Economic Outlook for 2010

A fragile recovery from the Great Recession will rebuild an economy that's stronger and more stable than ever.

By Patrick S. Duffy

Given the depth of the Great Recession's impact on the housing industry, most insiders are hoping for that long-awaited economic rebound that will finally provide some solid flooring to our decimated industry. And some may get their wish, although the recovery will be uneven, slow and prone to a variety of unknown risks.

Since most of the economic growth noted in the third quarter of 2009 was due to fiscal stimuli such as the homebuyer tax credit and Cash for Clunkers programs, it still remains to be seen if the economy can rebound without any government training wheels. In their latest economic forecasts, our partners at Beacon Economics are calling for growth in U.S. GDP of about 2 percent in 2010, fueled mostly by increased business investments related to higher savings rates, and a closing trade gap. Yet as tax cuts from the Bush years begin to expire in late 2010 and early 2011, if there is not a double-dip recession, 2011 could see a slow growth rate close to 0 percent. Thankfully, it seems that unemployment levels may have peaked at around 10 percent and will gradually decline to 5.5 percent by 2013.

One wild card which remains is that of "shadow inventory": with 1.7 million homes scheduled for potential sale due to defaults and foreclosures at the end of September 2009 — up by 55 percent over the past year — any housing recovery will remain in limbo until the supply of discounted foreclosures is largely exhausted. Still, there is a significant silver lining to declining prices, which is that of sharply rising national affordability levels, which have recently been averaging close to or over 70 percent.

> **"...there is a significant silver lining to declining prices, which is that of sharply rising national affordability levels, which have recently been averaging close to or over 70 percent."**

For those builders working in the commercial sectors, most of that pain is yet to come, especially since changes in the Financial Accounting Standards Board (FASB) rules give banks more leeway to ignore short-term declines in asset values, commonly referred to as "extend and pretend." What that means is that banks will avoid taking back commercial properties until the one-two punch of rising vacancy rates and falling rents forces property owners into default on current loans. For cash-rich investors, however, 2010 could bring some of the best opportunities in years.

Another wild card is that of the huge surplus of cash — about $1 trillion — sloshing around in the reserve accounts of the nation's banks and originally employed to avoid financial Armageddon. Assuming the Federal Reserve can stomach higher interest rates and a stronger economy can mop up this extra liquidity, inflation can be held in check, but it will require a careful balancing act in a highly politicized time in which there are no good guides to follow.

Finally, there are always a series of economic risks which could upset most forecast scenarios, which include a lack of private sector buyers of mortgage-backed securities after the federal government steps back from the market, a weakening dollar leading to a trade war, a rising federal debt, higher tax rates, a bear market for Treasury bonds, persistent high unemployment, geopolitical conflict and a foreign government defaulting on its debt. In other words, the usual suspects.

But fear not. When the impacts from the Great Recession are over, the U.S. will emerge stronger, healthier and with a more stable economy yielding realistic asset prices. Consumers will save more, leading to more balanced trade and a return to steady growth of about 3 percent per year. And ultimately, the nation's quality of life will remain one of the best in the world. Happy 2010!

Patrick S. Duffy *is a principal with MetroIntelligence Real Estate Advisors (www.metrointel.com), a division of Beacon Economics (www.beaconecon.com) and authors The Housing Chronicles Blog (www.housingchronicles.com). He can be reached at pduffy@metrointel.com or at 888-82-DEVELOP.*

Fast Facts

- **U.S. GDP is projected to grow by about 2 percent in 2010 but remain flat in 2011.**
- **The shadow inventory of homes in default and foreclosure is growing and will delay a sustained housing rebound.**
- **The economic pain in commercial markets will continue to play out in 2010 and 2011.**