The second wave of mortgage defaults and foreclosures will hit the economy this year

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As we have been forecasting for the last two years, the second wave of mortgage defaults and foreclosures will hit the economy this year. Not only will we have failure in prime loans and option-arm loans, but we are faced with a new crop of subprime and ALT-A loans put into motion by Fannie Mae, Freddie Mac, Ginnie Mae and FHA. In addition, we find it of great interest that the FHA is changing the rules to purchase homes. That, of course, means less homes will be purchased.

The incidence of unemployment may be lessening, but it isn't going away. Those of you who keep your ear to the ground know that real unemployment is 22.5% and in cities like Detroit it is somewhere near 45 to 50 percent. This is the result of free trade, globalization, offshoring and outsourcing. No city in America has been deprived of their livelihood more than Detroit. Yet, this is only the beginning. If allowed to continue 30 percent more of our jobs will be allowed to leave America, making our country an economic basket case over the next 20 years. The $25 billion that our federal government is about to loan to the states will help keep unemployment paying out and save some 40 states from going into bankruptcy. That will keep some Americans going but not for long.

Foreigners are buying less and less US dollar denominated assets, specifically Treasury and Agency bonds. As an example, Russia is buying Canadian dollar denominated assets. We ask how does the US fund its debt and its growing debt? The administration is planning for some sort of exchange of retirement funds for a government guaranteed annuity. That is so they can fund their enormous debt domestically as Japan has done for almost 20 years. Who would want to have a government guaranteed annuity from a bankrupt nation? It should also be noted that these retirement plans are still vastly under funded. What will happen if the Dow again revisits 6,600 and these funds' assets again fall 40 percent? The collateral behind any annuity would be almost cut in half. We will have to see what the government comes up with but any kind of voluntary plan would in time become a mandatory plan. The funds may well be funneled to insurance companies, so they can take part of the action, but they will be buying Treasuries and Agencies with those funds, you can take that to the bank. One of the rumors floating about is that a new 5 percent tax will be foisted upon what is left of American taxpayers, in the form of forced savings, which would be in the form of an annuity. The need for funds to run the government is advancing by more than 10 percent a year, as government becomes bigger and bigger. We see no abatement in Marxist, socialist or fascists in government in their desire to spend to make government ever bigger.

The public is howling for blood, particularly from banking and Wall Street, and rightly so, but the main culprit was the Fed and in third place lies our government. In populist pose our

President wants to tax Wall Street and banking for looting our economy. We might remind our President that these are the very people who financially put him in office. There is also talk emanating from the Oval Office of breaking up the banks, so that the too big to fail problem will be solved. This is the result of trillions of bailout funds for banks, which then post outsized mega profits, and little or nothing to assist the taxpayer. Investigations are going on to find out what caused the collapse of the system, but Americans believe they will go nowhere. The main brokerages and banks that caused most of the problems are the owners of the FED, the 12 regional Fed banks and the legacy, money center banks in NYC. How far do you have to investigate to find that out? Billions are being paid out to banks' top employees, money they made with the assistance of a taxpayer bailout. The public believes it is unfair and they are right. As an example, Lloyd Blankfein, CEO of Goldman Sachs, who says, "He is doing God's work," will receive $100 million as the unemployment lines lengthen day by day. The President in his new budget says he will spend $100 billion creating jobs for Americans and $25 billion will be loaned to 40 states, so they can pay extended unemployment benefits. The gap between the haves and have-nots grows wider.

As a result of the changing of the guard in who rules Wall Street and Washington, JP Morgan Chase has again surged to the forefront and with them former Chairman of the Federal Reserve, Paul Volcker. This time his role will be more subdued then it was in the early 1980s. He cannot advocate a purging of the system as he did in the early 80s, because the financial system has been allowed to go too far. Any such purge would take the system down; something of that nature should have been done three years ago. Mr. Volcker wants banks to go back to taking deposits, making loans and to return to 8 to 10 to one leverage, not 40 to 70 to one. He believes banks should not have proprietary trading operations and that they should be transferred into unregulated hedge funds. That would solve very little. The change would be cosmetic. Then again isn't that what government, Wall Street and banking are all about – subterfuge?

The administration and Congress refuse to deal with ever growing debt in spite of its decaying affect on our financial structure and banks and many other corporations are carrying two sets of books and refuse to deal with toxic assets. The Fed has purchased $900 billion of these toxic assets and they won't tell us what they paid and from who they bought them from. Monetary growth continues and much of it sits on bank balance sheets having borrowed it from the Fed, where much of it lies gaining interest that is being paid by the taxpayer. Those are costs that are deducted from any profit the Fed makes that is returned to the Treasury. In addition, overall there is no transparency and the gambling by Wall Street and banking goes on unabated just as it has in the past – the sort of high velocity risk that caused all these problems in the first place. Much of what they do is off balance sheet. The next three years will see lenders buried in falling commercial real estate, so the death dance won't end for some time to come.

The banks and hybrid brokerage-banks are all involved in flash trading, which is more appropriately known as front running. They continue to engage in naked shorting and the SEC stands by and does nothing. This gambling and criminal activity is funded by the Fed via very cheap loans. Then there is their business and relationship with totally unregulated hedge funds. The money center legacy banks are growing not shrinking and now control more than 70 percent of global banking assets. You add this all up and you find you have a financial oligarchy that is gaining in dominance not shrinking, as Wall Street would have you believe. While this transpires our President and Congress have doubled the federal deficit. The previous two administrations and the current one have taken debt from almost nothing

to $12.3 trillion, which will be $14.3 trillion by December. Even the Fed's debt has risen to $2.2 trillion having engorged themselves on bonds from Agencies, Treasuries and with toxic waste. The Fed is lying about their holdings; they purchased 80 percent of last year's Treasury debt. What they did was stuff billions in purchases under other investors – household, which is ludicrous.

While the Fed went overboard lending, extending credit and buying paper, the government saw spending grow 13 percent, not counting $200 billion for wars as tax revenues fell 14%. Household debt only improved slightly but is still 165% of disposable income. That is as unsustainable as is the public making up 69.5% of GDP.

America is nowhere near solving its debt problems and in fact the situation is worsening. That means in the second half of the year we could see a drop in the US credit rating. This problem is true worldwide. US debt to GDP could be 85% by the end of the year with Germany at 80% and Ireland 83%. As you can see many nations have debt problems. All nations have and are continuing to debase their currencies versus gold, which will range higher as continued debauchery takes place.

The number of mortgage applications in the U.S. rose 21 percent last week to the highest level in more than a month as refinancing rebounded.

The Mortgage Bankers Association's index rose to 620.7 in the week ended Jan. 29 from 513 in the prior week. The group's refinancing gauge increased 26 percent, while the purchase gauge rose 10 percent.

The gain in purchase applications may be the first sign a renewed and expanded government tax credit is stirring demand after sales dropped late last year on expectations the incentive would expire. The market, faced with mounting foreclosures and 10 percent unemployment, may need continued government assistance to sustain gains in the second half of 2010.

"Both mortgage rates and house prices remain low, but the market lacks a catalyst for a vigorous recovery," Michael Larson, an analyst at Weiss Research in Jupiter, Florida, said before the report. "We're muddling through."

The mortgage bankers group's refinancing gauge increased to 2,854.8 from 2,260.4 the prior week. The purchase index rose to 237.8 from 215.6.

The average rate on a 30-year fixed loan fell to 5.01 percent from 5.02 percent the prior week, the group said. The rate reached 4.61 percent at the end of March, the lowest since the group's records began in 1990.

At the current 30-year rate, monthly borrowing costs for each $100,000 of a loan would be $537.43, or about $17 less than a year ago, when the rate was 5.29 percent.

Mohamed A. El-Erian, whose firm runs the world's biggest mutual fund, said the largest stock market decline in 11 months may worsen amid persistent U.S. joblessness and economic growth that trails analysts' forecasts.

Investors have wrongly priced in an "orderly" withdrawal of stimulus measures, a rebound in bank lending and coordinated government policy to restore growth, the chief executive

officer of Pacific Investment Management Co. wrote in a Bloomberg News column. That means Wall Street projections for gains in 2010 may prove incorrect and prices will slump, he said.

“Investors may well find that January’s global equity sell-off was just a precursor to a disappointing year for several asset classes,” El-Erian, 51, wrote. “The global financial crisis has undermined growth and job creation; it has clogged many of the pipes that allocate funds to productive uses; and it has rapidly taken public debt and the budget deficit to worrisome levels.”

A “safe harbor” agreement that protects the underlying assets of securities held by failed banks from being seized by U.S. regulators may be kept in place beyond March, a Federal Deposit Insurance Corp. official said.

FDIC officials had wanted to exempt all assets securitized through March 31 to ensure a smooth transition to a new accounting rule that rattled credit markets because of the prospect of more aggressive asset seizures.

“I think it’s safe to say that we will need to extend the March 31 safe harbor period,” Michael Krimminger, a special policy adviser to FDIC Chairman Sheila Bair, said yesterday at the American Securitization Forum’s annual conference near Washington.

New accounting rules sparked concern among bond buyers and rating firms that the FDIC would be able to tap the pools of debt underlying credit-card securities to protect its deposit insurance fund after banks fail. The concern halted sales of such bonds in October and early November after issuance totaled $10.7 billion in September, according to data compiled by Bloomberg.

Policy makers are seeking to transform the almost $4 trillion U.S. market for securitizations not created by government-supported entities. Risky lending enabled by asset- backed bonds and investor losses on debt including subprime- mortgage securities contributed to a collapse in the world’s economies.

The US economy appears to be positioning itself to make the vital turn to positive job growth by beating market expectation only losing 22,000 positions in January while forecasts had called for 35,000 persons to join the unemployment roles. January’s figures mark the lowest job destruction recorded since February 2008 when the recession pushed the job market into negative numbers as well as the eleventh straight month of a slowdown in the number of jobs shed.December’s reading was also revised upwardly to -69,000 from the originally reported -84,000.

Employers announced 71,482 planned job cuts last month, up 59 percent from December and the most monthly job cuts since August, according to the report from Challenger, Gray & Christmas, Inc, a global outplacement consultancy.

“The increase in January is not necessarily a sign of a recession relapse. It is not uncommon to see a surge in job-cut announcements to begin the year,” said John Challenger, chief executive of Challenger, Gray & Christmas, in a statement.

“Companies are making adjustments based on the previous year’s results and the outlook for the year ahead. The beginning of the year is particularly rough on retail workers, as these employers enter one of the slower sales periods of the year,” he said.

The January job cuts were up from 45,094 in December and marked the first increase since July. December had marked the fewest job cuts in 24 months.

Still, the planned layoffs remain well below year-ago levels, when planned job cuts hit 241,749 in January 2009, the peak of downsizing activity in the recession.

Technology wages in Silicon Valley, home to Google Inc. and Intel Corp., have declined almost 14 percent since 2000, a sign that the region has yet to recover fully from the dot-com bust.

The average compensation for technology workers was $103,850 in 2008, down from $120,064 in 2000, with the biggest drops caused by the falling value of stock-based pay, the U.S. Bureau of Labor Statistics said today in a report. Average wages increased to $105,500 in the first half of 2009.

The Internet bust triggered job cuts across Silicon Valley, with semiconductor makers, Internet startups and telecommunications companies taking the largest losses. Silicon Valley, which runs from San Francisco to San Jose, will probably be slow to recover from the latest recession, said Amar Mann, an economist with the Bureau of Labor Statistics.

"We agree with more of a U shape, a gradual rise," Mann said today at a press conference. Declines in venture capital investment resulted in slow technology-job growth in past economic cycles, a pattern that the current recovery will likely follow, he said.

Silicon Valley has lost 134,000 technology jobs since 2000, including 30,000 during the nine months ended in June. The six- county region now has about 410,000 technology jobs, Mann said. The area lost jobs from 2000 to 2004, then added positions before the latest recession, he said. Technology accounts for about one in seven local jobs. http://www.dailyjobcuts.com/

The end of a Federal Reserve program that helped unlock credit markets is spurring sales of asset- backed bonds with relative yields five times wider than on debt secured by car loans.

The expiration of the Fed's Term Asset-Backed Securities Loan Facility is driving companies to sell bonds tied to loans that would otherwise require higher yields. Borrowers are offering bonds backed by subprime auto loans, mortgage-servicing payments and assets that have proved hard to sell after the worst credit seizure since the Great Depression.

"What we are seeing in the last couple of rounds are issuers in non-traditional asset classes and weaker issuers looking to fund as much as they can before the window closes," said James Grady, a managing director at Deutsche Asset Management in New York. The firm has $240 billion in assets under management, including asset-backed securities.

Ally Bank, a Midvale, Utah-based unit of GMAC Inc., is selling $750 million in so-called floorplan securities backed by payments on loans that finance cars on lots. Nissan Motor Co., in Yokohama, Japan, issued $900 million of the debt last week. Sales total $3.35 billion this year, including deals being prepared, compared with $3.9 billion all of last year, according to Informa Global Markets in New York.

The bonds offer investors higher relative yields because the collateral is considered riskier. Ally Bank's sale of AAA debt backed by floorplans may yield 1.75 percentage points more than swap rates, compared with a spread of 0.35 percentage point for top-rated auto-loan

bonds, according to Bank of America Corp. data.

The annual revision of US employment to be issued tomorrow, February 5, will show that the US labor market was even worse off than was known during the deepest stretch of the recession when it shed 824,000 jobs from April 2008 to March 2009, reports Bloomberg. This would make it the worst 12-month period for the American worker in 18 years.The Labor Department's annual revision adjusts the monthly figures which, according to Bloomberg, suffer a flaw in assuming that the number of company closings is offset by new ones opening, the so-called "birth/death model". This means that in times of a deep economic downturn when the number of companies going under greatly outstrips the number of those starting up, the monthly model gives a positively distorted vision of the labor market.

Service industries in the U.S. expanded less than anticipated in January, a sign the recovery will be slow to spread from manufacturing to the rest of the economy.

The Institute for Supply Management's index of non- manufacturing businesses, which make up almost 90 percent of the economy, climbed to 50.5 from 49.8 in December, figures from the Tempe, Arizona-based group showed today. Readings above 50 signal growth. Other reports showed firings eased last month.

The Obama administration's plan to cut more than $1 trillion from the deficit over the next decade relies heavily on so-called backdoor tax increases that will result in a bigger tax bill for middle-class families.

In the 2010 budget tabled by President Barack Obama on Monday, the White House wants to let billions of dollars in tax breaks expire by the end of the year — effectively a tax hike by stealth.

The US Treasury reports withheld taxes of $140.381B for Jan 2010; FYTD is $547.710B. For January 2009 withheld taxes are $151.285B; FYTD is $597.593B. Jan 2010 withheld taxes are down 7.2% y/y; FYTD is down 8.35%. January NFP should continue to show job losses. But it could be crafted to show unrealistic strength like the ridiculous Q4 GDP of 5.7%, or seasonally adjusted employment surveys.

Fifteen months after Fannie and Freddie were effectively nationalized; neither the Obama administration nor Congressional leaders see a quick solution to one of the thorniest problems in.

American finance: how to fix the twin mortgage giants without choking the flow of credit to homeowners and dealing a blow to a still-fragile housing market. But for now, the only real consensus is that no one quite knows what to do with the companies.

Just as the recovery of securitisation around the world was gathering momentum, the asset class is facing another disastrous blow. This time, its nemesis is the judge handling the bankruptcy of Lehman Brothers, who announced a ruling last week that threw out a crucial assumption about the subordination of failed swap counterparties.

A swathe of deals now face downgrades and new deals may be much harder to sell. William Thornhill and Matthew Davies report.

Last week a US bankruptcy court passed a judgment that threatens the future of the structured finance industry. If upheld, the ruling would have "profound effects on structured

finance transactions because it challenges long-held assumptions relating to the subordination of swap termination payments to a swap counterparty following a swap counterparty bankruptcy", said Moody's.

US law firm Cleary Gottlieb Steen & Hamilton shares those concerns. "This case creates significant uncertainty regarding the enforceability of market-standard subordination provisions and threatens the legitimate commercial expectations of CDO noteholders and other participants in structured finance transactions," the firm said in a commentary explaining the significance of the ruling.

In our opinion, the conditions examiners observed during a 2007 examination provided FRB Atlanta with an opportunity to be more aggressive in addressing Neighborhood's high speculative real estate concentration, the report said.

Zero Hedge on Obama's proposed FY2011 budget: We are confident that not one politician will read the whole thing from cover to cover. We won't either. Not because we don't care about what's in it, but because we are much more concerned with what is not included, namely $2.8 Trillion and $1.9 Trillion of MBS guaranteed portfolios at Fannie and Freddie, and an additional $782 billion and $809 billion in company debt outstanding for the two GSEs, respectively.

This amounts to a total of $6.3 trillion in liabilities, which should be counted toward the budget. And yet, oddly, the error-checker somehow made this rather justifiable omission: after all if we were to look at a number which written out looks as follows $6,264,000,000,000.00, we would also probably just avoid it – it is somewhat difficult to hide a number that big even in the 1,420 pages of the budget's appendix. That's ok, we are here to remind them about the omission, and also to remind Mr. Orszag, who himself, in that long ago 2008, espoused that these companies should be put on the Federal Budget.

The unemployment rate in the U.S. unexpectedly declined in January to 9.7 percent, the lowest level since August, while payrolls dropped as companies boosted worker hours and overtime instead of taking on new hires.

Employment fell by 20,000 last month, reflecting a plunge in construction jobs and a drop in state and local government hiring, figures from the Labor Department in Washington showed. Economists surveyed by Bloomberg News forecast a gain. Manufacturing employment, factory hours and overtime increased.

Payrolls were forecast to increase by 15,000, according to the median estimate of 85 economists surveyed by Bloomberg News. Estimates ranged from a decrease of 100,000 to a gain of 100,000. The jobless rate fell from 10 percent in December. It was projected to hold there. Forecasts ranged from 9.8 percent to 10.3 percent.

The survey of households showed employment increased by 541,000 workers last month and the number of people in the labor force rose. The gain brought the participation rate, or the share of the population in the labor force, up to 64.7 percent in January from 64.6 percent.

In early 2009, the Obama administration's economic advisers forecast the $787 billion stimulus plan would keep unemployment below 8 percent.

Employment declined a revised 150,000 in December and increased 64,000 a month earlier.

The revisions subtracted 5,000 from payroll figures previously reported for those two months.

Government payrolls decreased by 8,000 in January. State and local governments reduced employment by 41,000 during the month, while the federal government added 33,000. The increase at the federal level reflected in part the hiring of temporary workers to conduct the 2010 census.

The Labor Department today also issued the annual benchmark update showing the economy lost 930,000 more jobs than previously estimated in the 12 months ended March 2009.

With this report, the Labor Department for the first time issued data on earnings and hours for all workers. Before today, the figures reflected changes in earnings and hours for production staff.

The average workweek for all workers rose to 33.9 hours in January from 33.8 hours the prior month. The increase signals companies making more part-time workers full-time employees. The number of part-time workers for economic reasons dropped to 8.3 million in January from 9.2 million the previous month.

Average weekly earnings increased to $761.06 from $757.46.

Factory payrolls increased 11,000 in January, the biggest gain since April 2006, after falling 23,000 in the prior month. The median forecast by economists called for a drop of 20,000.

Payrolls at builders fell 75,000 last month, after decreasing 32,000. Financial firms reduced payrolls by 16,000, after a 7,000 decline the prior month.

Service industries, which include banks, insurance companies, restaurants and retailers, added 40,000 workers after subtracting 96,000 in December.

The number of temporary workers increased 52,000 in January. Payrolls at temporary-help agencies often turn up before total employment because companies prefer to see a steady increase in demand before taking on permanent staff.

Retail payrolls increased by 42,000 after an 18,000 decline.

The so-called underemployment rate — which includes part-time workers who'd prefer a full-time position and people who want work but have given up looking — fell to 16.5 percent from 17.3 percent.

The economy grew at a 5.7 percent annual rate in the fourth quarter, the biggest gain in six years, according to data from the Commerce Department released last week.

The government revised its job loss numbers for November, saying the economy gained 64,000 in that month rather than 4,000. But the numbers in December were much worse than previously stated; the economy lost 150,000 jobs rather than the 85,000 originally reported.

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