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Greenspan Says Home-Price Drop May Spur New Recession (Update1)

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By Joshua Zumbrun



Aug. 1 (Bloomberg) -- Former Federal Reserve Chairman **Alan Greenspan** said the slowing economic recovery in the U.S. feels like a “quasi-recession” and the economy might contract again if home **prices** decline.

“We’re in a pause in a recovery, a modest recovery, but a pause in the modest recovery feels like a quasi-recession,” Greenspan said in an interview on NBC’s “Meet the Press.”

Asked if another economic contraction, a so-called “double dip,” was possible, Greenspan said, “It is possible if home prices go down. Home prices, as best we can judge, have really flattened out in the last year.”

Slowing economic growth, and a decline in housing activity following the expiration of a government tax credit, have raised

fears that the economy could return to a recession before completing its recovery from the worst downturn since the 1930s.

The former U.S. central bank chairman said that most economists expect “a small dip” in home prices. The National Association of Realtors reported that the pace of home **sales** fell in June for a second month. Homes are selling at an annual rate of 5.37 million, and the group’s chief economist **Lawrence Yun** said transactions will be “very low” in coming months.

“If home prices stay stable, then I think we will skirt the worst of the housing problem,” Greenspan said. “But right under this current price level, mainly 5, 7 or 8 percent below, is a very large block of mortgages, which are under water, so to speak, or could be under water. And that would induce a major increase in foreclosures, foreclosures would feed on the weakness in prices, and it would create a problem.”

Home Prices

Home **prices** in 20 cities rose by 4.6 percent in May, according to a report from S&P/Case-Shiller last week. Because of the index’s lag in reporting, the extent to which home prices may slacken in June and July is not yet determined.

Greenspan’s successor, **Ben S. Bernanke**, told Congress last month that the economic outlook is “unusually uncertain.” Bernanke and his colleagues on the Federal Open Market Committee will meet Aug. 10 in Washington. Last week, the Commerce Department reported that the recovery slowed in the second half of 2010. The economy grew at a 2.4 percent pace, following growth of 3.7 percent in the first quarter.

“Our problem basically is that we have a very distorted economy,” Greenspan said. Any recovery has

mostly been limited to large banks, large businesses and “high-income individuals who have just had \$800 billion added to their 401(k)s, and are spending it and are carrying what consumption there is.”

S&P 500

While the Standard & Poor’s 500 **Index** has fallen from its highest levels of 2010, its July 30 close of 1101.6 is 63 percent higher than its trough in 2009. Greenspan said a continuing rise in the stock market would further stimulate the economy.

“The rest of the economy, small business, small banks, and a very significant amount of the labor force, which is in tragic unemployment, long term unemployment -- that is pulling the economy apart,” Greenspan said.

The Labor Department will report on Aug. 6 that the unemployment **rate** rose to 9.6 percent in July from 9.5 percent in the prior month, according to the median of a Bloomberg survey of 57 economists. Greenspan said he expects “we just stay where we are” with unemployment for the rest of the year.

“There’s nothing out there that I can see which will alter the trend or the level of unemployment,” he said.

Greenspan repeated his warning that fiscal **deficits** could push up long-term interest rates and threaten the recovery.

Financial System ‘Broke’

“At the moment, there is no sign of that, basically because the financial system is broke, and you cannot have inflation if the financial system is not working.”

In an interview last month on Bloomberg Television’s “Conversations with **Judy Woodruff**,” Greenspan said that tax cuts enacted under President George W. Bush should be allowed to expire at the end of the year.

Greenspan repeated this view on NBC, saying, “I’m very much in favor of tax cuts. But not with borrowed money.”

Greenspan appeared on “Meet the Press” alongside Pennsylvania Governor **Ed Rendell** and New York City Mayor **Michael Bloomberg**. The mayor is founder and majority owner of Bloomberg News parent Bloomberg LP.

Bloomberg said the tax cuts should be continued for now. “I would say let’s go on with the tax cuts for another couple of years, but you couple it with long-term solutions,” Bloomberg said.

Rendell said he would accept phasing out the tax cuts over two or three years, though eventually “you have to have increased taxes along with those reductions.”

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