Nevada Economic Conditions and Outlook 2011

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Nevada Economy Moving in the Right Direction

The good news is that the Nevada economy is finally moving in the right direction—about 18 months after the U.S. economy began its recovery. The Nevada tourism, gaming and hospitality sectors showed some improvement in the second half of 2010. Since the first of the year, Nevada employment has risen, and the unemployment rate has fallen. We can expect to see moderate improvements in Nevada economic conditions in 2011 and 2012. In most areas of the state, however, construction has a long way to go before a recovery is likely.

1. International Economic Conditions and Outlook

Data compiled by the International Monetary Fund (IMF), shows the world economy has been in recovery since late 2009 (Figure 1). According to the IMF, the world economy was a bit overheated prior to the recession. As a consequence, the IMF sees the near-term outlook for world economic growth as taking a more sustainable pace that is a little slower than the recession. Growth is expected to be stronger in the emerging and developing economies than in the advanced economies.

![Figure 1](image-url)
2. U.S. Economic Conditions and Outlook

Figure 2 shows the evolution of U.S. GDP during the most recent recession and recovery and all 10 of the previous recessions since World War II. For each recession and recovery, economic activity is indexed with 100 representing the prerecession peak. The figure also shows the average for the previous 10 recessions and recoveries.

As shown in the figure, real U.S. GDP fell by more in the most recent recession than in any of the previous recessions since World War II. The recovery was also particularly slow, with real GDP rising above its post-recession peak only in fourth quarter 2010—six quarters after the trough. In the previous 10 recessions, real GDP reached its prerecession peak an average of one quarter after the trough.

Figure 2
The most recent estimate of real GDP growth for fourth quarter 2010 was a fairly robust 3.1 percent at an annualized rate—considerably stronger than the 2.6 percent figure posted for third quarter 2010. Nonetheless, the deep recession and slow recovery have kept U.S. GDP well below its potential (Figure 3).

**Figure 3**

![Real GDP and Real Potential GDP](source: Bureau of Economic Analysis; Congressional Budget Office)
U.S. industrial production remains well below its most recent peak and well off the average pace of recovery in past recessions (Figure 4). This development mostly reflects U.S. deindustrialization and underscores the reorganization that characterizes most recoveries.

Figure 4

As shown in Figure 5, 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 lost 3.89 million jobs during the recession, and then an additional 233 thousand jobs through the end of 2010 (Figure 6). That is a very different experience than during previous recessions and recoveries. During the first three months of 2011, however, the U.S. economy added 478 thousand jobs.
With the job market improving, U.S. unemployment has declined and initial claims for unemployment are falling (Figure 7). That is generally good news, though the unemployment rate remains high at an 8.8 percent rate.

**Figure 7**

![Initial Claims for Unemployment and Unemployment Rate](chart)

With the economy recovering slowly and employment picking up only recently, consumer confidence has risen only gradually since the recession’s end (Figure 8). Most recently, sharply rising oil prices reduced consumer confidence.

Rising food and energy prices have also pushed up the consumer price index (CPI), but the most recent data shows core CPI (which excludes food and energy) rising above 1 percent (Figure 9).
Figure 8

Consumer Confidence/Sentiment Indices

Source: University of Michigan, The Conference Board

Figure 9

Annual Percent Change in the CPI and CPI Core

Source: Bureau of Labor Statistics
2.1 Headwinds to U.S. Economic Growth May Be Increasing

In early 2011, the U.S. economy finally began to show a decent rate of employment growth, with a gain of nearly 480,000 nonfarm jobs in the first quarter. As the economy nears its second year of recovery and expansion, however, the headwinds to economic growth seem to be increasing. Oil prices have risen substantially in the past year, and U.S. fiscal policy is set to become less expansionary. Perhaps surprisingly, financial problems have become much less of an obstacle to growth. Monetary policy remains quite accommodative to economic expansion but is mostly ineffective.

Rising Oil Prices May Slow U.S. Economic Growth

Over the past year, world oil prices have risen by about 45 percent (Figure 10). As a result, U.S. gasoline prices have risen by more than $0.90 per gallon (Figure 11). Jet fuel prices have increased by nearly $1 per gallon (Figure 12).

Figure 10

Crude Oil Spot Prices

Source: U.S. Energy Information Administration
Figure 11

Gasoline Pump Price

![Graph showing the price of gasoline over time, with a peak in 2008.]

Source: U.S. Energy Information Administration

Figure 12

Jet Fuel Spot Price

![Graph showing the price of jet fuel over time, with a peak in 2008.]

Source: U.S. Energy Information Administration
Economic research suggests that these gains in oil prices will reduce the annual growth rate of U.S. GDP by 0.2 to 0.8 percentage points over the next two years. U.S. consumers will see an additional reduction in their discretionary income as they pay an additional $267 billion each year on petroleum products—through their purchases of gasoline, diesel fuel, airline tickets and other goods and services in which rising oil prices are passed on to them.

The rise in oil prices owes to several factors, none of which is likely to be reversed anytime soon. Oil demand in China, India and other countries has resumed growing along with their economies. Oil production in Libya has been disrupted, which reduces supply. In addition, social unrest in North Africa and parts of the Middle East threatens to further disrupt production and reduce supply. As a consequence, oil traders have tried to put some oil aside against the possibility of greater disruptions and in doing so have further bid up the price of oil.

**Fiscal Policy**

The stance of fiscal policy is measured by the extent to which government spending exceeds revenue. Deficit spending is generally regarded as enhancing economic growth in the short run, but large government deficits create long-term imbalances that are harmful to future economic growth. As is widely recognized, the borrowing and spending policies we saw from 2003 to 2008 combined with bank bailouts and the Obama administration’s stimulus package led to large U.S. budget deficits. Many economists see those deficits as stimulating short-term gains in economic activity at the expense of future growth.

The current tax and spending proposals that Congress seems likely to adopt for fiscal year 2012 will sharply reduce the federal government deficit. That action will increase near-term headwinds to economic activity while potentially easing future headwinds to economic growth.

A well-designed fiscal stimulus could ease these short-term headwinds to some degree without stirring up much of an increase in future headwinds. For instance, a package of infrastructure spending to improve roads and bridges would provide public capital that would boost private-sector productivity in future years. It also would reduce the need for such public-sector spending in future years.

**Financial Problems Abating Nationwide**

The Kansas City Financial Stress Index remains below its long-run average, which suggests that financial markets are ready to support economic growth. In addition, a survey conducted by the National Federation of Independent Business shows that small businesses are now finding it easier to obtain credit than they have at any time in the past six years. (CBER’s similar survey of Las Vegas small businesses is less optimistic.)
Monetary Policy: Accommodative and Ineffective

When the economy is performing poorly, we typically look to monetary policy for help. Monetary policy has been taken to its limits. Short-term interest rates—such as the federal funds rate and the three-month Treasury bill rate—are close to zero (Figure 13). Adjusted for inflationary expectations, the short-term interest rates are negative (Figure 14).

Figure 13

Short-Term Interest Rates

Source: Federal Reserve Board
Recognizing that it could not reduce short-term rates any further, the Federal Reserve System undertook a second round of what is called “quantitative easing.” Normal monetary policy is conducted through the management of the federal funds rate—an overnight rate at which financial institutions borrow from each other. The Fed adds or reduces liquidity by buying or selling short-term Treasury bills to maintain a particular target rate in the federal funds market.

Quantitative easing works differently. To accomplish quantitative easing, the Fed purchases long-term Treasury bonds. The goal is to increase the monetary aggregates and lower the long-term interest rates that influence investment decisions. In fact, during the second round of quantitative easing, long-term rates ticked up (Figure 15). In addition, the price of gold rose sharply—to $1,424 per ounce in March (Figure 16). Combined, these indicators show that Fed policy has increased concerns about future inflation without having much effect on investment or the pace of economic activity.
Liquidity Trap

Although the Fed has increased liquidity in the economy through low short-term interest rates and quantitative easing, uncertainty about the state of economic activity has meant that investment spending, lending and GDP have not responded very much. John Maynard Keynes called this situation a “liquidity trap.”

To examine this phenomenon, we must consider the relationships between the monetary base and M2, and between M2 and GDP (Figure 17). The monetary base is a relatively narrow measure of money. It includes cash and reserve accounts that commercial banks hold at the Federal Reserve System. Through the system of fractional reserves, the monetary base supports broader monetary aggregates, such as M2. M2 includes the monetary base plus checking and savings accounts.

Figure 17

As shown in the figure, the relationship between these monetary aggregates and the economy has weakened considerably even with a recovery underway. The money multiplier, which measures the extent to which the monetary base is used to create more money, has dropped considerably. As the Fed tries to push more liquidity into the economy through the monetary base, it’s finding that the monetary base is not being translated into as much monetary growth.
In addition, the velocity of money, which measures the relationship between M2 and GDP, has dropped considerably. The lower velocity means that less economic activity is associated with each dollar of M2.

The liquidity trap means that although the Fed has increased financial liquidity in the market, the economy has not responded. Keynes' prescription for such a situation was stimulative fiscal policy—that is, boosting government deficit spending.
3. Nevada Economic Conditions

U.S. employment has been growing since late last year. Nevada and Clark County are just now beginning to show positive job growth (Figure 18).

Figure 18

![Graph showing job growth in Clark County, Nevada, and the U.S.](source: Nevada Department of Employment, Training & Rehabilitation; Bureau of Labor Statistics)

After revision, the January 2010 Nevada unemployment rate was pegged at 15.3 percent (Figure 19). In July, the Clark County unemployment rate hit a high of 15.7 percent. Declines in these unemployment rates during 2010 were mostly the result of falling labor force participation. With Nevada and Clark County employment growing in early 2011, the respective unemployment rates have declined to 13.2 percent and 13.3 percent. During 2010, Nevada had a combined unemployment and underemployment rate of 22.3 percent.

When it comes to unemployment, Nevada remains at the top of the heap in the west (Figure 20). Unemployment rates also remain high in California, Oregon and Arizona.
Figure 19

Civilian Unemployment Rate

Source: Nevada Department of Employment, Training & Rehabilitation; Bureau of Labor Statistics

Figure 20

Western States' Unemployment Rates

Source: Bureau of Labor Statistics
More favorably, CBER’s Clark County business index has ticked up recently (Figure 21). The index is a composite of gaming revenues, employment and taxable sales.

Figure 21

CBER’s index of Clark County tourism has shown mixed signs of improvement over the past year (Figure 22). The index is a composite of passenger counts, room occupancy and gaming revenues.

CBER’s index of Clark County construction continues to slip downward, albeit at a slower rate (Figure 23). The index is a composite of commercial and residential building permits, and construction employment.

The Southern Nevada construction industry lost 6,000 jobs over the past year. Peak construction employment was 112,000 in June 2009. It currently stands at 39,000.
Figure 22

Clark County Tourism Index
January 1995=100

Index

Source: CBER

- Tourism Index
- Seasonally Adjusted

Figure 23

Clark County Construction Index
January 1995=100

Index

Source: CBER

- Construction Index
- 5-Month Moving Average
Although financial headwinds have mostly abated in the United States as a whole, they may remain present in Southern Nevada. According to a survey by the National Federation of Independent Business, more U.S. businesses are now seeking and obtaining credit than before the recession (Figure 24). Of those seeking additional credit, about 8 percent weren’t getting it.

According to CBER’s survey for Southern Nevada, however, very few businesses were seeking additional credit. Of those seeking additional credit, one-third weren’t getting it.

Figure 24

![U.S. and Southern Nevada Lending Practices](image-url)

Source: National Federation of Independent Business, CBER
4. Southern Nevada Housing Market Conditions

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 (Figure 25). 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.

Figure 25

Las Vegas Case-Shiller Home Price Index:
January 2000=100

Source: S&P/Case-Shiller
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 (Figure 26). 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 retirements.

Figure 26

![Housing Opportunity Index](image)

Source: National Association of Home Builders
4.1 Differing Perspectives on the Housing Overhang in Southern Nevada

Data from the Las Vegas Multiple Listing Service (MLS) and CBER, Clark County and the U.S. Bureau of the Census offer very different perspectives on the Las Vegas housing market (Table 1). According to MLS and CBER, the Las Vegas metropolitan area had 767,580 housing units in 2010; 735,530 were occupied and 32,050 were vacant in the fourth quarter. Clark County used its tax rolls to estimate the number of housing units in the Las Vegas metropolitan area at 814,868 in 2010. Using electric meter readings, the county said 749,269 were occupied and 65,599 were vacant. According to the U.S. Census, the Las Vegas metropolitan area had 840,343 housing units, 715,365 were occupied and 124,978 were vacant when the census was conducted in April 2010.

<table>
<thead>
<tr>
<th></th>
<th>Total Units</th>
<th>Occupied</th>
<th>Vacant</th>
<th>Percent Vacant</th>
</tr>
</thead>
<tbody>
<tr>
<td>MLS/CBER</td>
<td>767,580</td>
<td>735,530</td>
<td>32,050</td>
<td>4.2</td>
</tr>
<tr>
<td>Clark County</td>
<td>814,868</td>
<td>749,269</td>
<td>65,599</td>
<td>8.1</td>
</tr>
<tr>
<td>Census</td>
<td>840,343</td>
<td>715,365</td>
<td>124,978</td>
<td>14.9</td>
</tr>
</tbody>
</table>

The differences between these vacancy estimates imply very different outlooks for the potential recovery of the Las Vegas housing market. Historical trends show 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 0.8 percent suggests the vacancy rate must be reduced to 2.2 percent before residential real estate prices begin rising. The MLS/CBER data imply an additional 2.0 percent of the existing units need to be absorbed before the market recovers, but the Census data imply an additional 12.7 percent of the existing units must be absorbed. The Clark County data are consistent with the need to absorb an additional 5.9 percent of the existing units.

With an annual household formation rate of 0.8 percent, which the Western Blue Chip forecasts for Nevada’s population growth over the next few years, the MLS/CBER estimates suggest that the excess capacity in the Las Vegas metropolitan area housing market could be absorbed in little more than two years. In contrast, the Census estimates would require an annual household formation rate of 4.9 percent (the same annual rate at which the Clark County population grew from 2000 to 2007) for excess capacity to be absorbed in about the same number of years.

Higher absorption rates would mean that the excess capacity in the housing market would be worked off more quickly. Recent Las Vegas MLS data show houses selling at a monthly rate of about 3,000 per month, with 1,500 of those houses currently vacant. If those 1,500 units represent new occupancies, Clark County would be seeing a 2.4 percent annual absorption rate in housing, which would translate into elimination of the excess capacity in less than a year according to the MLS/CBER data, about 2.5 years according to the Clark County data, and about 6 years according to the Census data.
Differences in the Number of Housing Units

So which of these three perspectives on the Las Vegas housing market is correct? The differing number in the housing units estimated by the Census, Clark County and MLS/CBER are easily explained. As shown by Map 1, some of areas with high vacancy rates according to the Census include vacation homes; furnished apartments that offer daily, weekly and monthly rentals and condotels homes as part of the housing stock.

Map 1
Housing Vacancies by Clark County Census Tract

Clark County does not count furnished apartments that offer short-term rentals or condotels. The exclusion of these facilities appears to account for the difference between the Census and county estimates. The MLS/CBER data start with the county figures and then drop duplexes, triplexes, quadruplexes and mobile homes.

From the perspective of the real estate industry, one can argue that the 25,000+ housing units counted by the Census, but excluded by the county, aren't really part of the housing market for ordinary Las Vegas residents. Furnished apartments that offer daily, weekly and monthly rentals mostly compete with motels and hotels rather than other apartments.
Condotel units are typically owned by nonresidents who allow their unoccupied units to be rented out as hotel space.

One might disagree with the exclusion of duplexes, triplexes, quadruplexes and mobile homes from a count of housing units, but the MLS/CBER data also do not count the occupancy of such units. When these units are excluded from the Clark County data, the Clark County estimates are 707,053 occupied housing units, 60,527 vacant units and a vacancy rate of 7.9 percent.

**Differences in Occupancy**

The remaining differences are in the number of occupied units estimated by the Census, Clark County and MLS/CBER, with the Census offering the lowest figure. Some of these differences will be better explained when more detailed Census data are available. In the meantime, we must look at the differing methods for evaluating occupancy to judge which is likely to produce the most accurate estimates.

The Census workers counted as vacant any dwelling where they could not find evidence of residents in three visits. Such an approach could lead to an undercounting of retirees and others who took extended leaves from home. It could also include vacation homes and condotels that are owned by nonresidents who didn't happen to be visiting the area when the census was conducted. As shown by the map, vacancies are also high in areas with many vacation homes and condotels.

Clark County uses meter hookups and electricity consumption to provide an annual estimate of occupancy at midyear. Such an approach could lead to an overcounting of occupancy if electric power consumption was maintained in unoccupied units.

Las Vegas MLS uses vacancy reports of single family, condominiums and townhouses for sale or rent made by realtors. CBER collects vacancy reports from managers of apartment complexes. Such an approach provides data from people regularly in the field, but the assessments of single-family homes, condominiums and townhouses could lead to an upwardly biased estimate of occupancy if banks were holding vacant units off the market. The quarterly reports do show, however, a 1.5 percent increase in occupancy from third quarter to fourth quarter 2010.

**Bringing It All Back Home**

Because the Las Vegas MLS and CBER data offer quarterly updates from people in the field on a regular basis, it is tempting to conclude that the overhang of housing in the Las Vegas housing market may have fallen as low as 1.6 percent in fourth quarter 2010. The reputation of the U.S. Census for providing reliable enumerations leads to the dramatically different conclusion that there could be a 14.7 percent overhang in the Las Vegas area housing market. The Clark County data fall in the middle with a 5.8-6.0 percent overhang.
With banks reported as sitting on vacant units, probably the Clark County data should be judged as a more reliable assessment of occupancy than the Las Vegas MLS and CBER data, but the Las Vegas MLS and CBER data provide valuable information about the direction of the market. When more detailed Census data are provided in midsummer 2011, we will get an opportunity to more closely examine the reasons for the differences between the Census and county estimates and be better able to judge which housing market assessment is more accurate.

5. Nevada Economic Outlook

The U.S., Nevada and Southern Nevada indexes of leading economic indicators are all rising (Figure 27), an indication that economic conditions can be expected to improve. The DETR/CBER leading index for Nevada gave us a false reading at midyear 2010, but is likely a bit more sure-footed with its current reading.

Figure 27

CBER’s Southern Nevada index of leading economic indicators projects employment conditions 4-6 months in the future. The most recent reading (with January data) was among the largest one-month gains in the history of the series and was driven mostly by tourism. Although one month’s data do not establish a trend, the index indicates the likelihood of increased employment in the second half of 2011.
CBER’s business confidence index for Southern Nevada is also showing favorable signs (Figure 28). For the second quarter in a row, more respondents are optimistic about the outlook for business conditions than are pessimistic. In the series three-year history from first quarter 2008 through fourth quarter 2010, more respondents were pessimistic about the outlook for business conditions.

**Figure 28**

![CBER Southern Nevada Business Confidence Index](image)

Source: CBER
CBER expects general improving economic conditions in Nevada for 2011 and 2012 (Table 2). For personal income, gross gaming revenue, employment and population, CBER projects gains in 2011. For all these categories, except population growth, CBER is somewhat more optimistic than the consensus from the Western Blue Chip Forecast for Nevada (in which CBER’s outlook is included). Both CBER and the Western Blue Chip see economic conditions improving from 2011 and 2012.

Where CBER really differs from the Western Blue Chip consensus is in permits for single family housing. CBER sees continuing weakness in 2011 and only moderate gains in 2012. Our view is consistent with the substantial overhang in the housing market and with the real estate expectations reported in our business conditions survey. We think the Nevada housing market will recover, just later than 2012.

**Table 2**

<table>
<thead>
<tr>
<th>Western Blue Chip Forecast for Nevada Economic Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Income</td>
</tr>
<tr>
<td>2010 Actual</td>
</tr>
<tr>
<td>2011 CBER</td>
</tr>
<tr>
<td>Consensus</td>
</tr>
<tr>
<td>2012 CBER</td>
</tr>
<tr>
<td>Consensus</td>
</tr>
</tbody>
</table>

According to the Western Blue Chip Consensus, Nevada’s employment growth will lag behind other western states in 2011 and 2012 (Figure 29). A similar picture is expected for income growth (Figure 30). Far from seeing this as negative, we recognize that strong economic growth is necessary in neighboring states to drive Nevada’s tourism industry.

In short, the Nevada economy is showing initial signs of recovery, more than 18 months after the U.S. economy began its recovery. The outlook at the beginning is for slow and uneven growth that is mostly driven by gains in tourism. Construction will follow later, as Nevada’s population growth is driven by gains in employment and by gains in retirements from other parts of the country. Diversification can add to long-term gains.
An affirmative action/equal opportunity institution