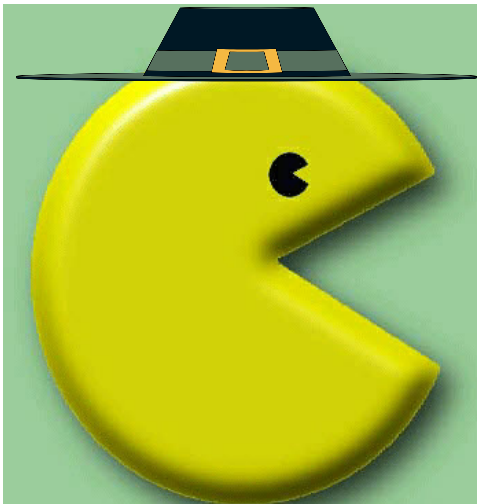

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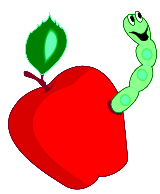
IN THIS MONTH'S ISSUE

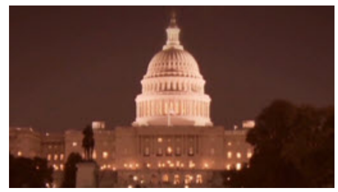


MACROECONOMIC MOVES AND MORTGAGE MARKET ANALYSIS

NO BUDGET DEAL
(week ending 10/4/2013)

Congress failed to reach a budget deal for the new fiscal year, causing a partial government shutdown for the first time in 17 years. The impact on mortgage rates was surprisingly small though. The reduced number of economic reports released this week also caused little reaction. Mortgage rates ended the week a little lower.

While the shutdown has caused disruptions in the mortgage origination process, the effect on mortgage-backed securities (MBS) prices, and therefore mortgage rates, has been minor. With respect to the shutdown, bond market investors adopted a wait and see attitude. The much more significant issue is the debt ceiling.



According to the Treasury, the government will reach its borrowing limit around October 17. If Congress does not raise the limit, there is a risk that the government technically will default on its obligations. The results of this unprecedented event could be severe for the economy and financial markets. At this point, though, few investors believe that Congress would actually allow the US to default.

One consequence of the shutdown is that economic reports produced by government agencies are not being released. The first Friday of each month is usually notable for the reaction to the Employment report, but this month's data has been delayed. Investors were forced to adjust their outlooks based on the less significant labor market data which did come out during the week, including the ADP forecast and Jobless Claims. These reports showed little change from recent readings, though, and had little impact.

PROGRESS IN CONGRESS
(week ending 10/11/2013)

With government produced economic reports postponed by the shutdown, the budget and debt ceiling discussions in Congress dominated the economic news again this week. The gridlock in Washington and the signs of progress have caused large movements in the stock market, but the impact on mortgage rates has been much more limited, and mortgage rates ended the week just a little higher.

Of the two, the debt ceiling has much more serious potential consequences for the economy and financial markets than the government shut-down. With the debt limit rapidly approaching, on Thursday, the two parties raised investors' hopes for a deal. It was reported that both sides might agree to a short-term deal which would extend US borrowing authority until November 22. Such a deal would remove the threat of a disruptive default in the short-term, and it would give Congress more time to reach a longer-term compromise. It is not known at this time whether the deal would end the government shutdown. On Thursday, stocks recovered all their losses from earlier in the week and turned positive for the week.

Investors almost universally misread the Fed's signals leading up to the September 18 Fed meeting, when the Fed decided not to taper its bond purchase program. As a result, investors were very eager to see the detailed Minutes from that meeting, which were released on Wednesday. The vote at the meeting was 9 to 1 in favor of maintaining the current level of bond purchases, but the Minutes revealed that Fed officials had very mixed feelings about whether to taper and that it was a "relatively close call". Overall, Fed officials wanted to wait for greater improvement in the labor market before reducing monetary stimulus. In addition, they expressed concern that the rise in interest rates that had been seen and the unresolved questions about fiscal policy could slow economic growth.

JOBS FALL SHORT (week ending 10/25/2013)

With the end of the government shutdown, investors turned their attention to the economic data. The September Employment report was weaker than expected, while the rest of the data released this week was mixed. As a result, mortgage rates ended the week a little lower.

Delayed by the shutdown, the September Employment data was released on Tuesday. Against a consensus forecast of 180K, the economy added just 148K jobs. The Unemployment Rate unexpectedly dropped from 7.3% to 7.2%, the lowest level since November 2008. The decline was mixed news though, since it was due to both job gains and to people who left the labor force, meaning that they stopped trying to find a job. Bottom line, the results were weaker than what Fed officials would like to see. Between the ongoing uncertainty about future fiscal policy and the slow pace of improvement in the labor market, investors now expect that the Fed will not begin to taper until at least the March Fed meeting.

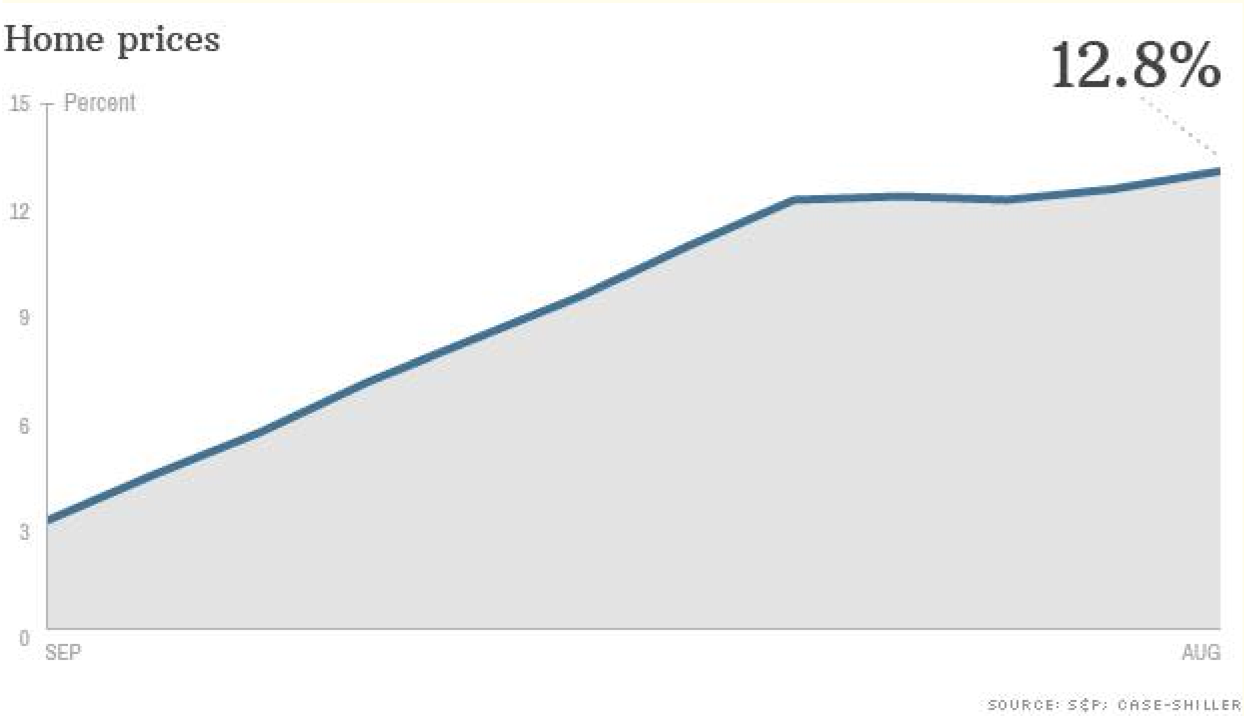
While the labor market data disappointed investors, the housing market continued to perform well. September Existing Home Sales were just slightly down from the four-year high reached in August, and they were 11% higher than one year ago. Total inventory of existing homes available for sale was unchanged at a five-month supply. Since the Existing Home Sales data is produced by the National Association of Realtors, it was unaffected by the government shutdown. The New Home Sales report, which is produced by the government, is delayed.

HOME PRICES CONTINUE TO CLIMB

Home prices posted the largest annual gain since housing bubble days in August, although the month-over-month gain slowed for the fourth straight month. The closely watched S&P/Case-Shiller home price index increased 12.8% from a year earlier, the biggest 12-month gain since February 2006.

But with mortgage rates significantly higher in recent months, the pace of increases is slowing. The 1.3% rise compared to July is only half the monthly increase posted in April when mortgage rates were near a record low. Still, the recovery in the housing market continues to be strong, helped by a drop in foreclosures that were weighing on overall prices. A drop in the unemployment rate is also helping to support the housing recovery.

Experts said the slowing of the monthly increase is not necessarily a bad thing, as it will reduce the chance of another bubble in home prices. "It's good to see the pace of home value appreciation moderate, allowing the market to get back into a more sustainable balance and not topple over," said Stan Humphries, chief economist of home price tracker Zillow.com. "Home value appreciation is better when it's boring, and we expect to see continued moderation."



Despite the rebound in prices, overall prices remain about 20% below the July 2006 peak. But prices in Dallas and Denver once again hit record highs. And markets, including Boston and Charlotte, are now less than 10% below their peak prices. The markets that rose fastest during the bubble—Las Vegas, Miami, Tampa and Phoenix—remain more than 35% below their peak valuations. But those markets are also among those with the most rapid price increases compared to a year ago. The fastest growth has been in Las Vegas, where prices are up 29%.

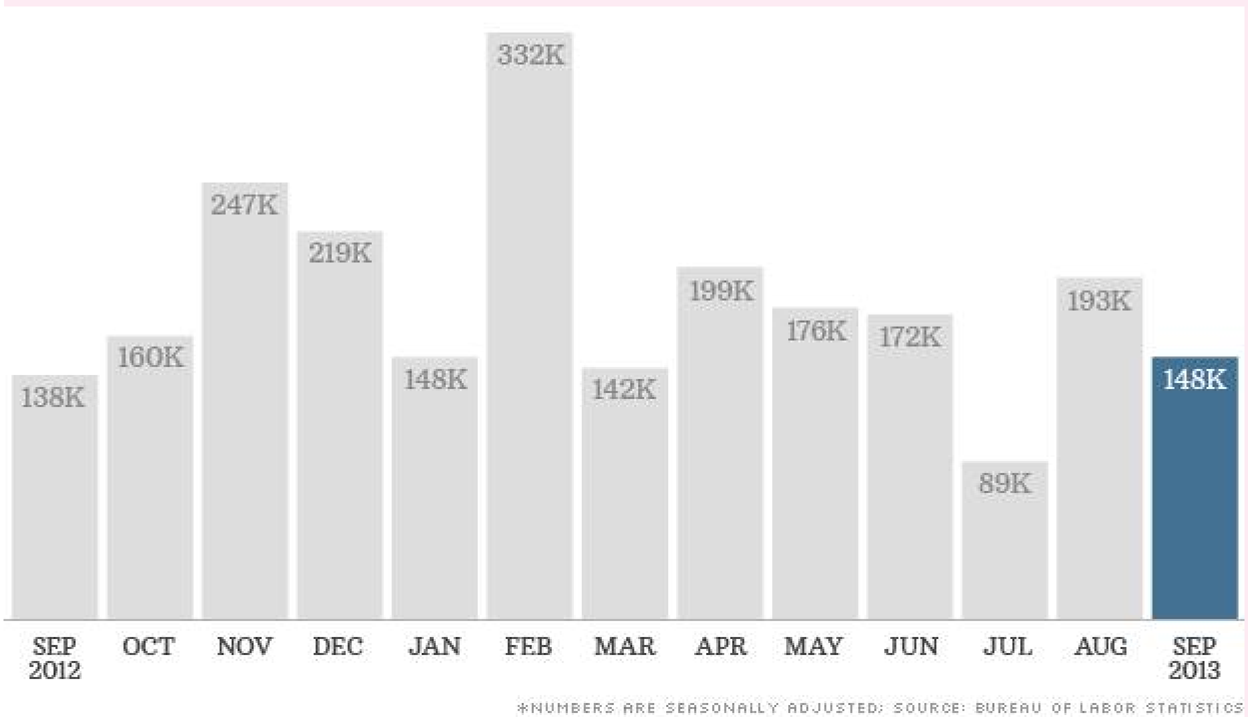
UNEMPLOYMENT FALLS BUT HIRING SLOWS

The unemployment rate fell to its lowest level since November 2008, but the government's latest jobs report still shows a muddled picture of the economy. According to the September jobs report, which was delayed 18 days by the government shutdown,

The unemployment rate fell to its lowest level since November 2008, but the government's latest jobs report still shows a muddled picture of the economy. According to the September jobs report, which was delayed 18 days by the government shutdown, hiring slowed last month. But the unemployment rate fell as more workers said they got jobs and joined the labor force. Employers added 148,000 jobs in September, fewer than the 193,000 jobs added in August, the Department of Labor reported.

But the good news is the unemployment rate fell to 7.2% as 73,000 people joined the labor force and 133,000 people said they got jobs. That's considered encouraging, after months in which thousands of Americans were dropping out of the workforce.

Still, 11.3 million jobless people continued to look for work. Economists called the report a "mixed bag," "underwhelming" and "disappointing."   The conflicting picture comes from two separate surveys conducted each month, which don't always match up. The first survey asks businesses and government agencies about their hiring, while the second survey covers employment status of individual households.



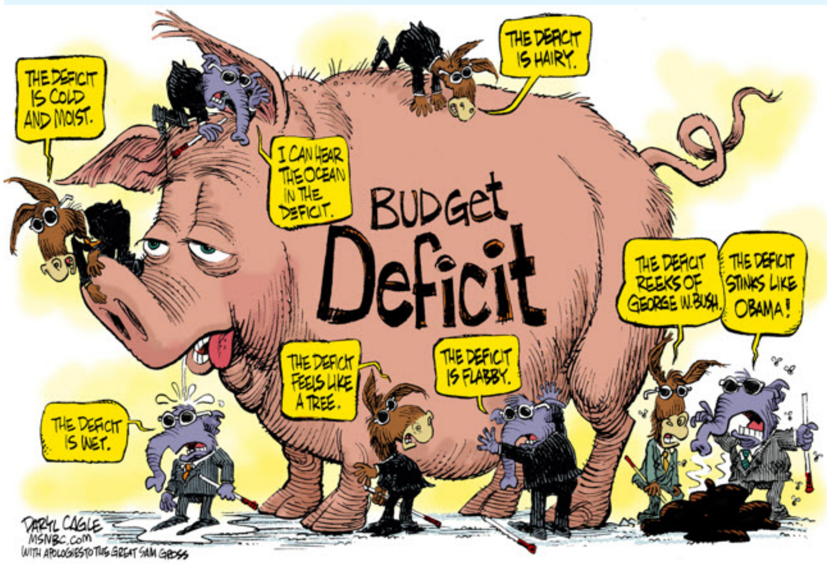
Construction firms added 20,000 jobs in September, more than the previous five months combined. Temp agencies hired 20,000 workers and state governments added 20,000 education jobs. Retailers hired 21,000 workers, marking six straight months of strong hiring for the sector. Meanwhile, restaurants and bars suddenly cut 7,000 jobs—the first job loss in the industry in three-and-a-half years. The average American employee worked 34.5 hours a week and earned $24.09 an hour in September, up 49 cents, or 2.1% from a year ago.

THE DEFICIT, THE NATIONAL DEBT, AND THE DEBT CEILING

EDITOR'S NOTE. Because of the government shutdown, about the only graphs available to me this month were the previous ones. As regular readers know, I normally feature a number of charts and graphs produced by various government agencies like the Federal Reserve, the BLS, the OMB, etc. So, in lieu of the usual government dispatches, I have elected to replace them with a tutorial, if you will, and explain some macroeconomic concepts that many Americans and evidently a number of our lawmakers don't understand like the national debt, the deficit, and the debt ceiling.

First of all the deficit, the national debt and the debt limit are three separate things, although I hear politicians refer to them as though they were one and the same or conflate one with the others. THEY ARE RELATED, BUT THEY ARE NOT ONE AND THE SAME. Let's tackle them one at a time.

THE DEFICIT



THE DEFICIT or annual "government deficit" is the difference between what the government takes in [TAXES] and what it pays out [EXPENDITURES] in a given year. The current deficit for 2013 is $460 billion.

It is hard to turn on your TV or read an editorial page these days without encountering someone declaring, with an air of great seriousness, that excessive spending and the resulting budget deficit is our biggest problem. Consequently, the average American is somewhat worried about budget deficits, which is no surprise given the constant barrage of deficit scare stories in the news media. If you are like the average American, you might not be surprised to hear that voters are uninformed about the deficit, but you may be surprised by just how misinformed they are. In a 1996 survey that asked voters whether the budget deficit had increased or decreased under President Clinton, a plurality of voters and a majority of Republicans believed that it had gone up when in fact it was down sharply. And today, with the deficit falling even faster than it did in the 1990s, a recent Google survey asked whether the deficit had gone up or down since January 2010 and the results were even worse than in the 1990s. A majority of those who replied said the deficit has gone up, with more than 40% saying that it has gone up a lot. Only 12 percent answered correctly that it has gone down a lot.

Am I saying that voters are unaware? The answer is pretty obviously Yes. They rely on what they hear from parties which shape the news to fit their agenda. People tend to read and/or watch newspapers and newscasts that agree with their positions. As a consequence much of what they hear is misleading, if not outright false. And Fox News, despite its "fair and balanced' slogan is one of the biggest purveyors of mistruths, as is the Wall St. Journal, though to a lesser degree. For example, Fox New reported that the government shut down was not a shut down, but a government "slim down". I'm not trying to beat up on anyone party here, but sometimes you have to "call a spade, a spade." In the previously referenced 1996 survey, Republicans were much more likely than Democrats to hold false views about the deficit, and the same must surely be true today. After all, Republicans made a lot of political hay over a supposedly

runaway deficit early in the Obama administration, and they have maintained the same rhetoric even as the deficit has plunged. Thus Eric Cantor, the second-ranking Republican in the House, declared on Fox News that we have a

"growing deficit," while Senator Rand Paul told Bloomberg Businessweek that we're running "a trillion-dollar deficit every year."

I suspect that the public often confuses the deficit with the national debt. More troubling, is that the people who have been feeding those fears and peddling those prejudices are equally unaware of the distinctions between the two and even worse, many of our policymakers don't have a clue about the economy actually works.

For three years and more, policy debate in Washington has been dominated by warnings about the dangers of budget deficits. A few lonely economists have tried from the beginning to point out that this fixation is all wrong, that deficit spending is actually appropriate in a depressed economy. So far, the deficit scolds have been wrong about everything. Remember how federal deficits were supposed to cause soaring interest rates? After four years of such warnings, rates remain near historic lows—just as Keynesians predicted. Remember how running the printing presses was going to cause runaway inflation? Since the recession began, the Fed has more than tripled the size of its balance sheet, but inflation has averaged less than 2 percent.

America's budget deficit soared after the 2008 financial crisis and the recession that went with it, as revenue plunged and spending on unemployment benefits and other safety net programs rose. And this rise was a good thing! Federal spending helped sustain the economy at a time when private sector was in panicked retreat; arguably, the stabilizing role of a large government was the main reason the Great Recession didn't turn into a full replay of the Great Depression.

From the beginning, it was or at least should have been obvious that the financial crisis had plunged us into a "liquidity trap", a situation in which many people figure that they might just as well sit on cash. America spent most of the 1930s in a liquidity trap. Japan has been in one since the mid-1990s. And we're in one now.

Right now, inflation—at barely above 1 percent by the Fed's favored measure—is dangerously low. Why is low inflation a problem? One reason is that it discourages borrowing and spending and encourages sitting on cash. Since our biggest economic problem is an overall lack of demand, falling inflation makes that problem worse because low inflation also makes it harder to pay down debt, worsening the private-sector debt troubles that are a main reason overall demand is too low. So why is inflation falling? The answer is the economy's persistent weakness, which keeps workers from bargaining for higher wages and forces many businesses to cut prices.

Unemployment, not excessive money printing, is what ails us now.

Under these conditions, economists realize that some of the usual rules of economics are in abeyance as long as the trap lasts. During these times budget deficits don't drive up interest rates; printing money isn't inflationary, but slashing government spending has real destructive effects on incomes and employment.

The reason interest rates are low right now is because everyone wants to save and nobody wants to invest which is why the federal government can borrow more cheaply than at almost any point in history and medium-term forecasts like the 10-year projection by the Congressional Budget Office, are distinctly not alarming. So, we're awash in savings with no place to go, and those excess savings are driving down borrowing costs. Meanwhile, stocks are high, in part, because bond yields are so low, and investors have to put their money somewhere.

Yes, there's a long-term fiscal problem, but it's not urgent that we resolve that long-term problem right now while we are still in a nascent recovery mode. Still, if we were to put off spending cuts for now, wouldn't it be a good thing if our politicians could simultaneously agree on a long-term fiscal plan? Indeed, it would. Ironically, Republican senators are saying that the situation is desperate—but not desperate enough to justify even a penny in additional taxes. It also completely ignores that it was Bush-era spending that dug the ditch we're in, e.g., the unfunded war in Iraq, prescription drug act that wasn't paid for and tax-cuts for the rich for nearly a decade.

What's really remarkable at this point, however, is the persistence of the deficit fixation in the face of rapidly changing facts. As we have already seen, the deficit is falling more rapidly than it has for generations, it is already down to sustainable levels, though it is too small given the state of the economy. But the deficit will come down further, if revenues are allowed to rise, while some categories of spending, such as unemployment benefits, will fall.

Bear in mind that the budget doesn't have to be balanced to be put on a fiscally sustainable path; ALL WE NEED IS A DEFICIT SMALL ENOUGH THAT DEBT GROWS MORE SLOWLY THAN THE ECONOMY. To take the classic example, America never did pay off the debt from World War II—in fact, our debt doubled in the 30 years that followed the war. But debt as a percentage of GDP fell by three-quarters over the same period.

There are, of course, longer-term fiscal issues: rising health care costs and an aging population will put the budget under growing pressure over the course of the 2020s. We want to reduce the deficits once the economy recovers, and there are gratifying signs that a solid recovery is finally under way. But unemployment, especially long-term unemployment is still unacceptably high.

Slashing government spending destroys jobs and causes the economy to shrink. This really isn't a debatable proposition. The contractionary effects of fiscal austerity have been demonstrated by study after study and overwhelmingly confirmed by recent experience—for example, by the severe and continuing slump in Ireland, which was for a while touted as a shining example of responsible policy, or by the way the Cameron government's turn to austerity derailed recovery in Britain.

THE NATIONAL DEBT

THE NATIONAL DEBT (also known as public debt or government debt) is the debt owed by the U.S. government. Right now, it stands at approximately $17.075 trillion. Roughly half of outstanding debt owed to the public, now $11.7 trillion, is owned by foreigners. This part of the debt is a direct burden on us and future generations. If our government had used borrowed money to improve infrastructure or to improve the skills of workers, the resulting extra production would have made repayment easier. Instead, over the last decade, it used the money for wars and tax cuts. The Treasury owes dollars, America's own currency (unlike Greece or Italy, whose debt is denominated in Euros). So the Treasury can always make payments when due—unless it is prevented from doing so by political blackmail over the statutory debt limit, which is now due to be reached, again, in February 2014. Notwithstanding the unprecedented credit-rating downgrade by Standard & Poor's in 2011, no foreign lenders realistically expect us to default. If they did, they would be insisting on higher interest rates, which they aren't. Of course, if we were stupid enough to default even once, the cost of borrowing would go much higher, for a long time.

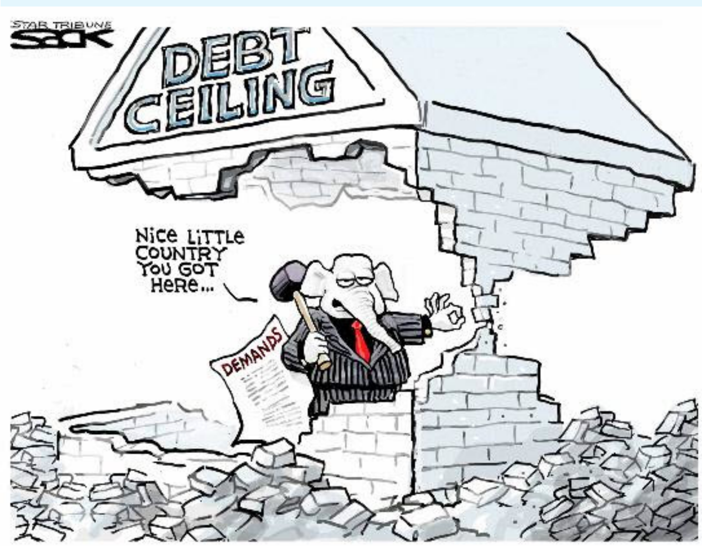
Treasury bonds owned by Americans are different from debt owed to foreigners. Debt owed to American households, businesses and banks is not a direct burden on the future. Of course the payments of interest and principal are a burden on current and future taxpayers, but they will ultimately be received by American people and organizations, many of them taxpayers. Some of our grandchildren would be paying off others of our grandchildren; the result will be a net transfer from American taxpayers to American bondholders.

The real burden of domestically owned Treasury debt is that it soaks up savings that might go into useful private investment. Savers own Treasury bonds because they are seen as safe, default-free assets, and the government can borrow at lower rates than corporations can. If there were less debt, and fewer bonds for sale, savers seeking higher returns would invest in corporate bonds or stocks instead. Business investment would expand and be more profitable.

But in bad times like now, Treasury bonds are not squeezing finance for investment out of the market. On the contrary, debt-financed government spending adds to the demand for privately produced goods and services, and the bonds provide a home for the excess savings. When employment returns to normal, we can return to debt reduction.

In the long run we need a clear plan to reduce the ratio of publicly held debt to national income. But for now the best chance to reinvigorate the economy, spur business investment and encourage consumer spending is through public borrowing and spending. Instead, House Republicans have insisted on an ill-advised, across-the board austerity program.

THE DEBT CEILING



The United States debt ceiling or debt limit is a legislative mechanism to limit the amount of national debt that can be issued by the Treasury. The debt ceiling is an aggregate figure which applies to the gross debt, which includes debt in the hands of the public and in Intra-government accounts. Because expenditures are authorized by separate legislation, the debt ceiling does not directly limit budget deficits. It can only restrain Treasury from paying for expenditures after the limit has been reached, but which have already been approved (in the budget) and appropriated.

The process of setting the debt ceiling is separate and distinct from the United States budget process, and RAISING THE DEBT CEILING NEITHER DIRECTLY INCREASES NOR DECREASES THE BUDGET DEFICT AND VICE VERSA. In effect, IT IS ONLY A LIMIT ON THE ABILITY TO PAY OBLIGATIONS ALREADY INCURRED.

Congress has imposed a strict limit on how much debt the federal government can accumulate, but for nearly 90 years, it has raised the debt ceiling well before it was reached. The apparent redundancy of the debt ceiling has led to suggestions that it should be abolished altogether and several house members agree. Moreover, in January 2013, a survey of 38 highly regarded economists found that 84% agreed that since Congress already approves spending and taxation, "a separate debt ceiling that has to be increased periodically creates unneeded uncertainty and can potentially lead to worse fiscal outcomes.

RATE SUMMARY

Rates improved in the past month, once the showdown over the budget and debt ceiling negotiations had concluded

*Conforming programs—an 1/8th to quarter better ↓
*Jumbos— an eighth to a quarter better ↓
*Governments— a quarter to 3/8ths better ↓

FOR CURRENT INTEREST RATES FOR THE 16 MOST POPULAR PROGRAMS GO TO: www.mortgagestraighttalk.com Then, click on the menu tab labeled "RATES". The rate sheets are updated every Friday.

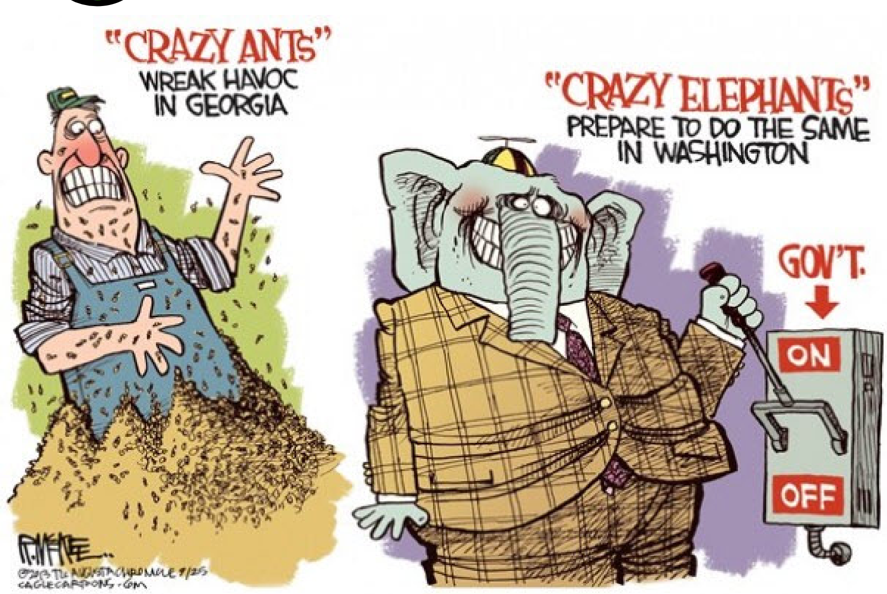
SPECIAL(S) OF THE MONTH

- Conforming 5/1 ARM @ 2.625% & Conf. 5/1 Interest Only ARM @ 3.000%
- Conforming 30 yr. fixed @ 3.875%
- High Balance Conforming 30 yr. fixed @ 4.000%
- Jumbo 5/1 ARM @ 2.750%
- Jumbo 30 yr. fixed @ 4.250%
- FHA Conforming 15 yr. fixed @ 2.875%
- VA Conforming 30 Yr. fixed @ 3.5%
- HomePath 30 yr. fixed @ 3.875%
- HARP DU REFI PLUS 30 yr. fixed @ 3.875%

MORTY'S MAILBAG

Q. As regular readers of your newsletter, my wife and I are curious as to your take on the government shut down.

A. Well, okay, but remember--you asked for it. First off, these Republican tantrums must end. Much like a spoiled child threatening to hold its breath until it gets its way, Republican factions need to be reprimanded for their extortionate demands and shutting down the government. Republicans have these wonderful political slogans that belie their actual politics. Remember 2008's?—Country First. But, since Newt Gingrich's House Chairmanship their actions have consistently put Party First.

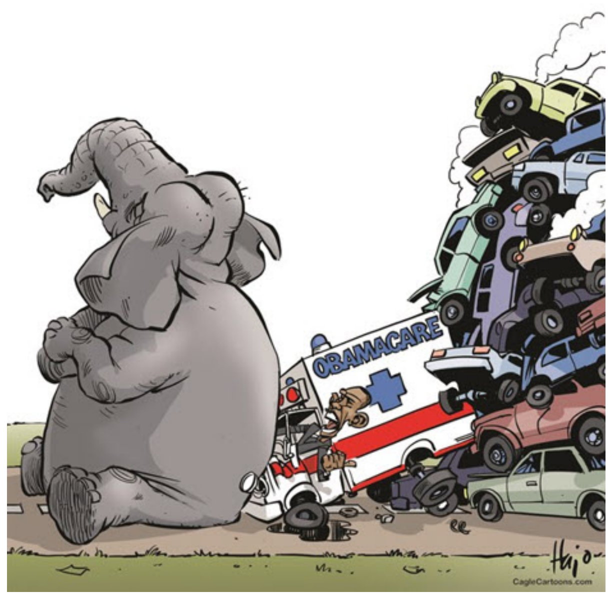


Some Americans think that this crisis reflects typical partisan squabbling. No, Democrats and Republicans have always disagreed, sometimes ferociously, about what economic policy is best, but in the past, it was not normal for either side to hold the government hostage to enforce one's political ideology. Government cannot function when one-side resorts to quasi-terrorism or threatened with temporary extinction, periodically. Yet, I have seen many news reporters (in order to appear objective) say that both sides of the aisle are to blame for the government shutdown, but this is a false equivalency—both sides are not blameworthy when one side threatens to sabotage the economy as a negotiating tactic. The thing that I found genuinely outrageous was the ingenuous of their arguments.

Why It's Not Our Fault: It's the Democrats! If they want to end the government shutdown or avoid a debt-limit crisis, all they have to do is make a concession or two. How can President Obama be willing to negotiate with tyrants in Russia and Iran, but not with the House majority?

Think about it. Suppose Russia or Iran said, "we will use cyber-attacks to shut down your government and wreck your economy, unless you make concessions." Would we then blithely sit down and negotiate an amicable solution? Yet that's what a band of extremist House Republicans were saying in the hopes of gaining leverage on unrelated issues. They insisted that Obama make concessions on a 3-year-old law, or else they would throw 800,000 government employees out of work and threaten to damage the national economy. In effect, they were presuming that Obama had to be more responsible than they were—that he would be forced to capitulate to protect the economy. Let's be clear. This is not government as usual. I can't think of the last time a major political party undertook a serious campaign to damage the American economy, unless the other party gave in.

That's not fair! We want to compromise. All the Democrats have to do is accept some changes in Obamacare, which is unpopular to begin with.



Obama compromised constantly in passing the Affordable Care Act (that's why there's no public option in the law, and why he disappointed so many liberals by watering down health care reform in a doomed effort to get Republican support). But this compromise became law in 2010 and is now being implemented. Republicans need to accept that. If Obamacare performs poorly, then Republicans can run against it in 2014 and 2016 and probably win seats. But, rather than persuading a majority of Americans that its policies are right, and winning elections to enact the changes it sought—the essence of our democratic system—the Tea Party threatened to undermine our nation's credit rating if the Democrats would not agree to defund Obamacare.

Had such strong-arm tactics worked, it would have meant that constitutionally enacted law could be nullified if determined minorities opposed them. Republicans were encouraged by their success in wringing concessions in 2011 by holding the debt-ceiling negotiations hostage which led them to do it again. This time, the Obama administration saw such extortionate tactics as a constitutional crisis from which it couldn't budge which is why unreasonable demands must remain non-negotiable.

The only reason for the government shutdown was that a small number of Republican hard-liners, around 40, insisted on re-litigating health care reform over and over (45 times at last count). If Speaker John Boehner had allowed an open vote on the budget, it would have passed. But Boehner didn't do that.

A U.S. Default would have been unprecedented and catastrophic. No wealthy country has ever voluntarily decided—in the middle of an economic recovery, no less—to default. And there's no record of that happening to the country that controls the world's currency reserve. In the summer of 2011, when Republicans refused to raise the debt ceiling unless President Obama caved in to their extortionist demands. It scared politicians enough that they kicked the can down the road and avoided a default. This time around, the need to raise the debt ceiling didn't seem to generate nearly the same concern. During the 2011 debt-ceiling crisis, consumer confidence dropped by 22 percent. When consumer confidence falls, people are less willing to spend and businesses are less willing to hire. That's how recessions—or depressions—begin, and that may be the most important consequence of all. The dollar is the global reserve currency and U.S. government debt is the only risk-free asset in the world. That debt undergirds the entire world financial system—precisely because the whole world has such faith in it. Why on earth would we ever risk that? Why? Indeed, Tea Party Republicans seemed to be almost rooting for the government to default, as if that would somehow bring about the smaller government they so yearn for.

It was mind-boggling how many extremists downplayed the risks of a default. We require driver's licenses before people can operate motor vehicles, similarly our law makers should be required to have an understanding of macroeconomics before they get to vote on matters of this magnitude, lest they steer the ship of state into a ditch. Astonishingly, Representative Ted Yoho, a large-animal veterinarian, said that missing the debt ceiling deadline "would bring stability to world markets." He explained further, "Everybody talks about how destabilizing doing this will be on the markets. And you'll see that initially, but heck I've seen that in my business. When you go through that, and you address the problem and you address your creditors and say, 'Listen, we're going to pay you. We're just not going to pay you today, but we're going to pay you with interest and we will pay everybody that's due money'—if you did that, the world would say America is finally addressing their problem."

Or, there's Senator Rand Paul, who said that not raising the debt limit could be reframed as a "pretty reasonable idea." Even senator Tom Coburn said it wouldn't be so bad to miss the debt-limit deadline and face a "managed catastrophe."

Then, there's wantonness of congressman Martin Stutzman's admission on the shutdown: "We have to get something out of this, and I don't know what that even is."

There's now a right wing echo chamber, shaped by Fox News Channel and websites like RedState.com that repeats such nonsense until it acquires a patina of plausibility—thus making a catastrophe more difficult to avoid. A Pew Research Center poll this month found that 54 percent of Republicans believe that the United State can miss the debt-limit deadline (go into default) without major problems.

If an individual were to default on their mortgage or a credit card account, the repercussions are serious, even with something as minor as a 30 day late payment. Firstly, your FICO (credit) score would drop by 70 to 100 points. If you were to have two thirty day mortgage lates in 12 months, you would find obtaining new financing well-nigh impossible. Now with a lower FICO score any credit extended to you would be at a higher interest rate because you are a riskier proposition. Similarly, once the full faith and credit of U.S. government had been compromised by a non-payment, the U.S. would have to offer a significantly higher risk premium to attract buyers for its bonds.

Also, what these lawmakers failed to acknowledge or apologize for is that the shutdown was actually very expensive and will wind up costing the taxpayers and the economy far more than the regular operations of government. The same people who have built their careers on railing about the deficit are responsible for increasing it. As it was, according to Standard & Poors, the 16-day shutdown cost the economy $25 billion. That amount includes the cost of back pay for government employees who performed no work during those 16 days. (Congress has to decide whether to grant that pay, but it usually does). The backlogs of work—benefits claims, passport applications, loan requests — then slowed down the government when employees returned, making them less efficient, which has a quantifiable cost. Many employees also had to be paid to prepare for the shutdown and later for the resumption of work. Then there is the cost to the economy from the lost productivity of the 800,000 furloughed workers and the delayed paychecks to the more than one million "essential" employees who are still on the job. In areas with heavy government employment, like the District of Columbia and its suburbs in Maryland and Virginia, the lack of income means lost retail sales and fewer restaurant meals.

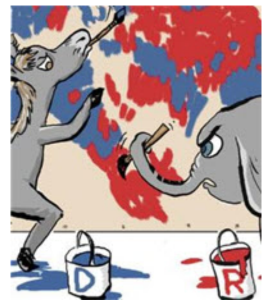
While the government is closed, it cannot collect fines and fees, only a portion of which are later recouped. Contractors add the cost of the interruption — and the possibility of future interruptions— to their charges to the government, raising the cost of contracts for years. Tax revenues will be lower in many states and cities as economic activity slows down. It cost the country 0.7% in 4th quarter economic growth. In short it is appalling the way that Congress behaved: lurching from one crisis management situation to the next. This is NO way to run the world's largest economy.

Had the debt ceiling not been raised, it would have been by most accounts, the largest self-imposed financial disaster in history. Why? The U.S. benefits enormously from its status as a global reserve currency and safe haven. Our interest and mortgage rates are lower; companies are able to borrow money to finance their new products more cheaply. For as long as anyone can remember, the ability of the United States government to pay its bills on time has given the rest of the world tremendous confidence. At the same time, to have the one asset everyone in the world trusts has given America great advantages. There is always demand for U.S. government debt. Almost every other asset you can think of is in some way measured against it. A default would destabilize the market for Treasuries. And that, in turn, would likely destabilize every other asset, throwing the world economy into chaos. The stock market would have fallen. Interest rates would have necessarily risen—meaning, for instance, mortgages would become more expensive just as the housing market is starting to revive. Treasuries themselves would likely have to pay higher interest to investors, which would create a rather sad irony: a default would exacerbate the country's long-term debt (the very problem the Republicans claim to care about).

A destabilized Treasury debt would have wreaked further havoc on the banking system. The plumbing of the global financial system depends on Treasuries. Remember what happened to Lehman Brothers? As the market lost faith in the company's ability to meet its obligations, Lehman lost access to the "repo" market, which is the way banks are funded on a short-term basis. Treasuries make up a great deal of the collateral in the repo market. If a default were to cause the repo market to freeze, the entire banking system would find itself in crisis. Meanwhile — more shades of Lehman Brothers—the ratings agencies would likely downgrade Treasuries, forcing money market funds to start dumping government debt.

Painful choices would have had to have been made. Currently, the Treasury Department says it does not have the authority to pick and choose which creditors to pay. But, in the event of a default, it is hard to imagine that the government wouldn't make some tough decisions about who should get paid

in the short term—and who would have to wait. "From a purely cost-benefit analysis," says Mark Zandi of Moody's Analytics, "not paying bondholders would wind up costing the U.S. much more than not paying Social Security recipients" — because if bondholders lost faith in Treasuries, it would cost the government billions more in interest payments each year. And, though this would infuriate millions of Americans, bondholders in China would likely get their money ahead of, say, Social Security recipients.

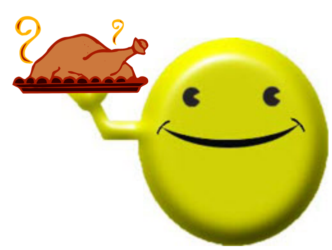


The most obvious way of dealing with these miscreants would be to vote the responsible parties out of office in the next election, but they have little to fear because their House seats are secure due to gerrymandering. The broader problem was (is) that many Republicans now are in safe districts and are less worried about a Democratic challenger than about a primary opponent from the Tea Party. That's a structural problem with Congressional districts that makes America less governable. There are plenty of savvy Republicans who are aghast at what was going on, and let's hope they take ownership.

It has created blatantly rigged situations like Pennsylvania's where Obama won 52 percent of the 2012 vote, yet the House delegation ended up with 13 Republicans to 5 Democrats. This inequity needs to be addressed and eliminated through political reforms like the drawing of Congressional districts by nonpartisan commissions, not by political hacks. Voters should take their disgust with this shutdown and turn it into a fierce, sustained push for a better fairer system.

I hate to sound cynical, but Americans' memories seem to be as short-term. The 2014 midterm elections are a year away and by that time much of this debacle will have been forgotten and many of the malefactors will be returned to office to repeat their misdeeds.

Recipients of the newsletter are invited to Ask Morty any real estate or financing questions. The answer to the question will be answered either by phone or email and posted in the next issue for the benefit of all. Questions may be forwarded via mail phone or fax. Due to the high incidence of spam, if you email me a question it needs to be identified as a "real estate question" on the subject line of the email. (See front of issue for phone and fax numbers). Morty's email address is morty@mortgagestraightTalk.com



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