New Jersey Economic Insights

Dr. Charles Steindel,
Chief Economist
May 2013

Outlook New Jersey

Key Indicators Show Marked Improvement in Employment and Economic Activity

New Jersey

We have seen some marked improvements in New Jersey's economy in recent months. The most dramatic has been the substantial drop in the state's unemployment rate. It fell from 9.5 percent in January to 9.3 percent in February, 9.0 percent in March, and then to 8.7 percent in April. April was the first month with unemployment under 9 percent since April 2009. The 0.8 percentage point decline in the unemployment rate from January to April was the largest three month drop since 1978. The 0.6 percentage point decline from February to April was the largest over two months since 1977.

- ***New Jersey economic indicators are moving up briskly, led by the drop in unemployment.***
- ***The national economy is swimming ahead through some choppy waters, possibly related to federal budget cuts.***

Unemployment has moved down because of the improvement in jobs. From April 2012 to April 2013 employers in the state added 69,100 positions – including 59,600 in the private sector. With the job count rising, more residents have been at work: 60,900 more New Jersey residents were employed this April than last April. The state's labor force has risen 31,200 over the past year, but the gains in employment have been larger. This is what moved the unemployment rate down to 8.7 percent from 9.4 percent last April. In the second half of 2012 a very sharp increase in the state's labor force obscured the improvement in employment and the unemployment rate stayed quite high. But early this year, as the labor force reversed part of that run-up, the genuine improvement showed through to the headline numbers.

Through all these gyrations, the basic uptrend in jobs has continued. Month after month, with few exceptions, we have seen increases in payrolls. April saw another gain of 3,300. Over the 12 months ending in April, the number of jobs in New Jersey rose 1.8 percent, beating the national rate of increase of 1.6 percent. Over the past year, New Jersey ranked 10th in the nation in percentage job growth, the best of any state in the Northeastern quadrant of the nation. In absolute numbers of jobs created, New Jersey ranked sixth.

We are also seeing robust readings in other state indicators. Car sales in April, both new and used, were sharply higher than a year earlier. The New Jersey Association of Realtors reported another increase in existing home sales in the first quarter. The number of housing permits granted in the state in the first four months of 2013 was nearly 28 percent higher than in the same period of 2013. The indexes of New Jersey economic indicators compiled by the Federal Reserve Banks of Philadelphia and New York both show higher rates of growth. Indeed, the Philly Fed reported that over the last 12 months New

(Continued on page 2)

Jersey's index grew more rapidly than the nation's as a whole, ranking us 10th and, as was the case for jobs, higher than any other state in the Northeastern quadrant of the U.S. April's level of the Philly index for New Jersey set a new all-time high, edging past the previous February 2008 peak.

Still, not everything is rosy. The Philadelphia Fed's May survey of local manufacturers, which includes some South Jersey firms, was negative, which goes along with recent softening in national manufacturing indicators. Nonetheless, six months after Sandy, the state's economy is showing remarkable resiliency and improvement.

U.S. Economic Outlook

National economic growth in the second quarter looks like it will step down from the first quarter, but should remain positive. The big pluses are that retail sales figures show consumer spending is growing at a rate higher than earlier expected, while the nation continues to add jobs at a pace averaging around 200,000 a month. That, unfortunately, is not rapid enough to move unemployment down very quickly, but it is still sufficient to support ongoing growth in spending. Housing numbers, though, as usual, are still erratic from month to month, but show the sector finally rebounding sharply.

The negative elements come from federal spending and manufacturing. The sequester is coming through on top of other notable cuts in federal spending — defense outlays fell quite sharply in each of the last two quarters, perhaps related to the wind down of the Afghanistan conflict. Manufacturing production fell in both March and April. Surveys of industrial activity, conducted by the Philadelphia Fed and others, have softened, and capital goods orders weakened in late winter, though April figures showed them turning back up. A combination of factors looks to have been holding back manufacturing, including the tapering of defense-related demand, foreign economic weakness affecting U.S. producers, and Boeing's problems with the Dreamliner. Most of these problems should ease in the second half of the year, setting the stage for improved national growth.

There's recently been some vigorous discussions about the effects of federal debt on the economy. Some prominent economists had been arguing that, based on international data, after a certain point, further increases in federal debt are likely to be associated with dramatically lower economic growth. With the deficits of the last few years, federal debt has risen substantially, and these arguments have been used to support proposals for significant cuts in spending in order to bring down the growth of debt. Just about all economists agree that there is some negative relation between high debt and lower growth. After all, when the economy is weak, tax revenues are low, which tends to increase debt, and in a period of low growth governments will often try to spur activity with increased spending.

"Over the past year, New Jersey ranked 10th in the nation in percentage job growth, the best of any state in the Northeastern quadrant of the nation."

Of course, very high debt levels could increase interest rates, crowding out some private investment and holding down economic growth. However, the argument that these effects become much larger after debt levels reach a certain point was rather surprising. In the last month it's been shown that there were significant errors in some of the calculations used to support the case that, after a certain threshold, increases in debt will be accompanied with sharp reductions in growth. Economics is not a hard science, so showing these technical errors does not resolve the dispute. The argument continues.

— *Charles Steindel*

Economic Analysis

Have Consumers Got Their Mojo Back?

American consumers staggered into the recession in 2008 with a heavy burden on their backs. Their aggregate debt had grown to more than 125 percent of after-tax income, up from less than 90 percent a decade earlier.

The debt load was caused by massive mortgage borrowing. So long as home prices were rising, this heavy burden was sustainable. Households could always sell their homes in a pinch to pay off the debt. But when the housing bubble burst, consumers had to bear the full burden of the debt.

Rising unemployment and massive losses in the stock market further eroded consumer resources. Consumer confidence collapsed in this dismal environment and 2009 saw the sharpest decline in real consumer spending since World War II.

Since 2009, consumer spending has grown at a modest pace averaging, in real terms, about 2 percent a year. This growth, while a sharp contrast to the earlier collapse, is still significantly under the gains of 3 to 3.5 percent that were typical in previous economic expansions. Since consumer spending accounts for about two-thirds of aggregate spending in the U.S., this softness has been a major reason for the tepid pace of the recovery.

"There is now an active debate among economists about whether and when consumer spending will step up to the more traditional faster pace of growth."

There is now an active debate among economists about whether and when consumer spending will step up to the more traditional faster pace of growth. Optimists point to the dissipation of a number of "headwinds' that have held back consumer spending, while others point to factors that will likely continue to keep household checkbooks closed.

The Optimistic View: Better Balance Sheets, Higher Income, Pent-Up Demand

The most dramatic change since the depths of the recession has been in the wealth and debt of households. The Federal Reserve Board reports that aggregate household net worth at the end of 2012 amounted to $66.1 trillion. Since the low point in early 2009, it has grown by $14.6 trillion – a gain nearly equal to one year's national GDP. While this staggering increase has not quite offset the losses seen in the recession, it certainly refutes the odd notion that the last few years have seen the "destruction" of U.S. wealth. What actually happened was swings in the valuation of assets – first sharply down, then sharply up.

As wealth has risen, debt burdens have been reduced sharply. Household debt is now about $1 trillion less than its peak level, and the ratio of debt to aggregate income has fallen to 105 percent. This is still a fairly high ratio, but much less than the peak.

Clearly, the reduction in debt burdens also owes a lot to income gains. While the recovery has been slow, it has been sufficient to regenerate growth in after-tax income, and employment has been gradually recovering.

The improvement in wealth and income, and the reduction in debt burdens, has not only increased consumers ability to spend, but has also restored their creditworthiness, enabling them to borrow again to finance big-ticket purchases like houses, cars and appliances. Strong demand for these items is likely to continue. With the deep and prolonged recession, and the sluggish recovery, Americans' stock of autos and other long-lived goods has been aging, increasing the potential demand for replacements. The revived housing market will fuel

(Continued on page 4)

demand for furniture and appliances. All these positives will fuel faster spending growth. The recovery in measures of consumer confidence to levels not seen since before the worst of the recession also supports this more positive outlook.

The Cautious View: Income and Wealth Gains May Be too Narrow, Lenders and Borrowers Remain Cautious, Taxes Have Increased

Those who take a more cautious view will point out that while aggregate wealth may have recovered virtually all of its losses, there have been marked changes in its distribution. The stock market is at all-time highs, but home values, though now increasing again, remain well below their peaks. Only a small share of the population has substantial stock market holdings. For most people their only important asset is their home, and home values remain under their peak. Also, while it is true that debt, particularly mortgage debt, is down, a good deal of that drop is due to the write-off of mortgages after foreclosure. As a result, the still precarious financial position of many households prevents them from increasing their spending.

Furthermore, even if household balance sheets look improved, one likely legacy of the 2008-2009 collapse in the financial markets is that both lenders and borrowers will be extremely cautious in the future. In other words, we can't compare the statistics on household leverage – debt relative to income – today to past figures and draw the same conclusions about the amount of borrowing that might follow.

Finally, taxes have started to rise. From the point of view of the average consumer, the recent increase in upper-bracket income and capital gains taxes was probably not too important, but the 2 percentage point boost to employee Social Security taxes in January was quite large. For instance, a wage-earner with a $35,000 year salary has seen his or her payroll taxes rise by $700 a year. Such a significant tax increase would be likely to prompt a comparable pullback in consumer spending. While recent gas price declines have been a favorable development, they only offset a small portion of the payroll tax hike.

On balance, the arguments on both sides are plausible, meaning that it is hard to believe that consumer spending growth will return to its pre-recession pace, but it is also a bit hard to think that spending will continue to drag along at the sluggish pace of the last few years. The most telling argument on the side of sluggishness is probably the tax increase. What is striking, though, is that despite the hefty tax hike, consumer spending continued to grow at the start of the year. Given the size of the tax increase, especially for lower-income workers – who generally need to rein in spending in the wake of a cut in income – the resiliency of the numbers suggests that some underlying strength in spending may be asserting itself.

"What is striking, though, is that despite the hefty tax hike, consumer spending continued to grow at the start of the year."

That's the national picture; what about New Jersey? We don't have detailed numbers on wealth and spending for the state comparable to the aggregate numbers for the nation as a whole. However, the Federal Reserve Bank of New York does track data from a private household credit rating firm on debt outstanding for households in a number of states and for the nation as a whole.

The Fed's latest figures suggest debt trends for New Jersey households have been broadly comparable to those for the nation at large. This indicates that the financial condition of Garden State households have, on average, been improving. This could bode well for spending, given the ongoing impetus from post-Sandy outlays on new cars and household furnishings to replace those destroyed by the storm. — *Charles Steindel*

New Jersey Business Pulse Survey

Optimism Starts to Translate into Action for New Jersey Businesses

The New Jersey Business Pulse survey asks respondents for their views on current and prospective economic conditions in New Jersey and the nation and also asks them for their views on other topics of their choice. Fifty-four firms responded to the March survey and fifty responded to the April survey. Detailed results from these and past surveys can be found at http://www.state.nj.us/treasury/economicsurveyresults.shtml. The website also contains charts and tables summarizing the results, as well as an explanation on how indices are constructed from the answers to the questions.

General Conditions Remain Strong

March survey responders reported moderate improvements in economic conditions in both the U.S. and New Jersey, while April was reported as largely unchanged. This can still be viewed as optimistic since the survey asks about changes from the prior month and the March conditions were viewed favorably. Moreover, in both months, businesses remained relatively upbeat about their expectations for future economic conditions for both the state and the nation with most respondents expecting higher revenues in the near future.

Optimism Transforms into Investments

For five straight months now business owners have been reporting that they expect conditions to improve in the near future. That optimism is now being put into action in the form of plans to expand capital investments both in New Jersey and outside of the state. April also marked the fifth month in a row that the consensus of responders said they planned to either expand employment moderately or keep payrolls stable. Of the companies that planned to increase employment in New Jersey, 63 percent said they are not having problems finding qualified candidates in the state.

Businesses Keeping Selling Prices Competitive

After only one month (January 2013) of firms reporting they had increased their prices, the overwhelming majority has once again stated that they have not charged more for their products or services despite paying more for input materials and services. This suggests that New Jersey businesses are striving to offer fair and competitive rates to their customers despite some cost price pressures.

Conclusion

The best news from these two months of survey results is that businesses are starting to move from an optimistic opinion of the future to an active role in positioning their companies to drive the economic growth that they anticipate. — *Joseph Mengedoth*

The New Jersey Business Pulse Survey has been created to look beyond conventional economic data and gather views in real time directly from a diverse group of businesses in the state. If your New Jersey firm is interested in participating in this monthly survey, please contact Mary Filipowicz at 609-633-6781.

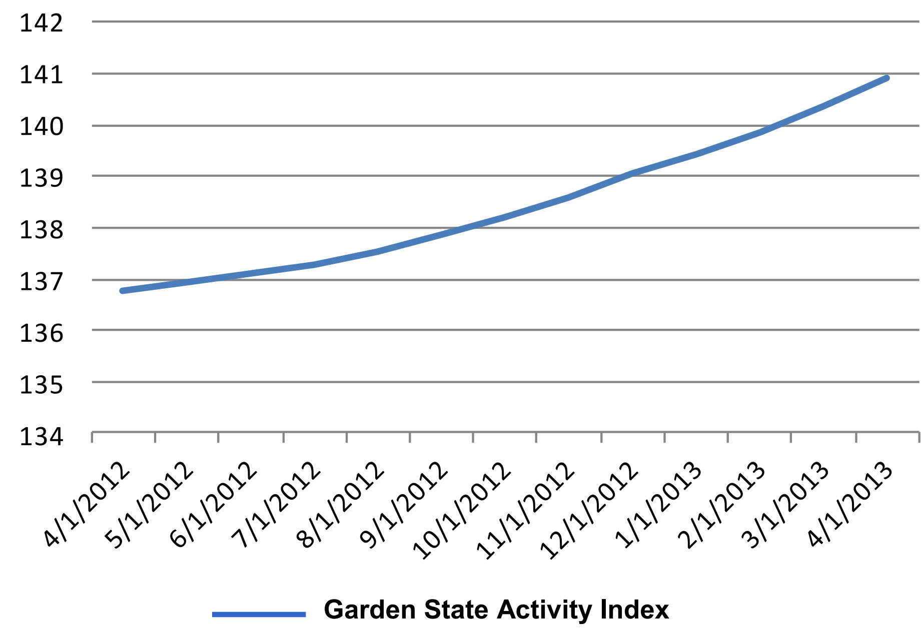
Garden State Activity Index

The Garden State Activity Index is our broad measure of monthly economic activity in the state of New Jersey. The index incorporates information from three sources: the Federal Reserve Bank of New York's coincident index, the Federal Reserve Bank of Philadelphia's coincident index, and the Philadelphia Fed's South Jersey Business Survey.

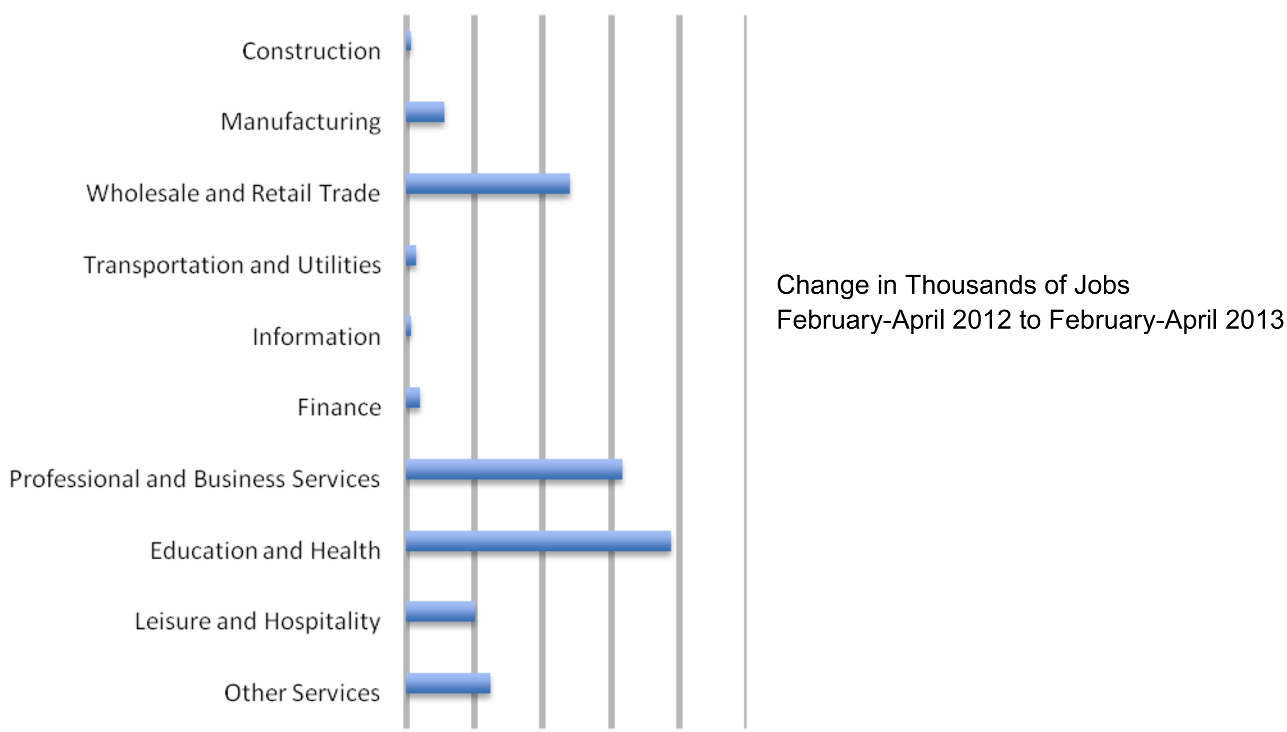
To construct the Activity Index we use principal components analysis, which takes a weighted average of the three Fed indicators. The composite index reflects the current state of the New Jersey economy.

Based on the most current monthly data, New Jersey's economic growth has gotten noticeably stronger over the past year. This past April, the state's economy reached an index level 3 percent higher than in April 2012.

— Andrew Lai

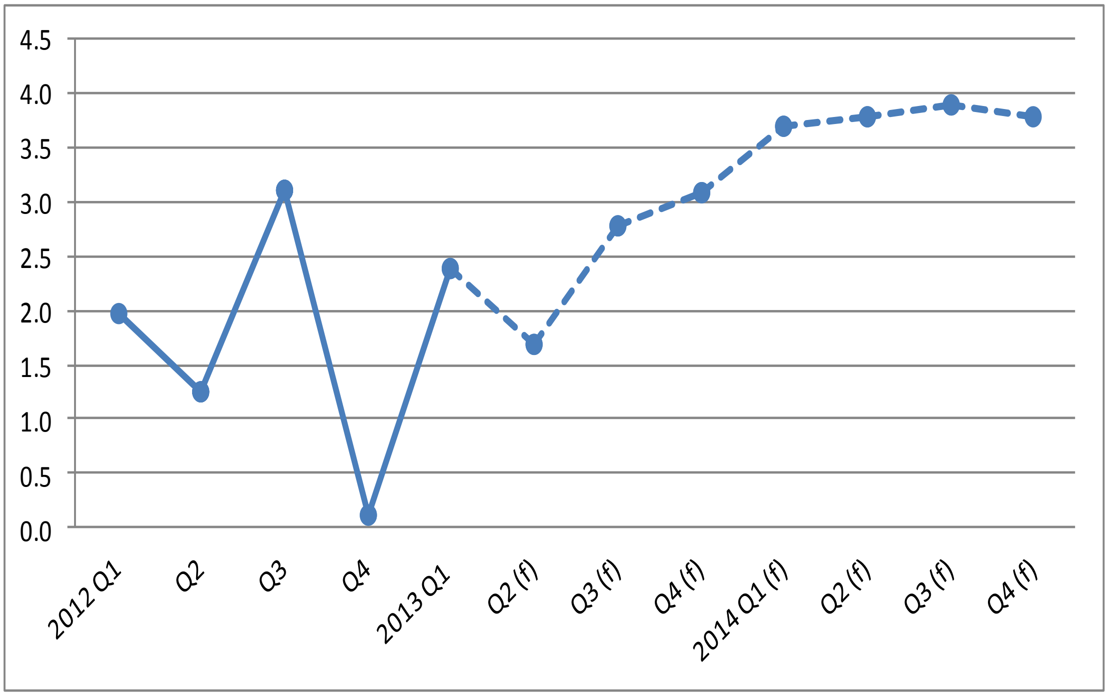


Private Industry Employment Trends



Data source: New Jersey Department of Labor

Real U.S. GDP Growth

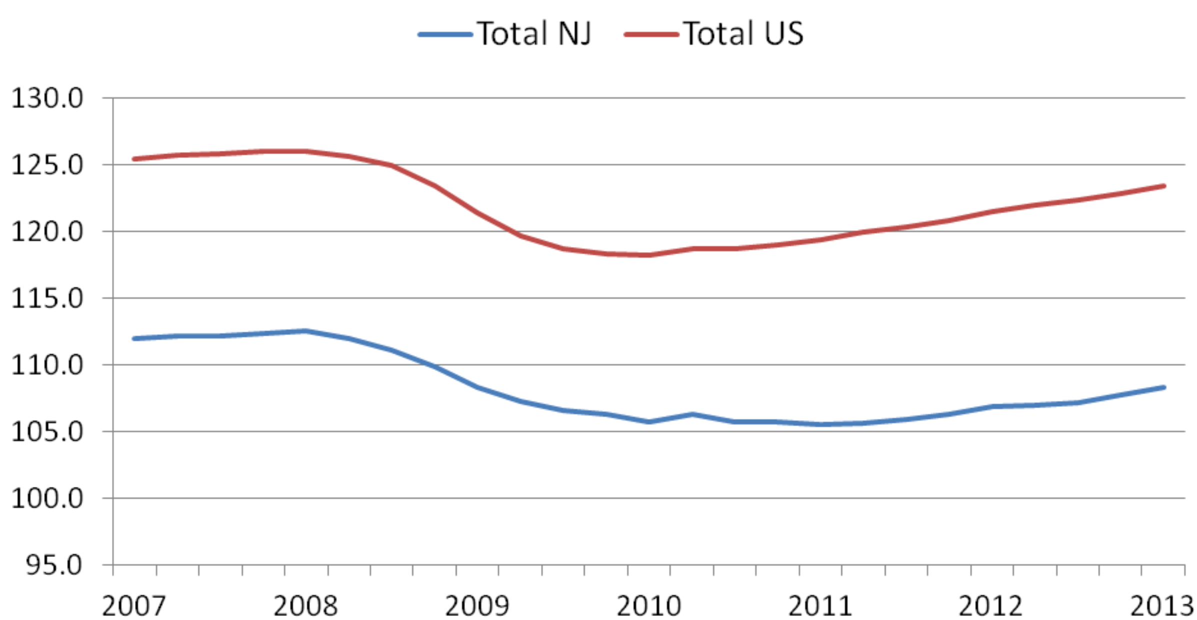


(f) - forecast
Data source: U.S. Bureau of Economic Analysis

State & National Job Trends

Total Employment *(Relative Employment 1990=100)*

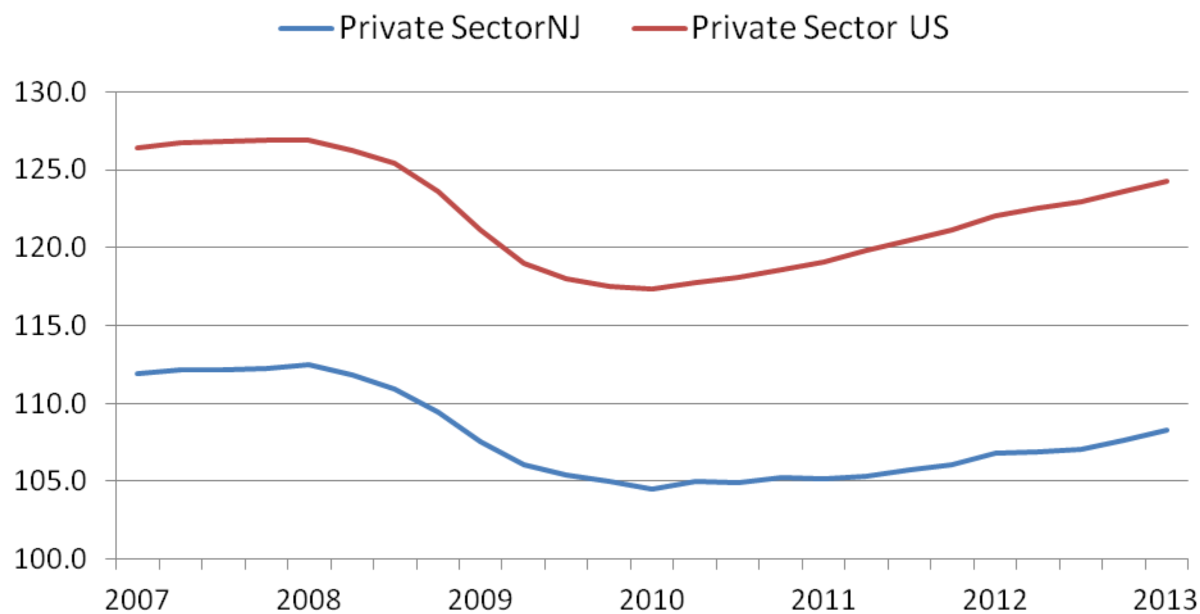
This chart compares the number of employed workers to the base year of 1990. The number 100 represents employment in 1990.



State & National Job Trends

Private Sector Jobs *(Relative Employment 1990=100)*

This chart compares the number of employed workers to the base year of 1990. The number 100 represents employment in 1990.



Data source: U.S. Bureau of Labor Statistics, New Jersey Department of Labor

Explanatory note: These charts track trends in total and private sector employment in New Jersey and compare them with those of the nation as whole measured against a 1990 baseline.

Disclaimer

This communication is for informational purposes only and is not an offer, solicitation or recommendation regarding the purchase of any security of the State of New Jersey or any governmental authority of the State of New Jersey. The views expressed herein are solely those of Dr. Steindel and do not necessarily represent the views of the State Treasurer or any other official of the State of New Jersey.