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Americans Pay for Housing Boom's Excess

By MADLEN READ and JOE BEL BRUNO, AP Business Writers
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The bill for America's excessive borrowing during the housing boom has arrived, and more people are having trouble paying it.

JPMorgan Chase & Co. and Wells Fargo & Co., two of the nation's largest banks, on Wednesday joined a growing chorus warning that the subprime mortgage mess is just the start of a sweeping lending crisis. And some fear that consumers falling behind on all kinds of loan payments could tip the economy's scale toward recession.

Strapped consumers are having a tough time making payments on credit cards, home-equity loans, and even for their cars. This has caused three of the top five U.S. commercial banks that have already reported damaging fourth-quarter results to set aside some $12.5 billion to cover future loan losses — and that number will likely grow as the year wears on.

Problems in the subprime mortgage market are rapidly spilling over into other areas of the economy. No matter what the experts call it — a recession, slowdown or even the makings of a depression — it's clear banks are under mounting pressure to be more cautious about lending.

"If consumption growth stagnates, the odds of a recession are incredibly high," said Andrew Bernard, director of the Center for International Business at the Tuck School of Business at Dartmouth. "All the pieces of household financial health are starting to be shakier, especially at the low end."

He and others are paying close attention to what top U.S. banks say about their customers' payment habits. Many view this as an early indicator about where the overall economy is headed, but there are other signs that are troublesome.

The stock market has had its worst start to the year in three decades, with investors rattled by signs from the Labor Department that unemployment is on the rise and retail sales are on the decline. Further, the Commerce Department reported Wednesday that higher costs for energy and food in 2007 pushed inflation for the year up by the largest amount in 17 years.

There was no sign of a turnaround in the last few months of the year. The Federal Reserve reported that the economy grew at a slower pace in late November and December as credit problems intensified and consumers tightened their spending.

To some, it appears that the Fed came to its rate-cutting decision in August a bit too late. Others point to the falling dollar and surging oil prices, factors that usually prevent the central bank from easing its monetary policy.

While debate persists about the Fed's timing and the extent of the slowdown, bank executives — who have scrambled to prepare for another tumble in home prices and higher unemployment in 2008, feel academic definitions are beside the point.

"We're not predicting a recession — it's not our job — but we're prepared," JPMorgan Chase CEO Jamie Dimon told analysts after the nation's third-largest bank wrote down $1.3 billion and said profit dropped 34 percent.

His financial institution didn't do all that bad. Rival Citigroup Inc. fared the worst during the fourth quarter, losing $9.83 billion after writing down the value of its portfolio of mortgage and mortgage-backed products by $18.1 billion.

Wells Fargo, a more traditional bank that avoided last year's trading woes, saw its profit fall 38 percent due to troubles with home equity loan and mortgage defaults.

JPMorgan is girding for home prices to decline further in 2008 by 5 percent to 10 percent; Citigroup's estimate of 7 percent falls within that range, too.

"The banks are the infrastructure for everything, the heartbeat of the market," said Chris Johnson, president of Johnson Research Group. "They need to be fixed before the market, and economy, can move forward with confidence. They need to get all their dirty laundry out there."

Banks and card companies like American Express Co. — which warned last week that it would add $440 million to loan loss provisions — said in the regions where home prices are declining, card default rates are rising faster. The same goes for auto loans, subprime mortgages and home equity loans in these areas, which include Florida, Michigan and California.

A big reason for the rise in credit card default rates is that they are returning to more usual levels following a change in bankruptcy law that sent rates lower for a time. But the fact that more losses are being seen in the weaker parts of the country shows the increase is economically driven as well.

Analysts believe this means one thing: Consumers will be the ones paying for years of lax lending standards by U.S. financial institutions. Many will become more restrictive about who gets credit in a bid to stem future losses — and that could curb consumer spending, which accounts for more than two-thirds of the economy.

"We've pushed the envelope," Johnson said. "Along with the joy of a market that goes as high as ours is the agony of when it starts to correct itself."

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