

## Mary Rowland Personal Finance Column—December 2008

### Recovering in a Financial Crisis

Wherever you live in the U.S. -- or in the world --- you've heard about the crisis in the financial markets. But what does it mean for you? What should you do about it? Two things: Pay down debt. Make sure you have a credit line in place for emergencies.

What the U.S. has experienced is a classic credit bubble. Over the past couple of years, mortgage loans were made on inflated property prices and to marginal borrowers. Everyone stretched so thin that they couldn't add another nickel in payments. Then interest rates went up on adjustable rate mortgages. Housing values and prices started to go down. Nearly everyone got caught in a crunch.

Homeowners couldn't afford the increased mortgage payments along with rising fuel costs and the economic downturn that meant job loss. They defaulted. Banks had stretched too thin and they couldn't cover the bad loans and they foreclosed on properties. The foreclosure price wasn't enough to pay off the mortgage.

The credit bubble burst and money began to dry up everywhere. Banks stopped lending. They didn't trust anyone. When a credit crisis develops, it can quickly take down the big players like a house of cards. That's why the government propped up the failing banks and Wall Street firms. Because lending is now a global business, ripples spread all over the world, not just to Europe but to developing countries. Without cash or credit, businesses couldn't get money to buy supplies or pay employees.

As the crisis deepened, it became clear that the big brokerages and other Wall Street players had highly leveraged their loans and they were in too deep to get out. That meant when people panicked and tried to turn investments like stocks and mutual funds and money market funds into cash, the cash was not there to pay them. That caused more panic.

This has been a very painful lesson for Americans, many of whom do not remember the Great Depression of the 1930s when a similar chain of events occurred. Fortunately, government regulators responsible for protecting our money supply today know a lot more than they did in the 1930s and they are taking action to prime the pump, to get the credit lines unclogged and moving. It doesn't seem possible, though, that the country can avoid an economic downturn. Too much damage has been done.

What we can do is protect ourselves from getting caught in the whirlpool of this type of crunch in the future. This fall, many credit worthy Americans found they couldn't borrow money to repair a roof or buy a car or send their kids to college.

All of us need credit. Our credit record (or credit score) is used by employers, lenders and many others to check on our character, something the credit scoring companies believe they can determine with a three-digit number.

If you are JUST STARTING OUT out in your career, this might be perfect timing for you. Search for two credit cards with the best deals for your lifestyle (frequent flyer miles, a savings plan, discounts) as well as low interest rates. Don't let the balance revolve. Pay off your bills each time you get them. If you do this, the credit card issuer will raise your credit limit. If that doesn't happen, contact the bank and ask to have it raised.

You don't want to *USE* credit but you want to *HAVE* credit. In an emergency like the current one, you want a clean record. And you want to have credit available to you in the event you need it. Consider setting up an account with a local community bank. If it's small enough, go in to meet with a loan officer just to introduce yourself. At a community bank, you can still be a face rather than just a three-digit number. Don't forget to pay as much as you can on your college loans.

If you are AT MID-CAREER, perhaps, like many Americans, you are head over heels in debt. This is a wake up call. You need to make paying down debt your first priority. Set up a debt schedule to pay as much as you can on credit card bills each month. Then pay the minimum balance on all cards except the one with the highest balance. Put everything extra on this card balance until you pay it off. Then move to the card with the second highest interest rate and do the same thing. Find out your credit score. You will need it.

Set up a home equity credit line. Yes, these lines are controversial. You don't have to use it but you should have it. Home equity lines saved some people from disaster over the autumn months when they lost their jobs and paychecks stopped coming in.

Think ahead about paying for college. College costs keep going up and college loans have all but disappeared. Discuss this with your child and work out an arrangement where he/she can start working and saving.

If you are NEARING RETIREMENT or already retired, the same rules apply to you: Pay down all your debt. Check your credit score. Get a line of credit, such as a home equity line, that will be available to you in an emergency. If you do business at a small community bank, meet with a loan officer and express your concerns.

If you are flush, don't go overboard on gifts for the kids or the grandkids this year. Often people feel that the holidays are even more important in tough economic times and they go wild on gifts, hoping to make up for the dark, grey days and the required penny pinching. Don't do it. Save for a rainy day.

The most important thing to learn from this national financial disaster is that most everybody and every company carry too much debt. And, further, because they already have so much debt, they couldn't tap into credit in an emergency. Pay down debt. Set up an emergency credit line. That gives you a jump start on your New Year's resolutions.

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