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A Recession, If It Comes, Could Be Worse Than Those of Recent Past

By JUSTIN LAHART
January 21, 2008; Page A4

The U.S. has suffered recessions only twice in the past quarter century, and both were short and mild. But there are good reasons to fear that the looming recession, if it arrives, could be worse.

Housing is in the midst of its worst downturn since at least the 1970s. That has led to a meltdown in the nation's mortgage market; with financial firms struggling to make sense of their losses, they are making it harder for even credit-worthy borrowers to get loans. The combination of heavy debt loads, still-high energy and food prices and a weakening job market has households tightening their belts. Consumer spending, long a bulwark of the economy, is faltering.

That sets the stage for something more severe than the 2001 recession, which spanned just eight months, says Merrill Lynch economist David Rosenberg. During that slump, in which gross domestic product declined by a slight 0.4%, quarterly consumer spending slowed but never contracted -- the first time that happened during a recession since the 1940s.

The eight-month recession that ended in early 1991, when a housing downturn and credit problems sapped the economy, is a better guide. From its peak to its trough, GDP shrank 1.3%, and consumer spending slipped.

Today's housing debacle is even worse, says Mr. Rosenberg, and the financial crisis it has precipitated is far more severe.

University of Maryland economist Carmen Reinhart and Harvard University economist Kenneth Rogoff agree. They say the current crisis appears on track to be at least as bad as the five most catastrophic financial crises to hit industrialized countries since World War II.

If those past experiences are any guide, the economy is in trouble, they argue in a recent paper. Indeed, "if the United States does not experience a significant and protracted growth slowdown, it should either be considered very lucky or even more 'special' than most optimistic theories suggest," they write.

One reason that large crises inflict so much damage is that financial institutions have a hard time getting a handle on how bad their losses will be, and that uncertainty makes them less willing to lend. Citigroup, Inc. and Merrill Lynch & Co. each reported billions of dollars in losses last week that were in addition to the billions in losses they reported in

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NEWS

Credit Card Borrowers Feel the Heat

Will someone please get Chris Consumer a couple of aspirins? His party's over, and he's waking up to the stench of stale beer. He has a creepy feeling he doesn't know the guy snoring under his coffee table. His wallet is empty, and he's got a humming of a headache.

Chris Consumer is us. We're a nation about to suffer a serious debt hangover. We've saved little to nothing. Our credit card debt rose nearly 8% in 2007, to a number that will soon round up to \$1 trillion.

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the fall. Citigroup said it was building its loan-loss reserves for auto loans and credit-card debt, in addition to mortgages, and that it was tightening credit-card lending standards.

"Part of the problem is just not knowing," Ms. Reinhart says. "The longer the process of not knowing what the losses are takes, the longer the resolution takes." Japan was the extreme example, she says. Japan's inability to appropriately gauge the losses from the collapse of its 1990s real-estate and stock bubble led to a "lost decade" of economic growth.

A critical difference between the U.S. and Japan is that the Federal Reserve has been cutting the target for its benchmark federal-funds rate and appears ready to cut it more deeply, whereas the Bank of Japan was still raising rates a year after Japan's bubble began to collapse. Also, Congress and the White House are both promising a fiscal-stimulus package, with Fed Chairman Ben Bernanke pushing for a plan that would help boost spending this year.

Businesses, at least those outside of the banking and housing sectors, might also take some of the sting out of a recession. Their finances are in far better shape now than they were in 2001, and credit so far is still widely available. As they repaired their balance sheets in the wake of the 2001 recession, companies were also slower to hire than in past economic expansions. That may mean they won't be able to cut jobs as deeply, says Goldman Sachs economist Jan Hatzius.

Robert Gordon, an economist at Northwestern University who is also a member of the National Bureau of Economic Research committee that determines (usually long after the fact) when recessions begin, is hopeful that overseas growth may continue to bolster the U.S. economy. He notes that exports, which have been growing rapidly and account for more than twice as large a share of GDP as home construction does, will continue to post strong growth, easing the pain of the housing decline.

Still, he thinks a recession is probably coming and that the challenges facing consumers, in particular, are more severe than they were in the two previous downturns. In addition to the housing troubles and mortgage-market woes, higher food and energy costs are cutting into household budgets, he says.

"While energy is not as important a part of the consumer budget as it was in the '70s -- nor is food -- nevertheless, the squeeze will push out consumption in everything else," Mr. Gordon says. "Across the board, I think we're going to have significant ongoing pressure in inflation-adjusted retail sales."

Robert Barbera, an economist at New York trading-services firm Investment Technology Group Inc., agrees. "Consumers will be part of this recession in a way that they weren't in 2001," he says.

Even if the country is in for just a mild recession, the pressure on spending, coupled with what has happened in the housing and mortgage markets, may make it feel a lot worse for most Americans than the past two downturns did.

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Arm Teens With Good Credit Skills

By SHELLY BANJO
January 27, 2008

From the minute teen-agers step onto college campuses, they are bombarded with offers of free T-shirts or airline miles from credit-card companies seeking their business. By the end of freshman year, the average student has racked up \$1,500 in credit-card debt, according to college lender Nellie Mae.

PLASTIC POSSIBILITIES

Debit and Prepaid Cards

Pros:

- Tied to set sum in bank.
- A step toward true credit cards.

Cons:

- Fees can add up quickly.
- Don't build credit history.

Joint Credit Card With Parent

Pros:

- Teen learns how revolving credit works.
- Builds credit history.

Cons:

- A high credit limit could prove too tempting.
- Missed payments hurt both holders' credit histories.

To help your child avoid the pitfalls of credit, teach teens credit-management skills early,

while they are still at home.

Education First

There are various choices for your teen's first plastic, including debit cards and prepaid cards as well as traditional credit cards. At whatever age you feel appropriate to assist your child in signing up for a card, make sure you explain that "credit is a tool of convenience, not an extension of income," says Kim McGrigg, spokeswoman for credit-counseling firm Money Management International.

Establish clear guidelines for monthly spending limits and items worthy for credit-card use, and also be clear on which of you is putting up the cash.

Set up online access for accounts, noting user names and passwords, so that you can "monitor your child's spending along with them, keeping an eye on overspending or missed bill payments," says financial adviser William Jordan, founder of Sentinel College Funding.

Training Wheels

Debit and prepaid cards "can teach children to live within their means, setting the groundwork for responsible credit-card use in the future," Ms. McGrigg says. They also offer a safer alternative to carrying a stack of cash around the mall. One caveat: they don't help your child build a credit history.

When making purchases with a debit card, money is immediately deducted from the checking or savings account to which it is linked. These cards can introduce your teen to the plastic culture, but watch out for overdraft fees that can add up quickly.

Also, fraud protections are weaker with debit cards than credit, so you may be held liable for a stolen card or fraudulent use if you don't report the problem quickly.

With prepaid cards like Visa's Buxx Card and MasterCard's Allow Card, individual purchases aren't directly charged to a bank account. Instead, parents sign up for the card online and then load, say, \$100 in monthly allowance for their teen. Parents can choose how often to re-load the card and a selected amount can be transferred from your checking account or charged to your credit card.

On most cards, once the balance drops to zero, your child won't be able to spend any more money; in other cases, there could be overdrafts and related charges.

Prepaid cards can allow parents to track their teens' spending closely. For example, MasterCard's Allow Card program sends parents email or text-message alerts on their teens' spending activity. Parents can even block their teens from shopping at certain types of merchants or using automated teller machines.

Carefully review the terms of each card, paying close attention to fees for activation, loading money and monthly maintenance. In most cases, every action entails a separate fee ranging from 25 cents to \$5. To compare prepaid cards, go online to prepaidcardguide.com or cardtrak.com.

Revolving Credit

When you determine your teens are ready for a true credit card, you have three main choices: a secured credit card, a joint credit card, or adding your teen as an authorized user to your credit card.

The safest form of a traditional credit card is a secured card, where your teen either sends in a security deposit or links the card to a savings account. This way, if your child misses a payment, the amount is automatically deducted from the deposit or bank account and your child doesn't go into debt.

But watch out for the high interest rates that may accompany a secured card and stress that the balance should be paid in full each month.

Another option is a low-limit joint credit card, where both you and your child are responsible for the debt incurred. A parent must co-sign the card for a child under 18.

Alternatively, you could add your child to one of your accounts as an authorized user. But keep an eye on your child's spending so the bills don't get out of hand.

"Missed payments reflect poorly on both credit scores," notes Laura Levine, executive director of the JumpStart Coalition for Personal Financial Literacy. "One missed payment can remain on your credit report for seven years."

Finally, financial adviser Mr. Jordan suggests sitting down with teens every month to pay bills together. Take this opportunity to teach them simple steps like reviewing each transaction and paying bills promptly, alongside bigger issues of debt and interest rates.

