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Trying to Recover

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As the economy crawled into 2009, there was never any reasonable doubt about the need for immense federal stimulus. But there was plenty of unreasonable opposition. Only three Republicans voted in February to pass a $787 billion stimulus package, President Obama’s first legislative victory. Ever since, some of Mr. Obama’s Republican opponents have routinely asserted that the ongoing recession is evidence that the stimulus has failed.

The assertion was always silly. Now it has been proved wrong. The report on second-quarter economic activity, released on Friday, showed that the pace of contraction slowed markedly from April through June — falling at an annual rate of 1 percent after shrinking at an annual rate of 6.4 percent in the first quarter. If it weren’t for stimulus spending, the contraction would have been closer to 4 percent. From July through September, when the largest chunk of stimulus money is scheduled to be spent, the boost to activity is projected to be even greater.

The good news, then, is that the stimulus is, indeed, cushioning the worst effects of the downturn. Still uncertain is whether it will lay a foundation for future growth or whether, once most all of the money is spent in 2010, the economy will stall or even regress.

Unfortunately, a muted recovery seems to be the most likely scenario. The stimulus, while helpful, was designed for a milder recession than what has actually occurred. So unless the administration and Congress agree on more stimulus, federal spending is unlikely to spark a strong, self-sustaining recovery.

Worse, whatever growth the economy manages to eke out over the next year or so is bound to be constrained by unrelenting foreclosures and tight credit — and the lack of a robust policy response to either.

This week, many of the nation’s big mortgage servicers met at the Treasury Department to discuss their lack of progress in modifying bad mortgage loans. At the end of the day, they committed to modifying 500,000 loans by November. That’s not really a solution.

The issue is not only how many loans are modified, but how they are reworked. The administration has earmarked $75 billion to help servicers reduce troubled borrowers’ monthly payments. But when a homeowner has no home equity — as is increasingly the case with troubled borrowers — the most effective modification is to reduce the loan’s principal balance, restoring some of the lost equity. That’s what the administration should be pressing for.

Economic recovery will also be impaired by the ongoing credit crunch. The stress tests of the nation’s big banks in May — and the banks’ subsequent success at raising new capital — calmed the banking industry. But the underlying problems endure. For instance, bad loans remain on the banks’ books, feeding uncertainty about potential future losses and constraining credit. The administration’s policy seems to be to buy time, hoping that confidence and growth resume gradually and that nothing terrible happens in the meantime. At best, that portends a tepid recovery.

The stimulus is helping, and more stimulus would help even more. But going forward, new policies to stop foreclosures and to jump-start lending must also be part of the plan for economic recovery.