

The Seattle Times

Saturday, April 10, 2010 - Page updated at 11:31 PM

Permission to reprint or copy this article or photo, other than personal use, must be obtained from The Seattle Times. Call 206-464-3113 or e-mail resale@seattletimes.com with your request.

Era of low interest rates may be coming to an end

By **NELSON D. SCHWARTZ**
The New York Times

As prospects for the U.S. economy brighten, consumers are about to face a new financial burden: a sustained period of rising interest rates.

That, economists say, is the inevitable outcome of the nation's ballooning debt and the renewed prospect of inflation as the economy recovers from the recession.

The shift is sure to shock consumers whose spending habits were shaped by a historic 30-year decline in the cost of borrowing.

"Americans have assumed the roller coaster goes one way," said Bill Gross, whose investment firm, Pimco, has taken part in a broad sell-off of government debt, which has pushed up interest rates. "It's been a great thrill as rates descended, but now we face an extended climb."

The impact of higher rates is likely to be felt first in the housing market, which has recently begun to rebound. The rate for a 30-year fixed rate mortgage has risen half a point since December, hitting 5.31 last week, the highest since last summer.

Along with the sell-off in bonds, the Federal Reserve has halted its emergency \$1.25 trillion program to buy mortgage debt, placing more upward pressure on rates.

"Mortgage rates are unlikely to go lower than they are now, and if they go higher, we're likely to see a reversal of the gains in the housing market," said Christopher Mayer, a professor of finance and economics at Columbia Business School. "It's a really big risk."

Each 1 percent increase in rates adds up to 19 percent to the total cost of a home, according to Mayer.

The Mortgage Bankers Association expects the rise to continue, with the 30-year mortgage rate going to 5.5 percent by late summer and as high as 6 percent by the end of the year.

Another area in which higher rates are likely to affect consumers is credit-card use. Last week, the Federal Reserve reported the average interest rate on credit cards reached 14.26 percent in February, the highest since 2001. That is up from 12.03 percent when rates bottomed out in the fourth quarter of 2008, a jump that amounts to about \$200 a year in additional interest payments for the typical U.S. household.

With losses from credit-card defaults rising and with capital to back credit cards harder to come by, issuers are likely to increase rates to 16 or 17 percent by the fall, said Dennis Moroney, a research director at the TowerGroup, a financial-research company.

Similarly, many car loans have become significantly more expensive, with rates at auto-finance companies rising to 4.72 percent in February from 3.26 percent in December, according to the Federal Reserve.

The federal government, too, is expecting to have to pay more to borrow. The Office of Management and Budget expects the rate on the benchmark 10-year U.S. Treasury note to remain close to 3.9 percent for the rest of the year, but then rise to 4.5 percent in 2011 and 5 percent in 2012.

The long decline in interest rates also helped prop up the stock market; lower rates for investments such as bonds make stocks more attractive.

That tail wind, which prevented even worse economic pain during the recession, has ceased, according to economists, analysts and money managers.

"We've had almost a 30-year rally," said David Wyss of Standard & Poor's. "That's come to an end."

Copyright © The Seattle Times Company