2013: Impediments and Opportunities

NAIOP
Economic Outlook

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REGIONTRACK

Regional Economic Forecasting and Analysis

Recovery and Outlook….

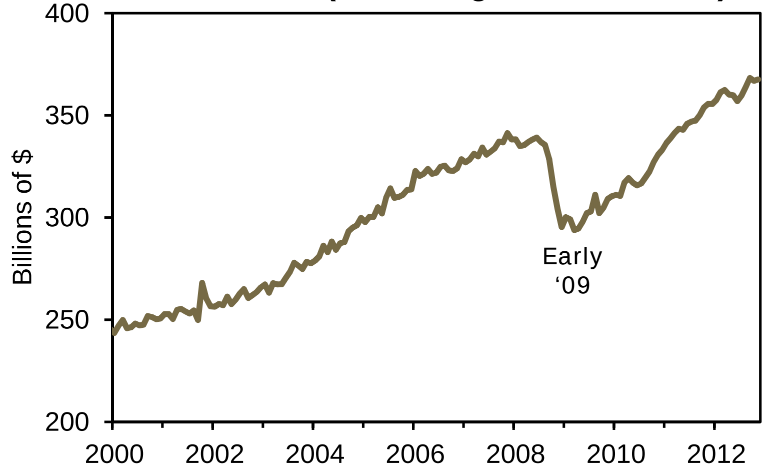
Objectives:

1. Update the status of the U.S. recovery
2. Which impediments remain a risk to the recovery?
3. Secondary keys to the recovery
4. Forecasts and key assumptions

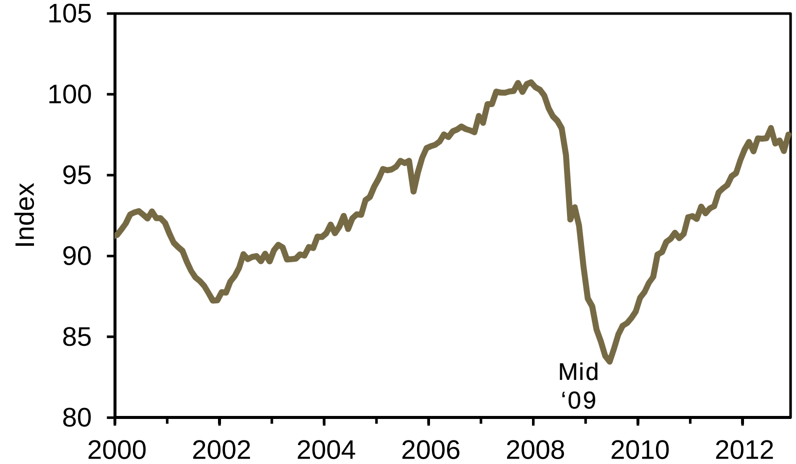
Recovery remains steady (but unspectacular) and broad-based

improvement across a range of indicators

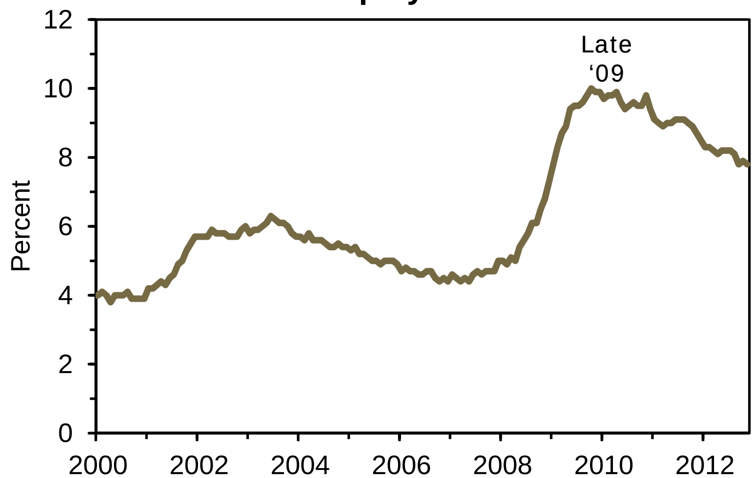
Retail Sales (Excluding Food Services)



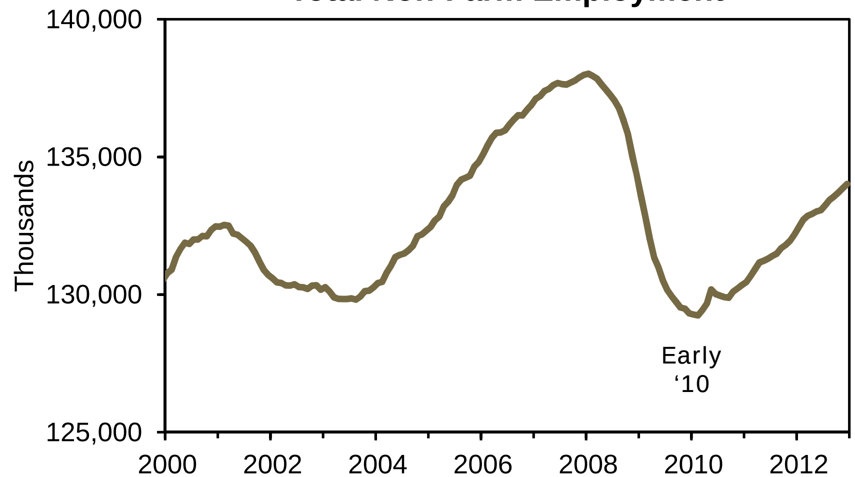
Industrial Production Index



Unemployment Rate



Total Non-Farm Employment



Source: Bureau of Labor Statistics, Bureau of Economic Analysis , Census Bureau

Entering a new round of industry sector rotation in 2013

Most services sectors strong, goods have slowed

Strength:

State and local government rebounding
Skilled professional and business services
Health care – recession-proof?
Export industries – particularly agriculture and manufactured exports
Supply Chain: retail / transportation / warehousing / wholesale
Eating & drinking / leisure & hospitality

Weakness:

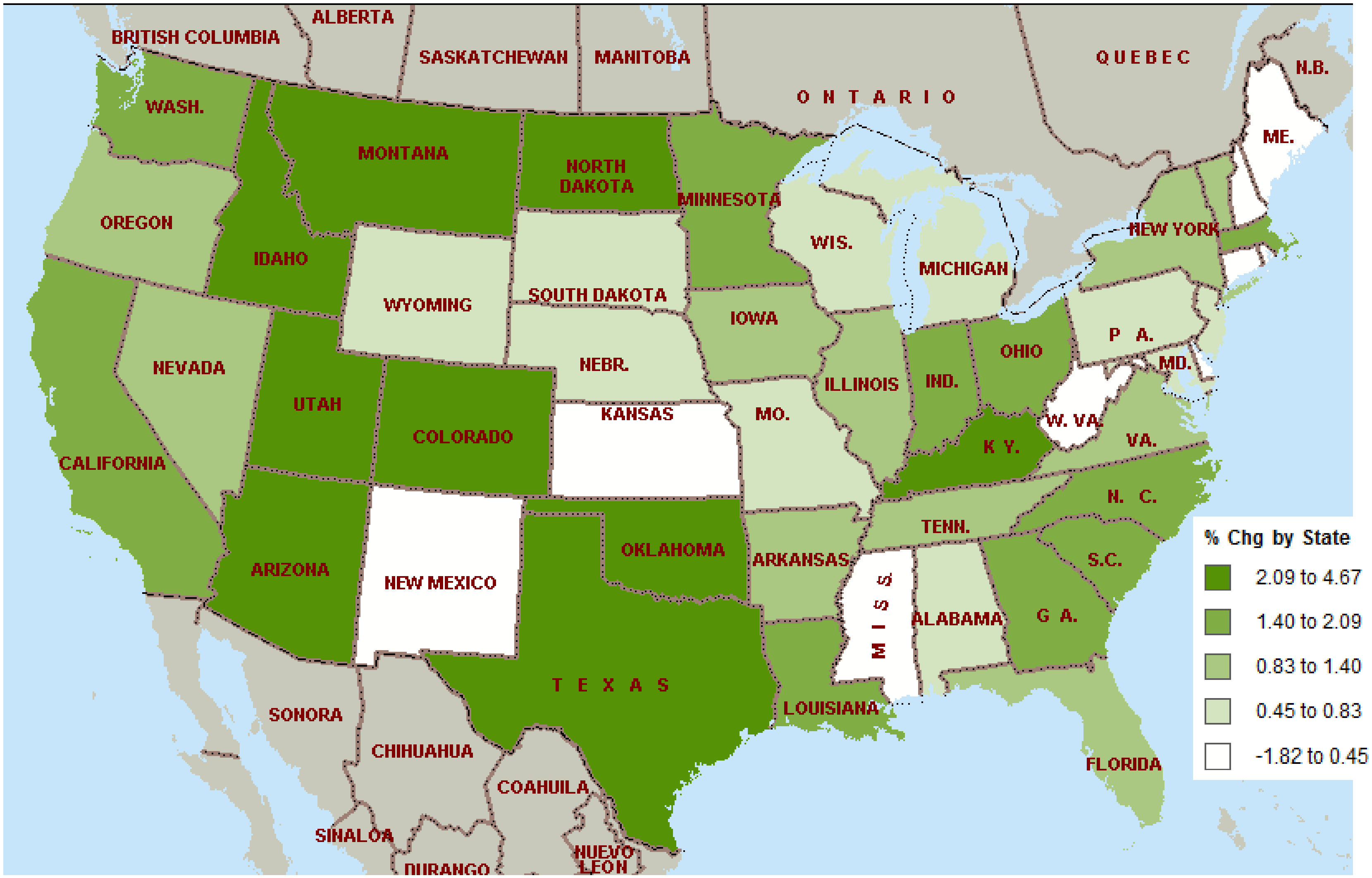
Construction / Manufacturing / Mining – softness in 2nd half of 2012
Federal government – much is Postal Service
Telecommunications
Publishing
Areas of tourism remain weak

Big states are once again leading in # of jobs

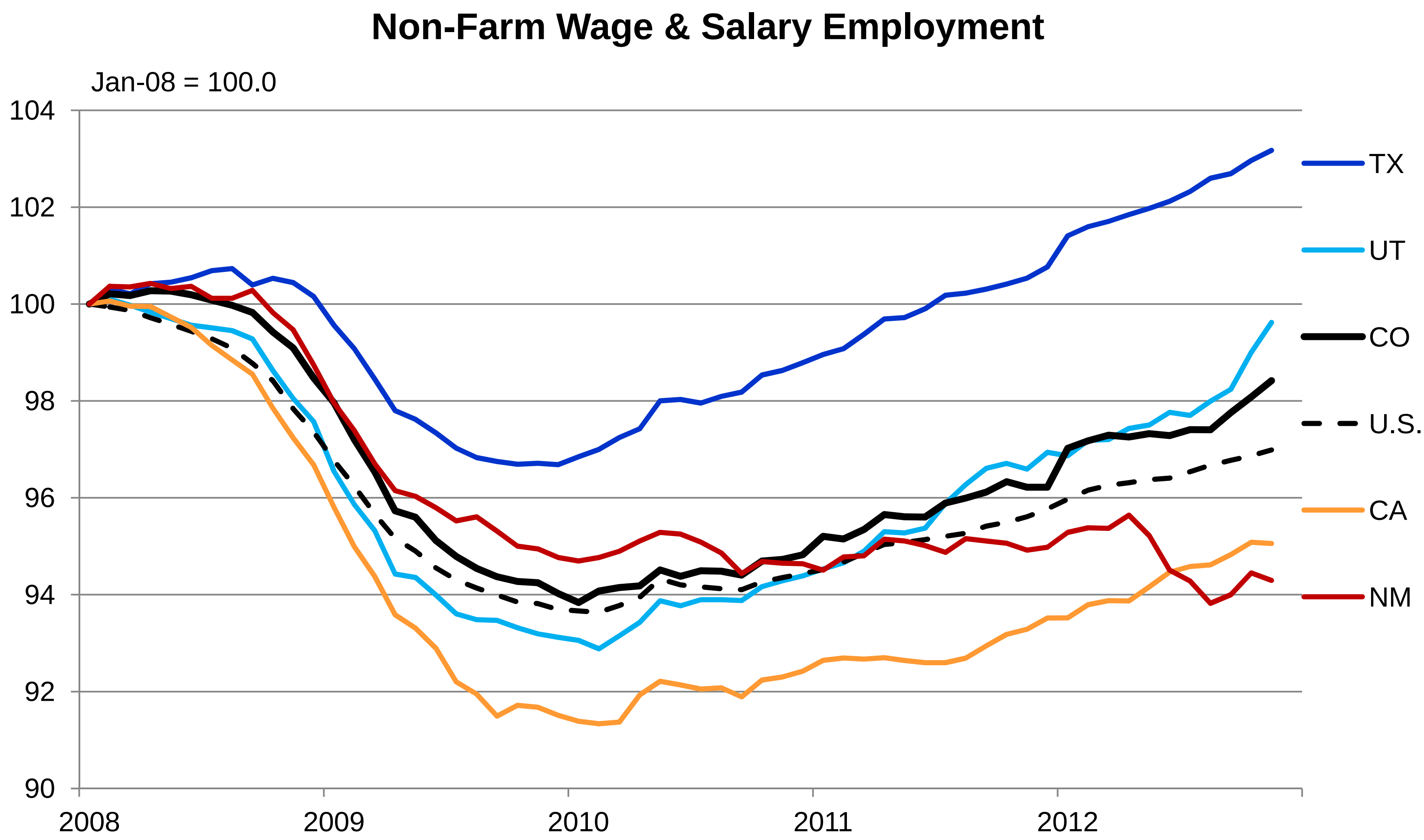
Largest gains in TX, CA, OH, NY, FL

But regional growth patterns still present

Mountain, energy, and in-migration states leading: CO is all three



Colorado: leading or national-like?



Serious impediments to recovery remain in place

The major economic issues we face will require more than short-run policy tactics to resolve:

1. Real estate / bank mortgage portfolios
2. Fiscal contraction
3. Deleveraging
4. International shocks: Euro area financial/fiscal crisis, slowdown in China and other developing regions

1. Residential Real Estate is a Four-Headed Beast

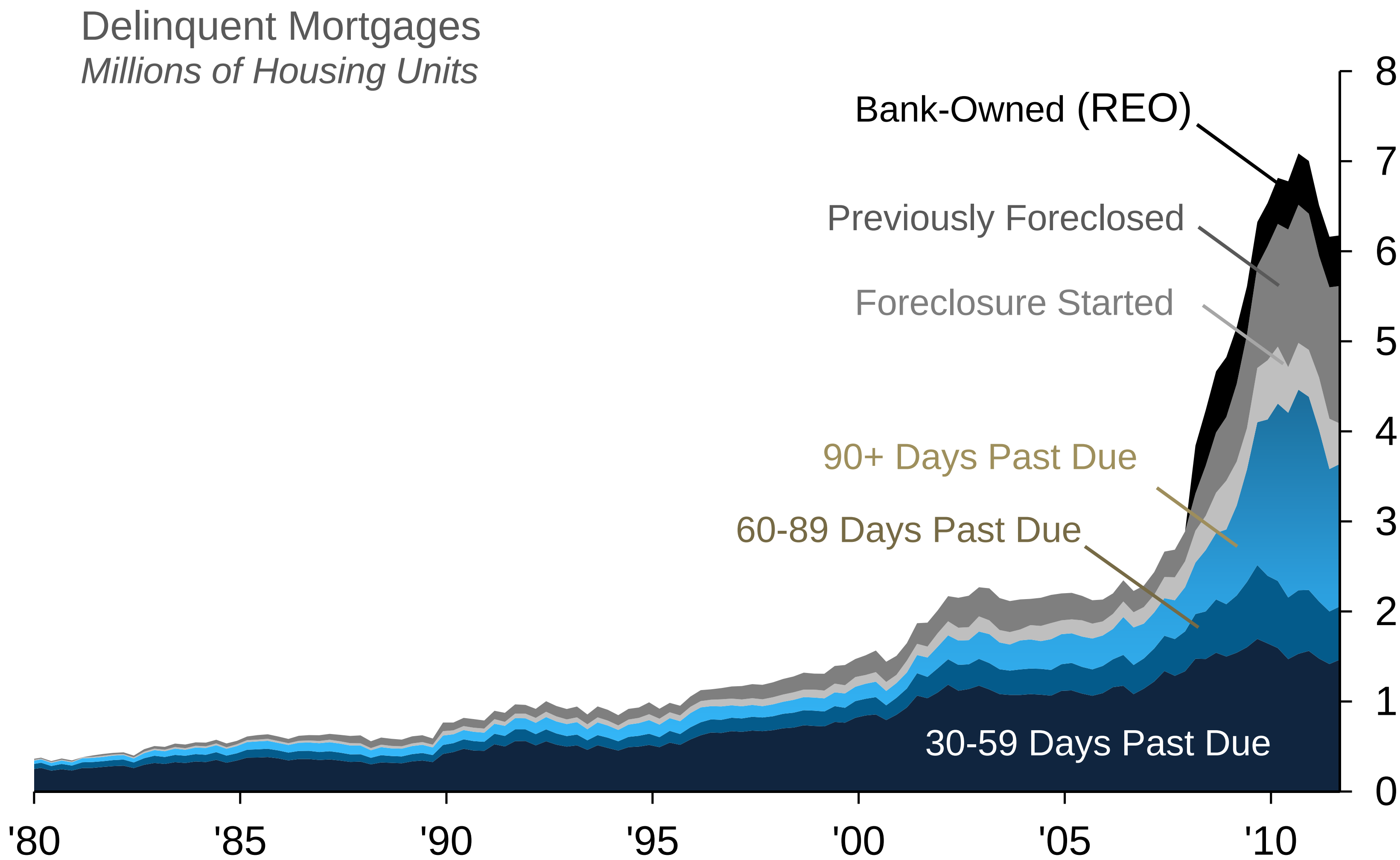
it will not be easy to defeat

Residential collapse hit economy on several fronts:

1. Collapse in sales – business activity (bottom found)
2. Construction halt – key cyclical sector (bottom found)
3. Housing price decline/foreclosures/delinquencies – wealth effects (ongoing)
4. Mortgage losses/restricted lending – financial system distress (ongoing)

1a. Delinquency and foreclosure pipeline remains full

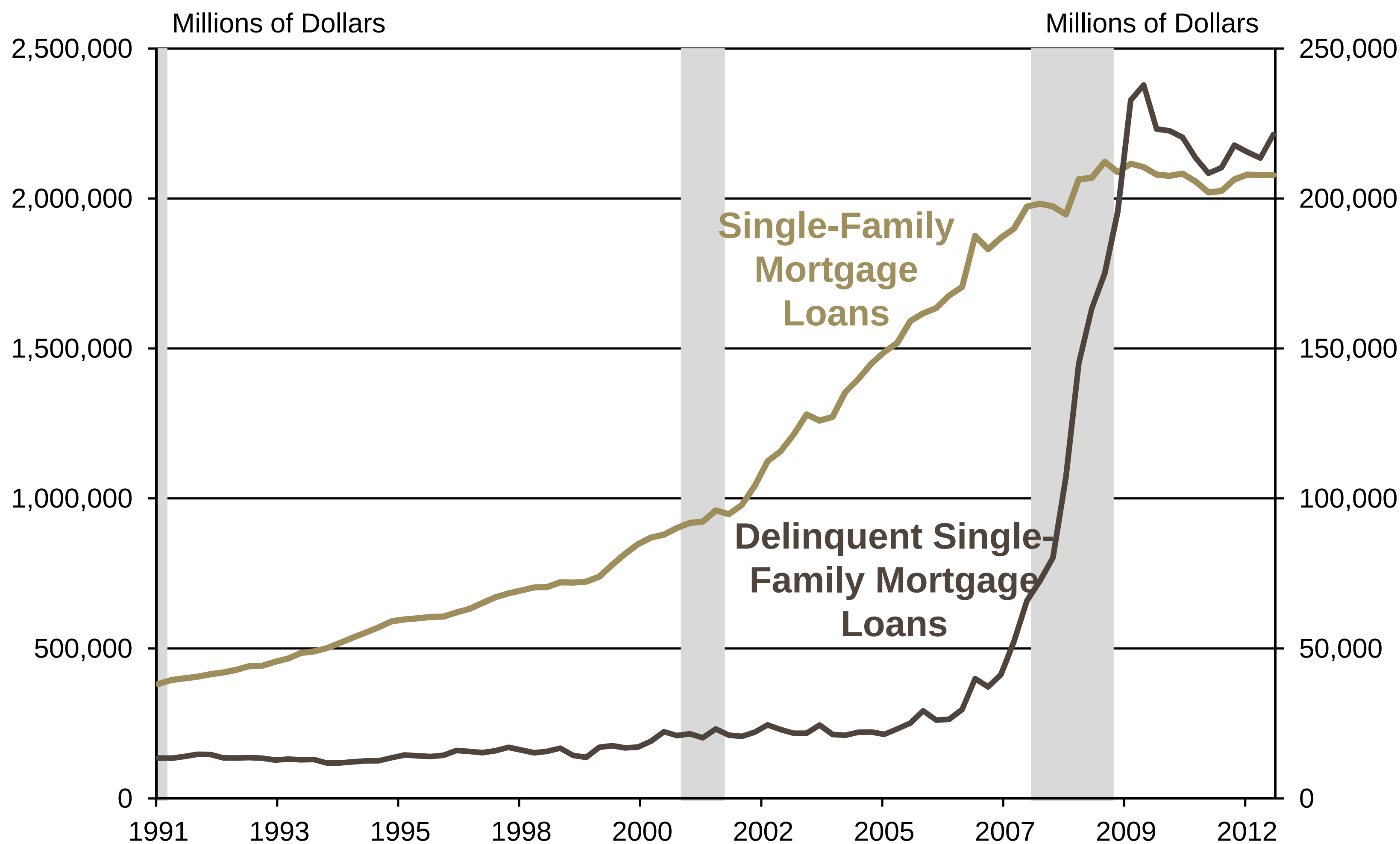
no easy resolution, but peak behind us



Source: Mortgage Bankers Association and Barclays

1b. Residential lending remains a problem for banks

mortgage portfolios still flat, delinquency rates elevated



Source: Board of Governors of the Federal Reserve System

2. U.S. Fiscal Cliff is Really Fiscal Mt. Everest

this will be a really *long* climb

Prediction: economic growth trumps deficit >> stop-gap action

Outcome: economic growth trumps deficit >> stop-gap action

- Tax Changes: reinstate payroll taxes, income tax increase and capital gains/dividends increase for $400K/$450K filers, AMT cuts extended, and limits on deductions for $250K/$300K filers, estate taxes up for $5Mil+ filers
- Spending Cuts: any potential cuts pushed out 2 months

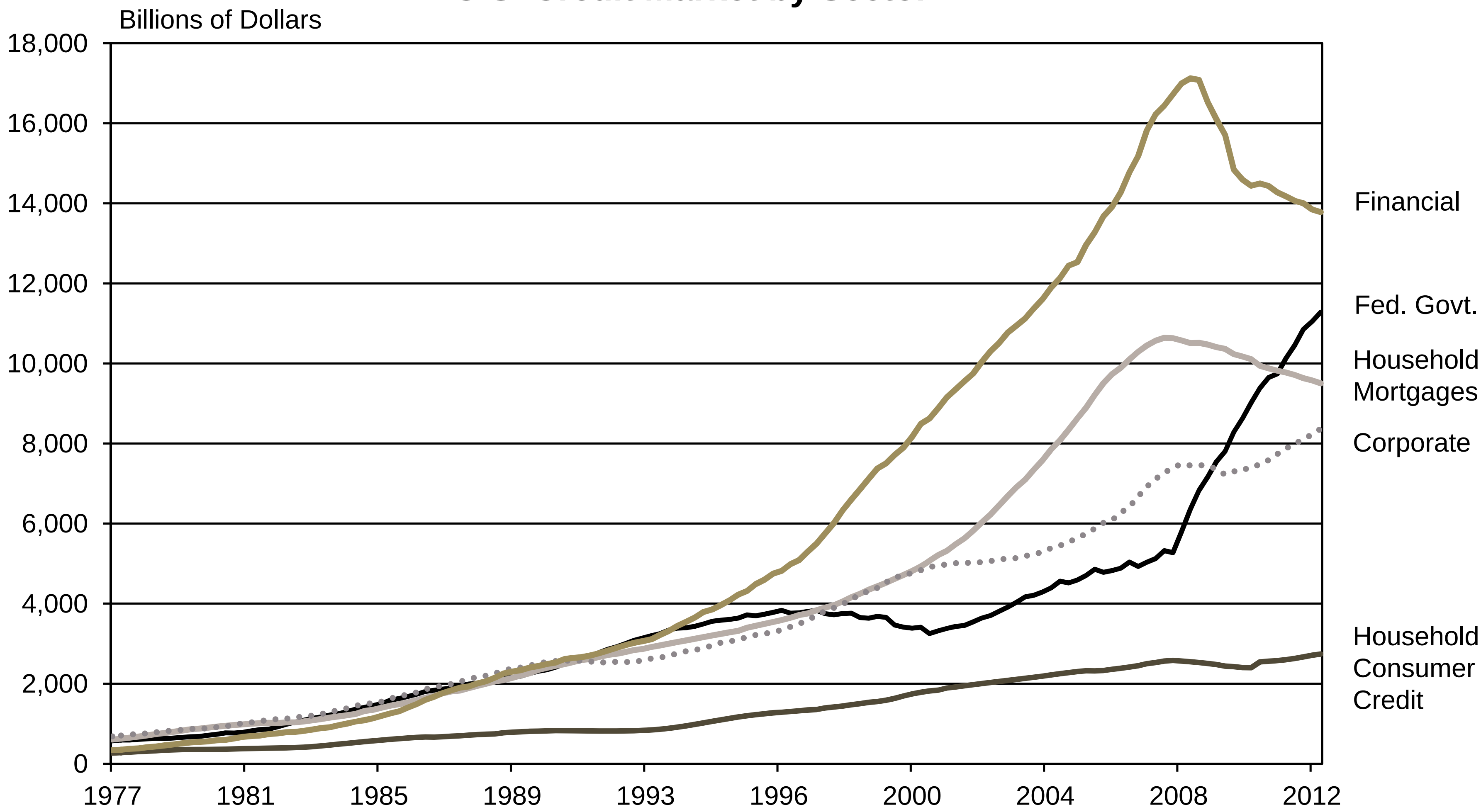
Budget process does not end with this agreement

The experience in Europe with sharp spending cuts will continue to shape the U.S. budget process

3. Deleveraging is a slow painful process

govt. borrowing has more than offset private sector deleveraging

U.S. Credit Market by Sector



Source: Board of Governors of the Federal Reserve Z.1

4. What Would Cause a U.S. Recession?

international shocks at top of list

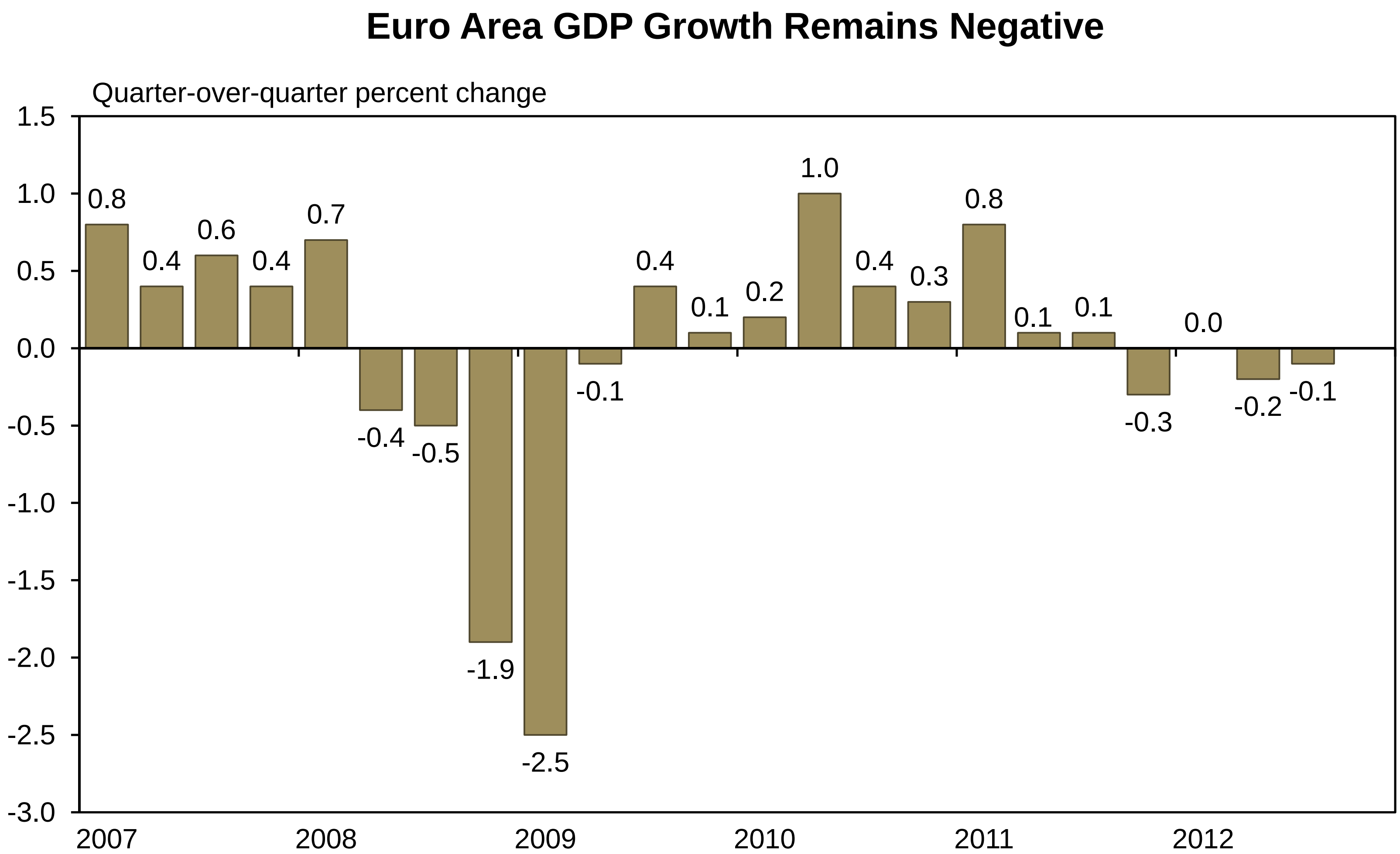
Another recession is a real possibility in the coming 9-12 months (but <25%)

Most likely triggers:

- Euro area meltdown coupled with China weakness
- U.S. policy mistake (federal budget)
- natural market forces: 3+ years into recovery

4a. European fiscal crisis will drag into 2013

resumption of growth is a real possibility by year-end



Source: Organization for Economic Co-operation & Development (OECD)

4b. Data suggest China is past the bottom

bank lending has resumed growth

China GDP Growth (Qtr/Qtr)

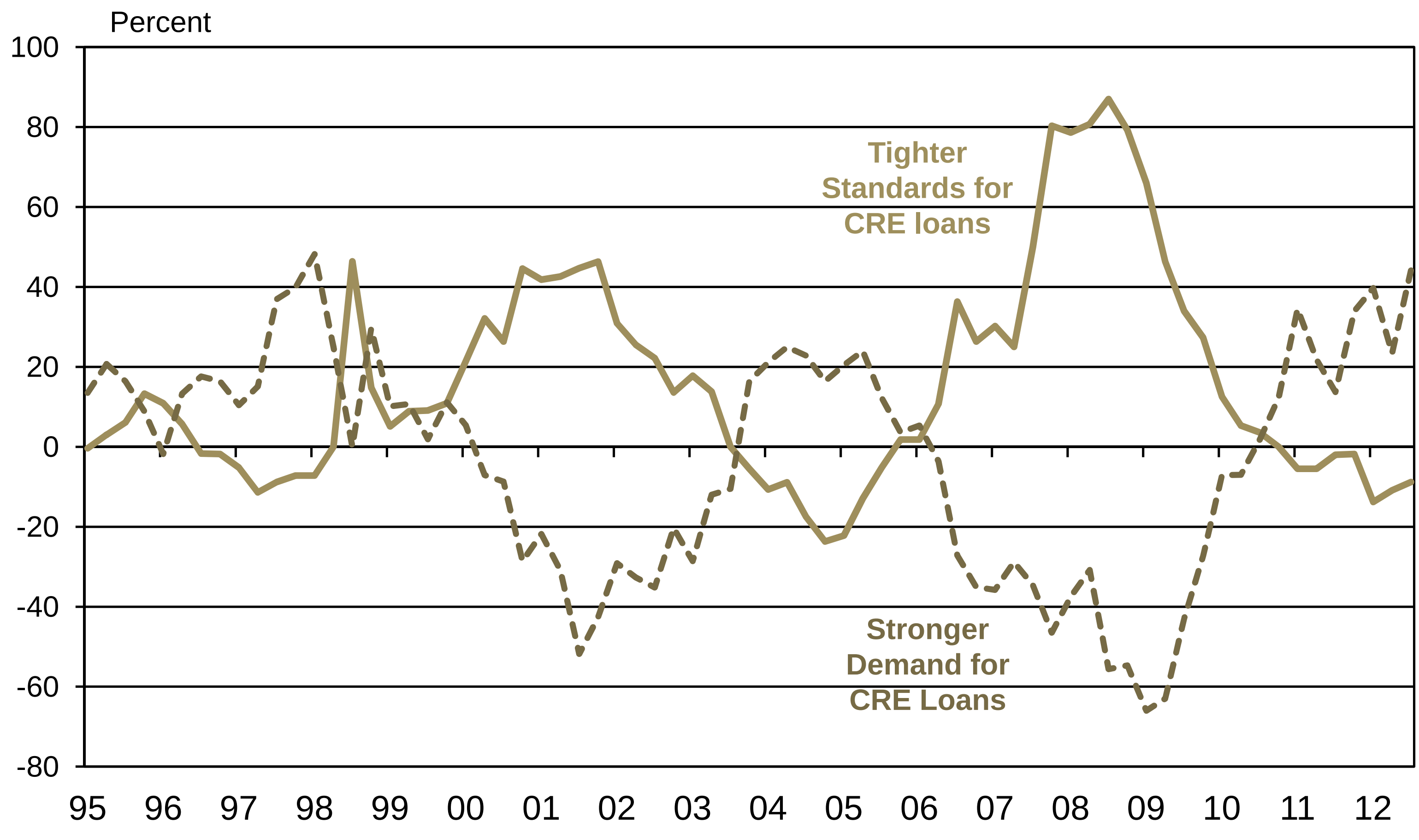
Year	Quarter	Growth Rate (%)
2011	Q1	2.2
	Q2	2.5
	Q3	2.4
	Q4	1.7
2012	Q1	1.5
	Q2	**2.0**
	Q3	**2.2**

Source: National Bureau of Statistics of China

CRE is no longer a risk factor to recovery

now following general economic conditions, lending resumes

Lending Terms vs. Demand for CRE Loans



Source: Board of Governors of the Federal Reserve System: Senior Loan Officer Survey

Fed Will Hold the Course in 2013

full employment at any cost? yes

Rates will remain exceptionally low as long as:

1. unemployment concerns dominate inflation worries
2. asset prices (real estate and stock prices) remain semi-soft
3. Bernanke deems it useful to eliminate the investor notion of a risk-free asset with positive yield (savers are a problem)
4. from "… mid 2015" to open-ended in the Dec. FOMC language (6.5% jobless target)

Growing number of FOMC members voicing a desire to end QE early: half said by mid 2013

Will 2013 be the Transition Year?

if so, where will the fuel come from?

1. Continued Fed accommodation
2. No chaos from fiscal cliff
3. Soft energy prices
4. Steady, but unspectacular, job gains
5. Greatly improved bank balance sheets
6. Low debt service for households
7. Housing bottom
8. Early stages of European resolution / China rebound

2013 U.S. forecast point estimates

Federal Reserve (central tendency Dec. 2012)			
GDP:	2.3-3.0% in 2013	Unemp:	7.4-7.7% in 2013
	3.0-3.5% in 2014		6.8-7.3% in 2014
	3.0-3.7% in 2015		6.0-6.6% in 2015
	core CPI inflation remains at or below 2.0% through 2015		
Wells Fargo			
GDP:	1.5% in 2013	Unemp:	7.8% in 2013
	2.4% in 2014		7.6% in 2014
WSJ Consensus			
GDP:	2.3% in 2013 (up)	Unemp:	7.5% Dec 2013
	2.8% in 2014		7.0% Dec 2014
RegionTrack			
GDP:	2.5% in 2013	Unemp:	7.3% Dec 2013
GDP:	3.0% in 2014	Unemp:	6.8% Dec 2014

Forecasting strategies are applicable to business planning

Errors that are becoming increasingly likely in 2013:

- Ignoring the evidence that there really is a recovery underway
- Overreacting to data noise
- Confusing the adjustment process with structural change in many segments of the economy
- Overestimating the importance of external shocks
- Focusing on tactical government policy actions rather than the markets and economic mechanisms at work

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