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Credit crunch, financial collapse fears fuel bailout push

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Arizona is a long way from Wall Street, but the U.S. government's proposed $700 billion bank bailout could have a significant impact on local businesses, Valley economists and financial analysts say.

It also could breathe life into the credit markets, which have been weakening daily.

"This credit crisis will affect many more businesses than can be counted," said Mitchel Medigovich, president of **Cattlemen's Mortgage and Investment Corp.** in Phoenix.

"If a bank is required to reduce the amount and number of loans it has, and if the bank is saturated with bad loans, the bank will have no choice but to ask some of its best customers to accept lower credit limits, pay off loans or simply go to another institution," said Medigovich.

"That credit scenario would force businesses to shrink capital expenditure and, eventually, jobs because their financing streams will be dried or dammed," he said.

Banks have been tightening their lending practices and cutting back on financing that spurs business activity, said regional economist Elliott Pollack. He also said

private-sector consumer spending is down — notably on homes, equipment and durable goods.

Lisa Von Bargen, CEO of Phoenix consulting firm **Beyond Implementation Inc.**, said businesses and consumers are having a hard time getting loans with good terms in this environment. She worries the problem could get worse and said tougher credit markets are putting business activity at risk.

Many businesses use credit and financing not only for capital and investment projects, but also for standard operations.

The bailout plan forwarded by U.S. Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke would have the government taking on bad mortgage debt from the finance sector, with the aim to keep lenders afloat and free up more lending streams clogged by the mortgage mess. Without quick action, Bernanke said the financial markets could further falter and bring on dark days for the U.S. economy.

But the bailout and the expected accompanying regulations on lending may be a double-edged sword.

On one hand, the credit crunch has hundreds of banks stuck with bad mortgages and in peril. The bailout could ease that credit gridlock.

"It will actually be a stimulus to the economy by taking bad loans off banks balance sheets. It will free up capital for more loans to be made," said John Mathis, a global finance expert and professor at **Thunderbird School of Global Management**.

Mathis said the bailout would increase mortgage lending, though the loans will be of the traditional nature.

On the other hand, the bailout could increase inflation and lead to new restrictions on lending to consumers and businesses, which could muffle financing after the short-term rescue.

Byron Schlomach, an economist with Phoenix think tank **The Goldwater Institute**, said the bailout could increase inflation if financial assistance is added for homeowners with distressed mortgages who owe more than the house is worth.

His worst-case scenario: "The Fed prints more money to accomplish all this. We go into double-digit inflation as the value of the dollar tanks. We suffer stagflation, with unemployment spiking closer to 10 percent when the Fed eventually tightens monetary policy."

The Federal Reserve and other central banks already have been pumping money into wobbly financial markets to ease the credit crunch, giving $30 billion to JPMorgan Chase to help it acquire Bear Stearns and $85 billion to save insurer American International Group. The feds also took over mortgage backers **Fannie Mae** and **Freddie Mac**.

As the bailout is debated, some have called for the government to take an equity stake in the banks benefiting from the plan. **Arizona State University** finance professor Tony Sanders opposes that idea.

"Everyone should be terrified of the government as a stakeholder in the banks they bail out," he said. "As we have seen, the government is pretty bad at enforcing regulations."

The impact on the Phoenix housing market also could cut both ways. If the Fed takes over bad mortgages, it could rescue mortgage lenders, resulting in more home loans. It also could lessen the glut of houses whose sale prices are being reduced as mortgage and real estate assets are dumped.

Mathis said if more consumers qualify and buy homes, demand and prices will increase. But if those houses and mortgages are dumped at discount prices, it could depress surrounding real estate values and hurt other homeowners.

Pollack predicts the housing market will bottom out next year, but said it will take several years to recover because of the number of subprime-driven foreclosures and the oversupply of homes. He sees a similar scenario starting next year with commercial real estate in the Phoenix market. That would further hurt the state's real estate industry.

Ryc Loope, a real estate development professor at ASU, said the government bailout may mitigate major pain, but it could take longer to work out some of the kinks in the marketplace.

Loope said the Resolution Trust Corp., established during the savings and loan crisis of the 1980s and 1990s, was a lengthy but overall effective program that disposed of S&L-owned real estate.

Speculators and investors also could come in and buy mortgages and homes at discount prices, then try to hold them until the market improves, Medigovich said, and that could help reduce the oversupply and help prices when the market rebounds.

"There will be speculators who may try to buy distressed assets," he said. "However, they will have to buy those assets very cheap and will have to hold them for a long period for a gain — but that is capitalism."

Reporters Jan Buchholz and Chris Casacchia contributed to this story.