

12/2005

Your Kiplinger Connection

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The economy

The Federal Reserve's words needed careful parsing Dec. 13, when officials added another quarter-point to interest rates. An accompanying statement is likely to drop a long-repeated reference to "measured" rate hikes...a code word for continued, gradual increases.

The Fed's message will signal that an end to rate hikes is near. The Fed will stop in the spring, when the federal funds rate reaches 5%.


Look for a 10% rise next year in nonresidential construction... offices, factories, retail, public projects...after a 5% gain this year. Newly flush state and local governments will boost construction spending. Facing tighter capacity, manufacturers will expand their facilities. And steady growth in employment will fuel demand for office buildings.

But contractors are going to face serious cost squeezes as expensive fuels and transportation bottlenecks raise materials costs. Price increases for plastic piping, insulation, asphalt, and roofing are likely to reach 20% or more. For bricks and glass...5% to 10%. Cement and concrete will fetch 10% more after a 13% advance this year.

Post-hurricane rebuilding won't have a major impact on demand for either materials or contracting services until 2007. Most of the money spent in 2006 will be for demolition and cleanup.

A better crop of films should help Hollywood's theater receipts next year. The box office tally for 2005 is on a path for a 6% drop. Potential blockbusters to be released in mid-2006: Superman Returns, Mission: Impossible 3, The Da Vinci Code, and Pirates of the Caribbean 2.

But the decline in DVD sales is going to continue. DVD retailers such as Wal-Mart have become more insistent about returning unsold stock. Young males, a key demographic, are opting for video games and the Web.

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And a possible strike clouds the outlook for production firms.
Actors want better deals with ad agencies on residuals for commercials. A strike, which could come in the fall, would halt commercial production.

Support industries likely to take a hit would include catering, trucking, equipment rentals, graphic arts, apparel, and furnishings.

Housing

A crackdown on risky mortgage lending is coming by late Jan.

Federal regulators are most concerned about the expanding use of interest-only adjustable rate mortgages (ARMs) and option ARMs. With both, payments are kept low for a few years before bumping higher. The feds will tell lenders to make sure borrowers can handle payments once they increase and to fully inform applicants of the risks involved.

The economic cost of such loans will be felt starting next year, when some \$300 billion worth of ARMs are due to be reset at higher rates. That'll probably knock about a quarter-point off the pace of growth of the economy as homeowners spend less on appliances, furniture, etc.

But mortgage shoppers in hot home markets can expect some relief:
Higher limits on conforming loans...those purchased by Fannie Mae and Freddie Mac and bundled together to resell in the secondary market.

The House has approved them. The Senate will give its OK in 2006.
Interest rates on conforming loans average about a quarter-point lower than those on "jumbo" loans. Conforming-loan limits increase annually, but they're lagging well behind home value increases in many areas.

Loan limits will be adjusted to reflect local price trends. This means, for example, that the conforming-loan ceiling may be higher in places such as Los Angeles, New York City, Boston, and San Francisco.

Insurance

Higher flood insurance premiums are on tap for property owners after Congress trims the flood program's subsidies next year. Many more homeowners and businesses will also have to buy insurance...upwards of 10 million, compared with 4.7 million now. A revised flood law will widen coverage to 500-year floodplains from 100-year plains now.

One positive: Maximum coverage levels will rise about 35% for structural damage...\$335,500 for homes and \$670,700 for businesses.

The cost of terrorism insurance is also likely to climb as lawmakers phase out the federal backstop on claims for terrorist acts. The government currently picks up the tab on all claims above \$5 million. The level will be hiked to \$50 million next year, \$100 million in 2007, and perhaps \$150 million in 2008 before the program is ended.

And it'll be harder to find insurers to write policies, which may pose problems for builders in areas considered high risk.

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