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Goldman Sees 'False Bottom,' Merrill Sees 'Treat' (Update1)

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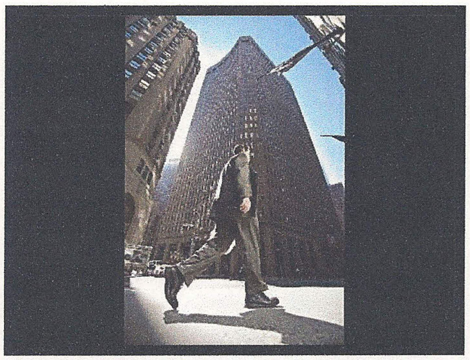

Oct. 27 (Bloomberg) -- The stabilization in U.S. home prices won't last, according to economists at Goldman Sachs Group Inc. in New York. Their counterparts at BofA Merrill Lynch Global Research see a "treat" rather than a retreat.

"The risk of renewed home price declines remains significant," **Alec Phillips**, an economist based in Goldman's Washington office, said in an Oct. 23 note to clients. "Our working assumption is a further 5 percent to 10 percent decline by mid-2010."

"We should expect subdued home price appreciation over the next few years," wrote Merrill Lynch's **Ethan Harris** and **Drew Matus** on the same day.

Both camps agree government stimulus programs, including the $8,000 first-time buyer tax credit, foreclosure moratoria and Federal Reserve purchases of mortgage-backed securities, have helped stem the slump in housing. At the center of the debate is how much influence these initiatives have had, and therefore what happens after they expire or wane.

On the supply side, the programs have reduced the number of foreclosed houses reaching the market by about 450,000, according to Goldman calculations, said Phillips. They have also boosted sales by about 200,000 homes, he said.

'Temporary Factors'

"Taken together, these moves might have added 5 percent to home prices nationally," Goldman's Phillips wrote. "If this estimate is correct, it suggests that most of the increase in home prices since this spring -- which has totaled between 2 percent and 4 percent in seasonally adjusted terms -- has been due to temporary factors."

The latest reading on one of those measures came today. The S&P/Case-Shiller index covering 20 U.S. cities climbed 1 percent in August from the prior month, the third consecutive increase. The measure was down 11.3 percent from August 2008, the smallest 12-month decrease since January 2008.

Combined sales of new and existing homes totaled 5.52 million at an annual rate in August, up 15 percent from a January low, according to figures from the Commerce Department and the National Association of Realtors.

Purchases of **previously owned** houses jumped 9.4 percent in September, the most since comparable records began in 1999, the real estate agents' groups reported last week. Figures on September sales of **new houses** are due from the Commerce Department tomorrow.

"Much of this strength seems to have been policy- induced," Phillips wrote in a section of the report titled: "A False Bottom?"

Halloween 'Treat'

"While tax credits and distressed property sales may be influencing both sales activity and prices, they are not the primary force behind the rebound in housing," Merrill Lynch's Harris, head of North American economics, and Matus, a senior economist, wrote in a Halloween-themed report that likened the improvement to a "treat."

Halloween is the Oct. 31 celebration in the U.S. when children go door-to-door "trick-or-treating." They wear costumes, ask for sweets and play pranks.

Home prices have fallen so much that prospective buyers no longer expect them to drop much further, said Harris and Matus, citing results of a question asked by the Reuters/University of Michigan survey of **consumer sentiment**.

'Dramatically' Affordable

The price drop has also made homes "dramatically" more **affordable**, they said.

"This combination of factors has created enough renewed demand to offset the ongoing negative impact of rising **unemployment** and foreclosures," Harris and Matus said.

The improvements will only lead to "subdued" price increases over the next few years because of "the magnitude of the housing downturn and high level of inventories," the Merrill Lynch economists concluded.

The differing views on housing may help explain the banks' divergent views on the economic outlook. Goldman projects the U.S. economy will grow 2 percent in 2010, while Merrill Lynch forecasts a 3.1 percent expansion.

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