Four Corners Economic Quarterly

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

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Smug…

By: Dr. Robert Sonora

Well, over the past couple of weeks or so I've been reviewing previous columns, and I'm feeling a bit smug. Why?

> *From August, 2006 "… consider the current environment: … a slowing housing market; and rising inflationary pressures and you have a dangerous synthesis."*

Since then, the big news is the sub-prime market slowdown, instigated by foreclosure, and its impacts on, well, everything.

New housing permits are the lowest they've been since the 1990 – 91 recession and of the ten percent largest declines in new housing permits over the past twenty years, just over 2/3s have occurred in the past 18 months.

The impacts of this decline in economy wide demand side bleed into additional consumer spending behavior – falling wealth reduces household purchases, which now account for about 70 percent of GDP, the highest ever.

> Well, over the past couple of weeks or so I've been reviewing previous columns, and I'm feeling a bit smug.

What does this mean? US growth has become drunk on household consumption. But, what happens when you take away the punch bowl? And the Fed has been reluctant to announce "last call". Rather, it keeps topping it up – seemingly preoccupied with keeping the party going by keeping liquidity high.

Unfortunately, "…. there appears to be a disconnect between the FFR and consumer medium to long term interest rates" (7/2006) which implies the Fed's efforts will have no lasting effect on the economy, except shore up our financial system which is key to our long term economic health.

Next on the agenda is the increasing cost of the war: some $5,000 per second. Standard economic theory suggests that massive expenditures translate into increase overall demand. Unfortunately, much of this cash is not being repatriated to the US, staying instead in the Middle East and elsewhere.

> *"Some experts are warning that $4 per gallon gas are not a question of 'if' but 'when' "*
> *- (4/2006).*

We are facing a "supply side" inflationary environment, spurned largely by the increasing price of oil and the we use corn for energy. The impacts of the rise in oil energy price increases is pretty transparent: rising transportation costs, gas and diesel prices, etc. – gas is $4 a gallon in some parts of the country.

Food prices are rising because the of the mandated increase in the production of ethanol. "Moreover, as farmers divert land away from food towards ethanol production, food prices will rise too." (4/2006) And the prices of downstream goods – e.g. the recent price increase at Home Slice pizza – rise too.

Finally, the dollar has been depreciating sharply against most other currencies. Indeed the dollar has fallen about 60% against the euro since June, 2001 – increasing the price of imports – inputs and final goods.

So what's to be done? The Federal government has responded by offering a tax credit, though may economists, myself included, are skeptical to its impact. Evidence from the 2001 rebate is uninspiring to say the least, as was the temporary tax rebate given by GW's father in the early 1990s.

The Fed is continuing to try and push liquidity into markets, though mortgage, and other consumer, rates have risen since the Fed's attempts to bail out an economy on the brink, if not already, of sinking. Now, I continue to worry about inflation "by combating inflation, the Fed risks increasing unemployment, and vice–versa (6/2006)".

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.

Stuck

By Dr. Robert Sonora

I am beginning to feel a bit like a stuck record. The national, state, and local economies are feeling the impact of a near "perfect storm" in the aftermath of the sub-prime meltdown. Rising inflation and unemployment (thought still pretty low), rapid increases in the price of food and energy; declining home values; etc. are all contributing to a sense of foreboding.
The University of Michigan Consumer Sentiment index is the lowest it's been since June of 1980, *See Figure 1 below*. At that time the unemployment rate was 6.3% and climbing. It peaked at 11% two years later and inflation was just under 15%.

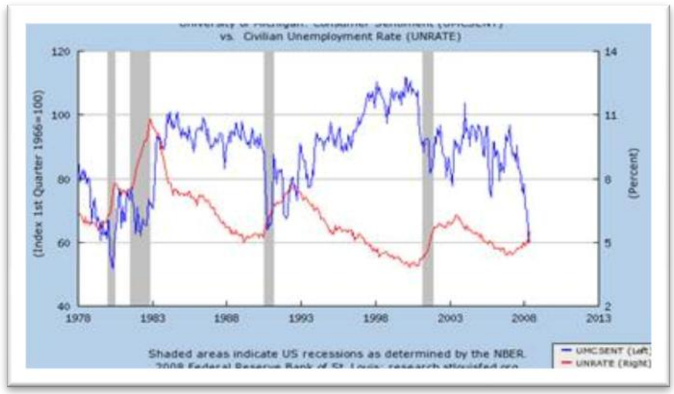

Figure 2. Oil prices and dollar-euro exchange rate (source: FRB St. Louis, FRED II)

Couple this with poor agricultural production now and for the foreseeable future (flooding in the Midwest, drought in Australia, typhoon in Burma) with increased demand and there will be considerable price pressure on food prices as well.

Figure 3 shows the core (without energy and food prices), food and energy inflation from 1970 to today. As can be seen core inflation remains fairly tame, about 2.3% while food and energy prices are accelerating.

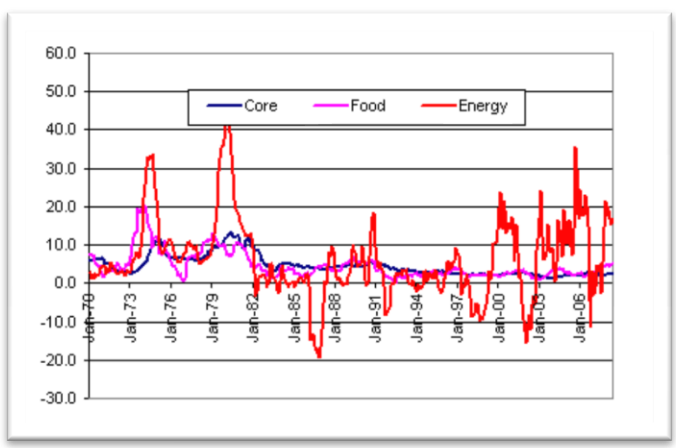

Figure 3 Core, food and energy inflation (source FRB St. Louis, FRED II)

In the Four Corners area the confluence of this conspires for even higher prices here. Given the remoteness of the area, rising transportation and food costs will drive prices of these goods higher than in less isolated areas.

Housing Sector

The Fed has been aggressively lowering the federal funds rate and offering banks and other financial institutions low rate loans to increase liquidity in these markets. The desired effect is what economists call the "monetary transmission mechanism" - more money impacts the real economy.

However, over the past five to six years, lower rates for banks have not been passed onto household consumers. The 30 year mortgage rate has become more or less fixed since 2000 at about 6%, while the fed funds rate as vacillated between one and 6.5% over the same period. Either we are in a "liquidity trap"; or lenders are demanding a far higher risk premium on consumer loans.

The Schiller index of housing US values in May fell 16% from a year ago - the most precipitous drop since the introduction of the index. The index for Denver fell by about 5%, quite tame by comparison, but this a secondary effect as housing prices in Denver have been flat since the recession a few years ago.

Figure 4 below is the Schiller-Standard & Poor Index of housing prices for Phoenix, Denver, LA and an overall Composite of ten metropolitan areas. As can be seen much of Denver's correction occurred in the early 2000s just when Phoenix was starting take off. Both Phoenix and LA saw a much more precipitous drop than Denver.

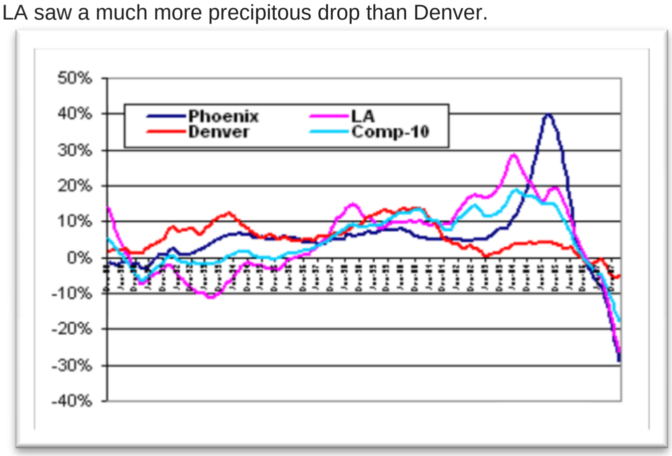

Figure 4 Schiller Index of Housing Prices
(Source: Standard and Poor/McGraw Hill)

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The effects of the tax refund will most likely be small and short lived. Many are taking their refund to pay down debt and increase their savings - in May the personal savings rate shot to 5% up from 0.4% in April, the highest since 1992.

Tourism

All of this news does not, I'm afraid, bode well for tourism and construction - the areas largest sectors in terms of percent of total income. Higher fuel prices mean less miles traveled, either by air or air. According to a report by Farmers Insurance Group a 10% increase in fuel prices yields a 7% decline in miles driven - indeed over the years 2003-2007 the cumulative effect has been a 18% decline in miles driven.

On the other hand, higher prices for international travel mean more domestic travel. Moreover, the falling value of the dollar vis-à-vis the euro, UK pound, Chinese RMB, and Japanese yen mean more foreign tourists as well. And they will buy more goods, Figure 2.

Good News

The only ray of light over the next 18 months or so will be producers in the energy and agricultural sectors. With oil on its way to $150 a barrel, we will begin to see an increase in the price of natural gas, which lags oil prices by six months or so.

Increased demand and several negative supply shocks will buoy prices of corn, wheat, soy, etc. Even if the production of these goods isn't that high in this area, we can expect to see increases in the prices all agricultural goods as resources are diverted towards the production of these goods.

Another positive is the falling value of the dollar. It increases exports and has buffered the economy from further declines. Now all we need is to attract euro toting visitors to our corner of the world.

But a proviso must be attached to this, a falling dollar is partially responsible for the increase in oil prices. Given that oil is generally trading in dollars -- though several oil exporting countries have either abandoned, or are considering doing so, the dollar. However, $150 per barrel may be the threshold price which sufficiently reduces demand slowing further price increases.

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