

Jobless claims, an end to the housing bubble: storm signals for US economy

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On Monday, September 26, in a speech to the American Bankers Association Annual Convention, Federal Reserve Board Chairman Alan Greenspan made unusually grave warnings about the risks to the economy resulting from a fall in housing prices.

Echoing a warning he has made repeatedly over the past year, Greenspan told the meeting of bankers that “the dramatic increase in the prevalence of interest-only loans, as well as the introduction of other, more-exotic forms of adjustable-rate mortgages, are developments that bear close scrutiny.”

These loans have allowed “highly leveraged borrowers to purchase homes at inflated prices,” and “in the event of widespread cooling in house prices, these borrowers, and the institutions that service them, could be exposed to *significant losses*” (emphasis added).

Although Greenspan attempted to put an optimistic spin on the situation, a barrage of economic data released this week makes it impossible to sugar-coat the dangers to the stability of American capitalism.

Hurricane Katrina created immense job losses, estimated at between 400,000 and 500,000. Katrina-related jobless claims filed at backed-up government offices rose to 214,000 last week. Total jobless claims rose consistently over the past three weeks, reaching a two-year high of 432,000 for the week ending September 17. The previous week saw a jump of 97,000, a bigger increase than after the terrorist attacks of September 11, 2001.

The day after Greenspan’s speech, the Conference Board reported that the Consumer Confidence Index fell 19 points, from 105.5 in August to 86.6 in September. Analysts had expected the index to fall to between 95 and 100. This is the lowest the index has reached since October 2003, but more significantly, it

represents the largest single drop in 15 years. The last such fall came amidst fear of oil shocks during the first invasion of Iraq.

Earlier this month, the University of Michigan’s Index of Consumer Sentiment also dropped to 76.9 in September from 89.1 in August. At 76.9, sentiment was more pessimistic than in the period after the September 11 attacks. Even before the hurricane, the university report noted, “Rising prices were expected to completely offset income gains by four-in-ten households in August, the highest level in more than ten years.”

Other figures confirmed the decline in consumer confidence, with twice as many expecting business conditions to worsen as believe conditions will improve. A recent Conference Board report found, “Consumers saying jobs are ‘hard to get’ increased to 25.4 percent from 23.1 percent, while those claiming jobs are ‘plentiful’ fell to 20.1 percent from 23.6 percent.”

These sentiments are leading to lower levels of consumption spending. The Commerce Department recently revealed that retail sales declined by a larger-than-expected 2.1 percent in August.

There is a direct relationship between the slowdown in consumer spending and the topping out of the housing market. A large part of consumer spending is financed by home equity loans and cash-outs. But housing prices are no longer rising at double-digit rates, creating paper increases in equity that can be used to sustain consumption.

A Commerce Department report Tuesday pointed to a downward turn in the housing market. New home sales sharply declined by 9.9 percent to a seasonally adjusted rate of 1.24 million units, far worse than the expected 5.5 percent decline. The decline was especially

concentrated in the Northeast, where sales fell by 22 percent. Sales in the West fell by 17.9 percent and by 10.6 percent in the Midwest. In the South, sales fell by only 2.2 percent.

Despite the slowdown, prices rose by 2.5 percent over July, but this is the first price rise in new homes in three months. New home prices in August 2005 were only 1 percent greater than last August, and the inventory of new homes for sale reached a five-year high, further indicating an end to the housing bubble.

The Mortgage Bankers Association said Wednesday that applications to purchase homes fell 3.4 percent last week atop a 2.6 percent loss the week before, and filings to refinance mortgages dropped by 10.5 percent.

In addition, mortgage rates rose for the second week in a row. Thirty-year fixed rates rose to 5.85 percent, compared to 5.81 the previous week and 5.64 the same time last year. One-year ARMs rose to 5.02 percent, from 4.94 last week. The rates on these loans respond much quicker to short-term rates, rising from 4 percent in September of last year.

With less home equity available to pay off debts, missed payments on credit card loans have already reached record levels, according to a report released Tuesday by the American Bankers Association. Credit card loan delinquencies reached 4.81 percent of account holders in the second quarter of 2005, the highest since the ABA began keeping records in 1973.

As of July, the total outstanding consumer debt, excluding mortgages, was about \$2.2 trillion. It will continue to increase with the current savings rate of negative 0.6 percent of income. The number of all consumer loan accounts missing a payment in the second quarter was 2.2 percent, also a relatively high rate.

The increasing inability to make credit card payments suggests that housing defaults may come next. In the past five years, household debt has skyrocketed by 60 percent, and the average household now spends as much as one fifth of its after-tax personal income to service debt.



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