

US commits \$800 billion more to bail out consumer credit and mortgage market

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US Treasury Secretary Henry Paulson announced Tuesday another extension of the Bush administration's bailout of the financial system, committing \$800 billion towards lending programs aimed at preventing the collapse of the home mortgage and consumer credit market. This marks the first time that the Treasury and the Fed have ever intervened to finance consumer debt.

The latest programs push the total size of the direct and indirect financial obligations assumed by the federal government to more than \$8 trillion. Paulson emphasized that the new lending measures were merely a "starting point" and could soon be extended to cover other debt, including commercial mortgage-backed securities, a move that would further increase the enormous public resources that have been diverted to protecting the interests of the financial oligarchy.

The new measures, announced a day after the \$249 billion bailout of Citigroup, underscore both the depth of the crisis wracking the financial markets and the increasingly disoriented response by the authorities in Washington. Just last week, Paulson told Congress that the financial system had been stabilized by the massive capital injections into the markets engineered by the Bush administration. His actions this week belie such claims.

The Federal Reserve is to create a Term Asset-Backed Securities Loan Facility (TALF) that will lend up to \$200 billion to holders of high-grade securities backed by assets including loans to small businesses, students, credit card holders, and car owners. The TALF is backed up by \$20 billion from the Treasury's \$700 billion bailout fund that was authorized by Congress in September.

The other aspect of Paulson's latest program is a \$600 billion mortgage lending fund. The Fed is to buy up to \$500 billion of mortgage bonds guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae, and will purchase another \$100 billion of the mortgage finance companies' debt securities—pools of mortgages bundled together and sold on the financial markets.

None of these measures address the root causes of the increasingly severe economic crisis. Even if the programs make credit more accessible and somewhat less expensive, the ability of

millions of ordinary working people to cover their debts amid rising unemployment and declining real wages will remain in doubt.

The immediate impact of Paulson's announcement was to trigger a wave of mortgage refinancing by indebted home owners. The *Wall Street Journal* reported that James Ramsey of Aurora, Illinois, locked in a 5.5 percent interest rate on his \$180,000 mortgage. His previous rate of 5.625 percent was due to rise by up to 1 percent in January. Ramsey explained that the refinance arrangement "is going to let me pay off a couple of credit cards really quick."

The *Journal* explained that the slightly lower mortgage rates are only available to borrowers who have the cash and credit rating to qualify for home loans under existing lending standards. Among those excluded are the roughly 11.8 million homeowners who are prevented from refinancing because their mortgage is now greater than the value of their property. The Paulson plan, in other words, will do nothing to alleviate the foreclosure crisis.

Home prices are continuing to decline. One gauge released by Standard & Poor's on Tuesday, the Case-Shiller Home Price Index, found that prices declined on an annualized basis in the third quarter by a national average of 16.6 percent. This is the largest quarterly decline recorded since the survey began in 1988. Some cities were especially hard hit, including Phoenix and Las Vegas (down more than 30 percent) and Los Angeles, Miami, San Diego and San Francisco (more than 26 percent). Additional data released yesterday by the Commerce Department showed sales of family homes dropped to their lowest level last month since January 1991.

One housing analyst cited in the *New York Times* on Tuesday said that "it is unlikely that we are anywhere near a bottom in nationwide home prices".

Meanwhile, concerns have been raised in the financial press about some of the implications of Paulson's new initiatives.

"[The Fed's] approach is similar to steps taken in Japan in the 1990s and earlier this decade, when the Bank of Japan pumped reserves into Japanese banks," the *Wall Street Journal* explained.

“The Fed is taking that process a step further. Not only is it pumping in reserves, it is deciding where that cash should go, through its own lending programs... There are many risks to this approach. Markets could become dependent on Fed financing, possibly slowing their own recovery. Fed officials are concerned about how they will exit from lending programs, but see that as a problem they’ll have to confront when the crisis subsides, something that is still seen as far off. There are other risks: that the new programs won’t work, that more money will be needed, and that the Fed could suffer losses on all of this lending, particularly with the economy so fragile.”

The *Financial Times* interviewed Tony Crezcenki, an analyst at trading firm Miller Tabak, who said: “We don’t know yet how it is that the Fed will finance its \$600 billion of purchases. What we do know is that it can’t do it with its current Treasury holdings, which total a comparatively smaller \$489 billion.” Tabak said he feared the Fed would undermine the greenback if the markets believed the central bank was pumping out an excessive supply of dollars. “Today’s action again begs the question: if the Fed and the Treasury are backing the US financial system, who is backing the US?”

US recession deepens

New economic data released in recent days again indicate that the unfolding recession is developing at a pace and scale unmatched since the 1930s.

On Tuesday, the Commerce Department revised its figures for economic activity in the third quarter. Gross domestic product, previously reported to have contracted by 0.3 percent, actually declined by 0.5 percent. Disposable personal income plummeted at an annual rate of 9.2 percent. Consumer spending declined by 3.7 percent on an annualized basis, significantly worse than the previously reported 3.1 percent.

More Commerce Department data was released yesterday. Consumer spending in October declined by 1 percent, the largest monthly fall since September 2001. October saw the fourth consecutive monthly drop in consumer spending; August recorded a 0.1 percent and September a 0.3 percent contraction. With consumer spending accounting for more than two-thirds of all economic activity, the accelerating downturn is an acute indicator of the mounting recessionary crisis.

Yesterday’s Commerce Department data added to deflation fears. Prices fell by 0.6 percent last month, compared to a 0.1 increase in September. The economic indicators suggested that to the extent that Americans have experienced slightly lower costs of living in some areas, such as the lower cost of gas, they are saving

more to prepare for anticipated hardships. Savings as a percentage of disposable income was 2.4 percent in October, up from 1 percent a month earlier.

Business investment and capital spending also took a severe hit last month. Orders for durable goods, regarded as a key indicator of business spending, plummeted by 6.2 percent in October, more than twice the rate anticipated by economists, and sharply up from the 0.2 fall recorded in September.

National capital investment, excluding aircraft and military expenditure, was down 4 percent in October. According to High Frequency Economics, capital investment has plunged by more than 30 percent on an annualized basis in the last three months. The firm’s chief US economist, Ian Shepherdson, told the *Washington Post* that this figure was “terrifying”.

Last Friday, before the release of the latest economic data, Goldman Sachs economists revised their fourth quarter forecasts downwards, from negative 3.5 percent to negative 5 percent GDP growth. The firm said it expects the economy to contract in each quarter until mid-2009. The official unemployment rate is expected to reach 9 percent by the end of next year, and continue to rise in 2010. “This forecast, if correct, makes the current recession unequivocally the worst single downturn on record since World War II,” the economists concluded.

The stagnating “real economy” is in turn rebounding into the financial markets and banking system, undermining the limited impact of the Treasury and Federal Reserve’s bailout programs. On Tuesday the Federal Deposit Insurance Corporation (FDIC) released a report on the third quarter performance of the banking industry. It found that US banks’ net income in the three months from July to September was just \$1.7 billion, down 94 percent from the \$27 billion recorded over the same period in 2007.

Nine banks collapsed during the quarter, the most recorded since 1993. Among the failures was Washington Mutual Bank, which was the largest insured institution to fall in the FDIC’s 75-year history. More collapses are inevitable. The number of banks on the FDIC’s “Problem List” increased from 117 to 171, and the assets of “problem” institutions increased from \$78 billion to \$115 billion in the third quarter.



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