THE INDICATOR

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What to expect from the 2009 economy

By Robert Carreira, Ph.D.
Director, Center for Economic Research

With 2009 upon us, we can expect the downward economic trend from 2008 to continue. Nationally, the economy will continue to lose jobs, the unemployment rate will continue to rise, and housing and credit markets will continue to falter, at least through the first half of the year and quite possibly longer. Most economists don't expect conditions to improve until at least the second half of the year, and many don't expect significant improvement until 2010.

Although inflation has moderated somewhat in recent months, as is typically the case in economic downturns, it remains a concern for 2009. The various iterations of economic stimulus packages and bailouts have to be paid for somehow. Since national policymakers will be reluctant to increase taxes or cut spending elsewhere in the economy, at the risk of making the current downturn worse, there is likely to be some expansion of the money supply, which is the classic definition of inflation.

There will be various factors pulling prices in opposite directions. Lower consumer demand for goods and services, reduced energy consumption, and general recessionary conditions will pull prices downward. In fact, this has caused some economists to fear the economy will experience deflation—a widespread decline in prices that can actually worsen recessionary conditions by providing a disincentive to production. The likely expansion of the money supply and cuts in oil production will push prices upward. The direction prices move is largely unknown and will depend on the net effect of those opposing forces. In either case, price level stability will be a top concern in 2009.

STATE SPENDING CUTS WILL IMPACT REVENUES THAT FLOW TO CITIES, COUNTIES, AND SCHOOLS. THIS MEANS LOCAL BUDGETS WILL BE STRAINED, THREATENING INFRASTRUCTURE PROJECTS, EDUCATION, AND OTHER LOCAL GOVERNMENT FUNCTIONS.

At the state level, the budget deficit will continue to dominate the legislative agenda. During the boom years, state government spending increased at unsustainable levels. To bring the budget back into balance, we should expect both cuts in spending and increases in taxes and fees. The Phoenix consensus at the moment seems to be toward spending cuts, but the size of the deficit may well make tax and fee increases unavoidable.

State spending cuts will impact revenues that flow to cities, counties, and schools. This means local budgets will be strained, threatening infrastructure projects, education, and other local government functions. This will create a ripple effect whereby local elected officials will be forced into some

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WHAT TO EXPECT FROM THE 2009 ECONOMY

combination of tax and fee increases and spending cuts. These actions, while unavoidable, tend to make recessionary conditions worse.

In Cochise County, areas will be affected disparately. Sierra Vista, because it is home to Fort Huachuca, will not be hit as hard as some other areas. Although the city has seen recessionary conditions since November 2007, the declines in economic activity have not been as steep as in other areas of the state. New construction in the city rebounded in 2008 and is likely now on a path of normal growth after weeding out the excesses of speculative building and buying. Home price declines in the city have been modest compared to other areas of the state, and that is likely to hold in 2009. Part of the reason is that real estate in the city prior to the housing boom was likely undervalued. The construction of the new Wal-Mart Supercenter and Sam's Club will also help the city reduce business leakage to other areas.

Benson is also likely to fare relatively well. Despite the housing decline at the national, state, and county levels, new residential construction in Benson saw strong growth in 2008 and is well above historic trends. The Wal-Mart Supercenter, which opened in late 2006, continues to draw shoppers from other cities and neighboring counties; however, the opening of the new Wal-Mart Supercenter in Sierra Vista projected for late 2009 may cut into Benson's retail market, especially those consumers residing in areas south of Benson, such as Whetstone and Tombstone. Benson has taken a fiscally conservative approach to managing recent increases in revenue resulting from Wal-Mart and increased residential and commercial construction, leaving the city relatively well poised to weather the current economic storm.

Douglas is also well positioned, with the recent addition of the ACT call center projected to create 600 jobs in the city. This, however, will be largely dependent on the success of the call center, which may be impacted by broader economic conditions.

Northeast Cochise County is also likely to be well positioned in 2009. As construction moves forward on the new Bowie Power Station, this will give a boost to jobs, income, and development in the area, including nearby Willcox.

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WHAT TO EXPECT FROM THE 2009 ECONOMY

Areas of the county likely to fare less well are Bisbee and Tombstone. As the county experienced a significant economic slowdown in 2008, Bisbee and Tombstone weren't hit as hard as other areas due to their status as tourist destinations. Higher gas prices and a weak dollar on the foreign exchange market were a boon for tourism. However, declining gas prices and a strengthening dollar, along with general recessionary conditions, will threaten this industry in 2009.

Staying focused on the future

By Charles P. Potucek
City Manager
City of Sierra Vista

In my 23 years with the City of Sierra Vista, our economy has gone through two significant downturns that I believe provide us with one of the best indicators we have as to how we will weather the current recession. In the late 1980s, a combination of the savings & loan crisis and Desert Shield/Storm deployments left Sierra Vista in rough shape economically. Between 1987 and 1988, the number of residential building permits issued by the city dropped by 50 percent and didn't fully recover until 1991, after which we enjoyed almost a decade of economic growth. We experienced another downturn in 2001 along with the rest of the country following the tragic events of 9-11. The decrease in building permits wasn't nearly as dramatic as it was in the 1980s, nor was the length of time it took us to recover. In both instances, however, our community did recover, and in both instances we never went into an economic slump as deep as many other communities across the state and across the nation. I am optimistic that Sierra Vista will get through this economic crunch in much the same way—we won't go as low as many other communities—and we will pull out of it in good shape more quickly than some.

There are a couple of reasons that Sierra Vista is fortunate enough to ride out tough economic times better than many other communities. First and foremost is Fort Huachuca, the area's primary economic driver that continues to help keep our economy strong. Sierra Vista is also fortunate enough to have a strong retail base and to serve as the retail center for much of our region and Northern Sonora. While Sierra Vista is home to only 35 percent of the population of Cochise County, we collect nearly 64 percent of the retail sales taxes in the county. That means that many people who live outside our city limits are shopping in our community and contributing to our local economy. These retail sales tax revenues play a big role in keeping our community going.

Along with being a retail and employment center for the region, Sierra Vista also provides access to educational opportunities and health care services for the surrounding areas. All of these factors help us avoid the deepest reaches of recession. In fact, in a recent issue of *Business Week* magazine, Sierra Vista

Flash Point

On Oct. 3, CER director Robert Carreira appeared on the Friday Report talk radio show. He and host Dan Abrams discussed the financial crisis, bailouts, and exotic investment instruments.

On Oct. 6, CER director Robert Carreira attended Gov. Napolitano's International State of the State Address in Tucson.

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STAYING FOCUSED ON THE FUTURE

was named as having the strongest housing market in all of Arizona. While our highs may not be as high as some communities that have seen housing prices and growth percentages soar in recent years, our lows have also been cushioned from the worst scenarios of plummeting home prices and negative growth numbers.

With that said, let's take a look at where we are now, compared to this time last year. Retail sales tax revenues remained steady in 2008, and although the lack of revenue growth is disappointing, it is encouraging that we did not see any dramatic decrease in this important revenue stream. In looking at building permits as an indicator of our economic health, it is important to note that we actually issued more residential building permits in 2008 than we did in 2007 (199 permits in 2008 vs. 178 permits in 2007). While commercial construction slowed somewhat in 2008, with issued permits valued at just over $23 million for the year compared to commercial permit values of $43 million in 2007, new commercial development is coming to Sierra Vista and private investment in our community remains strong.

The strength of private investment in Sierra Vista is reflected in the numerous projects that were completed last year in the West End of Sierra Vista. Those projects included the Shaieb Office Building, Garden Place Suites, and the Southeast Arizona Association of Realtors office building. A project currently in the planning stages is the Garden Gate Center offices, which will include a redesign and improvements to North Garden Avenue. In addition to this private investment, the city is also continuing to improve Sierra Vista's West End. One of the best examples is Cyr Center Park located just north of the city's recycling center on North Avenue. When this project is completed later this year it will include three lighted sports fields, restroom facilities, a parking lot, a walking path, a snack bar, and a dog park making it a premier recreational area for our West End residents and everyone in the community. We are also beginning increased efforts to annex the remaining county enclaves in and around the Fry Townsite area. Annexation will allow us to invest in street and park improvements in those areas, making the West End even more attractive to future private investment.

When markets began to shift, we began to proactively prepare for decreased revenues before the impact reached our community.

Last year the city was also able to make a number of other improvements and facilities for our residents. We opened the Nancy J. Brua Animal Care Center, the Sierra Vista/Kiwanis Skate and Bike Court, and Fire Station #3. Street improvements are planned and in the works, and although the widening of Charleston Road has been delayed because of a lack of state funding, we have been able to move forward with improvements to the intersection at Buffalo Soldier Trail and SR92 in partnership with the Arizona Department of Transportation and private investment by Castle & Cooke.

Of course we also know that it's time for us to be very careful with our

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STAYING FOCUSED ON THE FUTURE

spending and to make sure we keep focused on the future. We have not been complacent in preparing for this downturn. When markets began to shift, we began to proactively prepare for decreased revenues before the impact reached our community. At this point we are not adding new employees to our workforce except in the area of public safety, and we are slowing down on projects that had been planned for 2009. We will continue to finalize the plans for a new youth center, a new bandshell, and two water reclamation plants so we will be ready to begin construction when funds become available. And, we are moving forward this year with the expansion of our police station and construction of a new parks maintenance facility in Veterans' Memorial Park.

The last two years of city operations have been guided by "Our Future Vistas," the Mayor and Council's Strategic Plan that has a positive impact on our organization's ability to stay focused on the future and not get distracted by short-term issues. The specific nature of that document, which defines two-year goals for the city, has helped us continue to move forward on the projects that are the most critical to our community. The council will meet again in February of this year to revise its plan to take us out to 2011 with another set of two-year goals, which will be developed with the current economic climate firmly in mind.

In the meantime, Walmart and Sam's Club are on schedule to begin construction in 2009, local contractors will begin building new housing on Fort Huachuca, and we continue to see national interest from the private sector in investing in Sierra Vista. Our unemployment rate has not risen significantly and estimates show that our population is continuing to grow at a moderate and manageable pace. We will continue to watch the national and state economy closely and to budget very conservatively. I am confident we will weather this economic downturn as we have in the past, and emerge stronger than ever as the nation recovers from the current recession. We all know that Sierra Vista has always been a great place to live and work, and that remains especially true during these economic times.

Bisbee economic outlook

By Robert Carreira, Ph.D.

On Dec. 4, the Cochise College Center for Economic Research hosted the 7th Annual Bisbee Economic Outlook Luncheon. The following is a condensed version of the economic outlook presentation.

Cochise County's retail market has been in recession since November 2007. In 2007, the county's retail sales were down by 1.3 percent after adjusting for inflation. From January through August 2008, sales were down 4.6 percent. Sales were down in 9 of 10 months from November 2007 through August 2008.

The Bisbee retail market is not in recession, although growth has slowed significantly. In 2007, Bisbee's sales grew by 3.8 percent. From January through August 2008, sales were up by only 0.4 percent. Sales were down in 4 of 6 months from March thru August. In the first 8 months of 2008, Bisbee was the only city in Cochise County to see positive real growth in retail sales.

A continued slowdown in retail sales is expected countywide and in Bisbee. Part of the reason is recessionary conditions and concerns. As jobs are lost, the overall level of income in the economy declines, which leads to lower levels of sales. Workers who fear they may lose their jobs also curtail spending.

In Bisbee, retail sales performance will depend on tourism, which is impacted considerably by the value of U.S. dollar. In 2007 and for most of

Flash Point

On Oct. 8, CER director Robert Carreira met with Dr. David Torres, director of the University of Arizona South Commerce Program, to discuss partnership opportunities between the two organizations.

On Oct. 9, CER director Robert Carreira participated in the Community Partnership Panel in Bisbee, hosted by Freeport-McMoRan Copper & Gold.

CER Services

The CER provides economic and demographic information, analysis, and forecasting to help community leaders in the public, private, and nonprofit sectors make informed decisions. The CER hosts economic outlook luncheons each year in Benson, Bisbee, Douglas, and Sierra Vista. The Center also produces four major publications annually as part of its Cochise County Economic Outlook Publication Series: *Benson Economic Outlook, Bisbee Economic Outlook, Douglas Economic Outlook,* and *Sierra Vista Economic Outlook*. The CER provides personnel to serve on community projects, committees, and task forces, providing technical expertise in research methodology and serving as a community resource. The CER also prepares weekly press releases that are published in newspapers countywide providing insight into issues affecting Cochise County. The CER also produces the *Cochise County Economic Update*, a biweekly compilation of links to online newspaper articles relevant to the local economy, which is emailed to everyone on the CER's distribution list. The CER's website (www.cochise.edu/cer) provides economic news, information, analyses, forecasts, and studies. In addition, the CER is a state data center affiliate, receiving and disseminating U.S. Census Bureau data to users at no charge or on a cost-recovery or reimbursable basis.

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BISBEE ECONOMIC OUTLOOK

2008, the dollar was down against most major currencies. A weak dollar makes travel to the United States more affordable, encouraging foreign tourism. In recent months, however, the dollar has strengthened in the face of worldwide recessionary concerns.

Lower gas prices may also affect sales in Bisbee. Changes in gas prices alter tourism patterns. With the high prices we've seen over the past couple of years, the net effect on tourism to Bisbee appears to have been positive. So lower prices combined with recessionary conditions and concerns may slow tourism to the city.

Although Bisbee's retail sales have outperformed sales at the county level, the city's restaurant and bar sales have underperformed countywide sales. In Bisbee, sales have been in recession since June 2007. In 2007, sales were down 4.4 percent. For the first 8 months of 2008, the decline was even steeper, with sales down 6.6 percent. Sales were down in 14 of 15 months from June 2007 through August 2008.

At the county level, restaurant and bar sales have been in recession since October 2007. In 2007, sales were up 0.1 percent for the year. From January through August 2008, sales were up 1.4 percent. Although sales for the first 8 months of 2008 were in positive territory, sales were down in 8 of 11 months from October 2007 through August 2008.

As with retail sales, a continued slowdown is expected in restaurant and bar sales. Nonessential spending, such as dining out, is often one of the first things cut from family budgets. Over the past year or so, recessionary fears and conditions, along with higher consumer prices, have encouraged families to cut spending. The lower gas prices we've seen recently may help, but wider fears about the economic downturn are likely to trump lower prices, further weakening consumer confidence.

Accommodation sales in Cochise County, which include hotel, motel, and other temporary lodging stays, have been in recession since April 2008. In 2007, the county's accommodation sales were up 19.7 percent. From January through August 2008, sales were down 4.2 percent.

Bisbee's accommodation sales are not in recession. Bisbee sales saw strong

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BISBEE ECONOMIC OUTLOOK

growth of 21.0 percent in 2007 and 15.3 percent from January through August 2008. There have been some troubling signs, however, with sales down in April and July of 2008. A continued slowdown is expected at the county level. In Bisbee, accommodation receipts will depend heavily on tourism trends and the performance of U.S. dollar.

According to the Arizona Department of Commerce, Bisbee's unemployment rate in 2007 was 4.5 percent, fourth-tenths of a point above the countywide rate of 4.1 percent. For the first 10 months of 2008, Bisbee's average monthly unemployment rate rose to 5.5 percent and the county rate rose to 4.9 percent. For the month of October, Bisbee's rate rose to 6.7 percent and the county rate hit 6.1 percent.

BISBEE'S ACCOMMODATION SALES ARE NOT IN RECESSION. BISBEE SALES SAW STRONG GROWTH OF 21.0 PERCENT IN 2007 AND 15.3 PERCENT FROM JANUARY THROUGH AUGUST 2008.

In the 12 months ending Oct. 31, Cochise County lost 1,400 jobs, for a 12-month job growth rate of -3.7 percent. Most of the job losses were in trade, transportation, and utilities; construction; and other services. With the current economic downturn, we should expect continued job losses and rising unemployment.

From January through August 2008, new single family home permits in Cochise County were down 21 percent. In 2008 there were 295 permits issued, compared to 373 in the same period of 2007. In Bisbee, there were 3 permits issued in 2008, compared to 5 for the same period of 2007.

The new home market in Cochise County may have bottomed out in 2007-2008. Some areas of the county, including Sierra Vista and Benson, have already begun to see a recovery. Although new construction in Bisbee has been slow in recent years, developers have expressed interest and the city seems well poised for growth once conditions at the national and state levels improve.

Existing home sales in Cochise County were down 22.8 percent in the first 9 months of 2008, following declines of 20.7 and 10.2 percent in 2006 and 2007, respectively. In Bisbee, the decline in 2008 was even steeper, with sales down 36.3 percent, following declines of 2.3 and 19.2 percent in 2006 and 2007.

The countywide median home price in the first 9 months of 2008 fell 3.6 percent to $188,000. In Bisbee, the median price fell 7.1 percent to $130,000. The existing home market has not yet hit bottom in Cochise County or Bisbee. A recovery is not expected until 2009 or 2010.

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The recession is here, inflation remains a problem

By Robert Carreira, Ph.D.

The big question for quite some time has been whether we're in a recession. We now know the answer is yes. The national recession officially began in December last year, which is a little surprising considering the Gross Domestic Product data.

GDP is the most watched figure when looking for a recession. It's the value of all final goods and services produced in the economy and it's our broadest measure of production and economic performance. Generally, a recession is a sustained period of economic decline. Usually this shows up as at least two consecutive quarters of negative GDP growth.

We haven't yet seen that sustained period of decline. GDP growth was negative in the third quarter of 2008, and most economists predict we'll see negative growth for the fourth quarter.

But the National Bureau of Economic Research called the recession as beginning in December 2007. We saw negative GDP growth in the fourth quarter of 2007, but then there was modest growth in the first quarter and relatively strong growth in the second quarter of 2008. The second quarter growth was likely attributable to the economic stimulus package that sent tax rebate checks to millions of American households back in May, in an effort to stimulate consumer spending. Consumer spending accounts for about two-thirds of GDP.

So we have a somewhat unusual picture of GDP during the current recession. Sometimes in recessions we see a single quarter of modest growth within a longer period of overall decline, but it's unusual to see two consecutive quarters of positive growth, especially with one of those quarters at 2.8 percent, as we saw in the second quarter of 2008.

SOMETIMES IN RECESSIONS WE SEE A SINGLE QUARTER OF MODEST GROWTH WITHIN A LONGER PERIOD OF OVERALL DECLINE, BUT IT'S UNUSUAL TO SEE TWO CONSECUTIVE QUARTERS OF POSITIVE GROWTH…

The GDP data underscore the weight of other factors in defining a recession. Those include nonfarm employment, real personal income minus transfer receipts, industrial production, and real manufacturing and trade sales. Although we had positive economic growth in the first two quarters of 2008, we also lost 461,000 jobs nationwide during that period.

Although we found out only recently that we're in a recession, the current recession has already been longer than either of the previous two, which were

Flash Point

In October, CER director Robert Carreira met with the Greater Sierra Vista Area Chamber of Commerce's Per Diem Committee, which is seeking to request the Department of Defense review its per diem lodging rates for personnel on temporary duty to the area.

On Oct. 20, CER director Robert Carreira met with members of the Southeast Arizona Economic Development Group to gain input to the economic development asset inventory for Cochise County, currently being prepared by the CER.

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THE RECESSION IS HERE, INFLATION REMAINS A PROBLEM

in 2001 and 1990-1991. Each of those lasted 8 months, and we've already been in the current recession for more than a year.

Both the 1973-1975 and 1981-1982 recessions lasted 16 months. Those were the longest since the Great Depression. So there's a good chance the current recession will become the new longest recession since the Great Depression; in fact, that's almost certain to be the case.

The fact is we're coming out of a period that saw an unprecedented expansion of credit that simply wasn't sustainable. That means that, even if the credit markets are unfrozen, people are still going to take a break from spending until they can significantly pay down the debt they've already incurred. So the injection of liquidity into credit markets, interest rate cuts, tax cuts, and other measures can lead the horse to water, but as the saying goes it cannot make it drink. We can lower interest rates and make credit available, but that doesn't mean consumers are going to borrow and spend.

Although we've been in a recession for more than a year, inflation has remained a problem. Normally, inflation isn't a problem during recessions. Most economists are comfortable with inflation of 2 to 2.5 percent per year. Even in the first half of 2007 we were near the upper limit of what most economists would like to see. Beginning in the second half of 2007, inflation was in the 3 to 4 percent range; and beginning in the second half of 2008, prices were 5 to 5.5 percent higher.

The good news is that inflation has moderated somewhat in recent months. The price of energy has come down considerably, so that should help. One factor that is likely to stoke inflation in the coming year, however, is the effect of the various government bailouts and rescue packages. That money has to come from somewhere, and it'll likely come from printing more treasury bills, bonds, and notes, and the effect of that tends to be inflationary.

U.S. Recessions Since 1945

PEAK	TROUGH	DURATION (MONTHS)
February 1945	October 1945	8
November 1948	October 1949	11
July 1953	May 1954	10
August 1957	April 1958	8
April 1960	February 1961	10
December 1969	November 1970	11
November 1973	March 1975	16
January 1980	July 1980	6
July 1981	November 1982	16
July 1990	March 1991	8
March 2001	November 2001	8
December 2007	?	?

Source: National Bureau of Economic Research.

Pulling in the opposite direction is the slowed economic growth associated with the recession, which tends to ease inflationary pressures. So we'll have competing forces pulling prices in opposite directions. It'll be a matter of net effect. We're probably not out of the woods yet on inflation, and stagflation remains a concern. Stagflation is slowed economic growth and high inflation occurring at the same time and creates great difficulty for monetary and fiscal policymakers.

As we've seen over the past year, inflation hits household budgets immediately and quite visibly and is an important factor in consumer confidence. Dismal consumer confidence over the past year or so has been a primary factor in the curtailment of consumer spending, which has contributed considerably to the current economic downturn.

Flash Point

On Oct. 29, CER director Robert Carreira met with University of Arizona student Seth Fuller to discuss traits of successful leaders.

On Nov. 6, the CER gave an economic outlook presentation at the Economic and Trade Forum hosted by the City of Douglas.

On Nov. 12, CER director Robert Carreira participated in the Cover the Uninsured Task Force quarterly meeting to discuss ways in which to expand health care services and coverage in Cochise County.

Find out why more and more people are visiting the CER website.

Visit our website at **www.cochise.edu/cer** to find statistics on the local economy; information on upcoming events; sponsorship information; CER economic outlook publications; PowerPoint slides from CER presentations; special studies; press releases; the *Cochise County Economic Update*, a compilation of links to online newspaper stories of economic interest from across Cochise County; the CER's quarterly newsletter, *The Indicator*; and links to websites relevant to the local, state, and national economy.

Flash Point

On Nov. 21, CER director Robert Carreira participated in the Cochise College Strategic Planning Group's meeting to finalize the college's strategic plan.

From October through December, CER director Robert Carreira participated in the United Way of Sierra Vista and Cochise County's Community Impact Initiative to help identify goals for the organization.

Understanding derivatives

By Robert Carreira, Ph.D.

With the current financial crisis, we're learning lots of new words. One is "derivatives," the unregulated nature of which some politicians and economists blame for contributing to the present calamity. Derivatives are a broad class of investments that includes futures, forwards, options, and swaps.

Futures are agreements to purchase a set amount of something at a certain price at a particular time in the future. Oil is a commodity traded quite extensively in futures markets. Let's say the current price of oil is $100 a barrel. Someone thinks the price of oil is going to rise to $150 a barrel 3 months from now, but someone else thinks it'll fall to $50 a barrel.

The two parties might enter into a futures agreement whereby one agrees to sell a certain quantity of oil to the other in 3 months at a certain price – let's say $100 a barrel. If the market price of oil rises to $150, the purchaser will earn $50 a barrel. He or she will be entitled to purchase oil at $100 a barrel, and turn around and sell it for $150 – the going market price. If the price falls to $50 a barrel, the purchaser will lose $50 a barrel since he or she will be obligated to pay $100 a barrel.

FOR EXAMPLE, THE PERSON WHO THOUGHT OIL WOULD HIT $150 A BARREL IN THREE MONTHS MIGHT PURCHASE AN OPTIONS CONTRACT TO BUY OIL AT $100 A BARREL AT THE END OF THE 3 MONTHS.

The futures contract has no value in and of itself – its value is "derived" from the price of the underlying commodity, in this case oil. Futures are standardized and traded openly on organized exchanges, such as the New York Mercantile Exchange.

Forwards are similar to futures, but involve very specific purchases, perhaps a shipment of automobiles that includes a certain mix of models in certain quantities. Because they are custom tailored to the needs of the specific parties involved, forwards are not openly traded.

Options are similar to futures and forwards except, as the name implies, there is no obligation to go through with the contract – doing so is an option. For example, the person who thought oil would hit $150 a barrel in three months might purchase an options contract to buy oil at $100 a barrel at the end of the three months. If in 3 months the price of oil is $50 a barrel, the person can simply elect to not exercise the option. In this case, the person is out only the price of the options contract, not the losses that would result if actually forced to purchase the oil.

Swaps, as the name implies, refers to trading something – usually interest rates. Someone might borrow money at a variable interest rate that is currently 5 percent, but there is an expectation that the rate will increase over the next year. Someone else might borrow money at a fixed rate of 5 percent,

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UNDERSTANDING DERIVATIVES

but that person thinks interest rates, in general, will fall. The two agree to swap interest payments. Both parties maintain their own loans with the original lenders, but they make payments to each other to cover the other's interest rate payments.

One type of swap that has been particularly troublesome for some investors is credit default swaps. These involve a contract between two parties whereby one party agrees to swap a specified payment for the payment received by the other party. Let's say a certain party holds a bundle of home mortgages that, based on the combined interest rates, will pay $100,000 a year in interest. The other party might agree to swap a payment of $95,000 a year in return for whatever payments are collected on the bundled mortgages. If this sounds a lot like an insurance policy, that's because it's strikingly similar to one. It's not called insurance because, if it were, it would be regulated as such.

An important feature of derivatives is that their net impact on the economy is zero. For every gain on derivatives, there is an equal and opposing loss (one person's loss is another's gain). The problem occurs when a losing party can't afford to pay up.

There are a couple of reasons derivatives have become so popular. One is that they allow parties to offset some of their risk; for example, through credit default swaps or options contracts that provide an opportunity to recoup losses. Another reason is they allow for large investments without tying up large amounts of capital.

Understanding hedge funds

By Robert Carreira, Ph.D.

As I pointed out in my column on derivatives, we're learning lots of new words associated with the current financial crisis. One is "hedge funds," the unregulated nature of which some politicians and economists blame for contributing to the crisis. Although the term is new to many, hedge funds have been around for more than half a century.

A hedge fund is an investment designed to protect against potential losses—hence the word "hedge." Hedge means to protect, be cautious, or guard against. It also means evade, circumvent, or get around. Some critics have noted the latter terms have been more appropriate because these funds have evaded, circumvented, and got around the regulatory structures that apply to mainstream financial investments.

Hedge funds are an exclusive class of investments available to only a small number of wealthy investors. They are not traded openly on exchanges, the way mutual funds, for example, are traded openly. Because of the exclusivity and limits on the number of investors, hedge funds aren't subject to the public reporting requirements and other regulatory efforts at ensuring greater transparency, such as registration with the Securities and Exchange Commission.

> HEDGE FUNDS ARE AN EXCLUSIVE CLASS OF INVESTMENTS AVAILABLE TO ONLY A SMALL NUMBER OF WEALTHY INVESTORS. THEY ARE NOT TRADED OPENLY ON EXCHANGES…

Hedge funds include a variety of different investment instruments, including short selling and derivatives. These instruments

Flash Point

On Nov. 23, CER director Robert Carreira was awarded the Doctor of Philosophy degree in Public Policy and Administration from Walden University. Robert also holds master's degrees in public administration, education, and international political economics from Troy University, along with a Bachelor of Arts degree in sociology from St. Leo University and an Associate of Applied Science degree in criminal justice from Austin Peay.

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UNDERSTANDING HEDGE FUNDS

tend to be regulated to some extent when part of mainstream, publicly traded investment funds, but escape regulation when they become part of private hedge funds.

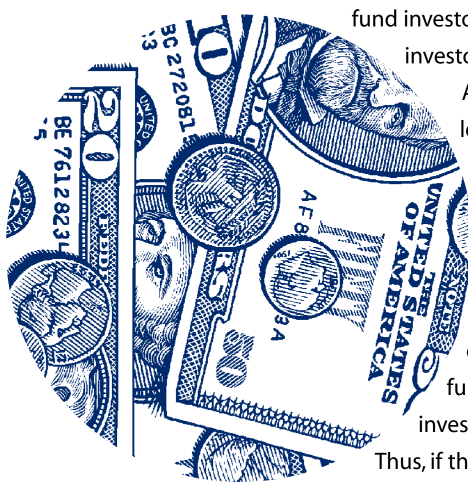
Short selling is one of the most common types of hedge fund investments. In short selling, an investor borrows a number of shares of stock he or she believes will decline in price. The investor then sells the shares at the current market price. When the price of the stock falls, the investor buys back the shares at a lower price and returns them to the lender. The investor pays a fee for borrowing the shares, and pockets the difference between the higher price at which they were sold and the lower price at which they were repurchased.

Another word we've heard in the current crisis is "leverage." In the financial world, leverage means making a little go a long way. In the case of short selling, the investor does not have to come up with the money required to purchase the shares of stock. Instead, the investor pays only a fee for borrowing the shares, but earns a profit based on the total value of the shares. So, a little goes a long way—if things go well.

The reason short selling is such an integral part of hedge funds is that they hedge, or protect against potential losses. In the stock market, some stocks will rise in value while others fall. Thus, positive gains will be offset in part by losses. By predicting which stocks will fall, the investor gains not only from stocks that increase in value, but also from those that lose value.

One of the recent criticisms of short selling is that this sort of activity can manipulate the price of stocks. When an investor borrows certain shares of a stock, this does not cause the price to increase. The shares had already been sold, so there is no increase in demand for those shares. However, when the investor turns around and sells those shares, this increases the supply of shares on the market, putting downward pressure on prices.

Depending on the volume of shares involved in the transaction, this could cause the price of the shares to fall. So, it is more than a bet that the stocks will fall in value—it can also become a self-fulfilling prophecy. When the shares are bought back, the result is an increase in demand, which places upward pressure on prices bringing them back up. Critics have complained that this sort of activity artificially manipulates stock prices to the benefit of hedge fund investors and to the detriment of mainstream investors.



Another criticism involves the leveraging factor of hedge funds. Since an investment may be leveraged to many times the actual amount of the investment, the result may be overinvestment. With short selling, or options contracts which are also a common instrument found in hedge funds, only a fraction of the value of the investments is tied up in the investment. Thus, if things go wrong losses can be huge.

Consider a hedge fund with $10 billion in investments leveraged by only $1 billion in short-selling borrowing fees and options contract prices. If the investments decline by 10 percent, the total amount of the $1 billion investment can be lost. This is what makes hedge funds so risky.

2008: An economic year in review

By Robert Carreira, Ph.D.

There's little doubt that 2008 was the most eventful year for the economy in quite some time. In December, we found out the national economy had been in recession for the entire year. From January through December, 2.6 million people in the United States lost their jobs and the national unemployment rate rose from 4.9 to 7.2 percent.

The recession, which officially began in December 2007, will likely be the longest since the Great Depression. The current record is 16 months, occurring in 1973-1975 and again in 1981-1982.

Inflation was also big news in 2008. For most of the year, consumer prices were up by about 5 percent when compared to the same periods of 2007. This is more than twice the rate most economists would like to see. As recessionary conditions worsened toward the end of the year, inflation moderated somewhat, but still loomed as a concern.

Locally, Cochise County's retail market slipped into recession in late 2007 and remained there through 2008. The most recent figures show sales countywide were down 6.5 percent from January through October, after adjusting for inflation.

The county's restaurant and bar sales have also been in recession since late 2007. Although overall sales were flat from January through October, sales were down in 10 of the 13 months ending October 30.

The county's accommodation sales, which saw extraordinary growth in 2007, slipped into recession in April 2008. From January through October, sales were down by 3.8 percent. Sales were down every month from April through September, but saw strong growth of 9.7 percent in October.

Cochise County lost 1,325 jobs in the 12 months ending November 30, and the county's unemployment rate rose from 4.5 to 6.2 percent. The hardest hit industries were construction and other services, each of which lost 1 in 5 jobs over the year.

Countywide, existing homes sales continued to struggle in 2008, with sales down 20.9 percent. New construction continued its decline, which began in 2006. From January through September, new home permits countywide were down 17 percent compared to the same period of 2007.

NEW HOME PERMITS IN SIERRA VISTA WERE UP 10.6 PERCENT, AND PERMITS IN BENSON IN 2008 WERE MORE THAN DOUBLE THE NUMBER IN 2007.

New construction in some areas of the county, however, began to see a recovery in 2008. New home permits in Sierra Vista were up 10.6 percent, and permits in Benson in 2008 were more than double the number in 2007. Also in Benson, construction began on a new low-income multifamily housing development on State Route 80.

Benson also saw considerable commercial growth in 2008, including new retail centers near the Wal-Mart Supercenter. Construction also began on the new Gracie's Restaurant near the Holiday Inn Express on Highway 90. In Willcox, construction continued to move forward on a new justice complex, firehouse, and Willcox Chamber of Commerce and Agriculture building.

On Fort Huachuca, $100 million was approved in April for the construction of troop billets and other facilities. Also in April, the Huachuca City Town Council approved rezoning an 800-unit residential development for the

Flash Point

On Nov. 26, CER director Robert Carreira appeared on the Open House talk radio show. He and host Brad Snyder discussed the current housing market crisis and the outlook at the national and local levels.

On Dec. 4, the CER hosted the 7th Annual Bisbee Economic Outlook Luncheon.

CONTINUED

2008: AN ECONOMIC YEAR IN REVIEW

Campstone property west of Highway 90. Overall, more than 2,000 homes are planned for the Campstone development.

Significant economic events in Cochise County in 2008 included the City of Douglas' partnership with ACT to bring a call center to the city. The city underwrote the project, purchasing and remodeling a building to host the call center and purchasing the necessary information technology infrastructure. The call center is projected to create about 600 jobs in the city and began hiring and training employees in July.

Also in Douglas, the year 2008 saw the creation of the Douglas International Port Authority, with representatives from both sides of the border focused on expanding international trade. The city also saw construction begin on the long-awaited, three-story, 45,000 square-foot Best Western hotel. Construction is expected to be complete in early 2009.

In 2008, Cochise College began new construction as part of its master facilities plan, which includes an addition to the science building and construction of a new career-technical building and student services building on the Sierra Vista Campus. Other components of the master plan include the construction of a new Willcox Center and upgrades to the Douglas Campus, including the construction of new dorms.

In May, the City of Bisbee hosted its San Jose Planning Charrette. The week-long charrette solicited input from the community regarding opportunities, suggestions, and concerns for the San Jose district. Based on that input, the charrette team developed several recommendations for the future development of the San Jose area. The charrette team recommended updating the city's General Plan to include adopting a specific plan for the San Jose district; adopting a landscape ordinance; installing signage, wayfinding, and civic monumentation; and encouraging the use of public art in the San Jose area.

Also in Bisbee, Freeport-McMoRan Copper and Gold launched a feasibility study in 2008 to further explore the potential of resuming mining operations. Later in the year, the study was placed on hold in response to broader economic conditions nationally and internationally, including a steep decline in world copper prices. In the Elfrida area, Aurelio Resources Corp. continued discussions of moving forward with open-pit mining of copper, zinc, lead, gold, and silver.

In Sierra Vista, plans continued to move forward for the construction of a new Wal-Mart Supercenter, Sam's Club, and Sam's Only Gas Station. Construction is expected to begin in early 2009. In December, it was announced that the project would be downsized from its original plans.

In March, the Cochise County Board of Supervisors voted unanimously to amend zoning regulations to deny subdivisions that cannot

In March, the Cochise County Board of Supervisors voted unanimously to amend zoning regulations to deny subdivisions that cannot prove 100-year water adequacy.

Flash Point

On Dec. 17, the CER hosted the Greater Sierra Vista Area Chamber of Commerce's Leadership Sierra Vista Economic Development/County Government Day. The Leadership Sierra Vista group met at Cochise College for presentations by the CER and the Sierra Vista Economic Development Foundation, which was followed by a tour of Northrop Grumman in the morning and the Cochise County courthouse and government complex in Bisbee in the afternoon.

CONTINUED

2008: AN ECONOMIC YEAR IN REVIEW

prove 100-year water adequacy. The new regulation is the first of its kind in Arizona.

On a particularly sad note, 2008 saw the passing of Ken Jones, the founder of the Cochise College Center for Economic Research. Ken was a pioneer in rural economic research, bringing to Cochise County a multitude of research services that simply did not exist elsewhere, outside the nation's major metropolitan areas. Ken was 50.


Ken Jones, founder of the Cochise College Center for Economic Research

Flash Point

On Dec. 18, CER director Robert Carreira gave a presentation on economics to Marv Sorenson's economics class at Benson High School.

2008 COCHISE COUNTY EMPLOYMENT AND UNEMPLOYMENT STATISTICS

		JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	AVERAGE
UNITED STATES	UNEMP. RATE (SA)	4.9%	4.8%	5.1%	5.0%	5.5%	5.6%	5.8%	6.2%	6.2%	6.6%	6.8%	7.2%	5.8%
ARIZONA	LABOR FORCE*	3,075.4	3,063.2	3,066.4	3,053.7	3,057.4	3,085.8	3,100.0	3,105.8	3,142.9	3,158.5	3,150.4	3,163.4	3,101.9
	UNEMPLOYMENT*	138.9	121.8	119.8	111.1	125.4	153.9	168.2	181.2	191.1	194.0	193.8	210.8	159.2
	UNEMP. RATE	4.5%	4.0%	3.9%	3.6%	4.1%	5.0%	5.4%	5.8%	6.1%	6.1%	6.2%	6.7%	5.1%
	UNEMP. RATE (SA)	4.3%	4.0%	4.0%	3.9%	4.4%	4.8%	5.1%	5.6%	5.9%	6.1%	6.3%	6.9%	5.1%
	EMPLOYMENT*	2,936.5	2,941.5	2,946.6	2,942.6	2,932.0	2,931.9	2,931.8	2,924.6	2,951.8	2,964.4	2,956.5	2,952.6	2,942.7
COCHISE COUNTY	LABOR FORCE	58,325	57,625	57,775	57,450	57,600	59,050	58,925	58,425	59,025	58,750	58,800	59,425	58,425
	UNEMPLOYMENT	2,925	2,625	2,500	2,225	2,350	2,950	3,150	3,175	3,400	3,400	3,425	3,800	3,000
	UNEMP. RATE	5.0%	4.6%	4.3%	3.9%	4.1%	5.0%	5.3%	5.4%	5.7%	5.8%	5.8%	6.4%	5.1%
	UNEMP. RATE (SA)	4.4%	4.3%	4.2%	4.0%	4.5%	5.0%	5.1%	5.6%	6.0%	6.0%	6.1%	6.4%	5.1%
	EMPLOYMENT	55,400	55,025	55,275	55,250	55,250	56,125	55,750	55,250	55,625	55,350	55,375	55,650	55,450
BENSON	LABOR FORCE	2,421	2,383	2,384	2,362	2,373	2,451	2,452	2,433	2,464	2,454	2,457	2,495	2,428
	EMPLOYMENT	2,204	2,189	2,200	2,198	2,198	2,233	2,219	2,198	2,213	2,202	2,203	2,214	2,206
	UNEMPLOYMENT	217	194	184	164	175	218	233	235	251	252	254	281	222
	UNEMP. RATE	9.0%	8.1%	7.7%	6.9%	7.4%	8.9%	9.5%	9.7%	10.2%	10.3%	10.3%	11.3%	9.1%
	UNEMP. RATE (SA)	7.9%	7.6%	7.5%	7.1%	8.1%	8.9%	9.1%	10.1%	10.7%	10.7%	10.8%	11.3%	9.1%
BISBEE	LABOR FORCE	3,369	3,329	3,335	3,316	3,325	3,412	3,406	3,377	3,413	3,397	3,401	3,440	3,377
	EMPLOYMENT	3,182	3,161	3,176	3,174	3,174	3,224	3,204	3,174	3,196	3,179	3,181	3,197	3,185
	UNEMPLOYMENT	187	168	159	142	151	188	202	203	217	218	220	243	192
	UNEMP. RATE	5.6%	5.0%	4.8%	4.3%	4.5%	5.5%	5.9%	6.0%	6.4%	6.4%	6.5%	7.1%	5.7%
	UNEMP. RATE (SA)	4.9%	4.7%	4.7%	4.4%	4.9%	5.5%	5.7%	6.2%	6.7%	6.6%	6.8%	7.1%	5.7%
DOUGLAS	LABOR FORCE	6,222	6,133	6,137	6,089	6,112	6,298	6,297	6,247	6,322	6,294	6,302	6,391	6,237
	EMPLOYMENT	5,739	5,700	5,727	5,723	5,723	5,813	5,777	5,724	5,763	5,733	5,736	5,765	5,744
	UNEMPLOYMENT	483	433	410	366	389	485	520	523	559	561	566	626	493
	UNEMP. RATE	7.8%	7.1%	6.7%	6.0%	6.4%	7.7%	8.3%	8.4%	8.8%	8.9%	9.0%	9.8%	7.9%
	UNEMP. RATE (SA)	6.9%	6.6%	6.5%	6.2%	7.0%	7.7%	8.0%	8.7%	9.3%	9.2%	9.5%	9.8%	7.9%
HUACHUCA CITY	LABOR FORCE	943	930	931	923	927	954	954	947	957	953	954	967	946
	EMPLOYMENT	874	868	872	871	871	885	880	872	877	873	873	878	875
	UNEMPLOYMENT	69	62	59	52	56	69	74	75	80	80	81	89	71
	UNEMP. RATE	7.3%	6.7%	6.3%	5.6%	6.0%	7.2%	7.8%	7.9%	8.4%	8.4%	8.5%	9.2%	7.5%
	UNEMP. RATE (SA)	6.4%	6.3%	6.2%	5.7%	6.6%	7.2%	7.5%	8.2%	8.8%	8.7%	8.9%	9.2%	7.5%
SIERRA VISTA	LABOR FORCE	18,382	18,203	18,262	18,198	18,226	18,615	18,542	18,380	18,543	18,454	18,468	18,625	18,408
	EMPLOYMENT	17,830	17,708	17,793	17,780	17,781	18,061	17,948	17,782	17,904	17,812	17,821	17,910	17,844
	UNEMPLOYMENT	552	495	469	418	445	554	594	598	639	642	647	715	564
	UNEMP. RATE	3.0%	2.7%	2.6%	2.3%	2.4%	3.0%	3.2%	3.3%	3.4%	3.5%	3.5%	3.8%	3.1%
	UNEMP. RATE (SA)	2.6%	2.5%	2.5%	2.4%	2.6%	3.0%	3.1%	3.4%	3.6%	3.6%	3.7%	3.8%	3.1%
TOMBSTONE	LABOR FORCE	878	868	871	867	869	889	885	878	885	881	882	890	878
	EMPLOYMENT	848	842	846	845	845	859	853	846	851	847	847	852	848
	UNEMPLOYMENT	30	26	25	22	24	30	32	32	34	34	35	38	30
	UNEMP. RATE	3.4%	3.0%	2.9%	2.5%	2.8%	3.4%	3.6%	3.6%	3.8%	3.9%	4.0%	4.3%	3.4%
	UNEMP. RATE (SA)	3.0%	2.8%	2.8%	2.6%	3.1%	3.4%	3.5%	3.7%	4.0%	4.0%	4.2%	4.3%	3.4%
WILLCOX	LABOR FORCE	1,922	1,894	1,896	1,881	1,888	1,945	1,945	1,929	1,952	1,944	1,946	1,974	1,926
	EMPLOYMENT	1,774	1,762	1,770	1,769	1,769	1,797	1,786	1,769	1,781	1,772	1,773	1,782	1,775
	UNEMPLOYMENT	148	132	126	112	119	148	159	160	171	172	173	192	151
	UNEMP. RATE	7.7%	7.0%	6.6%	6.0%	6.3%	7.6%	8.2%	8.3%	8.8%	8.8%	8.9%	9.7%	7.8%
	UNEMP. RATE (SA)	6.8%	6.5%	6.4%	6.2%	6.9%	7.6%	7.9%	8.6%	9.3%	9.1%	9.4%	9.7%	7.8%

SA=Seasonally Adjusted. *Data in thousands. Source: The State of Arizona Department of Commerce, Research Administration (ADOC), Arizona Workforce Informer website, www.workforce.az.gov and Cochise College Center for Economic Research. Determined by monthly household surveys in the LAUS program. County estimates are independently calculated. Sub-county figures are calculated by ADOC using a census share methodology; sub-county SA rates calculated by the Cochise College Center for Economic Research. Employment and unemployment estimates for cities, towns, and areas are a fixed ratio, derived from the 2000 Census of the county figures. Note: In cases where the year-end average does not equal the average of the 12 months shown, or when seasonally adjusted averages do not equal unadjusted averages, discrepancies are due to rounding.

Center for Economic Research
COCHISE COLLEGE

901 North Colombo Avenue • Sierra Vista, AZ 85635-2317
(520) 515-5486 (voice) • (520) 515-5343 (fax)
Email: cer@cochise.edu • Web address: www.cochise.edu/cer

The CER provides a variety of products and services including the Economic Outlook publications for Benson, Bisbee, Douglas, and Sierra Vista, released in conjunction with economic outlook luncheons held in those cities; the *Cochise County Economic Update* – a compilation of links to online newspaper articles from local newspapers, emailed biweekly to everyone on our distribution list; weekly press releases related to the local economy; *The Indicator* – our quarterly newsletter providing updates on the local economy and CER activities; numerous research studies on various topics of local economic interest; the tracking of local economic statistics, made available on our website *www.cochise.edu/cer*; and responding to requests for data from residents and local leaders in the public, private, and nonprofit sectors and business leaders from outside the area looking to expand or relocate to Cochise County. These products and services would not be available without support from members of the community such as yourself.

As you may know, the CER is an auxiliary department of Cochise College, which means we are expected to raise the necessary funds to meet our budget in order to keep our doors open. To do this, we rely on *tax-deductible* sponsorships, donations, and gifts from those who benefit from our services. If you've sponsored us in the past, we thank you for your generous support and would like to invite you to consider sponsoring us again. If you haven't yet had the opportunity to be a CER sponsor, we'd like to ask you to consider supporting the CER with a *tax-deductible* sponsorship, donation, or gift. To show our appreciation of your financial support, each sponsor level comes with its own set of benefits, outlined in detail on the reverse side of this letter.

For over a decade, the CER has provided timely and accurate information regarding the economy. The information provided by the CER can be helpful to you in making decisions about the future direction of your business or industry. By sponsoring the CER, you will be helping Cochise County stay informed on important economic issues.

On behalf of the CER, I would like to thank you for taking the time to consider partnering with us. Every sponsorship, donation, and gift counts and we thank you for considering the CER as a recipient of your support.

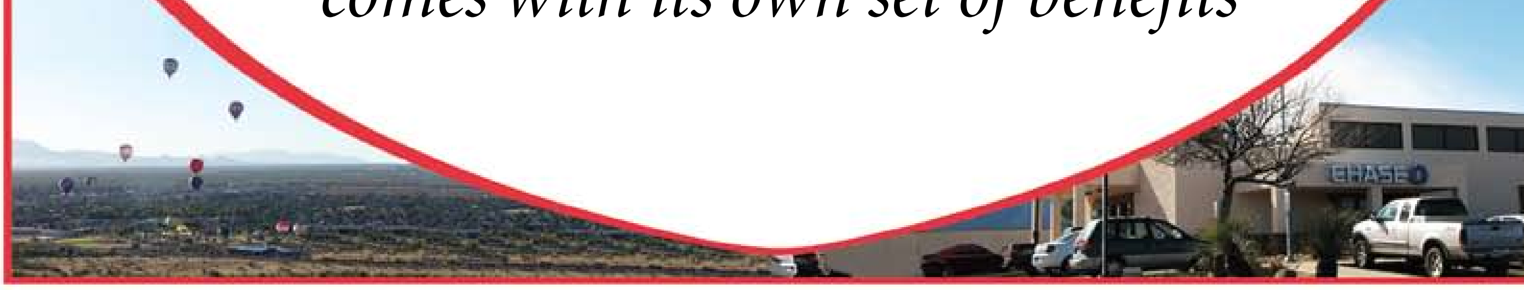
If you have any questions regarding sponsorship or suggestions on how we can improve our sponsor program, please feel free to contact me at (520) 515-5459 or email me at ceroffice@cochise.edu

Sincerely,

Debra Soto

Debra Soto
Sponsor Coordinator

"To show our appreciation of your financial support, each sponsor level comes with its own set of benefits"



Center for Economic Research
Sponsor Form

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Cochise College Center for Economic Research
15th Annual Sierra Vista Economic Outlook Luncheon

SIERRA VISTA

- An Economic Overview of Sierra Vista
- Wednesday, April 15, 11:30 a.m., Doors open at 11 a.m.
- Windemere Hotel & Conference Center
  2047 S. Highway 92, Sierra Vista, Arizona

The Cochise College Center for Economic Research will host an economic outlook luncheon for business and community leaders, students, and members of the general public. The program will provide an overview of the national, state, and local economy, with a focus on the economy of Sierra Vista. Attendees will receive a copy of the 2009 *Sierra Vista Economic Outlook*, published by the Center for Economic Research. The publication provides a review and forecast of the local economy. One unit of Continuing Professional Education will be offered in each of the following areas: accounting, financial planning, and real estate.

ROBERT CARREIRA

Speakers:

Robert Carreira, Ph.D., Director of the Center for Economic Research, will provide a review of the past year's economy and a forecast for the coming year.

CHUCK POTUCEK

Chuck Potucek, Sierra Vista City Manager, will give a presentation on current and planned projects within the city.

Cost is $45 per person or $315 for a table seating eight.

Pre-registration and pre-payment are required.

Reservations are accepted by mail, email at cer@cochise.edu, or fax at (520) 515-5343. For Visa®, MasterCard®, Discover®, or American Express® payments use form below, or call (520) 515-5486. All meals are vegetarian; please indicate if there are any other special dietary restrictions or accommodations necessary.

economic outlook luncheon 2009

COCHISE COLLEGE

DEADLINE FOR RESERVATIONS: APRIL 6, 2009

SIERRA VISTA ECONOMIC OUTLOOK LUNCHEON 2009 REGISTRATION FORM

Anyone needing an accommodation in order to attend should contact the Disability Services Office, (520) 515-5337 or (520) 417-4023 at least 72 hours in advance.

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Total $ ________

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