THE $915B BOMB IN CONSUMERS' WALLETS

Americans have record credit-card debt and banks are starting to sweat an uptick in default rates, reports Fortune's Peter Gumbel. Why some fear this could be the next subprime.

By Peter Gumbel, Fortune
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Note from Pastor Kevin Lea: The leaders of our nation continue to remove the teachings of the Bible, and the Ten Commandments from the courtrooms and classrooms of America. If the Bible is the truth, then we should expect to see the judgments of the Bible come upon us for doing so. The prophets were sent to warn Israel, but they did not listen. The Word of God has warned us, are we going to listen and repent of our evil and wicked ways, or are we going to suffer the effects of rejecting God's laws? We better hurry in our repentance, because it looks like the once great economy of America is about to crash, and crash hard.

> *Deut 28:15 "But it shall come to pass, if you do not obey the voice of the LORD your God, to observe carefully all His commandments and His statutes which I command you today, that all these curses will come upon you and overtake you: 16 "Cursed shall you be in the city, and cursed shall you be in the country.--- 43 "The alien who is among you shall rise higher and higher above you, and you shall come down lower and lower. 44 "**He shall lend to you, but you shall not lend to him; he shall be the head, and you shall be the tail.** --- 45 "Moreover all these curses shall come upon you and pursue and overtake you, **until you are destroyed, because you did not obey the voice of the LORD your God**, to keep His commandments and His statutes which He commanded you.*

(Fortune Magazine) -- This past summer's subprime meltdown involved about $900 billion in now-suspect securitized debt, reckless lending, and consumers who buckled under the weight of loans they couldn't afford. Now another link in the consumer debt chain - credit cards - is starting to show signs of strain. And the fear that the $915 billion in U.S. credit card debt (an uncannily similar figure) may blow up has major financial institutions like Citigroup, American Express, and Bank of America strapping on their Kevlar vests.

Last month, as banks reported their worst quarterly results since 2001, concerns about rising credit card delinquencies began to make their way onto earnings announcements alongside mentions of subprime woes.


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First Citigroup (Charts, Fortune 500), reporting a 57% decline in earnings, cited higher consumer credit costs and said it would put aside $2.24 billion in loan-loss reserves to cover future defaults.

In describing the situation to analysts, CFO Gary Crittenden said Citi's credit card holders were beginning to increase the balance on their cards or take cash advances on those cards for the first time - behavior that, in his experience (which includes seven years as CFO of American Express), can translate into future trouble. Citi said the change in loan losses was "inherent in the portfolio but not yet visible in delinquencies."

Then American Express (Charts, Fortune 500) said that it too was seeing "signs of stress" and would boost its loss reserves in its core U.S. card unit by 44%. Capital One (Charts, Fortune 500), Bank of America (Charts, Fortune 500), and Washington Mutual (Charts, Fortune 500) all said they are bracing for a 20% or higher increase in credit card losses over the near and medium term.

So are U.S. credit cards going to be the catalyst for the next seizing up of the global credit markets? It depends on whom you ask.

"We are in a heightened state of alert to monitor a potential domino effect," says Michael Mayo, Deutsche Bank's U.S. banking analyst.

Dennis Moroney, an analyst at TowerGroup, expects credit card delinquencies will rise as consumers, who have until now used home-equity lines of credit to pay off their cards, start ratcheting up higher card debt. When housing prices were rising, it was easy for consumers to tap the escalating values of their homes to keep borrowing. With the home-equity spigot turned off, over-leveraged consumers may have trouble keeping up with payments.

The doomsday scenario would play out something like this: Just like CDOs and other asset-backed securities, credit card debt is sliced, diced, and sold off again as packages of securities. Rising delinquencies would hurt not only the banks involved but the securities backed by the credit card receivables. Those securities would decline in value as consumers defaulted, leading to bank losses as well as portfolio losses in the hedge funds, institutions, and pensions that own the securities. If the damage is widespread enough, it could wreak havoc on the economy much as the subprime crisis has done.

To be sure, there are key differences between the subprime market and the problems brewing with credit cards. The first is that while rising mortgage delinquencies were apparent for months before the subprime market blew up, credit card delinquencies are actually coming off unusually low levels.

"This is absolutely not the next one to blow," says Meredith Whitney, banking analyst at CIBC. Christopher Marshall, CFO of Fifth Third Bancorp in Cincinnati, points out that the U.S. has a long history of credit card securitization, "so it's fairly well understood." The securitization of the subprime sector, by comparison, "got blurry, and people didn't focus on what it meant."

Credit agencies that monitor credit cards in the asset-backed securities market share that confidence. "The performance in the core consumer [asset-backed securities] sectors is expected to deteriorate modestly, but not enough to cause substantial downgrades," says Kevin Duignan, managing director at Fitch.

But credit card debt is different from subprime debt in another way: Unlike mortgages, credit card debt is unsecured, so a default means a total loss. And while missed payments are at a historical low, they show signs of an uptick: The quarterly delinquency rate for Capital One, Washington Mutual, Citigroup, J.P. Morgan Chase, and Bank of America rose an average of 13% in the third quarter, compared with a 2% drop in the previous quarter.

What's more, consumers and the people who market financial services to them may not have learned their lesson. Klaus-Peter Müller, CEO of Germany's Commerzbank, told Fortune he was stunned on a recent trip to the U.S. to see TV ads still aggressively touting no-questions-asked credit. In Germany he's calling for tighter standards.

"I'm speaking out on the ethical questions about consumer lending," he says.

If there is an international precedent the U.S. should be watching, it's actually that of the U.K. British consumers are just as overstretched as Americans, but since the real estate market there rose faster and fell earlier, they're about 18 months ahead in the credit cycle. Since the last quarter of 2005, credit card delinquencies and charge-off rates in Britain have risen as much as 50%, forcing banks to take huge write-offs.

It's a sign of the times that, according to one survey last month, 6% of British homeowners have been using their credit cards to pay their mortgages. That's suicidal, of course, given that credit card interest rates are more than double even the heftiest mortgage. Keep your fingers crossed that it's not a trend that crosses the Atlantic.

Alarm: China signals flight from dollar

Investment CEO says he's 'never seen people more nervous'

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An unprecedented signal from senior Chinese leaders that the Asian economic giant might abandon the U.S. dollar sent shockwaves through the markets today as the Dow Jones Industrial Average lost 360 points and the greenback fell to a record low against the euro.

Xu Jian, a Chinese central bank vice director, told a conference in Beijing, "The dollar is "losing its status as the world currency." Meanwhile, at the same meeting, Cheng Siwei, vice chairman of China's National People's Congress, said, "We will favor stronger currencies over weaker ones, and will readjust accordingly."

Craig Smith, CEO of Swiss America Trading Corp., told WND he's been in the investment business for 30 years and has "never seen people more nervous."

Alarmed by today's economic news, he dispatched a note to brokers with a warning of ominous potential consequences if China and other trading partners abandon the dollar.

"If that were to happen, all bets are off, and we will be in a depression that makes 1929 look like child's play," he said, "or we will experience Weimar Republic inflation as the dollar makes extreme moves toward devaluations."

China has $1.43 trillion of foreign exchange reserves. During the five months up to August, Chinese investors reduced their holdings of U.S. Treasuries by 5 percent to $400 billion.

Smith told WND that underlings in Beijing have been suggesting for some time that China could abandon the dollar, "but this is the first time a senior leader came forward, and it sent shockwaves through markets."

"What we're experiencing today is a result of loose monetary policy, deficit spending and bad trade policies," said Smith, a WND columnist. "It's all coming home to roost at once."

The dollar's decline today to $1.47 against the euro helped push the price of crude oil to a record $98.62 a barrel and gold to a 27-year high. The U.S. dollar also reached its lowest level against the Canadian dollar since the end of a fixed exchange rate in 1950 and a 23-year low against the Australian dollar. The New York Board of Trade's dollar index fell to 75.077, the lowest since March 1973, when the index began.

Smith said the U.S., and consequently the world, may face a major financial crisis if "we can't find a way to get the $3 billion a day we need to stay alive and make balance of payments with foreign countries."

The Federal Reserve faces a dilemma, he explained. If it raises interest rates to prop up the dollar, the housing market and the stock markets will be slammed, causing a recession. A lowering of interest rates to stimulate the economy would erode the dollar further and spark massive inflation.

Underscoring the alarm among investors, Smith said a prominent Connecticut investor called him this morning and said, "I'm terrified, I think we could be sitting on a collapse."

Smith said the fundamental conditions are worse today than in 1979 and 1980, when gold spiked to $850 an ounce then fell for the next 20 years.

Today, instead of a rapid increase, there has been a gradual rise in oil and gold prices, among others, that suggests a long-term condition. Gold, for example, has gone from $265 in 2000 to $845 today.

Smith said the only solution is fiscal responsibility by consumers, corporations and government.

"We cannot spend money we don't have, anymore," he said. "The only thing that keeps us alive as a nation is our ability to borrow. We spend more money that we make."

Now, Smith said, "the world is saying, 'We lent you that much money, we're not going to do it anymore.'"

The problem, of course, Smith notes, is that if Americans don't spend, the economy doesn't grow, and the nation goes into a recession.

But continuing to reduce interest rates and print money to maintain the spending leads to inflation.

Eventually, he said, Americans simply are going to have to live within their means to lay a foundation for long-term economic health.

"To get through some of this stuff, we're going to go through some pain," Smith said.