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DO ADJUSTABLES DAMAGE GROWTH?

A significant share of all outstanding mortgages have adjustable interest rates, and the majority of these will reset in 2007 and 2008 at much higher rates, says a new study by First American Corelogic, a subsidiary of First American Title Co. Adjustable rate mortgages, or ARMs, are loans that begin with relatively low payments and then reset at a higher rate. There are many variations, but most offer a "teaser" interest rate (as low as 1 percent) for the first two or three years before resetting.

ARMs account for about 30 percent of all mortgages—and 75 percent of subprime mortgages—and they can have a big impact on household budgets. The Corelogic study shows that over the next two years 60 percent of all ARMs made since 2004 will have their payments increase by 25 percent or higher, and 25 percent will increase by 50 percent or more.

Just what could these resets mean to the typical family? Monthly payments for the median family (with a median annual income of $58,000) could rise from about $1,100 per month to $1,400 to $1,700, increasing the mortgage payment from about 23 percent of income to about 35 percent. A family on the South Coast with a 1 percent initial teaser rate and typical loan amount of $600,000 could see their monthly payments double over that time.

A recent variation that attempts to address the problem of unlimited negative amortization is the so-called Option ARM, where both the payment and underlying interest rate can be fixed for 3, 5, or 7 years. This offers some security, in that the real interest rate won't fluctuate and so increase the amount of negative amortization added to principal. But in fact the maximum increase cap is usually 115 percent of the initial loan amount, which is also reached in 3 years. Its payment will then jump to the fixed underlying interest rate, which is 6.5 to 7, depending on the margin or spread added to the ARM index, a payment jump of as much as 6 percent!

Many low- and middle-income families were already squeezed by this recovery. The median income has fallen 5.4 percent for non-elderly households under 65 years of age since 2000, according to the

Economic Policy Institute, a labor think tank. As family budgets are already being pinched by higher energy and food prices, that may turn out to be small change compared to the impact of higher home mortgage payments.

A major sign of economic health is employment, of course. The April jobless rate rose from 4.4 to 4.5 percent, perhaps a sign of slower growth ahead. The Federal Reserve Open Market Committee meets next week, but few analysts expect any change in the 5.25 percent target interest rate. The Fed has said it's worried that inflationary pressures will not ease as expected, while evidence on the growth side of the economy has been mixed.

UNEMPLOYMENT-- The headlines of the report were weak, but the details were even weaker.

Nonfarm payrolls rose just 88,000 in April, according to the establishment survey. That's the weakest job growth in 29 months. Payrolls have grown by an average of 129,000 per month so far this year, down from 225,000 at this time last year.
In the separate household survey, employment plunged by 468,000, the most since November 2002.

The unemployment rate rose to 4.5 from 4.4 percent, but the increase would have been larger except 392,000 potential workers dropped out of the labor force altogether, the biggest decline in the labor force in nearly four years. Unemployment grew by 77,000 to 6.8 million.
The average workweek declined, and total hours worked in the economy dropped by 0.4 percent and the average wage growth was tepid, rising just 4 cents to $17.21, a 0.2 percent gain.

Many economists are attributing the employment slowdown to reduced consumerspending, which is being blamed in turn on the rising default rate in both prime and subprime adjustable rate mortgages. For example, financial firms shed 11,000 workers, including 8,000 in commercial banking and 1,000 in real estate, according to the jobless report. "The subprime mortgage story may be finally showing up in the payroll data," said one economist quoted on CBS Marketwatch.

But consumer spending has been weakened only slightly to date. Other indicators, such as the ISM factory and service sector surveys, increased in April. Consumer confidence also rose in the latest U. of Michigan survey. So it is too soon to conjecture when the Fed will begin to take their foot off the economic brakes.

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