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The Current Economic Outlook for Metropolitan Las Vegas

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Summary

The National Bureau of Economic Research dates the bottom of the most recent U.S. recession as June 2009. The U.S. economy has been in recovery since that date, but the pace of growth has been much slower than during any previous post-World War II recovery. The recovery should strengthen moderately in the second half of 2011 and continue into 2012 and thereafter.

Although U.S. economic growth was weak in the first half of 2011, the Las Vegas tourism, hospitality and gaming sector is showing a number of indications that it is in recovery. Other aspects of the Las Vegas economy, including overall employment and housing, construction and real estate, are mostly showing weakened economic conditions.

The Economic Outlook for Las Vegas

Perhaps more than ever, the fortunes of the Las Vegas economy are tied to overall economic conditions in the United States. With a recovery in the Las Vegas area real estate and construction industries probably still several years in the future, the near-term outlook for the Las Vegas economy remains heavily dependent on tourism. Fortunately, the Las Vegas hospitality and leisure industry has done well in the first half of 2011. A strengthening in national economic activity during the second half of the year could boost the tourism, hospitality and gaming portions of the Las Vegas economy during the second half of 2011 and into 2012.

U.S. Economic Activity Weak in First Half of 2011

The U.S. economy is in expansion after recovery from the longest and deepest recession since the Great Depression. The National Bureau of Economic Research dates the trough as June 2009, but the subsequent recovery has been the slowest since WWII. At the end of second quarter 2011, U.S. real gross domestic product

(GDP) had not yet reached its prerecession peak—some eight quarters after the economy hit bottom. In the previous ten recoveries, real GDP reached it prerecession peak an average of one quarter after the trough.

Employment gains were impressive in early 2011, but the pace of U.S. real GDP growth slipped from 2.3 percent at an annualized rate in fourth quarter to 0.4 percent at an annualized rate in first quarter. Second quarter showed some improvement, with real GDP rising at an anemic 1.0 percent annualized rate.

As expected, some of the weakness came from government spending. Perhaps more troubling, was the weakness in consumer spending. At least the lack of spending didn't lead to strong gains in unwanted inventories, which would need to be drawn down in the future. Without high levels of unwanted inventories, gains in consumer and investment spending should translate into somewhat stronger U.S. economic growth in the second half of 2011.

The deep recession and slow recovery have kept U.S. real GDP well below its potential—with the second quarter 2011 figure for U.S. real GDP 6.9 percent below potential. In addition, U.S. industrial production remains well below its most recent peak and well off the average pace of recovery in past recessions. This development reflects U.S. deindustrialization in addition to the slow recovery. It also underscores the reorganization that characterizes most recoveries.

U.S. corporate profits rebounded sharply, largely as the result of cost cutting. Much of the corporate cost cutting came at the expense of employment, which fell by 7.49 million jobs during the recession, and then saw a decline of an additional 233 thousand jobs through the end of 2010. That is a very different experience than during previous recessions and recoveries.

During the first four months of 2011, however, the U.S. economy added 714 thousand jobs, which amounts to a 1.7 percent annualized growth rate. That was one of the better pieces of economic news in early 2011. Unfortunately, the number of jobs added from May through August totaled only 216 thousand, which amounts to a 0.4 percent annualized growth rate.

One piece of economic information missing by looking at total employment growth is that private sector employment grew by 1,162 thousand jobs in the first eight months of 2011, which amounts to a 1.6 percent annualized growth rate. Over the same period, total nonmilitary government employment shrunk by 290 thousand jobs.

With the overall jobs picture showing weakness in the first eight months of 2011, the unemployment rate remained relatively high at a 9.1 percent rate in August. With the slow pace of economic growth, consumer confidence has only grown moderately since the recession's end. Weak house prices and high food and energy prices also have taken a toll on consumer confidence.

Why Such a Slow Recovery?

Overall, the most recent recession stacks up as the worst since World War II, and the recovery is the slowest. Considerable uncertainty is holding back investment and consumer spending. The real estate and financial problems that led to the collapse still overhang the economy. Government spending is also being reduced as state and local governments struggle to balance their budgets.

According to research by Reinhart and Rogoff (2009), financial crises lead to more severe recessions and slower recoveries than those arising from other causes. Using international data, Reinhart and Rogoff find that the average financial crisis creates a decline in GDP per person that lasts 1.9 years (Table 1). Other effects can take as long as five years.

Table 1. Average Peak-to-Bottom Changes from Severe Financial Crises

	Cumulative Change, %	Duration, Years
GDP per Person	-9.3	1.9
Stock Prices	-56	3.4
Unemployment Rate	7.0*	4.8
House Prices	-36	5.0

*percentage point change, low to high

Source: Reinhart, Carmen M. and Kenneth Rogoff (May 2009), "The Aftermath of Financial Crises," *American Economic Review* 99: 466-472.

By these four measures, the United States fared better during the recession than the average country hit with a financial crisis. As is shown in Table 2, U.S. GDP per capita sank only 6.4 percent from its prerecession peak and reached its bottom in 1.5 years. The Standard and Poor's (S&P) 500 sank 51 percent from its prerecession peak and reached bottom in 1.4 years—although it has since declined. The U.S. unemployment rate rose 5.7 percentage points from its prerecession low and reached a high in 2.4 years. U.S. house prices fell 33 percent from their prerecession peak and reached a bottom in 2.8 years—although they have since resumed falling.

Table 2. U.S. Peak-to-Bottom Changes, 2007-09 Recession

	Cumulative Change, %	Duration, Years
GDP per Person	-6.4	1.5
S&P 500	-51	1.4
Unemployment Rate	5.7*	2.4
Case-Shiller Index	-33	2.8

*percentage point change, low to high

Source: Author's calculations based on data from U.S. Bureau of Economic Analysis, U.S. Census Bureau, Standard and Poor's, and U.S. Bureau of Labor Statistics.

What Reinhart and Rogoff find is that financial crises create an uncertain environment that disrupts the relationships between lenders and investors and undermine private investment and job creation, which reduces consumer confidence and lowers consumer spending. The result is weakened economic activity and more uncertainty, which further undermine investment. These factors feed on each other, deepening a recession and slowing the subsequent recovery.

Inflationary Pressure on the Rise

We are seeing signs of increased inflation. Rising food and energy prices have pushed up the inflation rate—as measured by the consumer price index (CPI)—to 3.6 percent when measured on a year-over-year basis. The most recent reading shows a strong gain of 6.2 percent at an annualized rate from June to July 2011.

Excluding volatile food and energy prices yields what is known as the core measure of inflation. The most recent data also show the core CPI has increased to more than 1.8 percent when measured on a year-over-year basis. Underscoring concerns about inflationary pressure, the price of gold has risen above $1,820 per ounce.

Headwinds to U.S. Economic Growth

As we enter the last third of 2011, the United States still faces considerable headwinds to stronger economic growth. Oil prices are quite a bit higher than a year ago. U.S. and state and local fiscal policies are becoming less expansionary. Monetary policy remains quite accommodative to economic expansion but is mostly ineffective. Problems in the financial sector are no longer an obstacle to economic growth because stress in the sector has abated, but the uncertainty created in the financial crises continues to hamper investment and economic growth.

U.S. Economic Outlook

The index of U.S. leading economic indicators has generally been on the upswing in recent months. Consumer confidence has increased in the most recent month, but consumer sentiment continues slipping downward.

Although investors and consumers face considerable uncertainty about the economic climate, the pace of U.S. economic growth should accelerate moderately in the second half of the year and be reasonably strong in 2012 and 2013.

As shown in Table 3, domestic demand and improved net exports were the keys to the growth of real GDP in fourth quarter 2010. They were also responsible for the weakness in first quarter and second quarter 2011. Declining government spending is also contributing to GDP losses.

Table 3. Contributions to the Growth of Real GDP

	2010Q4	2011Q1	2011Q2	2011H2	2012
Real GDP (percent change annual rate)	2.3	0.4	1.0	1.6	2.8
<u>Contributions to Real GDP Growth</u>					
Final Domestic Sales	2.78	0.38	1.14	1.3	2.3
Consumption	2.48	1.47	0.30	0.5	1.2
Business Fixed Investment	0.82	0.20	0.94	1.0	1.1
Residential Investment	0.06	-0.06	0.08	0.1	0.2
Government Purchases	-0.58	-1.23	-0.18	-0.3	-0.2
Net Exports	1.37	-0.34	0.09	0.2	0.3
Exports	0.98	1.01	0.41	0.5	0.9
Imports	0.39	-1.35	-0.33	-0.3	-0.6
Inventory Investment	-1.79	0.32	-0.23	0.1	0.2

Sources: U.S. Bureau of Economic Analysis; Author's Projections

Looking forward, consumption spending, business fixed investment and residential investment are likely to increase moderately in the second half of the year. Government spending is declining as federal stimulus spending slows, and states and local governments move to close their budget deficits. As the result of a weaker dollar, exports should grow faster than imports. Domestic firms are likely to make small additions to inventories.

Economic growth isn't likely to accelerate sufficiently to close the gap with potential GDP in the next few years. According to Reinhart and Rogoff (2009), part of the legacy of a financial crisis is a slow recovery because the uncertainty created by a financial crisis continues to hold back investment, hiring and consumer spending.[1]

A slowly expanding economy should create jobs, but the U.S. unemployment rate is likely to rise to 9.2 percent by year's end. By the end of 2012, the current outlook is for an unemployment rate of about 8.7 percent. By the end of 2013, an unemployment rate of 8.4 percent is likely.

These projected unemployment rates are relatively high by prerecession standards. Without the economy accelerating quickly, however, employment is likely to grow too slowly in the remainder of 2011 to absorb the 150 thousand new entrants who typically join the labor market each month, and by only slightly more in the next few years.

Risks to the U.S. Outlook

On the downside, slow economic progress, lower house prices and higher food and energy costs continue to foster pessimism. The combination of pessimism and fiscal tightening that is resulting from governments reducing their budget deficits could

[1] Reinhart, Carmen M. and Kenneth Rogoff (2009), *This Time Is Different*, Princeton University Press.

further slow the recovery, yielding a weakening of growth throughout 2011. Mired in this manner, we could see the economy staying below a 1.5 percent annual growth rate in the second half of 2011 and just over a 2.0 percent annual growth rate in 2012. In 2012, job creation would be about 120,000 per month. With job creation not keeping pace with the growth of the work force, the unemployment rate could rise back toward 10.0 percent.

On the upside, U.S. corporations are sitting on sizable profits, and GDP is well below estimates of its potential. If the cloud of negativity lifts quickly, corporations could put considerable sums of money into investment and hiring. Because GDP growth correlates strongly with business investment, we could see the economy growing at a 3.5 percent annual rate in early 2012 and accelerating to a 4.5 percent rate by the end of 2013. By 2013, job creation would be more than 300,000 per month. The unemployment rate would gradually fall toward 6.0 percent.

Uneven Economic Conditions in Southern Nevada

In late 2010 and early 2011, parts of the Southern Nevada economy finally began moving in the right direction—about 15 to 18 months after the U.S. economy began its recovery. The Southern Nevada tourism, gaming and hospitality sectors showed some improvement in late 2010 and solid gains in the first half of 2011. What is particularly impressive about these gains is that they came even while growth of the national economy was particularly slow.

The patterns of employment and taxable sales show an uneven picture for the Las Vegas economy in the first half of 2011. On the whole, the June reading for taxable sales in Clark County was up 8.1 percent above a year earlier, while July employment was down 0.4 percent below a year earlier. In general, employment and taxable sales for the tourism, hospitality and gaming sectors are improving as are gross gaming revenues. Employment and taxable sales associated with construction are still declining, albeit at a slowing rate. Taxable sales are also improving for automobiles, merchant wholesalers, clothing and accessory stores and general merchandise stores. Construction; government; health services; information services; and trade, transportation and public utilities all showed declining employment in the first seven months of 2011. Employment in leisure and hospitality, other services and professional and business services showed gains.

Unemployment

In July 2010, the Las Vegas area unemployment rate hit a high of 15.7 percent. The most recent reading was a 14.0 percent unemployment rate for July 2011. Declines in the Las Vegas area unemployment rate since last July are mostly the result of falling labor force participation.

Headwinds to the Las Vegas Economy

Although financial headwinds have mostly abated in the United States as a whole, they may remain present in Southern Nevada. According to a survey conducted by the National Federation of Independent Business, more U.S. businesses are now seeking and obtaining credit than last year. Of those seeking additional credit, one out of six (16.7 percent) aren't getting it.

According to CBER's survey for Southern Nevada, however, the credit situation hasn't changed very much in the past year. Very few businesses are seeking additional credit. Of those seeking additional credit, 1 in 2.3 (43.5 percent) aren't getting it.

The overbuilt real estate market, in which house prices are below replacement costs, is another headwind to economic growth in Las Vegas. According to data from Clark County, 8.1 percent of the housing units in the Las Vegas metropolitan area were vacant in 2010. My assessment of historical trends shows a vacancy rate equal to 1.4 percent plus the population growth rate is necessary for the Las Vegas residential real estate market to show price gains. Therefore, a population growth rate of 1.0 percent would require the vacancy rate be reduced to 2.4 percent before residential real estate prices begin rising.

With an annual household formation rate of 1.0 percent, which the Western Blue Chip Forecast projects for Nevada's population growth in 2012, the excess capacity in the Las Vegas metropolitan area housing market would be absorbed in 5.7 years. If the annual household formation rate suddenly accelerated to 4.9 percent after 2012 (the same annual rate at which the Clark County population grew from 2000 to 2007) the excess capacity would be absorbed in early 2013.

According to the Case-Shiller index, housing prices in the Las Vegas metropolitan area are still falling, but the precipitous decline has come to an end. The Case-Shiller index is considered a preferred measure of housing prices because it uses prices from repeat sales, which more accurately captures quality than a more commonly used measure like median home prices.

Las Vegas house prices took a big decline from January 2007 to August 2009, falling by 45 percent. During that period of time, U.S. house prices fell by about 29 percent. From August 2009 to May 2010, Las Vegas house prices fell another 0.8 percent, while U.S. prices rose 2.5 percent. Since May 2010, Las Vegas home prices declined by another 6.9 percent, while U.S. home prices slipped by only 4.6 percent.

Housing Market Affordability a Plus

In the 1990s and early 2000s, Las Vegas had housing that was quite affordable by national standards. That was one of the keys to the region's growth. The decline in Las Vegas housing prices has once again restored that advantage.

Right now, Las Vegas housing is a very good deal. According to the housing opportunity index, which considers both price and income, Nevada housing is more affordable than the national average. That is one of the primary reasons that many long-term forecasts show strong population gains for the region, some of which are driven by projected retirements.

Southern Nevada Set for Continued Recovery

The U.S., Nevada and Las Vegas indexes of leading economic indicators are rising, an indication that economic conditions can be expected to improve over the next four to six months. CBER's Southern Nevada Business Confidence Index is more downbeat. It dropped below 100 for third quarter 2011 after being above 100 for the first two quarters of the year. A value below 100 means that more respondents are pessimistic about the outlook for business conditions than are optimistic.

The business confidence index consists of five components, all of which are measured by a survey of business leaders. Four components of the index—business expectations for sales, profits, hiring and capital investment—were weaker for third quarter than second quarter. The business outlook for overall economic conditions improved.

Economic Outlook for Southern Nevada

Visitor volume and gaming revenue will both rise, although gaming revenue might rise at a slower rate than visitor volume in 2011—as visitors continue to show up with somewhat less money to spend than in past years. In 2012, the gains in gaming revenue should be closer to those in visitor volume.

Even as visitor volume grows, the hospitality industry will continue to see the effects of its excess capacity during all but the busiest times of year. Southern Nevada hotel/motel capacity is set to increase slightly in 2011, as projects on the books more than offset the closures. Given the excess capacity, a small reduction in hotel capacity seems likely for 2012.

Contrary to Las Vegas' history, population growth is likely to be moderate and not the driver of economic growth over the next few years. Rather economic growth will drive population for the next few years. Although the early part of 2011 showed decent employment growth in some sectors, Southern Nevada will likely see fairly slow employment growth over the next few years. As a consequence, the unemployment rate will be slow to fall.

Southern Nevada real estate prices are likely to see a later recovery. Residential sales have already begun rising, but the real estate market has a substantial overhang of residential and commercial property. Southern Nevada will need a substantial growth in real estate demand before real estate prices rise.

Housing units permitted could show slippage as fewer and smaller apartments are built. Permitting for single-family residences is likely to show moderate gains in 2012.

Summary of the Southern Nevada Outlook

To sum it up, the Southern Nevada economy is showing uneven signs of a long-awaited recovery. Because the Southern Nevada economy is heavily dependent on tourism, its outlook is tied to the growth of the U.S. and western states' economies. Even with the U.S. economy faltering in the first half of 2011, Las Vegas tourism continued to grow. Mildly improving U.S. economic conditions should mean a stronger second half of 2011 for the Southern Nevada economy. Economic conditions in 2012 should prove even stronger.

Risks to the Southern Nevada Outlook

The outlook for slow improvement in the Southern Nevada economy is based on the idea that gradually improving economic conditions elsewhere in the world will benefit Southern Nevada—which is one of the premier tourist destinations in the world. The recovery of the Southern Nevada economy could be slowed if world economic conditions do not improve. If growth of the U.S. economy suddenly accelerates, the recovery of the Southern Nevada economy will be stronger. Another U.S. recession would postpone the recovery.