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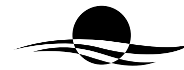
Trend Analysis That Builds Business Decisions



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1 – MORE ON THE PRESIDENTIAL ELECTION

Well, I gave myself an out, didn't I? Yes, I wrote last month that no President had been reelected in such poor economic conditions since FDR during the Depression, so I did not expect Obama to manage it. But he *has* (and our situation *is* Depression-like, hidden – and not so hidden – behind trillions of dollars of debt and spending). And just as in the 1930s, conditions may have to get worse before they get better. I hope this does not mean war, but for those who are interested in a powerful view of history as cyclical, read the article linked here:

My election "out" – my prediction caveat – was that if the coalition of special interests on which the Democrat Party is built each turned out and voted their own interests first, then maybe the President could be reelected. That's exactly what happened, with a vengeance. One of my best "fans" wrote me the following email on the day after the election:

> I'm shocked. And saddened. More than anything I am heartbroken over the state of the American people. I'm not devastated that they didn't elect Romney. But how could they possibly reelect Obama? Have we lost our country? Are there more takers than makers?

I had to respond that according to three recent books by well-respected authors, the answer is yes. They are the following:

A Nation of Takers: America's Entitlement Epidemic

(Nicholas Eberstadt)

One of the country's foremost demographers details the exponential growth in entitlement spending over the past fifty years. As he notes, in 1960, entitlement payments accounted for well under a third of the federal government's total outlays. Today, entitlement spending accounts for a full two-thirds of the federal budget. Eberstadt does not just chart the astonishing growth of entitlement spending; he also details the enormous economic and cultural costs of this epidemic. He powerfully argues that while this spending certainly drains our federal coffers, it also has a very real, long-lasting, negative impact on the character of our citizens.

A Nation of Moochers: America's Addiction to Getting Something for Nothing

(Charles Sykes)

Have we reached a tipping point where more Americans depend on the efforts of others than on their own? Charles Sykes argues that we have: from the corporate bailouts on Wall Street, to enormous pension, healthcare, and other entitlement costs, to questionable tax exemptions for businesses and individuals, to the alarming increases in personal default and dependency, the new moocher culture cuts across lines of class, race, and private and public sectors.

Millions of Americans, writes Sykes, are being forced to pay for the greed-driven problems of other people and corporations; increasingly, those who plan and behave sensibly are being asked to bail out the profligate. Sykes' argument is not against compassion or legitimate charity, but distinguishes between definable needs and the moocher culture, in which self-reliance and personal responsibility have given way to mass grasping after entitlements, tax breaks, benefits, bailouts, and other forms of feeding at the public trough.

A Nation of Deadbeats: An Uncommon History of America's Financial Disasters

(Scott Reynolds Nelson)

Nelson offers a crash course in America's worst financial disasters – and a concise explanation of the first principles that caused them all. Nelson shows how consumer debt, both at the highest levels of finance and in the everyday lives of citizens, has time and again left us unable to make good. The problem always starts with the chain of banks, brokers, moneylenders, and insurance companies that separate borrowers and lenders. At a certain point lenders cannot tell good loans from bad – and when chits are called in, lenders frantically try to unload the debts, hide from their own creditors, go into bankruptcy, and lobby state and federal institutions for relief. Sound familiar?

2 — MORE ON HOUSING FOLLIES

My other item last month was on the dismal state of the housing market; I wrote that that "the housing market is an artificial, even fraudulent market, anything but a free market where inventory is allowed to clear and prices are allowed to find a clearing point." Here are some of my further thoughts, the first parts of which are written, admittedly, with sarcasm in order to emphasize some important points:

We Elites Prospered While Killing the Singular Trend that Built America, And All You Proles Got Was a Dysfunctional Housing Market

By Roger Selbert

In a reversal of more than 100 years of American history, the singular trend that built the United States and the wealth of its inhabitants – geographic convergence – has been killed. Based on labor mobility and the income convergence it engendered, geographic convergence was our great equalizer, our socioeconomic outlet, our economy's ace in the hole: even in the worst of times people could always move from where they were to somewhere else to improve their prospects. Well, they can't anymore, and the reason is housing.

Who killed geographic and income convergence? Well, we did. We wealthy, older, property-rich elites in desirable zip codes. Call us the new landed gentry if you like. I would like to say we're really, really sorry but I don't see us doing anything to correct it. It wasn't on purpose; it was an inadvertent, unintended consequence of well-intentioned laws and regulations concerning land use, zoning, building codes, permits, property taxes and the like. We didn't undertake those restrictions on building and development specifically to exclude you people (wait – did I just say "you people?" I never say "you people!") Why heck, we're concerned as all get-out about rising inequality and income disparity (just not in our own neighborhoods, okay?). And besides, residential segregation is voluntary, isn't it? Didn't you read "The Great Sort"? We all naturally prefer to cluster among similar socioeconomic strata, don't we?

You see, we used to have something in this nation called "the housing market." This consisted of buyers, sellers, and the supply of homes for sale. Today the housing market is an artificial, even fraudulent market, anything but a free market in which inventory is allowed to clear and prices are allowed to find a clearing point. Millions have defaulted (and millions more are in the pipeline). Because of this massive shadow inventory of underwater and foreclosed homes that is only slowly being leaked out to market, there are millions of people who can't sell the house where they live, millions who can't buy a house where they want to live, and millions who may never get

a foot on the housing ladder at all (maybe a good thing, if the decline of housing as a store of wealth is structural, not cyclical).

The government response (bless 'em, they do represent us) is to do everything possible to keep housing prices inflated. Interest rates are kept absurdly low (if you can qualify, and we do!); the federal government now guarantees 90% of all mortgage loans (defaults and delinquencies are staggering, but so what?); inventory is being constrained by banks which have not only been bailed out, but given the ability to rewrite accounting rules, for example suspending mark-to-market and taking years to move on non-performing loans (some of your neighbors haven't made a mortgage payment in years but have yet to receive a notice of default). The result? Why, in some markets, housing mania has returned! Flippers and non-resident investors are flooding in and crowding out people who actually want to buy homes in which to live. We're inflating the bubble again. Thank you so much (don't mind the feudalism)!

All of this allows us to continue to buy expensive homes with low down payments and monthly payments (relative to income, of course, and ours is larger than yours), max out the tax deduction on the back-end, and escape capital gains taxes on the first $500,000 of profit on the sale of a home. Sweet. I guess they're trying to goose consumption but with your household incomes flat, it doesn't seem to be working.

HOW WE GOT HERE

In a recent working paper two Harvard economists, Peter Ganong and Daniel Shoag, explain that geographic and income convergence started to slow in the 1960s, when rich people in rich places started constraining land use through regulation. This limited the housing supply in those places, which forced housing prices up, and started to squeeze out those with lower incomes. Up until that time, throughout American history, poorer people could move to where the money was and improve their prospects.

Housing prices have always been more expensive in high-income places, but the difference now is unbridgeable. The result is that people can't get on the upward mobility ladder, thus increasing the inequality that these same elites bemoan. But they don't see or understand the connection between this income divergence and their own regulations and restrictions.

WHAT TO DO?

I recently had the opportunity to contribute to a symposium hosted by CORE (National Community Renaissance), one of the largest nonprofit affordable housing development corporations in the United States. As a catalyst we used an article by Joel Kotkin and Steve PonTell, CORE's President and CEO, "Is the Dream Dead? Housing's Next Challenge." In the piece the authors note that homeownership is at a 15-year low despite the fact that home-ownership is now cheaper than renting in most of the top 100 metro areas, but that lower housing prices have not done much to improve the conditions for lower-income people. Indeed, as people who would normally own housing become renters, price pressure has actually worsened for renters.

Housing has traditionally been the main way Americans accumulated assets, created wealth, raised families, and became part of communities, contributing to social stability and tranquility. But housing is only one factor squeezing lower and middle income Americans; in fact the real culprit has been stagnant and even declining incomes. The authors recommend two main approaches to dealing with the problem: regulatory reform that would allow for the construction of new market-friendly housing, and economic development to boost opportunities and income.

The authors conclude: "Providing low-cost housing to low-income residents may solve a temporary

problem, but it does not get at the heart of the matter. Housing developers and advocates need to become economic developers and business advocates if there's any hope to restore the American dream to its rightful place for the next generation." This is refreshing because as I read it, it is saying that if you want to champion those less well-off, the way to do it is not to give them housing and income, it is to take away the barriers to housing and wealth creation. In other words, solutions that are less government-centric and more community-centric will be more effective.

By the way, according to Arnold Kling of George Mason University, maybe home ownership is not the be-all and end-all we have assumed.

Home ownership subsidies, writes Kling, have imposed costs on the economy and society that are large and clear, while the benefits of such subsidies are, at best, small and vague. Of course the calculation looks different to real estate agents, mortgage bankers, and their allies in the housing lobby. That is why good public policy, concludes Kling, would be to do the opposite of whatever they recommend.

3 – MORE ON BANKING FOLLIES

BANKS THRIVE, NOT BORROWERS

The Federal Reserve is spending $40 billion a month to reduce mortgage rates to encourage Americans to buy homes. Instead, its policies may be generating more benefits for banks than borrowers. So reports the Washington Post.

Since the Fed announced its mortgage initiative, rates have ticked down. But banking analysts say the cost of issuing the loans has fallen much more, significantly boosting bank profits. JPMorgan Chase and Wells Fargo, the nation's largest mortgage lenders, both report sharp growth in their home loan businesses, revenues and profits.

The reason why mortgage bankers are seeing so much green is that the gap has widened between what banks charge a homeowner in interest rates and what they must pay those who finance mortgage lending. The latter has dropped significantly, largely as a result of the Fed's actions. With such large profit margins, government officials hope banks will eventually drop rates for homeowners. But they cannot force the companies to do so.

DODD-FRANK IS A GIFT TO BIG BANKS

Big Wall Street banks caused a financial crisis and brought the nation to the brink of economic collapse; President Obama signed the Dodd-Frank Act to punish those banks and end government bailouts of too-big-to-fail financial institutions. But as many analysts and officials have explained, Dodd-Frank subsidizes large, influential Wall Street financial institutions, while imposing disproportionately heavy burdens on Main Street banks and the communities they serve. Even if we take Dodd-Frank's supporters at face value when they protest that they actually intended to rein in Wall Street banks, the laws they passed accomplish the opposite result.

So write C. Boyden Gray and Adam White in the Weekly Standard. In short, Dodd-Frank's "liquidation" provisions will not actually end too big to fail – they will sustain it. Nor can it truthfully be said that "taxpayers" will not fund the liquidation process. Under Dodd-Frank, the Treasury Department and FDIC can fund liquidations by imposing fees on financial institutions – fees that ultimately are passed through to the taxpayers and others who own the stock of those fee-paying companies or who are the companies' customers. Bankers, however, say they are hesitant to expand their mortgage operations because of stricter federal standards.expand