

Chicago Fed study sees subprime woes contained

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CHICAGO (Reuters) - Problems created by subprime mortgage delinquencies could stay concentrated in areas already under stress and not infect the broader economy, according to a Chicago Federal Reserve analysis released on Thursday.

In a paper examining mortgage activity in the Fed's 7th District, economists Sumit Agarwal and Calvin Ho cited Michigan and Indiana as states where delinquency rates have been running as high as twice the national average.

"Indiana and Michigan, which have experienced slowdowns in the manufacturing sector, have reported higher rates of delinquencies ... in both prime and subprime mortgage markets," they said.

The economists noted that the recent jump in subprime mortgage delinquencies was mostly in the adjustable-rate segment, a growing but still small part of the \$10 trillion residential mortgage market in 2006.

"The subprime ARM market is less than 7.5 percent of the overall mortgage market and a vast majority of the subprime loans are performing well," they said.

Subprime mortgages are those offered to higher-risk borrowers, and typically carry interest rates 200 to 300 basis points above the prevailing prime rates.

Both Indiana and Michigan are struggling with contraction among the "Big Three" U.S. automakers and a migration of U.S. auto production to the southern states.

At the end of 2006 the delinquency rate for subprime mortgages in Michigan was 21 percent versus 14 percent for the overall United States.

The Chicago Fed district comprises all of Iowa and much of Illinois, Indiana, Wisconsin and Michigan.

The fraction of subprime loans that are ARMS jumped to about 50 percent in December 2006 from 28 percent in December 1998, the economists said.

Agarwal and Ho said that a number of recent public and private initiatives should help prevent the spread of subprime problems to the broader economy.

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