

Financial turbulence extends to borrowers with good credit

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WASHINGTON: Even with \$700 billion in government help, the U.S. economy appears headed for a deepening recession and it may be next summer before the gloom begins to lift.

It is not only that the United States has just witnessed the largest bankruptcy and the largest bank failure in its history, or that the government is debating the biggest financial bailout on record. More alarming is how the crisis is starting to hurt borrowers with good credit records.

The upheaval has virtually shut down corporate access to credit markets at a time when profits are falling. That means companies may have to cut spending by as much as 10 percent in the coming months, and job losses will mount.

The financial arm of the heavy equipment maker Caterpillar had to offer a hefty premium, almost three times what it had to pay a year earlier, to lure buyers to its recent \$1.3 billion debt offering.

Caterpillar considered itself lucky. The average premium that companies with similar credit ratings had to pay was even higher, according to a Merrill Lynch benchmark for corporate bond performance.

Outside of the financial sector, large U.S. companies are cash rich and may be able to wait out the worst of the credit crunch. But roughly \$173 billion in outstanding financial debt is due to mature this year, according to Morgan Stanley data, and those loans will most likely be replaced at higher cost.

The more banks have to pay to borrow, the less they have available to lend, and that is certain to constrain spending. [Privately held companies have also taken on more debt. Sageworks, a research company, calculated that the liabilities-to-sales ratio - a measure of how much debt companies hold - more than tripled between 2003 and 2008.](#)

Bruce Kasman, chief economist at JPMorgan Chase in New York, changed his U.S. economic forecast last week, projecting that the economy will contract for two quarters beginning in October. He sees U.S. gross domestic product declining at an 0.5 percent annual rate in both the fourth and first quarters.

"Our forecast of an economy that would skirt contraction depended on a business sector that did not turn to more aggressive cutbacks in hiring or capital spending," he said. "However, a steady decline in profits, which appears to have intensified around midyear, increases chances that firms will resort to more dramatic cutbacks."

Kasman now expects job cuts to average 150,000 per month in the coming six months, double the pace so far this year, with unemployment heading toward 7 percent around mid-year 2009.

Data released on Friday showed the U.S. economy would already be in recession if not for trade, said Bernard Baumohl, chief global economist at the Economic Outlook Group.

Second-quarter growth came in at a respectable 2.8 percent annual pace, but exports added 2.9 percentage points. A measure of domestic demand contracted 0.1 percent.

"Clearly, the U.S. economy is at risk of suffering a deep recession, especially with the credit markets so dysfunctional," Baumohl said. "There is no way economic activity will rebound if the banking sector is unable or unwilling to finance consumer and business activity."

Household wealth has already taken a hit and the spending outlook does not look promising as credit dries up. Consumer spending, which accounts for two-thirds of U.S. economic activity, looks set to fall about 1 percent in the third and fourth quarters. A 1 percent drop amounts to about \$80 billion.

On Monday, a government report on U.S. personal income is expected to show only modest growth in August, after an unexpected decline of 0.7 percent in July. When adjusted for inflation, the data will probably indicate that consumers curbed spending last month.

The highlight - or lowlight - of the week comes on Friday, when the Labor Department issues its employment report for September. Wall Street is looking for about 100,000 job losses, with some estimates as high as 156,000, according to a Reuters survey.

No jobs means no paycheck, and with credit availability tightening, the spending hit will be significant. While banks are still willing to lend to people with solid credit histories, they are clearly restricting credit to those with poor credit. With foreclosures on the rise, the number of people with shaky credit is growing.