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business

How will we know when it's working?

Keep watch on home values, the stocks of banks and brokerage firms and the bond markets for signs of success.

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Now that President Bush has signed the Troubled Asset Relief Program into law, economists don't expect it to reverse the economic slowdown, restore jobs or bring back easy mortgages.

So, how will taxpayers know the $700 billion Wall Street bailout is actually getting the job done?

If it works, it should thaw a freeze in the credit markets, make loans more available and cut down on bank failures. Eventually it might even help housing markets.

"No one should expect immediate recovery, but I believe this is overall a positive step," said Ronnie Phillips, an economics professor at Colorado State University.

Critics, such as former Treasury Secretary Paul O'Neill, view the plan as a gross intrusion by government into the private sector and a waste of taxpayer funds.

Some who support a rescue plan think TARP may fail because it targets the wrong end of the housing market.

"Without help for the bottom of the pyramid, Wall Street will be back next year asking for another trillion dollars," said Timothy Canova, professor of international economic law at Chapman University in Orange, Calif.

Below are some areas by which to measure the plan's success or failure.

Home prices

One thing many consumers are eager to see, rising home values, may take the longest time to achieve.

"Look at the inventory of unsold houses both new and existing. You need to look at the amount of mortgages being generated," said Campbell Harvey, a finance professor at Duke University.

Although no-money-down financing is a thing of the past, easier terms on mortgages will show that the crisis is easing, adds Phillips.

"We should see some reduction or slowdown in home-mortgage defaults. This may take a couple of months at least after TARP becomes effective," he said.

If defaults flatten out and inventories of homes for sale shrink, that should ease the downward pressure on home prices.

What to watch: The S&P/Case Shiller Home Price Indices and the OFHEO House Price Index are two home price measures that will signal a bottom in housing.

Stock prices

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A government agreement to purchase up to $700 billion in mortgage-backed securities and other troubled assets is at the heart of TARP.

"Those institutions that sell assets to TARP should see increases in their stock prices," Phillips said.

A rally in bank, insurance and brokerage stocks could signal that TARP is working. But stocks overall could still fall on worries that a deepening recession will hurt future profits.

Rising yields on short-term Treasuries and a drop in gold prices are two signs that investors have become more comfortable holding stocks.

The current crisis originated with subprime mortgage-backed securities, and how they respond to the plan will be crucial, said Fred Dickson, chief market strategist with The Davidson Cos. in Great Falls, Mont.

What to watch: The ABX "AAA" Subprime Mortgage Swap Index, which tracks the highest rated risky mortgages. The index, which traded at 42 cents on the dollar two weeks ago, is faring better, closer to 52 cents.

Bond market

Major stock indexes fell Friday despite passage of the plan, but that's not entirely a surprise. Commercial paper, municipal-bond and corporate-bond markets are expected to benefit before equities.

"Investors pulled money from their municipal money-market funds and fled to Treasury-only money-market funds," said Ken Harris, a research analyst with Denver Investment Advisors, a mutual-fund manager.

In particular, debt markets that set interest rates on a short-term basis froze up, causing rates to spike for government and business borrowers alike.

California is poised to ask the federal government for a $7 billion loan after its financing sources dried up. Closer to home, Denver International Airport is paying 12 percent interest on some of its debt after buyers disappeared.

A positive sign would be an increase in the supply of commercial paper or short-term debt issued by corporations. That market dipped to $1.6 trillion on Oct. 1, a three-year low.

More commercial paper and falling yields on corporate bonds will make it easier for large businesses to obtain capital.

What to watch: Lower yields on municipal and corporate bonds would signal that confidence has returned.

LIBOR falls

An immediate sign that TARP is restoring confidence would be a a drop in the London Interbank Offered Rate (LIBOR), a measure of the willingness of banks to lend to each other overnight.

Banks that aren't lending to each other aren't going to be eager to lend to consumers and businesses.

"Our problem is a credit problem. Small and medium businesses are having a terrible time getting the simplest of loans," said Harvey, the Duke University professor.

If credit markets remain frozen in coming weeks, then TARP is dead on arrival, he said.

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Looser credit markets will show up with a smaller spread between LIBOR and the overnight indexed swap rate, said economist Michael Orlando, formerly with the Federal Reserve.

Rising LIBOR rates are damaging for another reason — most adjustable-rate mortgages in the U.S. use the benchmark to determine what borrowers will pay.

Reduced borrowing from the Federal Reserve also will indicate credit markets are easing, adds Louis Llanes, a money manager with Blythe Lane Investment Management in Greenwood Village.

Banks and securities firms had borrowed $348.2 billion from the Federal Reserve last week, a 60 percent jump from the week before.

What to watch: The spread between the 3-month LIBOR and the overnight indexed swap, which rose to an all-time record 2.81 percent on Friday versus a more typical spread of 0.11 percent.

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