NEVADA'S Economy

A monthly report produced for COMMERCE REAL ESTATE SOLUTIONS by Stephen P. A. Brown, PhD, Center for Business & Economic Research University of Nevada, Las Vegas

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WHY U.S. MONETARY POLICY REMAINS EASY

On January 25, 2012, the Federal Open Market Committee (FOMC) announced that it decided "to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that economic conditions—including low rates of resource utilization and a subdued outlook for inflation over the medium run—are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014."[1]

Committee members are divided about the exact targets that will need to be sustained over the next few years, but the range of opinion includes federal funds rates that would maintain the stance of U.S. monetary policy about where it has been in place since 2009.[2] With U.S. economic conditions improving, why are some committee members expecting the necessity of holding federal funds rates at such low levels for a prolonged period?

U.S. Economic Activity Below Potential

The short answer is that U.S. economic activity remains well below potential. In fourth quarter 2011, U.S. real gross domestic product (GDP) was 5.5 percent below potential. Even with the relatively strong growth rates projected by the FOMC for the next few years, their median projection shows that U.S. real GDP will remain 4.4 percent below potential at the end of 2013. The committee's projections are consistent with a gap of 2.5 percent at year-end 2014.

The FOMC's expectation that U.S. real GDP will remain well below potential for several years is one indication that they believe the United States is experiencing low rates of resource utilization and will continue to do so for the next few years. These low rates are inconsistent with the first of the Fed's twin mandates in the conduct of monetary policy, which is to see that the economy achieves full employment.

The Fed's other mandate is to maintain stable prices. In practice, the FOMC has been able to pursue its seemingly contradictory twin goals because price stability promotes an economic environment that supports sustainable long-run growth. In addition,

1 See http://www.federalreserve.gov/newsevents/press/monetary/20120125a.htm. The FOMC is the policymaking arm of the U.S. Federal Reserve System (Fed), which determines U.S. monetary policy. The federal funds rate is the interest rate at which banks loan reserves to each other. The federal funds rate is the target interest rate that the Fed manages by buying and selling U.S. Treasury Bills.

2 See http://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20120125.pdf.

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many economists take the view that an economy that is running below potential will see relatively little inflationary pressure. It's only as an economy approaches full capacity that inflation accelerates.

U.S. Inflation Is Subdued

The FOMC currently uses the core personal consumption expenditure (PCE) deflator as its policy target for inflation.[3] Another standard measure of inflation is the core consumer price index (CPI).[4] The most recent readings of the annualized core inflation rates for both the CPI and the PCE are subdued, at 1.8 and 1.9, respectively. The FOMC projects core PCE inflation to remain around 2 percent and below 3 percent through 2014—as the economy grows but remains below potential.[5]

Monetary Policy Mostly Ineffective

Although the Federal Reserve System (Fed) has increased liquidity in the economy considerably through low short-term interest rates and quantitative easing, financial fragility and uncertainty about the state of economic activity have meant that investment spending, lending, and GDP have not responded by very much. John Maynard Keynes, who revolutionized economic thinking in the 1930s, called this situation a "liquidity trap."

To examine this phenomenon, we consider the relationships between the monetary base and M2, and between M2 and GDP. The monetary base is a relatively narrow measure of money. It includes cash and reserve accounts that commercial banks hold at the Fed. 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.

The relationship between M2 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 is finding that the monetary base is not being translated into nearly 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. In contrast with Keynes' views, many contemporary economists have reached a more nuanced view. They have concluded that government deficit spending will be offset by reduced consumption and investment spending unless the government spending is directed at activities—such as infrastructure development—that will lead to a reduced need for government spending in the future.

The Need for Nimble Monetary Policy

As the economic recovery gains traction, however, the relationships between the monetary base and M2 and between M2 and economic activity will strengthen. Under normal economic conditions, the current amount of financial liquidity that the Fed has injected into the economy would support much higher economic activity and/or inflation. Although the FOMC currently sees a subdued outlook for inflation, it must be prepared to act quickly to remove any excess liquidity as the economy gains traction. Otherwise, the liquidity will quickly turn into inflationary pressure.

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3 The deflator for PCE measures the average increase in prices for domestic personal consumption as contained in GDP. The core measure excludes the volatile food and energy components.

4 CPI measures the average increase in price for a basket of consumer goods. The core measure excludes the volatile food and energy components.

5 See http://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20120125.pdf.

Nevada Economic Conditions

U.S. economic activity strengthened in fourth quarter 2011, but strong inventory growth suggests first quarter will show weaker economic growth. Nevada's tourism and gaming were particularly strong late in the year in comparison to previous years. Nevada's construction sector is bumping along bottom. Seasonal factors contributed to reduced Nevada employment in December.

U.S. Economy Strengthened

According to the advance release, U.S. real GDP grew at an annualized rate of 2.8 percent during fourth quarter 2011, which represents a gain over the third-quarter figure of 1.8 percent. Consumption spending and inventory investment were particularly strong. Residential investment showed stronger growth, but business fixed investment slowed. U.S. nonfarm employment rose by 243,000 jobs in January, and the unemployment rate fell to 8.3 percent. After several months of gains, consumer confidence slipped in January, and consumer sentiment slipped in February. Sales of existing homes rose for the third straight month in December, reaching 3.6 percent above a year earlier. Sales of new homes slipped in December for the second straight month. Personal consumption expenditures declined by 0.02 percent in December after five straight months of gains. Retail sales rose in January for the eighth straight month. The Kansas City Financial Stress Index edged downward in January but remained slightly above its long-run average, suggesting that financial headwinds to U.S. economic growth have nearly abated, *Table 1*.

Nevada Economy Showing Slow Growth

The Nevada economy continues to show signs of slow growth. Taking a seasonal decline in December, visitor volume was 1.9 percent higher than a year earlier. Gaming revenue was 2.0 percent higher in December than a year earlier. Taxable sales were up by 9.6 percent in November above a year earlier. From December 2010 to December 2011, Nevada saw a gain of 3,500 jobs (0.3 percent), mostly the result of gains in leisure and hospitality, business services, and health and education services. The Nevada unemployment rate took a seasonal increase from 12.2 percent in November to 12.4 percent in December, *Table 2*.

Clark County Economic Activity Slowly Growing

Clark County's economic activity continues to expand at a slow pace. Compared to a year earlier, visitor volume was up by 1.7 percent in December. Gaming revenues were up by 1.2 percent over the same period. Taxable sales for November were 8.6 percent above those for the same month a year earlier. Residential construction permits rose from November to December, and commercial construction permits held steady at a low level. From December 2010 to December 2011, employment in the Las Vegas metropolitan area increased by 4,300 jobs (0.5 percent). The Las Vegas unemployment rate rose seasonally from 12.4 in November to 12.7 percent in December, *Table 3*.

Washoe County's Economy Is Mostly Weak

Washoe County's overall economic conditions remain mostly weak. Compared to a year earlier, December visitor volume was up by 4.1 percent, and gaming was up by 10.2 percent. Both residential and commercial construction permits slipped from November to December, and both remain near historically low levels. Reno-Sparks employment fell by 2,600 jobs

Story continues after graphs

Table 1

U.S.	Date	Units	Current	Previous	Change	Year Ago	Change
Employment	2012M01	million, SA	132.409	132.166	0.2%	130.456	1.5%
Unemployment Rate	2012M01	%, SA	8.3	8.5	-0.2%	9.1	-0.8%
Consumer Price Index	2011M12	82-84=100, NSA	226.7	226.7	0.0%	220.2	3.0%
Core CPI	2011M12	82-84=100, NSA	227.2	226.8	0.1%	222.2	2.2%
Employment Cost Index	2011Q4	89.06=100, SA	114.7	114.2	0.4%	112.8	1.7%
Productivity Index	2011Q4	2005=100, SA	111.0	110.8	0.1%	110.7	0.2%
Retail Sales	2012M01	$billion, SA	401.400	399.869	0.4%	379.332	5.8%
Auto and Truck Sales	2011M12	million, SA	14.13	13.50	4.7%	12.46	13.5%
Housing Starts	2011M12	million, SA	0.657	0.685	-4.1%	0.526	24.9%
Real GDP***	2011Q4	2000$billion, SA	13,422.4	13,331.6	2.8%	13,216.1	1.6%
U.S. Dollar	2012M01	97.01=100	99.843	100.464	-0.6%	98.623	1.2%
Trade Balance	2011M12	$billion, SA	-48.800	-47.058	3.7%	-40.454	20.6%
S and P 500	2012M01	monthly close	1,300.58	1,243.32	4.6%	1,282.62	1.4%
Real Short-term Rates*	2012M01	%, NSA	-3.27	-3.09	-0.2%	-3.25	0.0%
Treasury Yield Spread	2012M01	%, NSA	1.94	1.97	0.0%	3.24	-1.3%

Table 2

Nevada	Date	Units	Current	Previous	Change	Year Ago	Change
Employment	2011M12	000 employees	1,124.2	1,132.7	-0.8%	1,120.7	0.3%
Unemployment Rate*	2011M12	%, NSA	12.4	12.2	0.2%	14.7	-2.3%
Taxable Sales	2011M11	$billion	3.394	3.516	-3.5%	3.098	9.6%
Gaming Revenue	2011M12	$million	855.66	880.14	-2.8%	838.79	2.0%
Passengers	2011M12	passengers	3.531	3.644	-3.1%	3.428	3.0%
Gasoline Sales	2011M11	million gallons	86.05	90.82	-5.3%	86.89	-1.0%
Visitor Volume	2011M12	million visitors	3.660	3.743	-2.2%	3.592	1.9%

Table 3

Clark County	Date	Units	Current	Previous	Change	Year Ago	Change
Employment	2011M12	000 employees	806.7	813.8	-0.9%	802.4	0.5%
Unemployment Rate*	2011M12	%, NSA	12.7	12.4	0.3%	15.1	-2.4%
Taxable Sales	2011M11	$billion	2.474	2.524	-2.0%	2.278	8.6%
Gaming Revenue	2011M12	$million	742.37	771.88	-3.8%	733.78	1.2%
Residential Permits	2011M12	units permitted	550	289	90.3%	496	10.9%
Commercial Permits	2011M12	permits	13	13	0.0%	14	-7.1%
Passengers	2011M12	million persons	3.204	3.381	-5.2%	3.084	3.9%
Gasoline Sales	2011M11	million gallons	58.75	61.58	-4.6%	59.83	-1.8%
Visitor Volume	2011M12	million visitors	3.162	3.262	-3.1%	3.111	1.7%

Table 4

Washoe County	Date	Units	Current	Previous	Change	Year Ago	Change
Employment**	2011M12	000 employees	189.8	190.8	-0.5%	192.4	-1.4%
Unemployment Rate*	2011M12	%, NSA	11.9	11.6	0.3%	13.8	-1.9%
Taxable Sales	2011M10	$billion	0.430	0.475	-9.4%	0.409	5.1%
Gaming Revenue	2011M12	$million	58.47	53.51	9.3%	53.04	10.2%
Residential Permits	2011M12	units permitted	30	59	-49.2%	29	3.4%
Commercial Permits	2011M12	permits	6	11	-45.5%	6	0.0%
Passengers	2011M12	million persons	0.281	0.259	8.3%	0.300	-6.3%
Gasoline Sales	2011M11	million gallons	13.13	14.19	-7.5%	13.31	-1.4%
Visitor Volume	2011M12	million visitors	0.323	0.303	6.8%	0.311	4.1%

*Change in percentage rate
**Reflects the Reno-Sparks MSA which includes Washoe and Storey Counties
***Recent growth is an annualized rate

Sources: Nevada Department of Taxation; Nevada Department of Employment, Training, and Rehabilitation; UNR Bureau of Business and Economic Research; UNLV Center for Business and Economic Research; McCarran International Airport; Reno/Tahoe International Airport; Las Vegas Convention and Visitors Authority; Reno-Sparks Convention and Visitors Authority; U.S. Department of Commerce; U.S. Bureau of Labor Statistics; U.S. Census Bureau; U.S. Federal Reserve Bank.

Note: NSA = Not Seasonally Adjusted, SA = Seasonally Adjusted

(1.4 percent) from December 2010 to December 2011. The Reno-Sparks unemployment rate rose from 11.6 percent in November to 11.9 percent in December, as the result of seasonal factors, *Table 4*.

Nevada Economic Outlook in Brief

Driven by strong gains in consumer spending and inventory investment, national economic conditions improved in fourth quarter. If inventories prove too high, U.S. economic growth could slow in early 2012. The Southern Nevada tourism, hospitality, and gaming industries continued to show gains—as did other parts of the region's economy. Nevada's real estate and construction sectors remain close to bottom. The economy remains weak in Washoe County, but some favorable signs are seen in visitor volume and gaming.

This information is provided compliments of

Michael M. Lawson

PRESIDENT AND CEO OF COMMERCE REAL ESTATE SOLUTIONS

Mike Hillis, CCIM, SIOR

MANAGING PARTNER OF COMMERCE REAL ESTATE SOLUTIONS, LAS VEGAS

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COMMERCE REAL ESTATE SOLUTIONS
3800 Howard Hughes Parkway, Suite 1200
Las Vegas, NV 89169
Tel (702) 796-7200 • Fax (702) 796-7920
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