Navigating the FINANCIAL FRONT

The State of the Economy: One Year Later

by writer
J. Michael Ross

On September 15, 2008, Lehman Brothers, a financial services company founded before the Civil War, filed for Chapter 11 bankruptcy protection. At the time, Lehman held over $600 billion in assets, making it the largest bankruptcy filing in U.S. history. While the sheer scope of the collapse stunned most people, especially on Wall Street, it was merely the beginning.

In the year since then, the tsunami that roared forth when the corpse of Lehman Brothers hit the financial oceans has engulfed the entire world's economy and we are yet to fully measure the devastation as the monster wave rolls back out.

Troubled banks

Nothing is more telling in any financial crisis than bank failures. According to CNNMoney.com, 81 banks have failed in 2009, the largest so far being Colonial Bank, which is also the sixth largest bank failure in U.S. history.

The Colonial Bank failure reminds us that we are not out of danger yet. With $25 billion in assets and $20 billion in deposits, Colonial's failure is 100 times larger than any of the other banks that have failed this year.

But that's not all. Associated Press writer Marcy Gordon reports that on Friday, August 21, Austin-based Guaranty Bank "became the second-largest U.S. bank to fail this year after the Texas lender was shut down by regulators and most of its operations sold at a loss of billions of dollars for the U.S. government to a major Spanish bank. The transaction, approved by the Federal Deposit Insurance Corp, marked the first time a foreign bank has bought a failed U.S. bank."

Gordon goes on to point out that the number of bank failures so far in 2009 is "the highest number in a year since 1992, at the height of the savings and loan crisis; it compares with 25 last year and three in 2007."

With a bit under four months to go in 2009, we're on pace to see at least 100 U.S. bank failures, if not more.

The massive mortgage mess

So what set us up for all this? To a large extent, it was mortgages and how they were granted. During the go-go real estate boom that preceded this crash, many banks and mortgage lenders created no-money-down and stated-income loans (liar loans) as well as adjustable rate mortgages, or ARMs.

No money down loans meant having no money at risk (no "skin in the game" to use a gambling term) so the only thing of value to borrowers in a loan default was their credit rating. When the going got rough, that wasn't enough of an incentive to keep many people from just walking away.

ARMs allowed borrowers to get into a mortgage with a low "teaser" interest rate that would reset a couple of years down the road at a higher rate. That is, low monthly payments for awhile. The selling point was this: By the time the ARMs were ready to reset at those higher rates, the homeowner could refinance into a fixed mortgage based on the home's increase in value, because "home values always go up."

That's certainly been true over the long haul, as it has been with the stock market. So, many people who offered ARM loans firmly believed in what they were selling. But there can always be ups and downs associated with the price of anything, and this time we hit a down trend, big time. ARMs turned out to be a ticking time bomb because all didn't go as planned and for many homeowners, there was no way to recover.

The day of reckoning arrived as a perfect storm. Instead of home prices continuing to rise, they stalled, then dropped. Lots of homeowners "went underwater." In other words, their original mortgage was now higher than the current sales value of the home, which killed any refinancing effort or possibility of selling out.

As the ARMs began resetting to rates higher than the initial teaser rates, the borrowers mortgage payments went through the roof. Homeowners who'd counted on the ability to refinance out of the now-higher ARM rates couldn't. For many, this meant a complete inability to pay their higher mortgage payment. As a result, a giant wave of mortgage defaults rolled in, followed by home prices tumbling even further.

Enter the bailout kings and TARP

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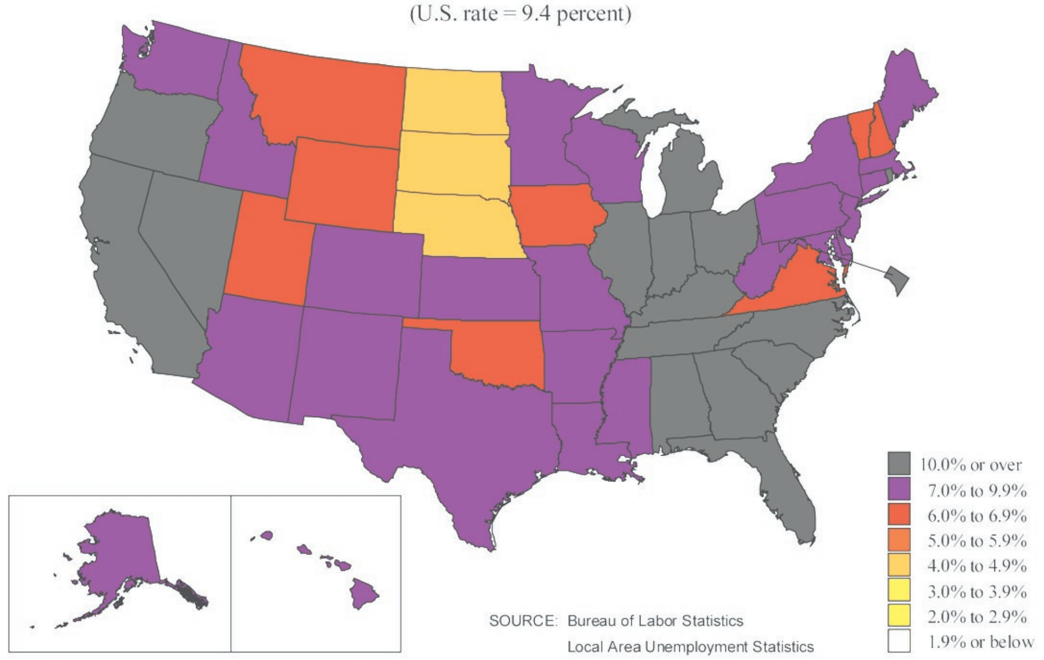
Unemployment rates by state, seasonally adjusted, July 2009

(U.S. rate = 9.4 percent)



Here's looking at you:

Economists turn to Texas for answers

by writer
Coby Kestner

A year ago this month, the United States' roller coaster of an economy took a severe downward plunge and soon became a much-talked-about, hotly debated topic. People of all economic classes felt the hit, and even those who had never given the economy a second thought knew one thing: It was bad.

Everyone felt the burden of last year's declining economy to some extent. But due in part to its world-famous resiliency (remember the Alamo?), Texas has fared considerably better than many other states in the nation.

Rapid growth

"The Texas economy, the world's 11th largest, continues to fare better than those of many other states," said Susan Combs, Texas Comptroller of Public Accounts, on her Web site, www.texasahead.org. "But Texas is feeling the effects of the worldwide recession. According to the National Bureau of Economic Research, the U.S. economy peaked in December 2007 and has been in recession since then. Although the Texas economy slowed with the nation's late in 2008, Texas' gross product expanded almost twice as fast as the U.S. economy (2.0 percent versus 1.1 percent) during calendar 2008."

Texas is also the fastest growing state in the country in terms of business, and a recent article published in *The Economist* magazine (www.economist.com) names the state as being home to more Fortune 500 companies than any other state in the country. Those companies include AT&T, Dell, Texas Instruments, Exxon Mobil, ConocoPhillips,Valero, American, Continental and Southwest Airlines, Fluor, J.C. Penney, Halliburton and 52 others.

The Economist article goes on to compare Texas' low-tax, low-spend model with states such as California and New York who were hit especially hard by the economic decline.

How Texas is different

Dr. Sankar Sundarrajan, head of Tarleton State University's accounting, finance and economics department, addressed Texas' economic status.

"House prices in California went up and people tapped into their home equity thinking that prices would continue to rise and they would make money," he said. "It didn't happen like that in Texas. In other words, people in Texas didn't see the kind of false prosperity that people in California and New York and places like that saw. Therefore it is reasonable to say that we didn't jump that high, so we're not going to fall that low."

The Texas unemployment rate is significantly lower than the U.S. rate, and the Jan./Feb. issue of *Chief Executive* magazine named Texas as the best state for job growth and business. North Carolina, Florida, Georgia and Tennessee rounded out the top five, with California, New York, Michigan, New Jersey and Massachusetts being named as the five worst.

A new economic model

Another *Economist* article, titled "California v. Texas: America's future" (published July 9), compares the economic models of the two biggest states in the nation. While the California model has long been looked upon as the standard, many states are beginning to look toward Texas for answers. "(Texas) has coped well with the recession, with an unemployment rate two points below the national

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Noted economist speaks at STEDCO annual meeting

by editor
Lainey Emoto

On August 6, The Stephenville Economic Development Foundation, Inc., or STEDCO, held its annual meeting. The self-described mission of STEDCO, a nonprofit corporation established in 1994, is to "promote and improve business and economic conditions" in Stephenville and the surrounding area by providing "economic aid, services and assistance to existing and potential businesses."

Dr. Ray Perryman

To fulfill its mission, STEDCO has provided land, loans, leased facilities and cash grants to fund economic studies, assist with key business ventures and provide incentives for businesses to locate or relocate to Stephenville.

Synopsis of the keynote address

A highlight of the annual meeting was a talk by Dr. M. Ray Perryman, a noted economist and founder of The Perryman Group, a Waco-based consulting firm. The critical subject was "How Did We Get into This Mess?! – Anatomy of the Recent Financial Crisis." A synopsis of his well-argued analysis follows.

In short, what began as a well-intentioned effort to increase the availability of "The American Dream" to millions of credit-worthy individuals went terribly wrong.

In the mid-1980s, some very capable analysts attempted to create a way to earn money on investments with absolutely no risk. The concept involved elaborate hedging strategies and creating exotic financial instruments.

In 1999, needed financial regulatory reforms were implemented. Unfortunately, there was no oversight of firms creating ever-more-complicated financial instruments and strategies. The system handsomely rewarded short-term results but had little regard for ultimate consequences.

Concurrently, the Fair Credit Reporting Act had been amended and a housing boom had begun. Early on, it allowed many deserving individuals to become home owners. Later, however, it became profitable to include questionable borrowers.

It was a perfect storm. First came the dot-com stock collapse, then the tragic events of September 11, 2001. Financial uncertainty mounted and the Fed dropped Treasury bill rates below 1 percent and kept them there.

Then the Enron, Adelphia and Worldcom scandals made things worse. Investors not only wanted better returns, they were losing confidence in financial reporting.

Faced with these uncertainties, fund managers with billions of dollars that would normally go into equities were seeking a new outlet.

With the economy experiencing a spurt of home building and, hence, mortgage activity, mortgages were pooled together and sold as mortgage-backed securities.

To attract ever more home buyers, teaser rates on

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