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What Financial Reform?

By: Dr. Robert Sonora

Over the years Microsoft Windows has been maligned for piling on lines of computer code to repair poorly written code rather than rewrite the bad software. Between Windows 3.1 and Windows Me the hard disk requirements grew from 8MB to 410MB. True much of this code updated existing, however, a lot of Me was dedicated to patches.

One of the problems culminated in the so-called "Millennium Bug", code which was written in the 1960. As you recall, concern over financial and government meltdown led to a spree of survival purchases with an estimated final cost of fixing Y2K to be upwards of $1.6 trillion.

The Fed responded to Y2K by pumping money into the banking system to ensure that there was enough money in the system to prevent a bank panic. Recently, the Fed and Treasury, responded to the financial crisis with an $11.6 trillion arsenal of patches to the financial system.

> By the way we own the two banks now. Lucky us.

That was the short run response. In the longer(ish) run, we have the financial reform bill: The Wall Street Reform and Consumer Protection Act. One goal of this legislation is to prevent yet another, seemingly decadal, financial crisis.

The Act is a 2,300 page blueprint for financial reform. That's right, a blueprint, with very little actual action items – much like the recent health care bill, which is also a behemoth of political wrangling. Essentially, the Act provides a skeleton and requires financial actors to add meat to the bones as they bumble along.

But does the Act do to prevent future crises?
Like Windows, many of those 2,300 pages are patches to repair pre-existing code. One of the measures asks to beef up oversight of banking practices. However, current banking laws already give regulators the authority to act, but what good is having banking regulations without bank regulators? Over the past thirty years or so, the number of regulators has been dropping. A bad fix.

The Act does little to eliminate "too big to fail". One of the causes of the crisis was excessive risk taking by financial institutions because they knew they would be rescued should they make mistakes. The Act allows banks to grow big, but creates a mechanism for orderly dismantling with minimal economic impact. So much for addressing that issue.

Fannie Mae and Freddie Mac, the de facto private, but backed by Federal commitments, mortgage banks were responsible for expanding the mortgage market to include sub-prime loans have been left largely untouched. By the way we own the two banks now. Lucky us.

Perhaps the best thing the Act does is to increase capital requirements for banks. Essentially, banks quit doing their fundamental task which is giving loans and taking deposits. Years of financial deregulation gave banks the freedom to dabble in other revenue sources – such as trading in exotic financial instruments (the Act does little to address this). However, regulation stipulated low capital-to-liabilities ratios meaning that banks didn't have to use their own money to purchases these assets. By increasing capital requirements, the Act should make banks think twice about purchasing risky assets.

And what does this legislation mean for getting the money flowing again? I fear nothing. Given the skeletal nature of the Act, there is still a considerable degree of uncertainty in financial markets. There is 55,102% more money in bank vaults sitting around doing nothing since the collapse of Lehman.

This "Reform Act" doesn't reform much, rather it cobbles together a lot regulatory patches. My guess: By not concentrating on political expediency rather than actual reform, we will see a replay of the current crisis in the next couple of decades.

The Pulse on Local Real Estate

By: Luke T Miller

At Fort Lewis College we regularly write about the local, state, and national real estate market. However, as many researchers will tell you, the type of data you have access to greatly impacts the studies selected and the resulting conclusions. In an effort to dig deeper into the Durango real estate market, I contacted Joe Clair with Prudential Triple S Realty and requested statistics I was unable to locate using my usual sources --- what resulted was a discussion of the local housing market providing insights not previously discussed in our column.

As 2009 winded down, the market was very quiet with the exception of a November 2009 flurry which was a result of the New/Repeat Home Buyer tax Credit which allowed qualifying Buyers to receive up to $8,000 in tax credits for purchasing a "new" home. This activity, coupled with interest rates hovering around 38 year record low rates caused lower priced homes, primarily town homes and condos, to sell at an increased pace. As the year progressed and the tax credit deadline approached, we saw a balance of supply and demand and an increase in units sold. As 1st Qtr has progressed it seems like this activity has spread to a much broader product offering and price range, as evidenced by YTD (Year to Date) sales and showing activity. Historically, 2005 to 2007, when sales were higher, the most credible source of information was sold activity in the MLS (Multiple Listing Service). As closed transactions decreased and consumers wanted more information, showing activity and internet website inquiries have become an additional resource for information relating to consumer's actions. Consider the following information through the 1st Qtr 2010, compared to the same 2009: (1) Sold Activity – across Durango, 1st Quarter residential sales increased from 40 in 2009 to 88 in 2010, (2) Showing Activity – Increased 54% over 1st Qtr 2009, while the average number of showings, prior to selling, decreased more than 17%, (3) Average Days on Market – decreased about 43%, from in excess of 11 months, to slightly more than 6 months on average, YTD 2010.

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What Looms for the remainder of 2010 – While there are plenty of opportunities creating deals for Buyers, the market's adjustment from being extremely weighted to the Buyer's benefit, is starting to shift ever-so-slightly back to a healthier balance of fairness between the Buyer and Seller. This shift has started in the lower price ranges and is now continuing upward to higher prices, including homes priced in excess of $600,000. Much of the delay in the higher ranges may be pegged to limited lending resources at prices that more frequently require jumbo loans, and also carried a substantially higher interest rate for most of last year. Furthermore, we also have observed an increase of activity when the Home Buyer Tax Credit Regulations were expanded to include higher income consumers and those who previously owned a home for 5 years. Accordingly 2nd Quarter will be very telling for the remainder of 2010.

Of note, the Federal Reserve has started their process of returning interest rates back to a more natural balance, not artificially impacted by the purchasing of mortgage-backed securities, which it had done to help reduce and control interest rates associated with home loans. Furthermore, the government again has an expiration date of June 30, 2010 for the termination of the Home Buyer Tax Credit Programs, which have been wildly beneficial in spurring market activity, and balancing the supply and demand ratios of our market. Needless to say, there is a lot for consideration, but Durango's Real Estate Market has shown signs of increased activity. Please direct questions and comments to Joe Clair, JClair@PTSR.com, or Luke Miller, miller_L@fortlewis.edu

What End?

By: Robert Sonora

There's a morbid joke about the Great Depression, it really wasn't that "great". So too appears to be the fate of the Great Recession of 2007-?.

Nationally, we are starting to get some good news. The US economy grew at an annual rate of about 3.2 percent. Inflation is still moderate, just under 2 percent when the volatile energy and food sectors are removed from the consumer price index, so-called "core inflation". Nationwide housing starts are 20 percent higher than last year. Household consumption growth was 2.3 percent in March.

And GM paid off its TARP loan, well, sort of (see "Repaying Taxpayers With Their Own Cash", *NY Times*, 4/30/10).

Statewide, housing starts are up over 100 percent from last year, though still extremely low by historical standards, and core inflation (Denver) is a pleasant 1.7 percent. But then the picture becomes a bit more bleak, total state income in the third quarter of 2009 was 6 percent below the previous year. Which probably helps explain the low rate of inflation, which lags income by 6-12 months. And in the state, as nationwide, unemployment continues to be problematic. The Colorado unemployment rate ticked up again, to 7.9%, after steadily falling in the last quarter of 2009.

The local economy does not look much more promising. My "ultra-sophisticated" discussions with local business have not yielded overly optimistic economic news. But I prefer to refer to objective data.

First, and foremost, is the rising unemployment rate rose two percentage points to 7.1 percent in five months. The labor force has been shrinking since July of 2008, even as the population has been growing – which can only be rationalized by an increase in the number of discouraged workers. In San Juan county, NM, unemployment hit 10.7 percent, quite a dramatic increase from the 2.6 unemployment rate in October of 2007.

Through the first quarter of 2010 median house prices are falling, though thankfully not as low as in the 2001 recession. The average days on the market has been steadily been rising since 2000, which could put further downward pressure on prices.

I am not sure how much the new house credit for first time homebuyers buoyed the local housing market as prices here are generally beyond the reach of young first time buyers.

Local county income, as in the state, has fallen dramatically – third quarter La Plata income was 7.5 percent below the previous year. And it appears we might not be able to fallback on foreign tourism which is being undermined by a relatively strong dollar and turmoil in much of the global economy – I don't think I'd count on too many Greek, Spanish or Portuguese tourists this year – with the exception of China and India.

So, is there any good news? Yes. La Plata income and unemployment is positively correlated with national income, with a lag. If national income can continue to eke out some positive growth we should see things start to turn around.

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For contact information:

Dr. Luke Miller, Director
Email: Miller_L@fortlewis.edu
Phone: (970) 247-7060

Dr. Robert (Tino) Sonora, Director
E-mail: sonora_t@fortlewis.edu
Phone: (970) 247-7296

Office of Economic Analysis & Business Research
School of Business Administration

Fort Lewis College
1000 Rim Drive
Durango, Colorado 81301

Web Address: www2.fortlewis.edu/ober

Region 9 Economic Development District of Southwest CO, Inc.
(970) 247-9621
www.scan.org