

THE

*Real Spelce*

# AUSTIN LETTER

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Dear Client:

**Every report you see says consumer confidence in the economy is down. On the surface that's correct. But, dig a little deeper and you find an interesting contradiction that could have some positive implications for a quicker economic recovery than many are predicting.**

Consumer confidence is important. **If the average family is concerned about its financial future, the family holds off making important purchases** – such as a washer/dryer – and generally will not make major commitments that involve debt. This attitude, of course, has a ripple effect throughout the entire fabric of the economy.

The Gallup Organization conducted a national poll a month after the 9/11/01 terrorist attack on the US and, predictably, found consumers had concerns about the *national* economy. But, it also found consumers were **more optimistic about their local communities, the businesses where they work, and their own financial institutions** than about the national economy.

One reason for this is the **nation's tragic events have been largely limited to selected industries** – airlines, travel, and the postal service – and to **particular areas of the country**. The local impact of these tragic events has yet to be realized. **So consumers feel okay about where they live, work and bank**. And, that's where they *spend* their hard-earned paychecks.

This is similar to polls over the years where respondents **cuss Congress, but say they like the job being done by their local Congressman**. As a result, it's rare to get a wholesale turnover in Congress because those same folks who say they don't approve of Congress turn right around and vote for their local Congressman.

As a result of Gallup's findings about consumer's positive views on *local* economies, the respected polling organization concludes economic recovery may not be far away.

**Despite the economic slowdown, the number of patents issued this year in Austin through October is higher than the same period last year.** As a result, Austin is on track to surpass last year's record totals. For the last five years, Austin has been in the nation's Top 20 in patent activity and growth in activity. Innovation is still alive and well and thriving in Austin.

**Many Austin airline passengers look around the plane and say the airlines must be back to making money because the planes seem to be almost full. But, a 70% full plane doesn't necessarily translate into a profitable flight these days.** This is because the breakeven bar has been raised much higher since the 9/11/01 terrorist airplane hijackings.

How can that be? Haven't most of the airlines **cut flight schedules by 20%** and **laid-off thousands of employees** to cut costs? And didn't the government shovel **billions of dollars in cash to the airlines** to help them recover from the devastating downturn that occurred as a result of the terrorist attacks? And, aren't **fuel costs lower** than they've been in a long while? The answer is yes to all those questions.

But it's not enough. **Increased security and insurance costs** are hammering the airlines. And, the longer ground time required for security procedures is making the **hub networks less efficient**. One example why cutting flight schedules by 20% didn't reduce costs by the same amount: cutting one flight from the hub-and-spoke system can remove passengers from connecting flights, lowering revenue.

There is no doubt the airline industry is in deep doo-doo (to quote a *former* president named Bush). In fact, analysts are speculating we may soon see **bankruptcies and mergers** involving **some of the industry's biggest names**, if there is no light at the end of the long return-to-normal runway. So far, the cost-cutting and financial aid has not been enough.

How can you tell when you get on a plane whether the airlines are getting **enough passengers to return to profitability**? *The Wall Street Journal* analyzed each major airline, post 9/11/01, and reported the percentage of seats it would take to break even in the fourth quarter.

American needs to fill 85% of its seats to break even. United, closer to 95%. Delta, about 85%. Northwest, 90%. Continental, 75%. Southwest only 65%. These percentages are approximate, but they are **roughly ten percentage points higher now** than they were prior to 9/11/01.

How much are they bleeding? American is losing a stunning \$10-\$15 million *a day*. Delta is losing more than \$8 million *a day*. United burned cash at the rate of \$15 million *a day* in October. **The two semi-bright spots in these dark skies can be found at Southwest Airlines and Alaska Airlines.** They're struggling, but they're profitable.

What can you look for? Well, right now, the airlines are cutting fares to try to get past the break-even load factor. **But they can't cut their way to profitability.** Keep an eye on some major moves that might be made in the near future. There is talk the airlines might try to get the **government to underwrite the security and insurance expense**. And, there may be an effort to **cut or reduce the excise tax on airlines**. Also, watch for **merger activity to increase**. A strong airline industry is vital to Austin and the nation's economy. We'll keep you posted.

**The elections this week turned out as expected. This means Travis County Republicans did not muster enough muscle to make an impact in the special election for Austin mayor. It also means the more extreme environmentalists had no impact on the outcome of the Travis County roadway bond issues.**

City elections are non-partisan only in the sense candidates are not identified by political party on the ballot. But, as we mentioned in our 10/26/01 letter to you, GOP leaders rallied behind a young political unknown to oppose heavily favored former city council member **Gus Garcia**, in the special election 11/6/01, to fill the remainder of **Kirk Watson**'s mayoral term (who resigned to run for Texas Attorney General).

The theory: **in a very low turnout for a special election, a reasonably well-financed candidate, with a motivated group of followers, could have an outsized impact** – even though the City of Austin rarely votes for a Republican candidate. **It didn't happen. Greg Gordon** spent a lot of money on signs and last-minute TV spots and the GOP tried to turn out its voters for him. But, it wasn't nearly enough against a formidable, favored foe – even though the turnout was very small.

How bad was it? Well, Gordon came in third, 2,000 votes behind former council member **Eric Mitchell**, who didn't campaign, turned down TV interviews and didn't accept campaign contributions. Not only that, Garcia got more than four times the votes for Gordon. In fourth-place behind Gordon (out of eight candidates) was a cross-dressing street "person", **Leslie Cochran**. The final spread: Garcia 60%, Mitchell 17%, Gordon 13%, Cochran 4%.

The more extreme environmentalists didn't do well either. The Save Our Springs organization (under the leadership of the combative **Bill Bunch**) and the Sierra Club opposed all four Travis County bond proposals. You expected them to be against the three roadway bond issues, but they also urged citizens to vote against the one parks proposal.

Some of the more moderate environmentalists, such as former SOS leader **Robin Rather**, **joined with business groups such as the Chamber and the Real Estate Council of Austin** (led by **Howard Falkenberg** and **Cathy Bonner**) **to push for passage of the bonds**. And, even though the residents of Travis County faced increased taxes by voting for the bonds, all four bond propositions passed easily – by 55% to 65% margins. This was a stinging defeat for the SOS and the Sierra Club.

Where do we go from here? Gus Garcia's term as mayor runs only until June 2003. In the spring of 2003, city voters will have a rare chance, due to the way staggered 3-year terms fall, to vote on a majority of the city's leadership positions. **Three council posts, along with the mayor's position, will be up for grabs at that time.** That's four out of seven council votes. As far as the county bond propositions are concerned, the Travis County Commissioners now have the authority to issue the bonds. The key question is **how quickly** they will move.

**With interest rates lower than they've been since the 1960s following this week's tenth interest rate cut this year, are short-term rates as low as they will go? Not necessarily.** The four full percentage points the rate has dropped since the beginning of 2001 may not be the end of the slicing.

Even though this has been one of the most aggressive rate-cutting campaigns in recent history, economist **Irwin Kellner** says the key Fed Funds rate, after this week's action dropping it another half-point, is finally "low enough that it is no longer restraining the economy. Now," he says, "**we need a few more reductions from the Federal Reserve in order to really jump-start things.**"

Kellner maintains all the short-term interest rate cutting so far has not been as stimulative as you would think. He says in the past, "when the Fed has gotten the Funds rate **significantly below the rate of inflation, consumers and businesspeople stepped up to the plate and began to borrow.**" He says this week's cut is not significantly below the inflation rate and "is hardly enough to turn the economy around" and, therefore, he thinks more cuts are needed.

**If you have been thinking about refinancing your mortgage or waiting to lock in your rate on a home purchase – but holding out for interest rates to hit bottom – you better act now.** It looks like mortgage interest rates are hitting bottom. Short-term rates may continue to dip some more, but long-term rates have gone about as low as they will go.

**David Lereah**, chief economist with the National Association of Realtors, says "**For the near future, we expect the 30-year fixed mortgage interest rate to stay about 6.7%, then gradually rise to 7.2% by the end of next year.**" He hedges his comments slightly by saying rates could tick down as low as 6.4%, but he's confident economic forces will combine to push rates higher from here on out. Now's the time to buy or re-finance your mortgage.

**Dr. Louis Overholster** says there is no question the computer is an incredible teaching device. "Look at all the new words your kids learn from you when it crashes!"

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