

The Impact of the Current National / International Financial Crisis on the Region's Economy

**Presented to
State of the Valley Symposium
Friday, October 9, 2008**

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The State Demography Office's Forecast for the Region

based on 2007 Population Estimates

- **Shows, overall, very strong growth rates.**
- **Mostly, unchanged from previous years.**
- **Reflects strong energy activity, mostly in natural gas,**
- **A decrease in the effect of second homes due to the current financial crisis and a substantial reduction of speculation in real estate.**
- **Labor shortages may be less acute than in past.**
- **Concerns re development patterns, structure.**

Population Forecasts

Garfield, Pitkin & Eagle Counties

COUNTY	2005	2010	2015	2025	Annual Aver. %Change		
					05 - '10	'10 - '15	'15 - '25
Garfield	50,700	67,300	79,400	115,000	5.8%	3.4%	3.8%
Pitkin	16,400	17,150	19,200	23,700	0.9%	2.3%	2.1%
Eagle	49,400	57,900	67,000	81,200	3.2%	3.0%	1.9%
3 Cnty Tl	116,500	142,350	165,600	219,900	4.1%	3.1%	2.9%

Current Financial Crisis

- Sources of Information -

The Economist magazine

Business Week magazine

Daily newspapers.

The Trillion Dollar Meltdown by Charles Morris.

Meetings of the Denver Area Business Economists.

Current Financial Crisis

- Overview -

The crisis is the result of a Credit “Bubble” caused by overdevelopment and hence, overvaluation of hedge and other funds that included large amounts of risk, that were “securitized” by sub-prime mortgages.

Credit: sum of financial assets – stocks, bonds, loans, mortgages . . . and financial derivatives (instruments which derive their value from other financial assets).

[Financial assets are presumably somehow tied to real assets.]

Current Financial Crisis

- Overview -

Why money – financing, credit – matters:

- People need houses, cars before than can go to work.**
- Businesses need buildings, machines, before they can start to provide goods and services.**
- Societies, communities need infrastructure before people and businesses can function.**

Money enables the creation of the physical capital that provides for these activities. It is traded in financial markets the bring savers and investors together.

Current Financial Crisis

- Overview -

Capitalism: a system that, more than other alternatives, develops money or financial capital that enables the development of physical capital. It is a relatively open system, allowing for individual ownership and considerable freedom . . . But, it is

Not disassociated from various human behaviors:

- Greed, human selfishness (vs. other aggressions).
- Desires for well-being, equality, justice . . . government intervention for public well-being, charity.
- Degrees of competence; “systems” of order.

Current Financial Crisis

- Overview -

The Issue of Regulation:

- The obvious need to prevent abuses, protect the public and create an awareness of how the system should work and establish a sense of fairness.
- But, difficulty in getting them (regulations) “right”:
 - Of not slowing things down unnecessarily.
 - Of actually achieving the objective desired.
 - Of not causing new developments designed to get around the regulations . . . with unintended consequences.

Current Financial Crisis

- Recent Background -

1960's – success of modest government fiscal policy.

1970's – dismal years for the economy, mainly caused by the Vietnam War and the OPEC rise in energy prices.

The failure of government to stem inflation, stagnation.

1980's withdrawal of government involvement, regulation

- Volker crack down on inflation.**
- Reagan deregulation .**
- Monetarism: shifts management to only money, the FRB.**
- Defense spending.**

Current Financial Crisis

- Recent Background -

11/9/89 – The end of the Cold War & removal of barriers.

Globalization; “the power of the free market”

Clinton budget balancing – endorsement of free market.

**Bumps in the road caused by the associated
development of the financial markets:**

- The Savings and Loan Crisis.**
- Trading-based market crisis in 1987; mortgage on in 1994.**
- Collapse of Land Term Capital Management hedge fund, 1998.**

All arose from new financial practices / instruments.

Current Financial Crisis

New Financial *Instruments* / Practices

Paradigms / models for trading and hedging by large customers like pension funds, insurance companies.

Hedge funds implemented model strategies with serious money; worked small margins; had unlimited leverage.

Collateralized mortgage obligations (CMOs) – combined mortgages into a trust (which were sliced into segments) which then issued bonds for each segment.

Portfolio insurance and the ultimate development of credit default swaps (CDS). (Investments now “safe”!)

Current Financial Crisis

New Financial Instruments / *Practices*

Models led to more complex, incomprehensible portfolios with little understanding of what they were worth

Hedge funds the big game in town with brokers, making big fees, bonuses, always pushing the envelope.

CMOs. Mis-evaluated; rated only by top segment. The need to “securitize” other new funds led to pressures for more (sub-prime) mortgages!!

Portfolio insurance a false idea to begin with, which led to a false sense of security regarding a portfolio.

Current Financial Crisis

- The Unwinding -

People, investors with lots of money -- but with interest rates low -- take more risk to meet earnings objectives.

The overbuilding of housing causes values to drop and leads to jobs losses in construction; payments cannot be made; & there is no equity to tap.

June, 2007 – Two Bear Stearns hedge funds cannot meet margin calls. Moody starts downgrading investment-grade sub-prime mortgage bonds.

August 9, 2007 – Countrywide Financial Corp. (nation's largest home lender) goes belly-up.

Current Financial Crisis

- The Unwinding -

November, 2007 – Citigroup does not know its worth.

March, 2008 Bear Stearns is bought out by JP Morgan.

July, 2008 – Federal takeover of Fannie Mae & Freddie Mac

August, 2008 – FRB Chairman “out of resources”.

Sept. 14, 2008 – FRB does bails out Amer. Int’l Group (Ins)

***BUT* does NOT bail out Lehman Brothers!!!**

National / International markets collapse.

Loss of trust, confidence, in value of funds, institutions.

Current Financial Crisis

- The Remedies -

FRB lowering of Fed funds rates and then interest rates.

FRB lending to banks for day or more – “life support”.

FRB lends to firms that are primary dealers in Treasuries

FHFA puts Fannie Mae / Freddie Mac in conservatorship.

Congress grants tax “rebates” (Spring, 2008).

**Congress passes bail-out bill authorizing Treasury Dept.
to buy mortgage-backed securities.**

Current Financial Crisis

- The Remedies -

FRB works to restore confidence in the banking system, begins to guarantee interbank loans, transactions.

FRB begins purchase of some short-term debt of non-financial institutions.

FRB begins revamping of capital and reserve requirements of financial institutions.

Government makes direct investments in selected banks on large scale.

Current Financial Crisis

- The Prospects -

Unusual learned and informed response.

Unusual international communication / cooperation.

Unusual commitment to fix the system so it stays / works

An unknown time period for determining real values,
and thus, still (after a year), a bumpy road to stability.

P. S. Real values will not be previous highs.

A significant and “prolonged” recession . . . But . . .

not a depression.

Current Financial Crisis

- Effects in the Valley Economy -

Natural gas will continue to create some new job and population growth, but its development is currently limited by pipeline capacity out of the state.

Oil shale still in distant future.

Tourism may slow somewhat, but *second home activity / development will slow considerably.*

Recession will cause some additional loss of jobs in retail, services.

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Appendix: Value of a Financial Instrument - A Stock or Bond = the Present Value of Future Earnings

Present Value	Interest Rate Discount Rate	Future Value in 5 Years
\$1,120	3.0%	\$1,230
\$1,295	3.0%	\$1,500
\$1,120	6.0%	\$1,500