

Economy: What's good, bad

MIAMI – Aug. 27, 2009 – Real estate agent Dave Gervase recently witnessed an astonishing spectacle: a bidding war for a house in South Florida.

When he showed a home to a client, he discovered that 23 other shoppers had already put in bids. “We offered 6 percent over the asking price – and lost out,” Gervase says.

What Gervase saw was an extreme example of a nationwide phenomenon: signs of life in the battered housing market and the overall economy. Housing prices rose 2.9 percent from the first quarter to the second – the first quarterly increase in three years, Standard & Poor’s reported Tuesday. Meanwhile, a business group announced Tuesday that amid signs of economic improvement, consumer confidence rebounded this month.

The S&P/Case-Shiller Home Price Index and the Conference Board’s consumer confidence index were the latest reports to suggest that the U.S. economy is staggering toward recovery. The progress is agonizing, and many ordinary people won’t see the payoff for a while. The Congressional Budget Office expects unemployment to rise from July’s 9.4 percent and average double digits next year.

But for all the caveats, the signs of recovery strike many economists as a huge relief. After the collapse of Lehman Bros. last Sept. 15, the United States and the world seemed to be teetering on the edge of a second Great Depression. And some say the improving outlook vindicates the aggressive actions taken since last fall by Federal Reserve Chairman Ben Bernanke. A student of the economic cataclysm of the 1930s, he slashed interest rates to zero and pumped hundreds of billions into the financial system.

President Obama is sold. Taking time off his vacation in Martha’s Vineyard in Massachusetts, the president announced Tuesday that he would reappoint Bernanke when his first four-year term as Fed chairman expires in January. “Ben approached a financial system on the verge of collapse with calm and wisdom; with bold action and outside-the-box thinking that has helped put the brakes on our economic free fall,” Obama said.

Bernanke “has done a first-rate job,” says S&P economist David Blitzer. “The risks were incredible, and the Fed had to step in.”

The Fed chief “deserves a significant amount of credit for ending the recession,” says Mark Zandi, chief economist at Moody’s Economy.com. “If he hadn’t acted as aggressively and creatively as he did, we would still be in a recession, and we’d be talking about a depression.”

Long climb ahead

Even so, the economy is a long, long way from a full recovery, and Bernanke has plenty of critics. The Congressional Budget Office predicts economic output will fall 1 percent this year and unemployment will average 10.2 percent in 2010. Housing prices are still down 30 percent from their 2006 peak, household incomes are shrinking, employers are still cutting jobs and consumer confidence is struggling back from rock-bottom levels.

Critics say Bernanke was slow to see trouble brewing, as President Bush’s chief economic adviser in 2005 and as Fed chairman. By not moving faster to counter the economy’s slide, Bernanke made “a huge, huge mistake,” says Dean Baker, co-director of the left-leaning Center for Economic and Policy Research in Washington D.C. “And millions of people are suffering for it.”

But after the Lehman Bros.' collapse sent the world economy into a tailspin last fall, Bernanke sprang into action. He pushed the rate that banks charge each other for short-term loans as low as zero and kept it there; and he announced unprecedented plans to pump up to \$1.75 trillion into parched financial markets by buying government debt and mortgage-backed securities. He kept investment banks afloat with billions in loans and made unorthodox cash infusions into the inter-bank lending market and the commercial paper market that companies rely on for short-term financing. "It stopped the plumbing from backing up," says Bruce Kasman, chief economist at JPMorgan Chase.

The idea was to get credit flowing and, along with Obama's \$787 billion stimulus program, jump-start the stalled economy.

It may be working. Unemployment fell unexpectedly last month, though partly because many discouraged workers stopped looking for jobs.

Industrial production rose in July for the first time in nine months. "We've had some nice, pleasant upbeat reports," Blitzer says. "We could haggle over whether it's June, July or August that the recession ends."

Even the housing market appears to be recuperating from a three-year bloodbath. Home prices rose in 18 of the 20 cities tracked by the S&P/Case-Shiller index from May to June. Month-to-month comparisons can be unreliable and overall prices are about where they were in early 2003. Still, "The numbers are telling us prices may have already hit bottom," says Patrick Newport, economist at IHS Global Insight. That helps by producing:

- More consumer spending. Rising home prices give homeowners more confidence to spend. They tend to tighten their belts if they owe the bank more than their house is worth.

"Everyone is very cautious, and there is instability in employment," says Jackie Williams, a real estate broker in Middletown, Conn. "But people will spend if (their home is worth) a reasonable price. Consumer confidence will build a little."

- More buyers moving into the housing market. Rising prices may nudge more potential homebuyers off the fence. Ryan Burns and his wife are renters in Bellingham, Wash., now, and their lease is almost up. "We were considering extending our lease another six to 12 months in order to pack away a larger downpayment," Burns says. "But if prices are on the rise, we might just speed up our search."

- Fewer toxic assets on the books for banks. Rising home prices are an elixir for banks stricken with questionable mortgage loans and foreclosed property. "It improves the balance sheet of the bank. That will hasten the end of the credit crunch," says Joel Naroff, of Naroff Economic Advisors. "Do I think it will happen very fast? No."

Worries about winter

Moody's Zandi expects the housing market to be depressed this winter when banks auction off foreclosed property. Lenders have delayed the sales, he says, while trying to figure out how to qualify for a government program to modify troubled mortgages; eventually, the foreclosures will continue.

Other government programs may be providing a one-time boost. An \$8,000 tax credit for first-time homebuyers ends Nov. 30. "Once this credit expires," Newport writes, "home sales, housing starts and house prices will take a hit. Unknown is how big this hit will be."

An uptick in prices "is encouraging," Blitzer says, "but happy days are not here again in the real

estate business. ... If you bought a house at exactly the wrong point in Miami or Las Vegas or Phoenix, say in 2006, you aren't going to sell it for that kind of money for a long time."

Even the South Florida house that drew 24 offers was a special case: An owner who owed more than the house was worth, was working with a bank to sell it for \$65,000 less than the mortgage. But real estate agent Gervase says he's seen market-priced homes set off bidding wars, too.

Critics also fret that Bernanke and the Fed will fail to keep inflation under control once the economy picks up strength. But for now, many economists say Bernanke's audacious intervention has averted disaster.

"Given where we are now and where we come from, he has been vindicated," Blitzer says. "My guess is that five years from now, he will still be vindicated."

Bad: Unemployment projected to hit 10 percent

In a new economic forecast, the Congressional Budget Office estimated the unemployment rate – 9.4 percent in July – will be 10.2 percent at the end of 2010 and 9.1 percent at the end of 2011.

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