Four Corners Economic Quarterly

2008 Q1

Office of Business and Economic Research, School of Business
Fort Lewis College, Durango Colorado

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Happy New Year, Good Times to Come!

By: Dr. Robert Sonora

Happy New Year one and all. If only I could be optimistic about the upcoming year on the economic front.

So, during this first week of the year, it's time to consider the upcoming year.

As we all know, the sub-prime market has exploded putting the kibosh on the housing market. And the concern about the decline in the housing market is not simply the decline in actual building construction, but also how many other sectors it impacts – lumber, building supply, appliances, plumbing, etc. And with workers in these sectors not working, there is less income for them to spend. And the cycle continues, raising the specter of recession and higher unemployment.

Analysts also believe that next year's economic growth will continue to be below potential growth by about a half a percent.

> Though, …some-what pessimistic, the US economy is pretty dynamic and adjusts … quickly to market pressures..

But the effects of the decline in the sub-prime market has other impacts. First, and perhaps most importantly, is the reduction in liquidity in the banking system, or the lessening willingness of banks to lend money.

This prompted the Fed to reduce short term interest rates *and*, controversially, to provide about $40 billion in liquidity at low rates.

Why is the Fed willing to do this? To stave off a decline in consumer spending. Household consumption, which accounts for 70 percent of US GDP, could go into decline as families reduce spending as the equity value in their home fall and as banks become less willing to loan cash.

And households will find it increasingly difficult to carry the US economy on their shoulders. The household debt-to-income ratio is at 130 percent and household debt service payments have reached historical highs of about 14.5 percent of disposable income. Not a lot of wiggle room.

Unfortunately, this injection of cash also tends to potentially lead to higher rates of inflation – many economists blame the Fed for monetary inspired inflation over the past few years, but you could also easily blame this on Federal Government borrowing.

Couple this with historically high oil prices – though there currently seems to be less pressure on oil prices – and a relatively weak dollar and you have a recipe for higher rates of inflation which will prompt the Fed to raise interest rates in the future.

So what we have is increasing inflationary pressures and rising unemployment, it may be time to dust off the misery index– which is a calculated as the unemployment rate plus the inflation rate, and rests at about nine percent. For comparison, it was at 7.5% in January of 2001.

What do we have to look forward to? Well, the weak dollar makes our exports more affordable and we have seen considerable growth, just under 10% in exports over the past year or so while imports have grown at just under two percent.

Moreover, the European Central Bank, Europe's version of the Federal Reserve, has been even more aggressive with its monetary expansion. Injecting many more billions of dollars into the euro zone than the US did. And the UK is also facing some uphill slog as its economic outlook, also experiencing a mini sub-prime meltdown, looks somewhat pessimistic. The result? A gradually rebounding dollar.

Though, the outlook appears somewhat pessimistic, the US economy is pretty dynamic and adjusts relatively quickly to market and economic pressures. And so we should see normalcy return relatively quickly.

Don't forget to join us at the Southwest Business Forum entitled "Focus on Our Future: Business & Economics" on January 11 at 7:30am held at the Community Concert Hall on the Fort Lewis College campus. Topics of discussion will include local, state, national, and international economies.

Stimulus and Inflation

By: Dr. Robert Sonora

> "Inflation is always and everywhere a monetary phenomenon"
> - Milton Friedman

By now we are familiar with the threat of an impending recession. We are close to being in a "perfect storm". Despite the deck being somewhat stacked against us, many economists don't believe this recession will be especially virulent. However, there is concern that it will be relatively prolonged and wide-reaching. The question is, what are the economic powers that be doing to alleviate some of the recessionary/slow down pressures that are building.

Tax Credits

Last week President Bush signed a stimulus package worth over $168 billion. Most of the package will end up in the pockets of tax payers with single tax payers receiving about $600 and couples $1,200, adding $300 per child. The remainder will go to tax breaks for business in an attempt to generate more investment.

The economic justification for such a plan is that giving an individual extra income will spur increased spending which will "bleed" into additional spending and thus nudge the economy back to health. The logic behind this can be found in the writings of Keynes who believed that tax reductions and/or government spending can pull an economy back from the brink of recession.

Despite the deck being somewhat stacked against us, many economists don't believe this recession will be especially virulent.

Unfortunately, since then, much of this textbook has somewhat been rejected – at least the size of the perceived boost. And the best place to look for evidence? The 2001 Tax Rebate. There is considerable evidence that individual tax payers did not spend much of their new found income, certainly not enough to jolt the economy out of recession.

Why? People spend their "permanent income" differently than "transitory income". People who are liquidity constrained will a relatively high percentage of transitory income while those with higher incomes save it. And according to an AP-Ipsos poll only 19% of those surveyed said they planned to spend their rebate checks. 45% said they will pay bills, and 32% said they plan to invest the money.
And of that 19%, how much would spend all of the rebate? And on what goods? First, if they buy imported goods, much of the tax rebate will be exported to other countries. And second, if they buy goods with little domestic value added in the production phase, there will be relatively little blood reaching the overall macroeconomy.

So will consumers continue to spend? Over the past fifteen years, the consumer debt –disposable income ratio has increased from about 82% to over 130%. Home values are dropping, and will continue to do so over the next year or two, as excess inventory is bought up. This leaves little wriggle room for households to continue to carry the economy especially as liquidity dries up.

The check doesn't go out until May, by which time it might be too late to have any real effects.

Monetary Policy

The Federal Reserve System (the Fed) has also done what it can to bail out the economy. Since October of 2007 the Fed has lowered the federal funds rate (an overnight bank to bank interest rate) by 2.25% to 3% and the Chairman Ben Bernanke has indicated the bank is open to further cuts in the face of continued falling job and housing markets. By lowering rates the Fed makes it easier for banks to borrow and thus make loans to households and businesses.

Once again, the sub-prime implosion will likely alter individual economic behavior thwarting any attempt by the Fed to rekindle these markets. First, from the supply side, banks have become, understandably, increasingly risk averse and are less willing to loan money. Moreover, they are making up their lost revenues by not lowering lending rates in step with the Fed's interest cuts.

Secondly, the increasing debt burden on individual households and declining home values mean that they will not be borrowing as much, even if the rate cuts are passed onto individuals.

Statistical evidence suggests that it takes over six months for interest rate cuts to effect the real economy. Too late to be effective?

Finally, both the Federal government and the Fed are walking a fine line between preventing an economic downturn and generating inflation. Putting money into the economy by either channel can lead to overheating as demand pressures build.

La Plata County 2007- Annual Changes

By: Dr. Deborah Walker

Most of the annual numbers for 2007 are now available and La Plata County's economy continues to look relatively strong, despite recent news that the national economy might be in, or headed for, a recession. Most of the economic indicators showed signs of improvement (when compared to 2006).

But there are signs that things have slowed down a little in some of the leading sectors of the local economy.

Interestingly, both La Plata County and the state of Colorado decreased their average annual unemployment rates from 2006 to 2007, while the nation's annual average remained the same at 4.6 percent. La Plata County's rate decreased by 0.6 percent from 3.4 percent to 2.8 percent and Colorado's rate dropped 0.5 percent from 4.3 percent to 3.8 percent.

Employment growth continued in 2007 with an increase of 7.3 percent. Every month of the year showed an increase in employment from the same month in the previous year.

Indicators for the tourism sector were mixed, but none declined by a large amount. Airport passengers at the Durango-La Plata County Airport continued to increase 2 percent annually and lodger's tax revenue (adjusted for inflation) increased by 5.5 percent.

Not as many tourists (and locals) took a ride on the Durango and Silverton Narrow Gauge Railroad in 2007 as they did in 2006. The number of train passengers (excluding special events) decreased by 1.4 percent.

In 2007 there were 2.1 percent fewer visitors to Mesa Verde than in 2006. Although the year started out with an 11.8 percent increase in the first three months, the remainder of the year saw declines in the number of visits from the same time in 2006.

The local agriculture market is pulling in higher prices. Alfalfa hay prices increased 34.2 percent and calf prices increased by about 2.6 percent. Among other factors, government subsidies to the corn farmers have given them the incentive to pull land away from other crops, decreasing their supply and thereby increasing their prices.

Industrial kilowatt-hours used by industry (most especially natural gas) decreased slightly by 0.5 percent.

Fort Lewis College enrollment (number of students registered in the fall semester of each year) increased by 0.7 percent in 2007. This comes after a decrease of 1 percent in 2006 and a decline of 5.8 percent experienced in 2005.

Crude energy prices are important to the local economy because of the large amount of natural gas produced locally. These prices can be very volatile. In 2007, they increased by 2.2 percent (but declined by 0.10 percent when adjusted for inflation).

Both the real estate and construction sectors of the local economy continue to be strong, but have started to show signs of slowing down. The median residential real estate price for La Plata County country homes decreased by 8 percent (unadjusted for inflation) in 2007. The same median price increased by 18 percent from 2005 to 2006. Average price decreased by 6 percent in 2007 and increased by 13 percent in 2006. Building permit values (La Plata County and the City of Durango) increased by 0.8 percent in 2007 but decreased by 4.2 percent when adjusted for inflation.

Finally, the population, measured by the installation of new residential electric meters, continued to increase by 2.5 percent in 2007. The financial resources available in La Plata County grew by 1.37 percent when inflation is not considered. But when adjusted for inflation, deposits fell by 1.32 percent (as of June 30 2007) according to the Federal Deposit Insurance Corporation.

The *Four Corners Economic Quarterly* is a newsletter on economic indicators of Southwest Colorado published by the Office of Economic Analysis and Business Research in the Fort Lewis College School of Business Administration and Region 9 Development District of Southwest Colorado, Inc.

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