

New Jersey Economic Insights

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September 2013



Outlook New Jersey

New Jersey's Unemployment Rate Continues to Drop as National Indicators Stay Mixed

New Jersey

New Jersey's unemployment rate moved down in both July and August, with August's 8.5 percent rate the state's lowest since March 2009. From August 2012 to August 2013 New Jersey's unemployment rate fell 1.2 percentage points – the largest decline over 12 months since 1993. Growth in New Jersey's labor force has moderated since its rapid rise from the middle of 2011 through the end of 2012, but looking over the past year, the drop in unemployment reflects increases in the number of New Jerseyans working.

The state saw a drop of 10,700 jobs in July. August also saw a modest decline of 1,500. Job losses, of course, are unwelcome, though even with the recent drops the figures show solid gains over the last year. During the summer months, job counts are sometimes difficult to properly measure because of increases in temporary jobs. For example, before seasonal adjustment July's job change was actually a loss of 51,900, which the seasonal adjustment process – which normalizes the number to take account of calendar-related ups and down in hiring – pared to 10,700. In July 2012, though, the not-seasonally adjusted numbers showed the state losing 77,900 jobs, while the seasonally adjusted figures brought that down to 11,400. Thus, the seasonal adjustment process added 41,200 to

the state's job growth from June to July this year; for the same two months in 2012 the process added 66,300!

In other indicators of state activity, new car sales in July and August were strong. July purchases were more than 60 percent higher than the depressed level of July 2012, while August saw a gain of more than nine percent over fairly strong sales last year.

Homebuilding continues its strong recovery. The number of permits for new units granted in the state in August was more than double the August 2012 level. Much of the surge was related to a spike in multifamily permits in Hudson County, but there was also a substantial increase in statewide single family permits.

The September survey of area manufacturers from the Federal

Reserve Bank of Philadelphia was also quite robust. Delaware Valley manufacturers reported their most positive readings on current conditions since March 2011, while their view of conditions six months from now reached a ten-year high. Both the Philadelphia and New York Reserve Banks also reported that over the twelve months ending in August their measures of New Jersey economic activity showed the largest increases since 2000.

- *New Jersey's unemployment rate has dropped to a multi-year low.*
- *Confusion over Federal Reserve policy and leadership has baffled markets, but national economic expansion continues.*

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U.S. Economic Outlook

The Federal Reserve has dominated much of the national economic dialogue. First, on Sept. 15, former Treasury Secretary Lawrence Summers sent a note to the President stating that he wished to have his name withdrawn from consideration as successor to Chairman Bernanke (whose term expires Jan. 31, 2014, and who is widely expected to step down). This has led to the general expectation that Janet Yellen, Vice-Chair of the Federal Reserve Board, will be nominated to the Chairmanship, perhaps in the very near future. There has been all sorts of speculation about the relative strengths and weaknesses of Summers and Yellen, and their policy views. The reality is that both are very experienced public servants and highly-regarded economists, whose policy views have enormous overlap.

Perhaps more substantively, on Sept. 18, the Fed's policy announcement, contrary to widespread expectations, did not begin the process of "tapering" the scale of monthly security purchases. Statements earlier in the year had suggested that the process could well begin as early as September. The announcement, and further statements by Bernanke at a press conference, showed that the Fed is still concerned about weakness in the national labor market and is worried about the potential negative influence on the economy of the upward movement in long-term interest rates. They also showed that it was concerned about the implications of the sequester and the federal budget stalemate, and saw inflation as very well-contained. Under those circumstances it seemed wiser to delay the start of the "tapering" process. The news reinforced a recent rally in the stock market and sent some major indexes back up to all-time highs.

The state of the national economy continues to be a bit choppy. Job growth has been somewhat less than earlier in the year (indeed, to put New Jersey's recent figures in some context, only eight states saw any gains in jobs in August), though the unemployment rate has continued to move down. Housing starts and sales have been somewhat erratic; despite widespread talk there isn't any real solid sign that recent increases in mortgage rates have had

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substantial negative effects. But at the same time there hasn't been rapid growth. In contrast, ongoing growth in car sales has kept consumer spending on the upswing, and manufacturing production rose sharply in August after a sluggish spell. This somewhat muddled picture likely played an important role in staying the Fed's hand. In cold, hard reality, reducing the Fed's monthly security purchases from \$85 billion to something a bit smaller really doesn't mean much. The fear was clearly that the action would raise the perception the Fed had started down the an irreversible path toward actually raising short-term interest rates. Until the Fed is more certain about the underlying economic trend, it will be somewhat hesitant to take any actual steps like this.

— *Charles Steindel*

Feature Story

The Federal Reserve and New Jersey: A Deep and Rich Connection

The Federal Reserve System is in the midst of commemorating its centennial (the Federal Reserve Act was enacted in 1913; the System began operations in 1914) and so a look back at some of its New Jersey roots seems to be in order.

While on the surface, the Fed's contacts with New Jersey are seemingly no greater than for any of the other states that lack the presence of either a headquarters of a regional Federal Reserve Bank or branch, when we probe a little further New Jersey's connections with the Fed turn out to be deep and rich.

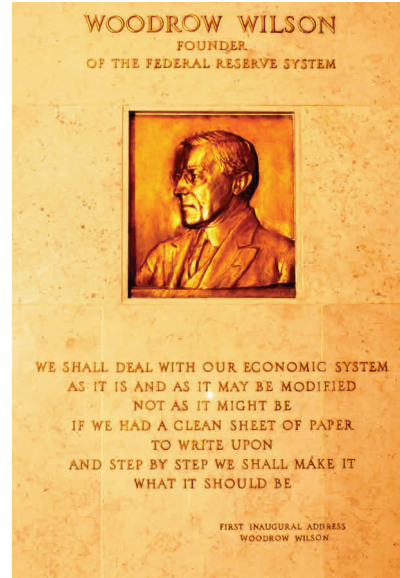
It all goes back to the beginning. Without Woodrow Wilson, we probably would not have the Federal Reserve System today. He was a strong backer of creating an institution intended to end the periodic financial panics

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that had long plagued the U.S. and worked on the details of the Federal Reserve Act with Representative Carter Glass, the Virginia Democrat who was the main sponsor of the bill in Congress. In fact, some of the final details of the Act are believed to have been agreed upon right here in New Jersey, at a meeting in the winter of 1912-13 at Wilson's home in Princeton, while he was President-elect.



Woodrow Wilson monuments can be found at the State House in Trenton and at the Federal Reserve Building in Washington, D.C.



Wilson later signed the act into law and named the first members of the Federal Reserve Board, the body that oversees the Federal Reserve System. Today, two important government buildings in the U.S. house memorials to Wilson: the New Jersey State House in Trenton, where he served as Governor from 1910 to 1912, and the Federal Reserve Building in

Washington. Along with Wilson, another person with close ties to the Garden State who made a major contribution to the Fed in its early days was Benjamin Strong, the first chief executive of the Federal Reserve Bank of New York. Strong, who had been president of Bankers Trust and a key lieutenant of legendary financier J.P. Morgan before joining the Fed, is universally acknowledged to have been the most important official in the Fed's first decade (the recent Pulitzer-prize winning book, *The Lords of Finance*, by Liaquat Ahamed, goes into depth about Strong and some of his European colleagues). But what is not as well-known about Strong is that he was a graduate of Montclair High.

Strong was followed by a series of other key Federal Reserve leaders with intimate ties to New Jersey. Arthur Burns, who served as the Fed Chair from 1970 to 1978, began his career teaching economics at Rutgers. Princeton Economics Professor Alan Blinder served as Vice Chair from 1994 to 1996. Of course, Ben Bernanke chaired Princeton's economics department years before he became Fed Chair – and, as a veteran of the

Montgomery Township School Board, he is the only New Jersey elected official who has gone on to lead the Fed. Perhaps the definitive “Jersey Guy” to head the Fed was Paul Volcker, Fed Chair from 1979 to 1987 and to this day looked upon as the elder statesman of U.S. economic and financial policy. Volcker, in many people’s eyes the greatest of all Fed leaders, was born in Cape May and raised in Teaneck. Unfortunately, neither Janet Yellen or Donald Kohn – with Lawrence Summers’ withdrawing from consideration, the most likely candidates to succeed Bernanke – have any particular New Jersey connections (though they are both regional neighbors – Kohn was raised in Philadelphia and Yellen in Brooklyn).

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New Jerseyans also have played a major role in analyzing the Fed. Rahway’s Milton Friedman was the most famous of this group. The tradition continues to this day: Christopher Sims, a Nobel-Prize winning economics professor at Princeton University, takes a highly technical approach to analyzing the effects of Fed policy on the broader economy. Michael Bordo and Eugene White of Rutgers’ economics department are both leading scholars of the history of the Fed. New Jersey is also home to many, many, private-sector “Fed watchers” who analyze and predict what the institution is or will be doing.

Finally, New Jersey high schools and colleges traditionally have been active participants in annual Federal Reserve competitions that test their knowledge of the economy and the Federal Reserve System. Teams from New Jersey schools have often won the New York district championships over teams from New York, and several times have won national titles at competitions at the Federal Reserve Board in Washington.

While New Jersey does not have any official Federal Reserve Banks or branches, the Federal Reserve Bank of New York has long had major operations centers in the

northern part of the state, handling practical tasks such as cash storage and disbursement as well as check clearance. The current site is in East Rutherford. Also, the unit that administers employee benefits for the entire Federal Reserve System is located in Newark. So there are, indeed, Federal Reserve employees working in the state. However, they are outnumbered by the hundreds of New York and Philadelphia Fed employees who live in New Jersey and commute to work across the Hudson and Delaware Rivers.

Aside from these personal and business relationships, what does the Fed do for New Jersey and the rest of the nation? Much of its work involves keeping the financial system functioning on a daily basis: overseeing, or actually carrying out, operations such as check clearing and other transactions between banks, distributing currency to banks, destroying worn-out currency, and administering auctions of Treasury debt. It’s a little hard to envision how the economy of New Jersey or any other state would function without some authority setting the standards and working out the details of such operations.

The other, higher profile, aspects of the Fed attract controversy. It is a key regulator of banks and other financial institutions. It has been criticized, along with the rest of the regulatory community, for its actions prior to the 2008 financial crisis. A lot of the special focus on and criticism of the Fed comes from its unique ability to lend essentially unlimited amounts of money to firms deemed sufficiently troubled and critical. And, of course, the Fed has the ability to exert enormous influence on the overall economy by setting short-term interest rates at whatever level above zero they desire, and by further communicating both where they think the economy is heading and where they think short-term rates might be set in the future. There is always great debate about the wisdom of the Fed’s choices in this latter area.

Some say the Fed should look only at “money supply” figures to guide its policy. This was one of Milton Friedman’s themes, but most scholars think that changes in the financial system now make measures of the

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money supply very poor guideposts. Others think the Fed should only focus on the inflation outlook and ignore unemployment numbers; while a few think the Fed should peg the price of gold. Still others question the unusual public-private structure of the system, where government officials (the Board) and the heads of the technically private regional Federal Reserve banks meet to determine policy. However, the operations of the regional banks are closely overseen by the Board, which also approves their budgets.

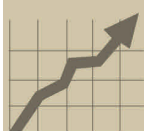
The recent furors over the Fed's decision not to "taper", or reduce the rate, of its purchases of government bonds, and the possibility that former Treasury Secretary Summers would be nominated to succeed Chairman Bernanke, show the passionate interest many have in the institution. In reality, the Fed is not all-powerful: it can't control the economy by itself, and there are many other institutions with a major role in regulating the financial markets. The Fed's true

uniqueness is that its decision-making bodies – the Board of Governors, and the Federal Open Market Committee, consisting of the Board and a rotating group of Reserve Bank Presidents – are relatively small and insulated from the partisan political process.

Thus, the Fed can act strongly and decisively when need be. When times are good (such as in the 1920s and 1990s) the Fed gets praised; when times are troubled (such as in the 1970s and in recent years) it can draw fire.

How the Fed will negotiate its next century remains to be seen but it has already had a major influence on New Jersey and New Jerseyans have had a major influence on the Fed.

— *Charles Steindel*



New Jersey Business Pulse Survey

July and August Survey Results Show Modest Improvement

The New Jersey Business Pulse survey includes 14 questions about current and perspective conditions in New Jersey and the nation and allows respondents to give their views on other topics of their choice. Thirty-eight firms responded to the July survey and thirty-nine responded to the August 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.

Current and Expected Business Conditions

In both July and August, survey responders reported seeing modest improvement in business conditions in New Jersey and the nation in general. Expectations for conditions in the near future also remained at an optimistic level, but slightly less than reported in June. The majority of business owners also remain positive about expected revenues, especially in New Jersey. In fact, some responders who said they were seeing a weakening business climate also reported that they expect to have revenue gains in the near future.

Employment and Capital Investments

In July's survey, business owners expressed plans to increase hiring both within and outside of New Jersey, whereas in August they reported unchanged levels of employment in the state, but noted that they still plan to increase staff outside of New Jersey. Of the responses that indicated plans to hire in New Jersey, the majority also stated that they were not having problems finding qualified candidates to fill slots. This continues the 11-month trend of New Jersey's labor force being considered capable of filling the positions available in the state.

Reports of short-term capital expenditures were mixed over the two months with July's survey producing the second-highest index of plans to increase spending in the state and the highest-ever index of plans to increase spending outside New Jersey. However, in August, these indexes receded to a status of unchanged spending outside of the state and plans to cut spending in New Jersey.

Prices

After an indication in May that businesses had recently increased the selling prices of their goods and/or services, the last three months have shown a strong reluctance to increase prices despite increased input prices. Every survey in the last year has reported that firms have been paying more for the products or services that they use but the majority of respondents have only stated that they had to raise their prices twice – in January and May of 2013.

Conclusion

Firms over the last two months have remained largely optimistic about current and near future business climates and revenue expectations, with some planning to increase employment levels. In general, firms report plans to keep prices unchanged despite increased input costs.

— *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.

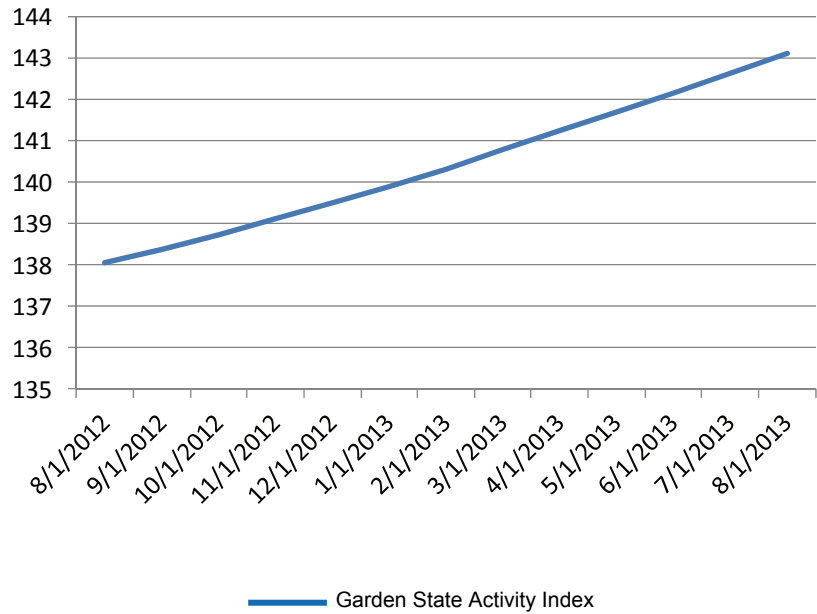
Garden State Activity Index

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.

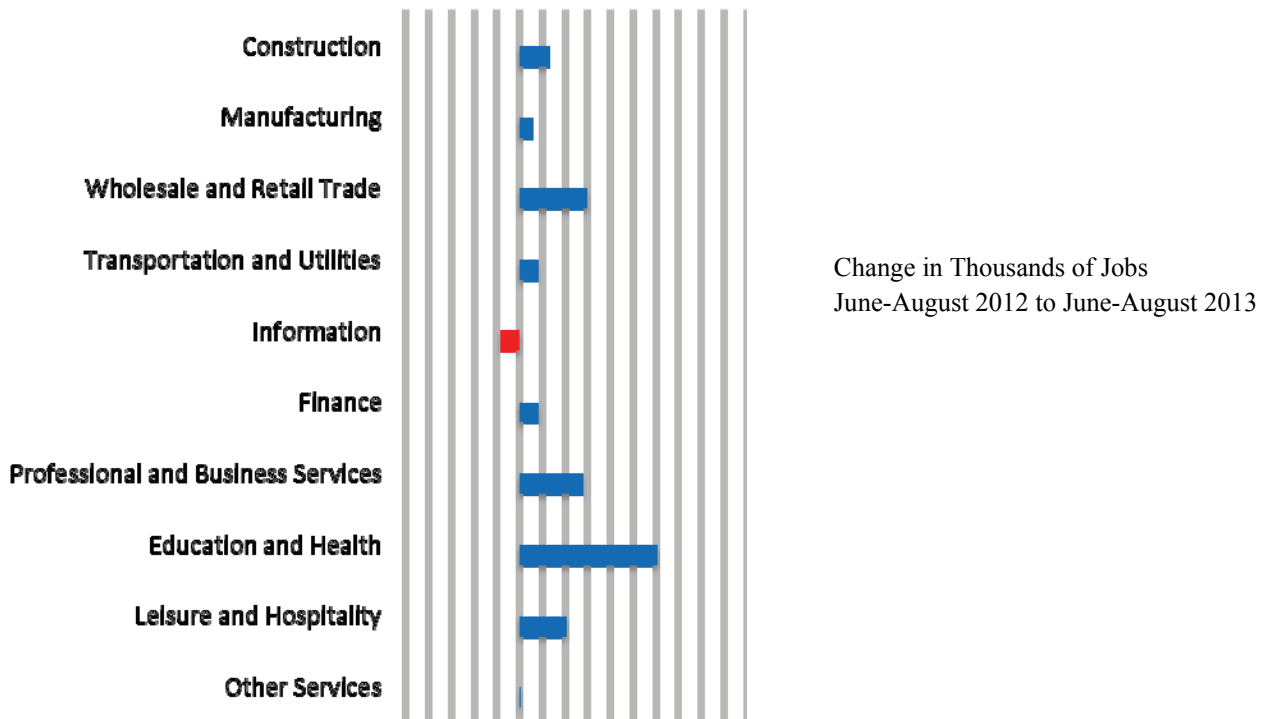
To construct the *Activity Index* we use principal components analysis, which takes a weighted average of the three Fed indicators. The composite index reflects the current state of the New Jersey economy.

Based on the most current monthly data, New Jersey's economy is beginning to grow at an accelerated pace compared to the past twelve months. The revised index now shows that New Jersey has sustained an accelerated rate of growth from a 2.5 percent year over year index change in February 2013 that has steadily increased to the current rate of 3.6 percent in August.

— Joseph Mengedoth

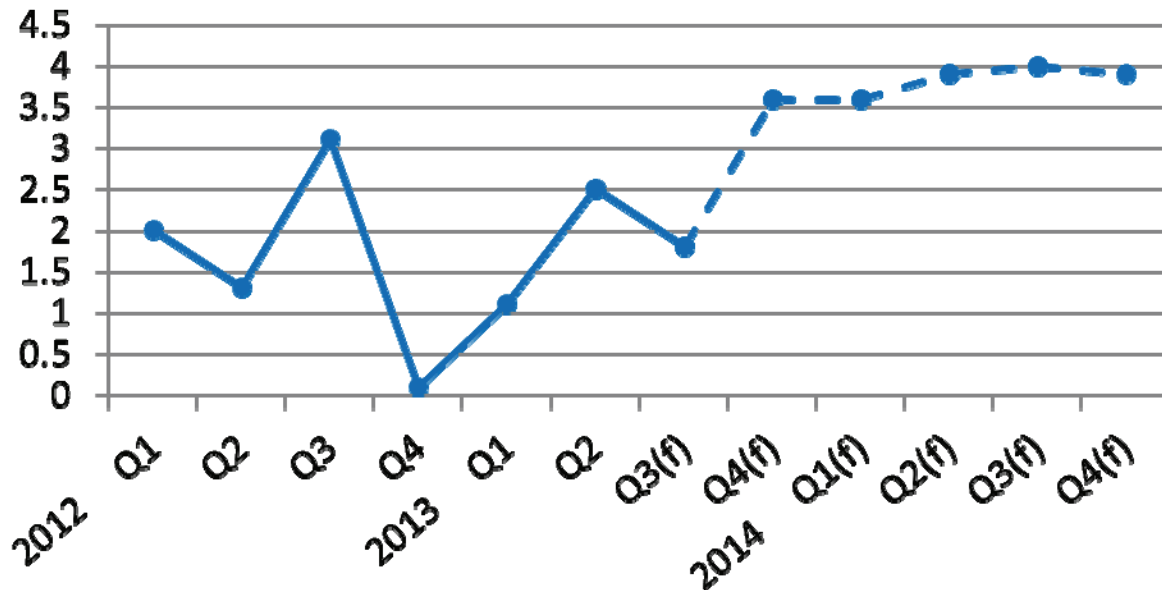


Private Industry Employment Trends



Data source: New Jersey Department of Labor

Real U.S. GDP Growth



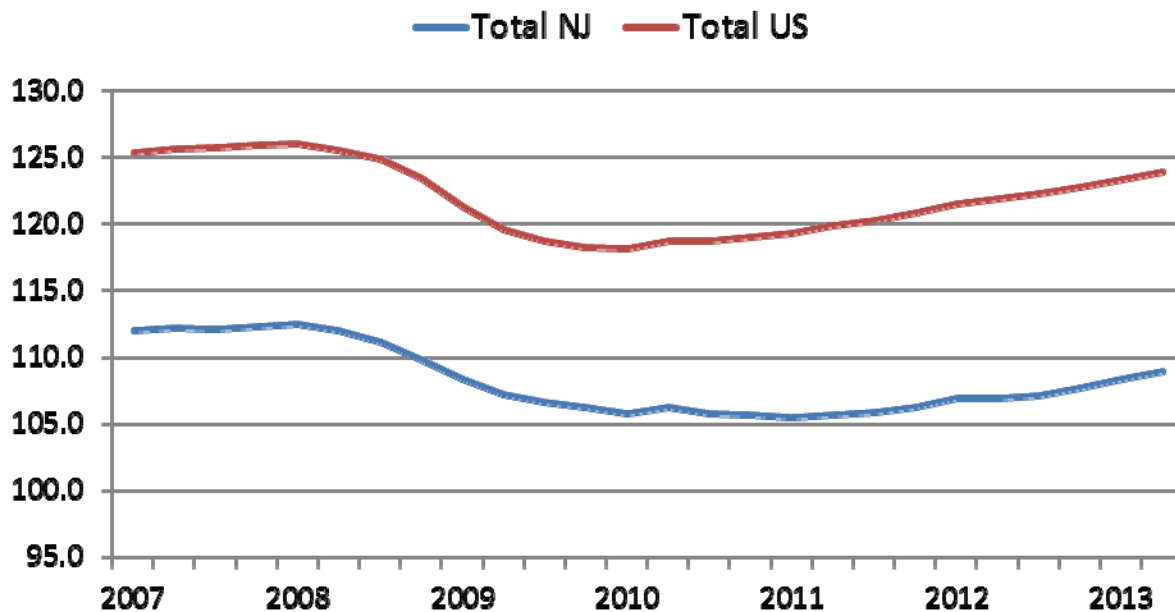
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Data source: U.S. Bureau of Economic Analysis

State & National Job Trends

Total Employment (Relative Employment 1990=100)

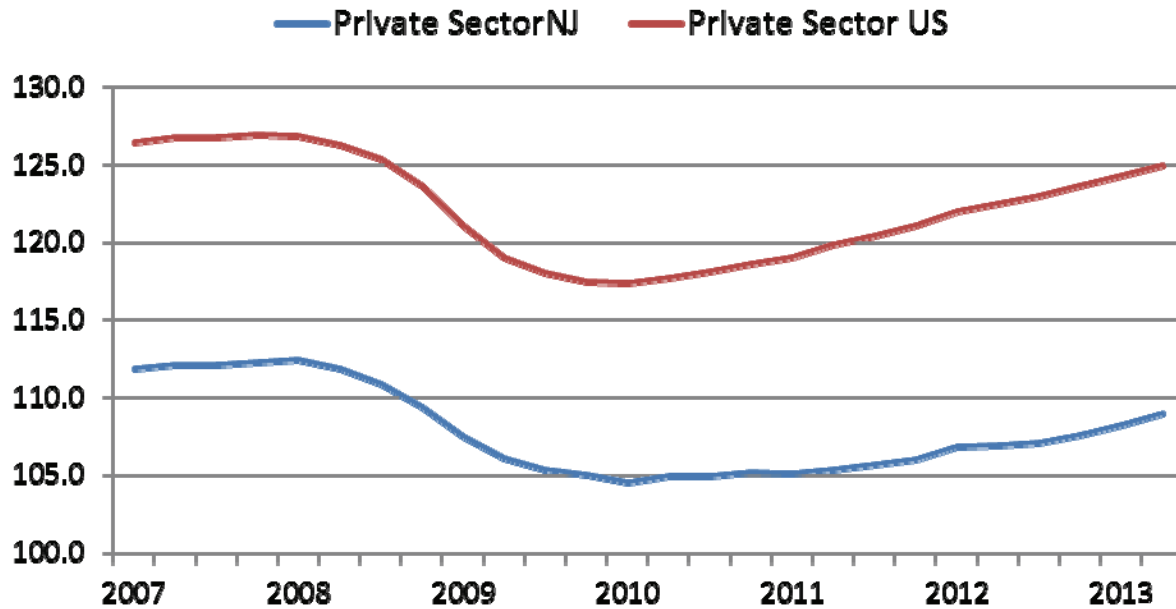
This chart compares the number of employed workers to the base year of 1990. The number 100 represents employment in 1990.



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.