Economists warn recovery fragile

Still-weak financial sector must rebound to sustain recovery

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FAYETTEVILLE — University of Arkansas economists and banking professors said Friday that in spite of recent reports showing better economic news, the recovery of the nation's economy will be a slow process.

The Northwest Arkansas economy is faring much better than the national economy, but most of this region's banks are in worse shape now than they were in a year ago, recent data shows.

The number of unsold new houses in Northwest Arkansas has fallen over several quarters, but a large number of undeveloped lots remains as a concern for banks.

Five UA officials offered their views during an economic forum Friday at the UA's Sam M. Walton College of Business. Using medical terminology, speakers said that stimulus funding had served like a defibrillator to shock and revive a dead economy.

Recovery 'quite fragile'

While economists cautioned against the dangersof continued government deficit spending, they also warned that government spending is currently serving as life support and pulling the plug too quickly could backfire and send the economy reeling downward again.

Raja Kali, an associate professor in economics, provided data showing that the national economy is showing some "signs of life":

◇The economy contracted by only 1 percent in the second quarter, compared to 6.4 percent in the first quarter.

◇Home sales in June increased 11 percent compared to last June.

◇Jobless claims have recently fallen by 1.5 percent, and unemployment dipped to 9.4 percent nationally.

Kali warned that the economy remains uncertain with its increasing dependence on consumer spending, which remains weak. The financial markets must get stronger to sustain an economic recovery, he said.

"The recovery is quite fragile," Kali said. "What we are seeing now will peter out unless the financial sector returns. ... If the financialsector collapses, it can drag the entire economy down."

Next 'weak link':

commercial real estate

Tim Yeager, assistant professor of finance at UA, said that "the crisis of trust" seems to have passed for financial markets but that he sees signs of continued weakness in banking, which "has surely not hit bottom."

"The next weak link in the chain" is the commercial real estate market, such as office buildings, retail shopping centers, gas stations and other properties. These properties are typically financed on five-year notes and as those loans come due, borrowers will struggle to refinance them, he said.

The local real estate market began its correction sooner than the rest of thecountry, he said.

"We began our contraction earlier than other parts of the country. We've gone through a lot of residential. Commercial will continue to bring us down - it's not pretty," Yeager said.

Local banking woes

Yeager provided a financial summary of the 14 Northwest Arkansas banks showing several areas of concern when comparing the annualized results from June 2008 to 2009:

◇Loan loss reserves increased by 28.7 percent.

◇Charged-off loans increased by 87.9 percent.

◇Foreclosed real estate owned by banks increased by 92.8 percent.

◇Loans past due between 30 and 90 days increased by 79 percent.

The report showed some bright spots:

◇Half the banks reported a lower number of nonperforming loans.

◇ More than half reported positive loan growth.

◇Four banks reported lower losses from chargedoff loans.

◇Four banks reported higher operating income.

'Drunken sailor' spending

John Dominick, a UA professor of finance, offered the most fiscally conservative message from the panel, saying that since 2008, the federal government has been spending money "like a drunken sailor."

He likened efforts to stimulate the economy with massive spending efforts to "throwing some mud at the wall to see if something sticks."

Dominick said that the government has recklessly spent money on the bailout of financial institutions and Wall Street firms that should have been allowed to fail.

He called the federal Troubled Asset Recovery Program, known as TARP, which was designed to help keepbanks from failing, as one of the worst uses of taxpayers' funds.

"I'm disgusted and thoroughly demoralized," he said.

Javier Reyes, an assistant professor of economics, expressed concern about the high levels of government debt and deficit spending, but he also cautioned that pulling the plug too quickly on stimulus spending could have a negative impact of the recovery.

Paradox of thrift

Kathy Deck, the director of the Center for Business and Economic Research at the Walton College, said in a telephone interview that an increase in consumer spending is critical to an economic recovery. However, consumers are concerned about the bad economy and putting off purchases and saving money, which is holding back the recovery.

She, who did not attendthe forum, said it's good for the economy when people save money - just not when everyone does it at the same time. Both Deck and Kali referred to this as the "paradox of thrift."

"You are most tempted to cut way back during a recession, but of course when things are bad is exactly when the economy needs people to spend money," Deck said.

Moderate consumer spending is needed, not the binge spending of the past several years or the current restrained spending, she said.

She said that the Northwest Arkansas economy has suffered setbacks, but it is doing much better than the nation's economy. The number of new but unsold houses has continued to drop over the past several quarters as new construction has slowed down, but a significant number of vacant lots remains in subdivisions, she said.

"The lots are still a significant problem," Deck said.

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