Low interest rates put cash in Americans' pockets

By Dennis Cauchon **March 27, 2012**

A historic drop in interest rates is helping save U.S. households more than $3,000 a year on average, allowing consumers to spend more even as their earnings fall, a USA TODAY analysis finds.

Americans spent 5.8% of their after-tax income paying interest on mortgages, credit cards, car loans and other debt, according to the latest data from the Bureau of Economic Analysis. That's the smallest share since 1977 and a steep drop from a record high of 9.1% in 2007.

The result: Low interest rates are reshaping household budgets and consumer spending, showing the economic force of the Federal Reserve's unprecedented effort to reduce mortgage and other long-term rates to restore an economy that was near collapse four years ago.

Household interest payments fell to an average of $469 per month at the end of last year, down from a peak of $728 in 2007, after adjusting for inflation. That equals $3,100 a year.

Three-fourths of the interest savings stem from falling rates, the rest from a reduction in debt.

Mortgage interest payments are down 30% from their 2007 peak. Interest payments on other debt, such as credit cards and car loans, are down 50%. The shrinking interest payments have no end in sight as old mortgages get refinanced and new cars get bought at lower rates. The Fed has pledged to keep interest rates low through 2014.

The economic gain for borrowers overshadows the importance of other stimulus efforts or even higher gas prices. A cut in the Social Security payroll tax, by contrast, will save households an average of about $70 a month this year,

"Even if people aren't paying attention to their interest payments falling, the money builds up in their checking account, and that especially benefits big ticket items like cars," says Paul Taylor, chief economist for the National Automobile Dealers Association. Lower rates are letting people spend more on cars for the same monthly payment, boosting the fortunes of automakers.

Interest savings have softened the blow of falling personal income, which is $1,700 lower per household than at the 2007 peak. The gains are even greater for businesses, which "depend more on borrowing," says Robert McTeer, former president of the Federal Reserve Bank of Dallas.

The big downside: falling rates hurt those who saved prudently while others spent and borrowed. And some borrowers still face crushing mortgages on homes that lost much of their value.

Other findings:

•The federal government doubled its debt from 2007 to 2011, but falling rates mean interest payments have barely changed.

•When household and government debt are combined, Americans are more indebted then ever — but interest payments have fallen 25%.