UNIVERSITY OF COLORADO AT BOULDER LEEDS SCHOOL OF BUSINESS

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Where Is the Economy Headed?

Indicators for Monitoring the Economy

Gary Horvath

The current recession was caused by a series of factors, including the failure of the financial markets, tighter credit markets, a decline in home prices and an oversupply of homes, and overleveraged consumers. As the economy begins to improve, the Business Research Division will evaluate a series of indicators, some of which are discussed below, to understand when the various segments of the economy will improve and how this timing will affect the overall return to prosperity.

As the nation enters its 16th month of recession, economists are projecting that the economy will recover within the next four to eight months. At the national level, negative seasonally adjusted month over prior month job growth has occurred since January 2008. Colorado's employment did not slide until later, which may be a sign that the impact of the recession may not be felt as deeply in the state.

In March, the U.S. Department of Labor released employment revisions for 2007 and 2008. Overall, Colorado employment in 2008 increased by 0.8%, or 18,000 jobs. State employment plummeted in November of 2008, with sharp declines continuing into this year. Average employment levels for the first two months of 2009 show 51,000 fewer workers compared to the same period last year.

The following data series are a sampling of those that the BRD will use to evaluate the economy in the months ahead.

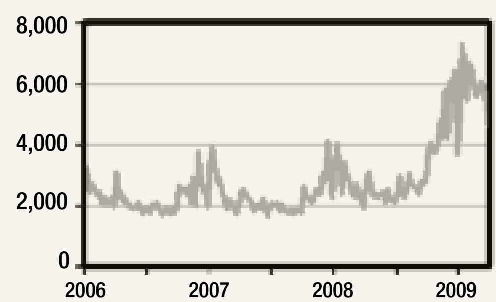
Equity Markets

The movement of the equity markets is thought to be a leading indicator of projected economic activity in the next three to six months. Following this, the March rally of the stock indices, if sustained in the months ahead, is pointing to a recovery in a similar time frame.

Business Leaders Confidence Index

Source: www.blci.com.

Colorado Jobless Claims



Source: Data are not seasonally adjusted. U.S. Department of Labor, Employment and Training Administration.

Real Estate and Construction

An example of forward-looking indicators for the real estate and construction industries is existing home sales, new home sales, and building permits. After experiencing sharp declines in the third quarter of last year, the U.S. real estate market appears to have bottomed out and is poised for growth in 2009. Although one period does not make a trend, the data for the most recent period, February 2009, are encouraging, reflecting a gain of 5.1% above really low levels.

New home sales, along with residential building permits and valuation, measure new construction activity for one or more quarters into the future. New home sales have been in a freefall since last year at this time; however, the most current data recorded a slight increase. Again, a trend cannot be established based on one month. This change in direction most likely indicates that the market is approaching the low point in the downturn.

In Colorado, the number of annual residential building permits has declined since 2005, while residential valuation has been trending downward since 2006. Both are expected to bottom out this year, with a slight increase projected for 2010. An evaluation of monthly data will point to the period when we reach the bottom of the trough.

Business Leaders Confidence Index

The Business Leaders Confidence Index (BLCI) has charted the Colorado economy for the past five years, accurately tracking changes in the state economy the majority of the time. This forward-looking quarterly index recorded an uptick from 30.6 to 35.5 for the second quarter of 2009. While the country and state remain in a recession, as illustrated by the fact that the Q2 index value of 35.5 is well below the neutral point of 50, the data suggest an improvement in economic conditions.

Gary Horvath (Gary.Horvath@Colorado.EDU) is the Managing Director of the Business Research Division.

Views from Around the State

How Is the Recession Impacting Colo

Individuals from economic development agencies, industry cluster associations, and companies from around the state were asked their thoughts about how the economy and the government's stimulus plans are affecting their region/industry. Responses appear below. See the box on page 4 for a list of participants.

What sectors of the economy will lead the recovery in your area/industry/cluster?

■ Renewable energy and other industries, where photonics technology adds value in terms of being faster, cheaper, or more energy efficient.

■ The current downturn in the coal bed methane drilling is impacting Las Animas County. While little can be done locally about national and international pricing of commodity natural gas, Colorado can reduce the impact to the gas industry by drafting rules and regulations that do not adversely impact existing businesses. Agriculture has also been hurt with the drought in Las Animas County. Adding value to our basic commodities is an economic driver that needs to be further developed. Opportunities exist to develop solar energy and help further diversify and strengthen farm and ranch operations.

■ Affordable housing will be key to growth in all areas, particularly rural Colorado.

■ Healthcare, entrepreneurship, and energy sectors will lead southeast Colorado in the economic recovery.

■ While predominantly an agricultural economy, the single-largest sector factor affecting Yuma County would be a rise in natural gas prices, which in turn would spur new drilling in the oil and gas (O&G) sector. The recent drop in the price of natural gas has contributed to a large local job loss—particularly jobs that tend to pay higher than the average wages. For several years, O&G revenue has typically made up 60% of total county receipts. The fear is that Colorado's new O&G permitting rules that take effect April 1 may hinder a return to drilling rates experienced in recent years.

■ The employment services subsector is anticipated to lead the recovery as jobs can be filled quickly this way. With all of the administrative and bureaucratic requirements for disbursement of the stimulus monies, it may take until summer for any significant employment increase to occur in this segment.

■ Manufacturing sectors that should lead the recovery include agriculture and innovative infrastructure products (e.g., water and wastewater equipment, pollution abatement equipment, energy efficient machinery, etc.) for export.

■ Recovery is doubtful based on lack of overall industrial and trade policy change. Efforts to stabilize credit markets are presently working at cross-purposes, with increased capital requirements and higher write-offs anticipated. Higher lending standards are being applied at a time when business performance is weakening.

■ Increased activity in the energy industry, including wind power and oil and gas-related businesses, along with defense, will lead in the recovery.

How will the stimulus plan(s) impact your area/industry/cluster between now and the end of the year?

■ So far, it appears the Small Business Innovative Research [SBIR] program, a source of funding for many small companies in the photonics cluster, is being hurt by the stimulus plan. The funding for additional research may help some industry companies.

■ The impact from the stimulus bill between now and end of the year will be little. Yes, the I-25 bridge project will continue in Trinidad. However, the rules are still being written in the stimulus bill, and the federal government's ability to implement projects that hit the ground by the end of year remains vague at best. Private businesses will be hard pressed to find enough willing and qualified workers to meet the deadlines proposed by the stimulus bill by year's end.

The Trinidad Industrial Park expansion is shovel-ready, and should be fully funded. Idle earth-moving equipment companies and operators could benefit from the expansion of the TIP [Transportation Improvement Program].

■ We still believe that within the next two years the stimulus program will have positive impacts on the wind energy production in the state, and we are hoping that it helps companies and organizations in southeast Colorado obtain funding for transmission projects in this arena.

■ At this point, projections out of Washington do not indicate any specific stimulus benefits to the

From the Editor

This issue offers a snapshot of the Colorado economy and examines how the government's stimulus plans are affecting regions and industries. The article on page 1 reviews various data series the BRD uses to evaluate the economy, including equity markets and construction. To better understand how these turbulent economic times are impacting communities, individuals from the government and business organizations from around the state were asked their observations about the economy and the government's stimulus plans. See this page for their responses. CU Real Estate Center Academic Director Thomas Thibodeau presents an update of the real estate markets on page 5.

We are interested in your suggestions for topics of future issues. Please contact me at 303-492-1147.

—Richard Wobbekind

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Yuma County economy. It is still unclear whether any Colorado Department of Transportation highway construction will occur in the county as a result of stimulus spending. The other stimulus fund programs appear to favor urban areas.

■ Any anticipated outsourcing is expected to be late 2009 or more likely second quarter of 2010.

■ It could have a huge impact. But the devil is in the details, which aren't known yet. If there are significant requirements for compliance monitoring and auditing, this could be a huge source of work for consultants.

■ There will be little impact on small business manufacturers.

■ All we've seen is a substitute for unemployment compensation and something for training that could be of benefit after turnaround. There has been nothing that will stimulate fundamental demand. With expectations that the trough will be long, normal stimulative maintenance spending is being deferred—if the businesses are surviving at all.

■ Hopefully, it will free up financial resources for customers.

Are companies in your area/industry/cluster seeing a loosening of credit?

■ No. Even local banks in southeast Colorado are still reluctant to loan money, and we are working with numerous businesses that have lost credit all together at banks where they have had credit for over 30 years.

■ Yuma County hosts several sound local banks, with local decision making, that have enjoyed continued lending at standard rates. Local banks did not tighten credit standards like the large commercial banks did, partially because these banks did not have the collection issues that the large banks experienced.

■ My small engineering company has had no problem with credit lines or any other type of financing needed. We bank with a small and very healthy bank in the metro area, though. However, I am hearing stories of some small companies that bank with big banks having problems, along with some people having difficulty obtaining mortgages even though they have good credit.

When do you think people in your area/industry/cluster will see increased confidence in the economy? What has to occur for them to achieve increased confidence?

■ First, photonics has not yet seen real fear—just concern that what is happening in other parts of the economy will impact us at some point and to some degree. Many companies are expecting follow-on orders from established customers to be placed between March and May. If these orders come in as expected, confidence will be boosted. Pent-up demand may show up as soon as confidence returns.

■ Confidence will be restored when elected officials in Denver back off newly drafted regulatory gas policies that adversely impact the natural gas industry. Bank lending needs to loosen up, and business development outside of the greater Denver metro area needs to occur. Development and support of some alternative energy projects would also help restore confidence.

■ The southeast Colorado economy is still closely tied to agriculture and water. As long as the drought continues in this area and the Front Range keeps buying up water rights, there will be hesitation and concern. Continued delay in implementing farm bill programs, such as CRP [Conservation Reserve Program], also impacts all businesses in this region, not just agriculture.

■ In Yuma County, stable crop prices and production costs in equipment, petroleum, fertilizer, etc., will tend to increase confidence. A stop in the recent decline and certainly any hiring growth in the O&G sector would dramatically improve confidence. Last year was relatively good across the local economic spectrum. Many business people have expressed a wait-and-see attitude about leadership direction from Washington.

■ Most people I talk to have given up on 2009 for any positive change in the economy. They are looking to 2010; however, I feel that depending on how our legislators in Colorado and in Washington, D.C. handle things this year, 2010 could be better or it could be a train wreck. Lots of bills are being passed both in the Colorado legislature and in D.C. that are increasing costs to businesses. Adding cost to businesses will delay or slow down the recovery at best; however, the part of this that is the most damaging is the growing uncertainty about the future business climate. Businesses can handle changes in cost structures to a large degree, but uncertainty in the future will shut down any business from hiring until the uncertainty is either determined or over.

■ I think that when we look back on this recession, we will see that about half of it was induced by media hysteria. Once that dies down, good old-fashioned greed will again dominate fear in the financial markets.

■ We have to "make" something for export in order to have Fair Trade.

■ The United States needs an industrial and trade policy. Not having one has produced a laissez-faire situation that is unsustainable. Without change, markets inherently know that turnaround is not possible.

■ Hopefully by the end of 2009. Business has to pickup so people can get back to work.

Has the current recession had a greater impact on advanced technology (AT) than the overall Colorado economy? What factors will allow Colorado to maintain its competitive advantage in AT over the next five years? What AT sectors do you think will prosper in the next five years?

■ The impact on AT appears to be less than on many other sectors. So far, there have been only isolated cases of companies closing, or even laying off. The biggest change has been a cessation of hiring that was heating up last summer, which will not start again until confidence is restored. Colorado must continue to keep its universities at the forefront of research, and also maintain the AT infrastructure (such as the CAPT Center) that the state has already invested in. The sectors that will prosper are the ones that are helping solve true problems—in biosciences, energy, for sure, but also in other areas where the new technology is more than just a gee-whiz improvement.

■ Start-up projects are suffering due to the tightening of the credit market in the form of reduced access to investment capital. Pass sound fiscal policy that does not strangle existing business while developing new industry. Renewable energy sectors must grow. Rural coops must embrace change as well and not hold out for more coal-fired power plants to be permitted. They need to be more open to work with small solar projects and purchase carbon credits and/or power from these projects.

■ A lot of interest is being expressed in wind power in southern Colorado. Many pieces of land have been leased by Pole Canyon Wind, LLC for wind power. Green energy is going to boost jobs and the economy the most.

■ The recession has decreased the use of AT overall. Some companies that have healthier balance sheets are taking advantage of upgrading their information and business systems while they can negotiate better discounts on technologies at this time. With the current political climate, it is expected that political mandates will push the generation of energy toward alternate resources rather than wait for market forces to occur. The Professional, Scientific, and Technical Services Sector should benefit in the next five years from this.

■ There will clearly be a bonanza for applied science and alternative energy technologies and all of the technologies that support them.

■ Innovation will be important.

■ Creating new intellectual property is critical to sustaining economic and national security. Loss of process knowledge translates to loss of intellectual property creation capability.

■ The emphasis has shifted. Construction and housing were strong and have faded. Road construction may improve with the emphasis on highway repairs.

How effectively are local (city, county, district) governments dealing with changing revenue streams? What is the impact of local policy decisions, driven by changing revenue streams, on your area/industry/cluster?

■ Local governments are not doing anything to help AT companies, which are mainly small companies and many of them early stage. If they have made changes, they are not effective in communicating them. More companies may consider relocation—to a community with support and lower cost structures or completely out of state—as support dwindles. With parts of the SBIR program in jeopardy, lack of support from local and state governments will result in an increased failure rate in companies with 25 or fewer employees.

■ Local government is not adapting well to the changes. It's easier to grow government than to reduce its size. We will see reduction in next year's budgets. The Trinidad-Las Animas County area is doing better than many areas of the country.

■ There is no doubt that cities and counties within southeast Colorado are tightening their belts right now and making tough decisions about program funding, especially for noncritical programs. Most counties haven't experienced changes that have had significant impacts on local businesses, but they have lost a lot of their reserves for disasters and that is a concern.

■ Local governments have reported they are monitoring expenditures weekly, with modifications immediately implemented if necessary.

■ Local and state governments tend to deal with changing revenue streams by pulling all work in-house. Since a portion of the Professional and Business Services Sector depends on these agencies outsourcing, the recession has had a negative effect on the sector.

■ A recession is a good way to get rid of programs you wish you never had. These programs often enter the budget during good times when politicians lack the will to say "no" and can't use the economy as an excuse for lack of funding. I'm seeing everything from old-fashioned hiring freezes and across-the-board cuts to more disciplined reductions in specific marginal programs and services.

■ Colorado state and local governments have been ineffective in managing revenue streams.

■ Unfortunately, local governments have stymied job growth and are now paying the price. When times were good they increased restrictions and fees to the point of being business unfriendly and forcing companies to look elsewhere.

Q&A Participants

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Steve Simonson
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Real Estate Market Update

Thomas G. Thibodeau

Thomas G. Thibodeau

House prices across the United States are showing some signs of life. On March 24, 2009, the Federal Housing Finance Agency (FHFA, formerly the Office of Federal Housing Enterprise Oversight [OFHEO]) announced that U.S. house prices increased 1.7% between December 2008 and January 2009. FHFA's most recent quarterly report indicates that house prices in the nation declined 4.5% during the 2008 calendar year. Most of the decline occurred in six states: Florida, California, Arizona, Nevada, Michigan, and Ohio. FHFA reported that Colorado house prices declined by 0.1% during 2008. According to FHFA, house prices increased 3% in Boulder and 0.6% in Grand Junction during 2008, but continued to decrease in Colorado Springs (-1.8%), Denver (-0.7%), Fort Collins (-0.1%), Greeley (-7.2%), and Pueblo (-0.2%).

FHFA REPORTED THAT COLORADO HOUSE PRICES DECLINED BY 0.1% DURING 2008.

The Case-Shiller House Price Index (HPI) tells a different story. According to the Case-Shiller house price index released on March 31, 2009, house prices in the United States declined by 19% between January 2008 and January 2009. The largest declines occurred in Phoenix (-35.0%) and Las Vegas (-32.5%), while the smallest occurred in Dallas (-4.9%) and Denver (-5.1%).

Why is there such a large discrepancy between these two reports? There are (at least) three reasons. First, the FHFA reports house price movement for 384 metropolitan areas across the nation; the Case-Shiller index tracks movement in only 20. In addition, most of the 20 places covered by Case-Shiller are those that have been hit hardest by the speculative bubble in house prices (e.g., Phoenix, Las Vegas, and most large cities in California and Florida).

Second, the FHFA index only tracks house prices for properties financed by government-sponsored enterprises (Freddie and Fannie). Consequently, the FHFA index excludes properties financed with jumbo loans and properties financed with subprime mortgages. (Contrary to popular belief, Freddie did not purchase subprime mortgages directly, but did purchase subprime mortgage-backed securities from Wall Street. Unfortunately, Freddie did purchase Alt-A mortgages.)

Third, the Case-Shiller index includes foreclosures. Because foreclosures are forced sales, they have no place in an index measuring changes in the market price of owner-occupied housing. A recent study by Zillow.com compared the Case-Shiller HPI to an index that excluded foreclosed homes and concluded that up to one-third of the decline that Case-Shiller reported in house prices is attributable to foreclosures. In Las Vegas, for example, 79% of all "transactions" were foreclosures in 2008. Excluding foreclosures from the Las Vegas HPI reduces the measured decline in house prices from 32.5% to 20.8%. Excluding foreclosures from the Phoenix HPI, where 68% of the 2008 "transactions" were foreclosures in 2008, reduces the measured decline from 35% to 22.3%.

Also impacting real estate markets is interest rates, which remain at historic lows. The average rate for 30-year fixed rate mortgages reported by Freddie Mac's Primary Mortgage Market Survey on April 9, 2009, was 4.87%, an increase of 9 basis points from the previous week.

Moving to the commercial real estate market, the main message is the lack of transactions. In Denver, for example, Real Capital Analytics reported 28 transactions totaling $761 million in volume for the six months ending February 2008. For roughly the same period ending February 2009, there were only 5 transactions totaling $99 million in transaction volume. For similar time periods in the Denver office market, the number of transactions went from 36 ($1,105 million in volume) to 7 ($232 million in volume). The number of transactions fell from 13 to 5 in the Denver retail market and from 26 to 5 in the Denver industrial property market. The lack of transactions is primarily due to the lack of available financing.

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Thank you!

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