The Economists

33rd Annual New York University
International Hospitality Industry
Investment Conference
Panelists

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The U.S. Lodging Industry and The Economy

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Demand Elasticity Correlation to Real GDP

1987 value = 100

Sources: Lodging demand – PwC based on Smith Travel Research data; Real GDP- U.S. Bureau of Economic Analysis.

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The Economic Outlook: A Half-Speed Recovery

David A. Wyss, Ph.D.
Chief Economist
Standard & Poor’s
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June 6, 2011
Data as of May 16
The Half-Speed Recovery

- A recovery has begun, but is likely to remain weak.
- Housing now appears to be stabilizing, although prices are still falling.
- Overseas partners are recovering, helping exports, but developed economies remain slow. The financial problems in Europe and the earthquake and subsequent nuclear problems in Japan add to risks from overseas.
- But the dollar weakness will help
- The fiscal stimulus helped boost the economy, but is being reversed. A government default would increase risk
- Private nonresidential construction is still plunging
- Consumers aren’t bouncing back as quickly as usual.
- Another dip into recession is possible if the financial markets lock up again or oil prices jump farther on Middle East turmoil.
The Housing Market Cycle

(Housing starts (1000) and 12-month % change in home prices (S&P/Case-Shiller))

Source: Standard & Poor’s and Census Bureau
The Fed Didn’t Stop At Nothing

Source: Federal Reserve
All Fall Down

(Percent change in real GDP, quarterly rate)

Source: Global Insight

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Trade Gap And Reserve Diversification Will Send Dollar Lower

(Index) (Percent of GDP)

Source: Bureau of Economic Analysis and Federal Reserve, S&P projections

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Can the Consumer Keep Spending?

- Consumer spending led recent expansions
- But wealth is down because home prices have dropped and
- Stocks are still below their 2007 peak
- Borrowing is more difficult, and home equity loans much less available
- Confidence has dropped and unemployment risen
- Consumers are likely to continue to save more and borrow less
- High oil prices hurt purchasing power and confidence
- Stimulus package provided some income boost
Debt Is Dropping From Record Highs

(Percent of after-tax income)

Source: Bureau of Economic Analysis and Federal Reserve
Tourism Is Starting To Pick Up

(Percent change over 12 months)

Source: Bureau of Economic Analysis, S&P projection
Default Rates Begin To Drop

Source: S&P/Experian

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Bottom Line: The Economy Will Recover Slowly

• The recession is the longest and deepest since the 1930s
• Fiscal stimulus has supported the recovery
• But recovery is likely to be slow because of financial markets and switch to higher savings
• If financial markets lock up again
• Home prices continue to fall
• And oil prices continue to rise
• The recession could be longer and deeper
• With the risk of a “lost decade” similar to Japan in the 1990s
Oil Prices Remain Down From Peak

($/barrel, WTI and deflated by CPI; household energy purchases as percent of disposable income)

Source: Bureau of Economic Analysis
Risks to the Economy

(Real GDP, percent change year ago)

Source: BEA, S&P projections
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The Economic Outlook: More Fizzle Than Sizzle

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www.EconomicOutlookGroup.com
Economy entered 2011 with lots of momentum… but geopolitical shocks and natural disasters sapped some energy.
Economy Faces Fresh Headwinds

- Geopolitical instability in North Africa and Middle East to last. Oil prices will remain elevated. New normal for crude is $90 to $130 a barrel.

- US households under new financial pressure. Inflation + softer job market = Consumers turn cautious.

- Japan’s natural disasters has interrupted output and sales in the US.

- Cuts in US federal, state and local spending will lessen demand.

- Economy cannot fully recover w/o housing. Swamp of home foreclosures and litigations. No new home-buying tax incentives foreseen.

- Global interest rates on the rise (except the US); This will slow world economic growth and cut into US exports.
Consumers are apprehensive about new borrowing

$ Billions, total consumer credit outstanding, end of period

Non-revolving debt creeping higher

Credit card debt holding still

Source: Federal Reserve
Americans instead are tapping more of their savings

(Amount of personal savings, $billions, quarterly & annualized)

Source: Bureau of Economic Analysis
Consumers have begun to scale back spending

Monthly % change in Real Personal Spending

Source: Bureau of Economic Analysis
Official unemployment rate has risen two consecutive months.

Broader definition is "underemployment" rate.
U.S. Job Market at Inflection Point!
Monthly Change in “Business” Payrolls
(thousands of net new jobs per month)

Source: Bureau of Labor Statistics

May: companies hired fewest workers in a year.
% of Americans working stands near 50-year lows

% of US civilian population employed

Source: Bureau of Labor Statistics

Near record lows
Companies are laser focused on improving productivity. Firms continue to boost spending equipment, software and computers.

Source: Commerce Department
US economic output now greater than ever before
…and able to accomplish this with 7 million fewer workers!!!
Commercial & industrial loans by banks are picking up. But commercial real estate loans still in decline.

Source: Federal Reserve
New orders to manufacturers have fallen off sharply!

ISM New orders index for manufacturing

Above ‘50’ points to stronger economic growth

Source: Institute for Supply Management
Service sector also receiving fewer new orders

Above 50 points to expansion

Substantial drop-off in services too

Source: Institute for Supply Management
New home construction still bouncing off the bottom
Thousands of new units, monthly annual rates

Shaded area = recession

New starts
Permits

Source: Census Bureau
After free fall, lodging construction spending levels off

Source: Commerce Department
Inflation to edge higher even as the economy slows

- Inflation typically accelerates 2 years after onset of recovery. Source of pricing pressures stems mostly from events outside US.

- The Federal Reserve is wrong in arguing that recent factors driving up fuel and food prices are “transitory.”
  - Turmoil in Middle East far from over.
  - Demand for commodities and finished goods from emerging countries will remain strong for decades.

- Weak dollar will contribute to inflation because imports become more expensive.

- China no longer a deflationary influence on US imports.
Consumer prices moving up more rapidly

% change, year-over-year

Consumer Price Inflation (overall)

April’s 3.2% inflation most since October 2008.

Source: Bureau of Labor Statistics
Consumer prices moving up more rapidly

% change, year-over-year

- **Consumer Price Inflation (overall)**
- **Core CPI (less food and energy)**

Source: Bureau of Labor Statistics
Risk of recession remains very small

- US short & long term interest rates to remain historically low.
- Federal Reserve will not tighten monetary policy this year.
- Budget deficits still provide stimulus to the economy.
- Business capital spending should remain fairly strong.
- Consumer purchases will fade, but not disappear.
- US exports to accelerate:
  -- Japan to embark on massive reconstruction ($350 billion plus). This will lift US shipments abroad.
  -- Emerging countries will continue to expand more rapidly than the mature economies.
Major threats the next 6 - 12 months

◆ Congress fails to raise the national debt ceiling and US defaults.  
  Probability: <10%

◆ Greece defaults, contagion spreads.  
  Probability of Greek default: 95%  
  Probability Ireland and/or Portugal will follow Greece: 70%  
  Probability damage will spill to the US (65%), and terminate recovery: (20%)

◆ US Treasury rates climb “sharply” on fear of inflation, erosion of dollar’s value, and with China, Japan and Fed buying less new US debt.  
  Probability: 30%

◆ US employers, sensing economic slowdown, scale back new hiring.  
  Probability: 70%

◆ More geopolitical disruptions in the Middle East. Turmoil could last yrs.  
  Probability: 90%
## Economic Forecasts

<table>
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<tr>
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<th>Standard &amp; Poor's</th>
<th>The Economic Outlook Group</th>
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<tbody>
<tr>
<td></td>
<td>2010</td>
<td>2011</td>
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<tr>
<td>Real GDP</td>
<td>2.9</td>
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<td>CPI</td>
<td>1.7</td>
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<td>Interest Rates – 3-Month T-Bills (Year-end)</td>
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<td>Euro / Dollar Exchange Rate (Year-end)</td>
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<td>Unemployment Rate (Year-end)</td>
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<tr>
<td>Peak Oil (Barrel)</td>
<td>$95</td>
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<tr>
<td>S&amp;P 500 (Year-end)</td>
<td>$1,258</td>
<td>$1,425</td>
</tr>
</tbody>
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Sources: Bureau of Economic Analysis, US Energy Information Administration, Standard & Poor’s, and The Economic Outlook Group.
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