Financial Crisis Shakes Up Economy

Muted effect in Fayetteville

KATE GREUBEL
staff reporter

Despite the attention paid to the ongoing global financial crisis, many Fayetteville High School students do not seem to know its causes and effects, let alone what the Bush administration has done to minimize the damage.

The roots of the crisis can be traced back to over a y ear ago to easy credit and excessive risk taking by the American banking system. University of Arkansas Associate Professor of Finance Tim Yeager says banks lent to borrowers who took advantage of inflated real estate values and to those who should not have been considered responsible home owners.

"Eventually a large percentage of those borrowers -- up to one-forth of them -- could not pay back their loans, leading to massive losses by the big banks," Yeager said.

Many borrowers received subprime mortgage loans, also known as bad mortgages or junk mortgages, which allowed them to buy expensive homes despite their bad credit history.

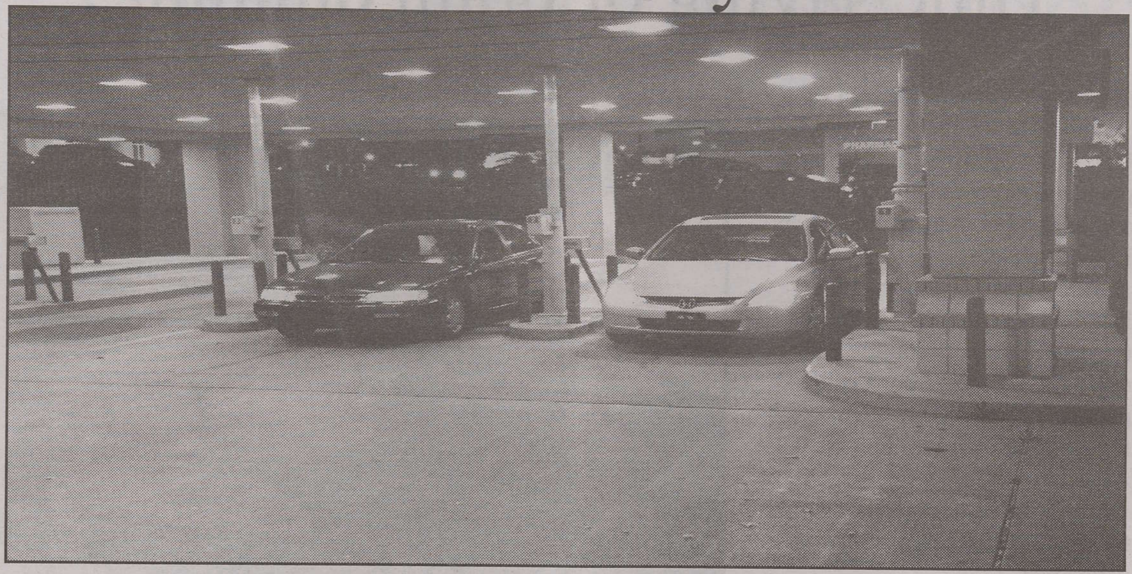
Many of these mortgage loans also had adjustable interest rates, according to Fayetteville High School government teacher and retired lawyer, Steve Adams.

"Adjustable interest rate loans fluctuate periodically," Adams said. "When the interest rates started to rise, many home owners could not longer afford their mortgage payments, leading to delinquency and then possible foreclosures."

Katherine Deck, University of Arkansas Director of the Center of Business and Economic Research at the Sam M. Walton College of Business, indicated financial internationalization is also involved.

"Much of the savings from the rest of the world has been invested in the United States," Deck said. "Because the other countries have been doing this, things like houses have been relatively cheap for U.S. borrowers."

When the economy began slowing, U.S. families were no longer able to afford the houses they bought with subprime home loans.



COLTON BAKER | photo editor

BANK LINES Waiting in line at a local Arvest bank, two account holders pull through the drive thru lanes to handle business matters. The Fayetteville area has kept a low level of subprime loans due in part to the fact that most local banks do not offer those types of loans.

According to Time magazine, foreign banks purchased many mortgage securities offered by U.S. investment banks and guaranteed by the Federal National Mortgage Association (called, Fannie Mae), and the Federal Home Mortgage Corporation (Freddie Mac). When problems in the financial market began to increase, Fannie and Freddie received immediate attention from the Federal Reserve Board and the U.S. Department of Treasury -- the government agencies are responsible for regenerating the economy under what is called a "bailout plan". The Fed and Treasury feared the collapse of Fannie Mae and Freddie Mac would further aggravate the already vulnerable economy and real estate market.

Industries and people around the world have already cut back on spending.

National unemployment has now reached over 6.1 percent, reported the economist.com, a Web site focusing on international politics, business news and opinion.

Compared to the national rate, Fayetteville has no unemployment problem.

Arkansas has a whole has 4.8 percent unemployed, also relatively low when compared to Michigan's 8.9 percent.

In the past decade, Fayetteville saw tremendous job growth, Deck said. This growth has slowed as a result of the national recession. But, it has not stopped.

"Our employment growth over the last year has been one percent -- that is slow growth but at least its positive," Yeager said.

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Yeager also cites Fayetteville's low level of subprime loans.

"We don't have many of those loan types because the banks in our area didn't offer those types of loans," Yeager said. "And, our real estate prices didn't rise to the absurd levels that they did on the East and West Coasts."

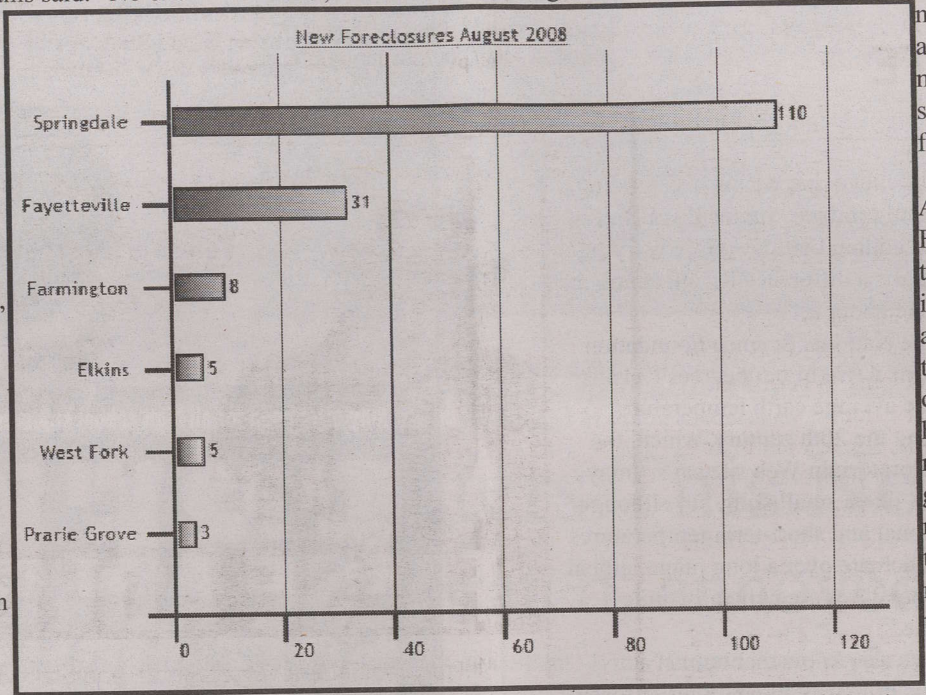
Lower real estate value, however, did not keep Fayetteville from suffering foreclosures.

According to realtytrac.com, Fayetteville reported 31 foreclosures in August and Springdale reported 110 foreclosures. These numbers are low compared to many areas throughout the nation.

Few foreclosures and low unemployment do not mean Fayetteville High students have not been touched by the financial crisis.

An surplus of unsold homes has hurt Fayetteville's housing section. The bloated real estate market has affected sophomore Lane Williams' family.

"We have been trying to sell our house for a couple of months now," Williams said. "No one wants to buy it because they're afraid a $199K house will be work $79K in a few weeks."



SOURCE: REALTYTRAC.COM

ANDREW SCHRIVER | graphic artist.

Many FHS students' families have also lost money in the stock market.

"My mom is an active investor in the stock market," junior Ben Costrell said. "When the market started to drop, she sold most of our stock holdings to reduce any losses."

Deck advises to stay calm when the stock market drops, but also to think ahead.

"Keep short term savings out of the market and in safer investments," Deck said. "Make good financial decisions, considering the long term."

The Fed and Treasury bailout plan is designed to reboot the economy by pumping money directly to banks (e.g. the federal government buying equity stock in banks). Buying mortgages from the banks, a previous plan, would be more difficult to implement and may not be successful.

Steve Adams, FHS teacher, is adamant that individual housing mortgage restructuring needs attention.

"This is important because the value of real estate needs to go up in order for the economy to recover," Adams said.

FHS students have mixed feelings about the government's actions.

"Getting the banks back on track so they can start loaning out money again is key," sophomore Jonathan Wang said.

Senior Jacob Purcell believes the government has not done enough to solve the financial crisis.

"The government ought to regulate all industries to keep this from happening," Purcell said.

Whether their attempts are correctly directed or not, the Fed and Treasury acted quickly to counter a second depression.

Junior Julie Blood is confident that the government has the recession under control.

"What we are going through now is not as bad as what we went through in the past," Blood said.

According to the economist.com, unemployment and foreclosures are nowhere near as low as they were during the beginning of the depression in 1929. At that time unemployment was 25 percent and foreclosures were topping 40 percent. The government seems determined to not let history repeat itself.