

Welcome to Subprime Nation

by **Bill Bonner**

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That's how Stephen Roach put it. The Morgan Stanley economist is in today's paper, explaining why the fall of the dollar is bad news. In its simplest form, a weaker dollar means it takes more dollars to buy things on the open market. This year, for example, Americans will probably buy about \$2.5 trillion worth of goods from overseas. They would get a lot more for their money if the dollar were stronger. Specifically, if the dollar were still worth what it was in 2002, they'd get 20% more. In other words, the dollar has lost 20% of its value – against most foreign currencies – in the last five years.

Against other things, also imported from overseas, the dollar has lost even more value. Zinc has gone up 60% in the last year alone. Nickel is up 125%. Over the last five years, oil has risen 158%. Wheat is 126% more expensive. And the aforementioned nickel has zoomed up 415%.

The dollar fell again yesterday – to another record low against the euro. You now have to pony up \$1.41 to buy a single euro.

Americans who think Bernanke's easy money policy is going to save the economy need to think harder. Lower interest rates are supposed to make credit more abundant. But more credit, we argue, is just what the U.S. economy doesn't need.

In the next 18 months, about 2.5 million households are supposed to be affected by mortgage rate adjustments. The total of the mortgages is about \$350 billion. First think about this: If the dollar were still worth what was worth five years ago, Americans could save about \$500 billion on their foreign purchases – in one single year! The value of all U.S.

assets is about, say, \$50 trillion. A 20% cut is equivalent to a loss of wealth equal to \$12.5 trillion...it is almost as if every single publicly traded company in the United States had gone broke.

Fed rate cuts are supposed to avoid a recession...so Americans don't get poorer. But the lower dollar makes them poorer anyway.

Now, consider this: Most of those subprime mortgages will be adjusted, not based on the Fed funds rate, but on the London InterBank lending rate. And long-term mortgage rates are not the same as the short-term rates. When the Fed cuts rates, it signals to lenders that inflation will increase. This pushes up rates on long-term loans – such as mortgages. So, when the Fed announced its cut last week, long-term rates actually rose almost as much as the Fed's half of a percentage point cut. Now, according to the *Financial Times*, the typical subprime mortgage will be reset to a rate around 10% – a huge increase in monthly expenses for the poor homeowner...and the effects (as we have seen) will be felt throughout the global economy.

Meanwhile, so many negative indicators are coming into headquarters that we feel we need to call in an exorcist. Is a recession on its way? It looks to us as though it has already begun:

Housing inventories are at an 18-year high.

Housing sales (resales) are at a 5-year low.

Housing prices, according to Case/Shiller, fell in America's top 20 cities last month – 3.9%.

Late payments are running well above the historical average.

More than 150 mortgage companies have closed up shop.

While the value of Americans' number one asset is going down, their living expenses are going up. And it looks to us as though they are going to go up a lot more. Why?

Remember, there's a war of prefixes going on. There is no doubt that we are living in a "flationary" world. But what kind of "flation"? "In" or "de"? Each time we approach the question, we hesitate; but now we can give you a definitive answer: Both.

The "flation" in the housing market clearly needs a "de" in front of it. And so does the entire subprime U.S. economy. Yes, dear reader, it is a subprime economy. Like the subprime homeowner, the whole U.S. economy has too much debt, and a lifestyle it can't really afford. The Fed's grand gesture (offering more credit) looks good on TV (the yahoos watching James Cramer must love it) but it doesn't make the debt go away...it can't really stop the inevitable deflation of U.S. financial assets...and it actually increases pressure on the typical household, because it forces up prices.

The U.S. economy now depends on consumers; never has any economy depended on consumer spending more. Nearly three out of four dollars in the GDP are consumer spending.

Last week, retailers' sales fell 1%. Consumers would like to spend. But where will they get the money?

Tax receipts are down. August employment numbers showed that jobs are disappearing. And there are 1.3 million real estate agents in the country whose incomes must be falling.

Meanwhile, over on the "in" side of the "flationary" battlefield, the forces of rising prices are gaining firepower too.

A report at *USA Today* tells us that this winter's heating costs will probably average about 10% more than last year for the typical family.

Commodities will be "skyrocketing," says our old friend Jim Rogers – because now the world has turned. All those millions of people in Asia, who were willing to work for such low wages, are now becoming consumers. What does a consumer consume? Nickel...copper...wheat...soybeans...

"Inflation lurking on global horizon," says a headline in today's *International Herald Tribune*. "Globalization..." says the article, "is clawing back some of the benefits it delivered to Europe and the United States over the past decade, and higher prices are an increasingly likely result."

Yes...dear, dear reader. The world turns...and turns...and turns again. Every time you have the warm sun on your face and the breeze at your

back...something happens. The world turns. The next thing you know, the sky is as dark as pitch...and a gale is blowing against you.

The poor subprime nation had it so good for so long. What a pity the world turns. Now, it seems to be at the twilight of a magnificent – if preposterous – era...in which Americans could spend money they didn't have on things they didn't need and not have to worry about what happened next. But now we find out. And we find ourselves in the worst possible situation – squeezed between the two prefixes like a skinny word in a fat dictionary. Deflation is taking the oomph out of our economy and the value out of our assets. Inflation, meanwhile, is increasing the cost of everything we buy.

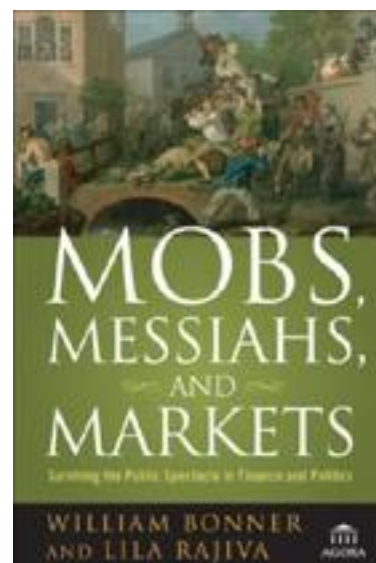
When globalization was just getting going it was a great thing for the rich countries. They could outsource manufacturing and other labor-intensive industries. Even at home, they could import – or let sneak across the border – millions of foreigners to do the dirty work. Profit margins rose as labor costs fell. And even though the price of raw materials was edging up, the lower labor expenses more than made up for it.

But that darned planet...it just keeps turning! Now, the Asians have a little change in their pockets and they're getting uppity. They want to buy OUR oil...our wheat...our nickel...our copper...and our beef. So prices are rising – OUR prices.

And now, get this, Chinese producers say their labor costs are rising too. "This development," reports the IHT, "a long-time coming in China, has picked up as coastal regions full of cheap workers begin to experience labor shortages."

Yes, those millions of Asian schleppers and bussers...whom we were nice enough to employ in unheated sweatshops at \$1 an hour...now want more money! The cheek.

The dollar is going down...along with the value of almost all U.S.-centric, domestic, dollar-priced assets. Stocks. Bonds. Wages. Houses. That's where the "de" in deflation comes from.





But it could be worse. In fact, it is worse.
There's the other kind of "flation" too.
Now, Americans will have to pay more for everything – energy, food,
housing....

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*Bill Bonner [send him mail] is the author, with Addison Wiggin, of
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