THE ALMIGHTY AMERICAN HOUSEHOLD

by Steve Brown

At present, the economy is at the proverbial fork in the road. There have been few other times in history where the economy has gone to the recessionary precipice and teetered on the edge. While real estate and the credit markets are attempting to tip us over, low interest rates, a weak dollar and the almighty consumer are all that stand between standing upright and going into a freefall. The key to this balance lies now with the consumer.

Household debt has risen rapidly for many years, and the savings rate is close to zero. Without home equity, credit card debt availability and a stable labor market, the fear is that households turn into a major destabilizing factor. The problem with this view is that it does not align with the facts.

Up to this point, household spending has acted like a buffer to shocks such as 9/11. Over the past 2Ys, changes in spending variability has been only 50% of that of changes in real income and only 20% of household wealth. The stabilizing tendency of consumer spending is best proven by the fact that over the last 25Ys, spending has posted no quarterly decline with the exception of the 1991 recession. This is against a backdrop of disposable income that has contracted for 14 quarters during the same time frame. Even today, with an average of a 9% decrease in median home values across the US, record energy/commodity prices and falling confidence, spending has increased at a 2.5% annualized pace and has just started to settle down closer to a 1% growth pace for the rest of 2008.

Like the spending downturn in 1991, energy prices were high and confidence lagged. Unlike 1991, short-term interest rates are going to be in the 2% range instead of the 8% range. Moreover, a fiscal stimulus package that will boost household disposable income is set to take effect within a matter of months.

The best argument we can make as to why the US economy will not teeter into oblivion is that the Boomers are still sitting on a fair amount of stored wealth in the form of housing equity, investment balances and potential inherited wealth. Boomers have become accustomed to a rising equity and real estate market and seeing few other investment opportunities will reinvest their money back into these markets over time. This will result in a slow and steady rebound starting the later half of this year. For those households that don't have wealth, despite the perception of severe credit market tightening, consumer installment debt and revolving home equity lines have been growing at a healthy pace. Asset sales, while a less attractive option, are still an option for many households.

2008 will continue to be rocky for sure. While the cheap dollar will keep foreign investment flowing in to the US to help, it will be the mighty US consumer that once again stabilizes the economy and keeps us from the "doomsday scenario" that is often discussed in the marketplace.

BANK NEWS

Problems

The Carlyle Capital Group failed to meet 4 margin calls yesterday. While this has become an everyday occurrence for hedge funds, the scary part is that this was a fund of $300mm Agency mortgages.

Wrong Math

A new study by the Mortgage Institute of Financial Professionals found that many rent vs. buy mortgage calculators overstated the interest deduction of home mortgages by as much as 300%. While mostly banks were on the list of calculators tested, those at GNMA, HUD, FHLMC and others were also found misrepresenting housing affordability.

FHLB M&A

In a number closely watched by bankers' banks and other FHLB banks, FHLB Chicago came up with a $800mm valuation for itself in connection with its merger with FHLB Dallas. In will now be up to the 2 sides to settle on a final number.

C&D

Integrity Bancshares ($1.2B, GA) agreed to a cease-and-desist order from the FDIC and State Banking of GA for failure to render proper supervision of the bank and inadequate capital/reserves.

RDC

According to the Aite Group, 100% of large banks, 80% of mid-sized banks and 45% of small banks offered remote deposit capture at the end of 2007.

Forbes

The list of the richest is out and Warren Buffet regains the lead over Bill Gates. The average net worth was $3.9B, up $250MM from last year. 61 was the average age.