze mortgage rates for the next 5 years.

There are more than 2 million homeowners in the US, today, all of whom had signed on the bottom lines of contracts with financial institutions, just a few years ago, borrowing tens of billions of dollars in order to live the age-long dream of owning their own homes.

Those mortgage contracts have, now, been given the nomenclature of subprime, mortgage loans, loans that were afforded to people who, in the light of day, could ill afford to commit to the terms and conditions of the mortgage contracts at the time of their drafting.

The subprime, mortgage loans were, originally, contracted at low interest rates, but, today, those interest rates are due to rise substantially higher.

Many of the homeowners, looking at negative equity in their homes due to the crisis in the housing market in the US where there are hundreds of thousands of sellers of homes, with buyers, being few and far between, may just opt to walk away from the dreams, leaving the financial institutions with the unwanted properties.

It is estimated that some 500,000 families in the US could lose their homes because these families will be unable to meet the higher payments on the mortgages.

The White House has, for some months, been trying to persuade the US subprime, mortgage-lending industry to freeze interest rates on some of these loans.

Thus far, to no avail.

Internationally, this situation has spread faster than the wildfires that scorched California a few weeks ago.

The levels of defaults in US subprime mortgages, many of which had been repackaged into various types of securities and sold, around the globe, have had the effect of strangling credit markets and placing many of the weaker economies at risk.

What the US Government is proposing, today, is akin to putting a Band-Aid on a severed artery.

Presidential hopeful, Senator Hillary Clinton, stated in a speech, recently, that she would endorse a policy of invoking a 90-day moratorium on home foreclosures.

Senator Hillary Clinton has said that the 90-day moratorium would allow homeowners, who have no chance of meeting their financial commitments to institutions and banks, to buy time and, perhaps, avoid the losses of their homes.

Senator Hillary Clinton referred to the present situation as being *'the scale of the problem'*.

One may only ponder what could take place in 90 days to stop the blood from gushing out of the open financial wound.

Treasury Secretary Henry Paulson acknowledges that *'This plan, in and of itself, is not going to deal with all of the problems, associated with the housing market and bad lending practices …'*.

He emphasised that the housing downturn in the US would exact *'a penalty'* on the growth of the US economy in 2008.

<u>The Good Doctor Hints</u>

On Thursday, November 29, 2007, Dr Ben S. Bernanke, the Chairman of the US Federal Reserve, gave a speech in North Carolina, entitled, *'National and Regional Economic Review'*.

In that speech, Dr Ben S. Bernanke said, inter alia:

> *'With respect to household spending, the data received over the past month have been on the soft side. The Committee will have considerable additional information on consumer purchases and sentiment to digest before its next meeting. I expect household income and spending to continue to grow, but the combination of higher gas prices, the weak housing market, tighter credit conditions, and declines in stock prices seem likely to create some headwinds for the consumer in the months ahead.*
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> *'Core inflation – that is, inflation excluding the relatively more volatile prices of food and energy – has remained moderate. However, the price of crude oil has continued its rise over the past month, a rise that will be reflected in gasoline and heating oil prices and, of course, in the overall inflation rate in the near term. Moreover, increases in food prices and in the prices of some imported goods have the potential to put additional pressures on inflation and inflation expectations. The effectiveness of monetary policy depends critically on maintaining the public's confidence that inflation will be well controlled. We are accordingly monitoring inflation developments closely.*
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> *'The incoming data on economic activity and prices will help to shape the Committee's outlook for the economy; however, the outlook has also been importantly affected over the past month by renewed turbulence in financial markets, which has partially reversed the improvement that occurred in September and October. Investors have focused on continued credit losses and write-downs across a number of financial institutions, prompted in many cases by credit-rating agencies' downgrades of securities backed by residential mortgages. The fresh wave of investor concern has contributed in recent weeks to a decline in equity values, a widening of risk spreads for many credit products (not only those related to housing), and increased short-term funding pressures. These developments have resulted in a further tightening in financial conditions, which has the potential to impose additional restraint on activity in housing markets and in other credit-sensitive sectors. Needless to say, the Federal Reserve is following the evolution of financial conditions carefully, with particular attention to the question of how strains in financial markets might affect the broader economy …'.*

In Germany, the largest exporter in the world, the Government knows fully well that, in the 2008 Fiscal Year, exports will wane, substantially, compared with the 2007-Year.

For this country, one job in every four jobs depends in exports, directly or indirectly.

However, due to diversification of its markets, only about 7.60 percent of the country's goods and services are sold, directly, to the US.

With the euro, flirting at the $US1.50 level, Germany sees the writing on the wall.

Germany knows that its products and services are becoming far too expensive in terms of the euro in order to be competitive on the world stage.

A number of industries in Europe are considering moving their factories to the US in order to take advantage of the lower translation value of the US dollar vis-à-vis other *'hard'* currencies of the world.

The view that is being taken, therefore, is that the US dollar will not recover its translation level of 1996 in a hurry.

Which appears quite logical, all things considered.

While US manufacturers may continue, at least for a short time, to enjoy the benefits of a strong global economy, the plight of a weak currency is, to be tritish, a double-edged sword.

Imports into the US will be dramatically more expensive due to the weakness of the US dollar and this is likely to lead to a material slowing of the largest, single economy of the world, resulting in slower demand growth for US manufactured goods.

US manufacturers are likely to face a rapidly deteriorating environment for their products and services.

Profits will be squeezed.

In fact, they have, already, been squeezed.

At the beginning of the fourth quarter of this Fiscal Year, it was noted that capacity utilisation in the US had fallen back to the level of the first half of the year.

For manufacturers of building materials, they are feeling the heat of the US housing downturn.

Revenue growth has halted.

Further contractions are well expected in 2008.

Housing starts are down about 28 percent, Year-On-Year.

Tighter credit conditions, throughout the US, is eroding home equity and this will, without question, further dampen demand in the months ahead.

The growth in sales of motor vehicles in the US will be limited and it is quite likely that Detroit, Michigan, will continue to bite the bullet as losses pile atop of losses.

And so on and so on.

Conclusion: The US is, definitely in for a rough ride in the coming year.

It is quite likely that Asia, or at least many parts of the most-populous part of the world, will not be immune from the US economic sickness that will sweep the globe.

As **TARGET** () has, already, demonstrated, the largest export country of the world – Germany – is bracing itself for trouble in the new year.

The UK, likewise, fears for the worst.

This would appear to be a time when, once again, cash will be king.

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