

Consumers are Roaring Back!

By Harlan Green

A little noted Federal Reserve report on consumer debt just pulled a big surprise. Consumers are borrowing on their credit cards again. Though personal consumption contracted in June, you'd never know it from consumer credit data, which show a \$15.5 billion surge for the largest gain in more than four years. The gain is led by a \$10.3 billion surge for non-revolving credit, less of a surprise given June's strength in motor vehicle sales, says Econoday. But the best news may be revolving credit which rose \$5.2 billion for a second straight solid gain. Are consumers really beginning to spend again? If so, look for higher GDP growth ahead!

This is important because the personal consumption expenditures (i.e., consumer spending) has not yet recovered from the recession. Last Friday, the BEA released revisions for GDP that showed the recession was significantly worse than originally estimated, mostly because consumers had cut back. And Personal Income less Transfer Payments is one of four indicators the National Bureau of Research (NBER) uses in business cycle dating to determine recessions.

Here is Calculated Risk's graph on the historical fluctuations in personal income that happens during recessions that was just revised downward. Prior to the revisions, the BEA reported this measure was off close to 7 percent from the previous peak at the trough

of the recession. With the revisions, this measure was off almost 11 percent at the trough - a significant downward revision and shows the recession was much worse than originally thought.

But the graph shows that it has improved to less than 5.1 percent from its prior peak. Combined with a rise to 5.4 percent in the personal savings rate in July, this is another sign that consumers are regaining their financial health.

Another sign of better consumer health is robust vehicle sales in July. Unit sales show a big monthly gain, up nearly six percent vs June to a 12.2 million annual rate. The gain points to relief for the motor vehicle component of the retail sales report which has posted four straight declines in the aftermath of the March earthquake and tsunami that disrupted the Japanese supply chain.

And finally, jobs are returning as the Bureau of Labor Statistics (BLS) reported 117,000 non-farm payroll jobs created, with the unemployment rate dropping back to 9.1 percent, and a good jump in average hourly wages, also a big relief from last month's jobs report.

The U.S. economy added an even larger 154,000 in the private sector while the unemployment rate fell from 9.2 percent, partly because 193,000 people dropped out of the labor force, according to the latest government data. Job gains in May and June were also revised up by a combined 56,000, the Labor Department reported last Friday. Average hourly wages rose 10 cents to \$23.13, though the workweek was unchanged at 34.3 hours.

We can hope that with the debt ceiling crisis on the back burner until after the 2012 election, the focus will return to job creation. There are lots of ways to create jobs in the private sector, and pressure will increase for politicians to do something about it.



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Mortgage Interest Deduction Gets New Scrutiny

By CAROLYN LOCHHEAD
San Francisco Chronicle

Ending tax breaks for oil, corporate jets and hedge fund managers is nearly every Democrat's favorite way to reduce the federal debt. But one of the biggest tax breaks of all is the mortgage interest deduction, and its benefits are heavily concentrated in a handful of pricey cities, none of which votes Republican.

As Congress' new deficit-reduction committee sets about finding another \$1.5 trillion to trim by Thanksgiving, tax breaks of all kinds, including the interest deduction, are getting new scrutiny. Beloved by the public and the real estate industry, the deduction will cost the government more than \$1 trillion over the next decade.

But few homeowners, even those claiming the deduction, know how skewed it is by region and by income.

Just three metro areas — greater New York, Los Angeles and San Francisco — receive more than 75 percent of the subsidy, according to a 2004 study by economists Todd Sinai and Joseph Gyourko. The tax break is available to anyone who borrows up to \$1 million for a mortgage — including for a vacation home — or takes as much as \$100,000 in a home equity loan.

The bigger the mortgage, and the higher one's income, the bigger the deduction. A person in the top tax bracket of 35 percent who borrows \$1 million can get a tax break of \$17,500. That's on top of a slew of other subsidies such as preferential capital gains taxes on the sale of a primary residence, deduction of local and state property taxes, and subsidies to mortgage giants Fannie Mae and Freddie Mac.

By comparison, households earning less than \$75,000 get less than \$200 in savings from the deduction. More than three-fourths of taxpayers do not itemize, and so don't claim the deduction at all. Those who rent or have paid off their mortgages, most of them seniors, get no benefit.

The chief recipients are younger, well-off households that receive "a big incentive to increase the size of their mortgage or house," said Eric Toder, co-director of the Tax Policy Center, a joint research group of the Urban Institute and Brookings Institution.

The deduction's value rises with the cost of a home, suiting pricey real estate markets such as San Francisco and Manhattan, or hot vacation spots such as Aspen, Colo.

Californians receive 2 1/2 times as much in mortgage interest deductions as Texans, and have for decades. Residents of the Dakotas, Mississippi and Arkansas regularly receive among the lowest share of benefit.

The deduction is the second-largest federal tax expenditure — a subsidy program that operates through the tax code. The largest is the exclusion of employer-paid health insurance from taxes. Such tax breaks, economists say, are identical to granting a direct subsidy. Tax rates for everyone have to be higher to make up for the revenue loss. Once created, tax expenditures need no congressional review.

"Among the very large tax expenditures, I think the mortgage interest deduction is one of the worst," Toder said.

That's because it encourages people to increase debt, distorts the housing market, sucks investment from more productive activities and subsidizes the well off, economists said.

"All that said, I love mine," conceded Maya MacGuineas, president of the centrist Committee for a Responsible Budget, who has proposed with Harvard economist Martin Feldstein to cap all tax subsidies, including the deduction, at 2 percent of income.

"An easier way to improve our tax code than going after each individual tax break, which each has its own constituency, is to find a way to kind of wrap them all together and cap them," she said. "So if one guy has three tax breaks, and another guy has 27, those 27 are probably going to end up in total being capped so they don't exceed 2 percent of total income."

Total tax expenditures now cost nearly \$1.3 trillion a year, as much as this year's deficit.

Several prominent panels that have laid the groundwork for the new committee — including the Erskine Bowles/Alan Simpson commission sponsored by President Obama and a plan by former Clinton administration budget chief Alice Rivlin and former New Mexico Republican Sen. Pete Domenici — call for replacing the deduction with a tax credit.

The deduction is "ingrained in the notion of the American dream," said Dean Stansel, an adjunct fellow with the libertarian Reason Foundation and an economist at Florida Gulf Coast University. "As it turns out, only 25 percent of people take the deduction."

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