New Jersey Economic Insights

Dr. Charles Steindel
Chief Economist
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Outlook New Jersey

Hard Numbers Hold Steady As Surveys Show Dip in Confidence

New Jersey

Our unemployment rate remained stuck at 9.5 percent in July. The numbers on private sector jobs, though, continue to show a good amount of forward momentum. Private payrolls increased by 3,900, bringing the total gain since January to 47,800. Our 1.5 percent gain over the last six months exceeds the 1 percent for the nation as a whole. We have also done somewhat better than our neighbors: New York posted a 1.3 percent gain since January, while Pennsylvania added 1 percent.

The July increase in private jobs was led, somewhat unusually, by gains in manufacturing and construction. Service sector jobs, the mainstay of New Jersey's economy, were little changed. Welcome as the increase in blue-collar jobs was, it's unlikely to persist. This is especially so in construction, where the fundamental conditions for homebuilding remain battered. (Rebuilding the damage from Hurricane Irene could help the construction sector in the short run. But on the whole, the impact of the storm on the state's economy should be much more modest than the news coverage suggests.) Nevertheless, even though these details can change radically from one month to the next they do not take away from the big picture that, at least through July, the state's job count was on a noticeable uptrend. Indeed, we have passed an important milestone. The July — and the revised June — aggregate job count, public and private, was higher than that of a year ago. Private sector job gains are now more than offsetting public sector cuts. The result is that for the first time in over three years the state is seeing job growth over a 12 month horizon.

The job numbers were for July. But with the astonishing turbulence in the financial markets we have seen in August, there is understandable worry about what the numbers will show for the period since then. Through mid-August, the state had not seen the sort of surge in new claims for unemployment insurance that would be associated with a massive round of new layoffs. The claims series did move up somewhat, but that appears to have largely reflected the effects of the brief strike at Verizon. Anecdotal evidence, though, from recent surveys of business sentiment, reveals considerable concerns. Our survey of New Jersey firms (see page 5) showed a considerable increase in fears about the future in August — though more of that is focused on events outside the state and less on the respondent firms' own outlook. The Federal Reserve Bank of Philadelphia's local manufacturing index for August plunged to a level typically connected to the onset of a recession. However, given that, as best as we can determine, hard conditions do not show this sort of sudden deterioration, we do not think the state's economy has gotten measurably worse in the last month. But we agree that there is heightened uncertainty about the future and that conditions may worsen.

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U.S. Economic Outlook

Financial markets have been in considerable turmoil and there has been fear that this is a sign that the economy

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will soon worsen. Indeed there have recently been some lackluster U.S. economic numbers — most notably the sluggish GDP figures.

As is the case in New Jersey, the recent numbers on the national economy look better than the financial markets imply or the surveys suggest. Retail sales and industrial production rose smartly in July and durable goods orders ramped up. New claims for unemployment insurance changed little in the first half of August. Admittedly, the estimate of real GDP growth for the quarter was reduced from a soft 1.3 percent to a very anemic 1 percent annual rate. But the details show the revision was mostly the result of less inventory accumulation than earlier thought.

The hard numbers on household and business spending and personal incomes were revised up and the first estimate of corporate profits showed robust gains. All this information points to a rebound in economic growth in the second half of 2011 — perhaps not as marked as earlier expected, but still likely.

The chaos we have seen in financial markets looks to mostly reflect concern over the policy stalemate in Washington and great uncertainty over national economic policy going into the 2012 election and after. Worries over the possibility of defaults or restructuring of European sovereign debt have also undoubtedly been a factor. While our soft economic recovery now looks even softer than earlier thought, the basic U.S. economic situation does not seem to have radically worsened.

However, various survey measures have indeed plunged. The drop in the Philadelphia Fed survey is particularly worrisome, since this index has a long and reasonably good record of tracking the national economy. The Richmond Federal Reserve Bank's manufacturing index also fell sharply in August and the Michigan survey of consumer sentiment dropped to its lowest point in nearly 30 years. We can't dismiss these moves out of hand but given the other harder numbers there's a good chance that large parts of these declines may be gut reactions to the moves in financial markets. In the fall of 1998 many survey measures dropped abruptly as financial markets were roiled in the wake of the Russian default and the near collapse of the huge Long Term Capital Management hedge fund. Those events quickly faded, the markets recovered and the economy stayed on track. In 2008, of course, financial market turmoil was fully reflected in the real economy — in part because the damage to the financial system resulted in the abrupt withdrawal of credit to the households and businesses. We don't see this sort of damage occurring at this time.

Chairman Bernanke's recent "Jackson Hole" speech suggests that the Federal Reserve remains reasonably optimistic that economic growth will continue. He indicated that the Fed is not likely to rush into another large round of bond purchases, though it is still on the table. The Fed, though, is far from satisfied about the economy. Bernanke specifically noted that prolonged high unemployment can create lasting damage. He suggested that fiscal expansion — meaning increased government spending or tax cuts — might be helpful now and could be done without jeopardizing longer-term reductions in federal debt. He also noted his concern about how poorly served we are by the current budget process. It is unusual for a Federal Reserve Chairman to speak out on topics such as this — suggesting the urgency of the problem.

Debt Overhangs in New Jersey and the Nation

The nation and the world continue to grapple with the debt overhang that was created in the years before 2008. During 2008's financial crisis banks lost their willingness and ability to lend. This was because of losses on previous loans — most notably in the form of subprime mortgages— as well as increased fears that borrowers would not be able to repay. Loan losses shrank the capital base of banks, reducing their ability to lend. The credit contraction that followed triggered massive cutbacks by firms, households and governments dependent on borrowing and intensified the already ongoing recession.

Many borrowers are still coping with the burdens of this old debt — a debt is still owed until it is repaid, forgiven by the lender, or discharged by a formal legal process such as bankruptcy or foreclosure[1]. It is often claimed that credit will not be restored and a full economic recovery will not be possible until all these debt overhangs are gone.

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So how much progress has been made in reducing debt overhangs, in the nation at large and here in New Jersey? The good news is that there has indeed been progress and there are signs that credit logjams are being reduced. The big exception may be housing finance.

Debt should be measured relative to the ability to repay and a good summary measure of the ability of U.S. households, businesses and governments to repay debt is the ratio of debt to gross domestic product (GDP). GDP is an estimate of the dollar value of everything produced in the U.S. The higher GDP is relative to debt, the greater the capacity of households, businesses, and governments to borrow.

Numbers compiled by the Federal Reserve show that the aggregate debt owed by the U.S. nonfinancial entities — households, governments, and nonfinancial businesses — was over $36 trillion at the end of the first quarter. That was nearly 2.5 times as high as U.S. GDP. In 2000, by contrast, nonfinancial debt was about 1.8 times as large as GDP. If we think the economy will not be in "balance" until the debt to GDP ratio is back down to its 2000 level we have a terribly long and hard way to go. Attempts to quickly repay debt will necessarily be associated with cutbacks in spending, thus driving down GDP and working to slow or even reverse any decline in the ratio of debt to GDP. This is a form of what is called "the paradox of thrift" — attempts by a nation to save more do not necessarily result in higher wealth and income, at least in the short run.

This glum perspective, though, assumes that all debt is equally important in depressing spending. That is just not the case. Private borrowers — especially households — face much sharper near-term constraints from debt than the federal government. It is their spending that has been curtailed by the debts accumulated since 2000.

But when we look at households alone we see an improving picture. The ratio of household debt to after-tax household income peaked at around 130 percent in 2007, up more than 40 percentage points over the prior decade. Since then, we have seen a pronounced decline. In the first quarter of 2011 the debt to income ratio was around 116 percent. In other words, about a third of the run-up has already been reversed. If income growth improves as projected, and borrowing remains modest, the ratio will continue to steadily move down.

This improvement (the jargon is "deleveraging") in aggregate household finances has prompted lenders to loosen their purse strings a bit. The Federal Reserve regularly surveys banks about their lending standards. The most recent report, reflecting conditions in July, suggests that outside of mortgages, banks have been easing their conditions for making loans. Potential borrowers may

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have a different viewpoint. Many news accounts say it is still tough to get a loan approved. In the "new normal" in financial markets baseline conditions and requirements for lending are more stringent than in the past and an easing of conditions relative to this baseline could still leave credit tighter than borrowers had been accustomed to. Nonetheless, there does seem to be ongoing improvement in credit conditions which should help support the expansion.

Of course, the federal government continues to accumulate debt at what many see as an alarming rate. A widely held view is that the recent buildup in federal debt has been primarily a consequence of the government's efforts to stabilize economic activity and restore growth. One way to look at this is to conclude that federal debt creation has taken the place of private debt creation as a means of financing activity. The current heated disputes about federal debt — stepping aside from ideological debates on the long-term role of government — hinge on whether the federal government is moving rapidly and decisively enough to normalize its finances. The fundamental points at issue involve assessments of the underlying strength of the economy over the next few years and projections of the longer-term trajectory of federal spending on programs such as Social Security, Medicare, and Medicaid.

Turning now to the local situation, the New York Federal Reserve Bank recently issued a report on household credit conditions that included data on New Jersey. The numbers were derived from information held by Equifax, the large credit-rating company. The figures showed that, on average, New Jersey residents with debt owed $61,000 at the end of the second quarter. That's noticeably higher than the national average of $47,000, but we should recall that New Jerseyans typically have higher income than the national average and should thus be able to carry more debt. About 90 percent of the debt owed by New Jersey residents is current. That's more or less equal to the national average and well above states such as Nevada. Generally, movements in debt owed by New Jerseyans have been in synch with those of the nation, suggesting some moderate improvement in credit conditions.

State averages, though, can also hide major concerns. In the first quarter, 8 percent of all home mortgages in New Jersey were in foreclosure[2] — one of the highest rates in the nation. Resolution of the foreclosure situation will be a major step in improving conditions in the state's housing market as well as in the nation as a whole. Fortunately, other aspects of the credit market seem to be improving. The debt burden is not gone, but it may be easing.

1. Lenders often "write-off" nonperforming loans from their balance sheets, but by itself a write-off does not extinguish a borrower's obligation to repay.

*2. This number does **not** mean that 8 percent of New Jersey families are dealing with foreclosure. The fraction only applies to mortgages. Roughly half the state's households rent or own their homes free and clear while others have mortgages on multiple properties or multiple mortgages on one property.*

New Jersey Business Pulse Survey

Local Outlook Is Stable but Worries Grow over Broader Economy

New Jersey businesses became noticeably more pessimistic about general economic conditions and the outlook in August though they remain fairly upbeat about their own firms' future. These findings come from a survey administered by the New Jersey Department of the Treasury.

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. Responses to the August survey were made by about 100 firms spanning a wide spectrum of industries and sizes. The survey was done throughout the month of August and included 14 questions about current and prospective conditions and also allowed respondents to give their views on other topics of their choice. Detailed results may be found at August Business Pulse Results.

General Conditions: Current Situation and Outlook Are Worrisome

Roughly half the respondents see U.S. and global economic conditions as currently deteriorating while only about one-tenth see current improvement. This is a notable change from July's survey when a much higher portion — roughly a fifth — reported that current conditions were improving. The general outlook is also rather bleak with a bit less than half seeing that deterioration continuing over the next year and only about a fifth anticipating improvement. In July, by contrast, a majority of respondents were expecting conditions to improve next year. Results for general conditions inside New Jersey were comparable to July's, but interestingly, a bit less on the gloomy side — about one in eight respondents reported that conditions have been improving and the fraction expecting conditions to worsen in the state was somewhat smaller than that with a negative national and global outlook.

Revenues, Hiring and Capital Spending: Modest Changes or Improvement Anticipated

In contrast to their expressed assessments and outlooks for general conditions and revenues, firms are sanguine about the outlook for their own companies. And on balance they expect their revenues outside New Jersey to rise. Three-fourths of respondents expect no change in their payrolls — either inside or outside of New Jersey — and two-thirds expect capital spending levels to be sustained.

Product Prices Moderating, Input Cost Growth Cooling Slightly

Roughly one-fourth of the respondents report that they have recently increased prices; this is a smaller fraction than in the past few surveys. On the input cost side, about three-fourths agreed that costs have recent risen. This global fraction is comparable to those reported in June and July. But the fraction of respondents who strongly agree that input costs have risen fell to about one-fifth suggesting input price hikes are becoming either more limited or less steep.

Conclusion

The divergence between assessments of internal and external situation looks striking. Respondents report bleak views on current and perspective general conditions; but when it comes to their own firms, they were more upbeat. One explanation for the divergence could be that the bad news simply has not yet directly affected a lot of firms; in that case assessments of internal firm conditions should worsen. More optimistically, the general conditions responses could be influenced by the recent financial market turbulence and the very dire news accounts — so responses may have been at least partly based on these, rather than independent assessments.

If your New Jersey firm is interested in participating in this monthly survey, please contact Mary Filipowicz at 609-633-6781.

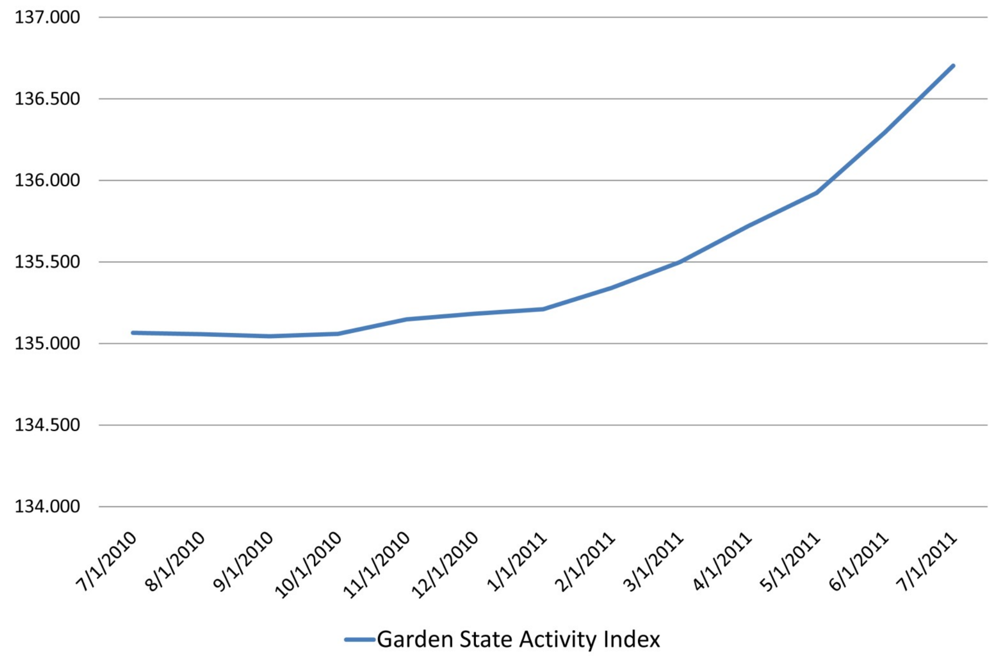
Charles Steindel

Garden State Activity Index

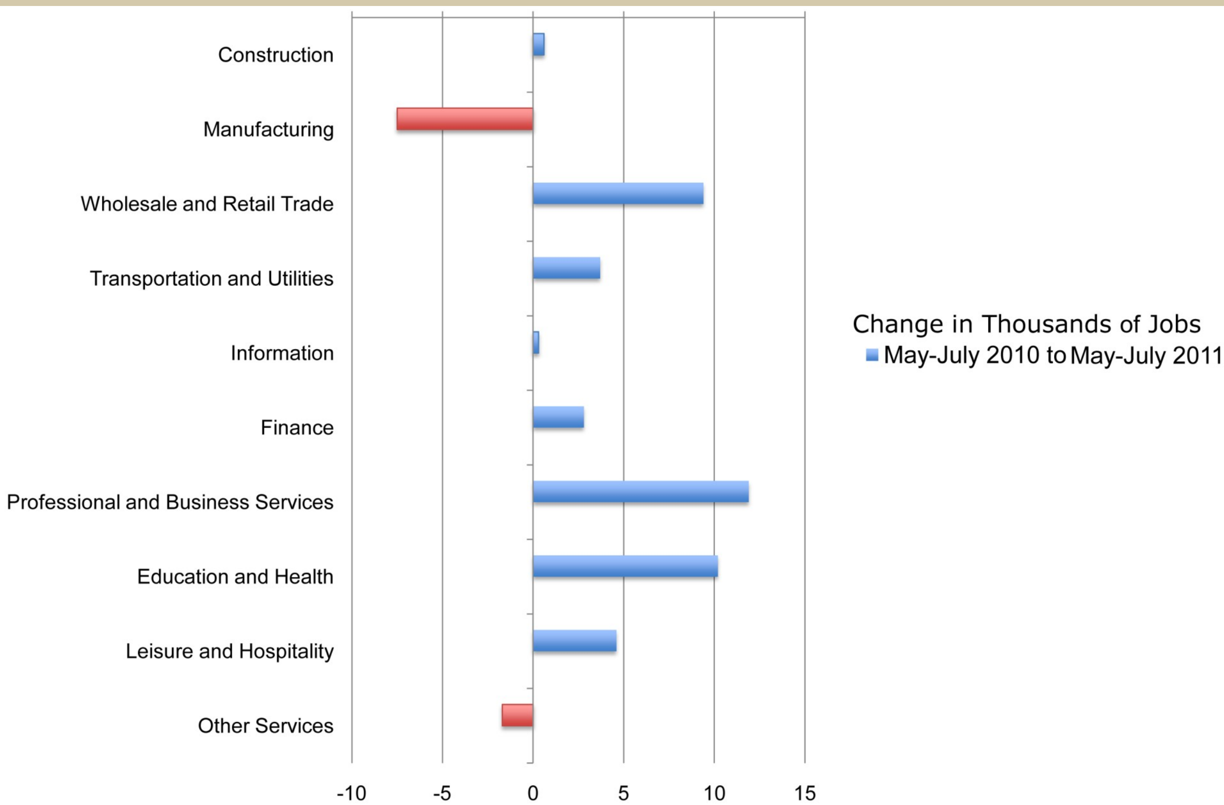
The *Garden State Activity Index* is our broad measure of monthly economic activity in the state of New Jersey. The index incorporates information from three sources: the Federal Reserve Bank of New York's coincident index, the Federal Reserve Bank of Philadelphia's coincident index, and the Philadelphia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

In our previous August 2011 newsletter, we began using principal components analysis to calculate our activity index. This statistical technique systemically constructs weighted averages of the three Fed indicators. The new weighted index should more accurately capture the state of the Garden State's economy.

Based on the latest data, the New Jersey economy continues to grow at a moderate pace. In July, it reached an index level **1.2 percent higher** than the level in July 2010.

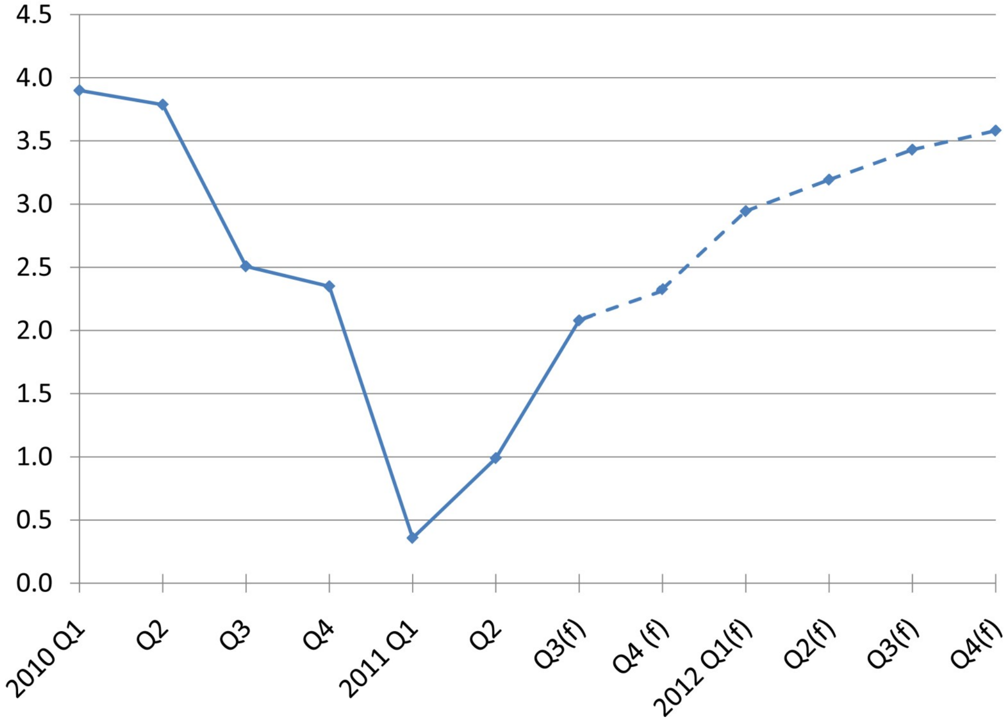


Private Industry Employment Trends



Data source: New Jersey Department of Labor

Real U.S. GDP Growth *(Percent change, compound annual rate)*



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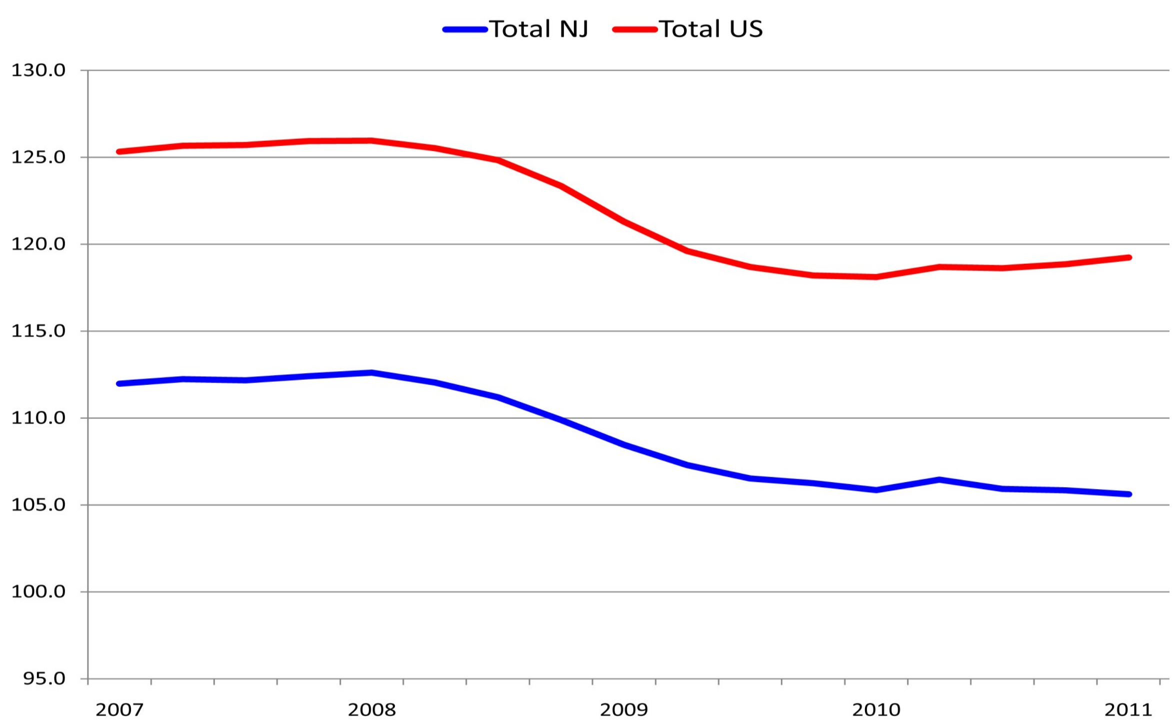
Data source: U.S. Bureau of Economic Analysis

State & National Job Trends

Total Employment *(Relative Employment 1990=100)*

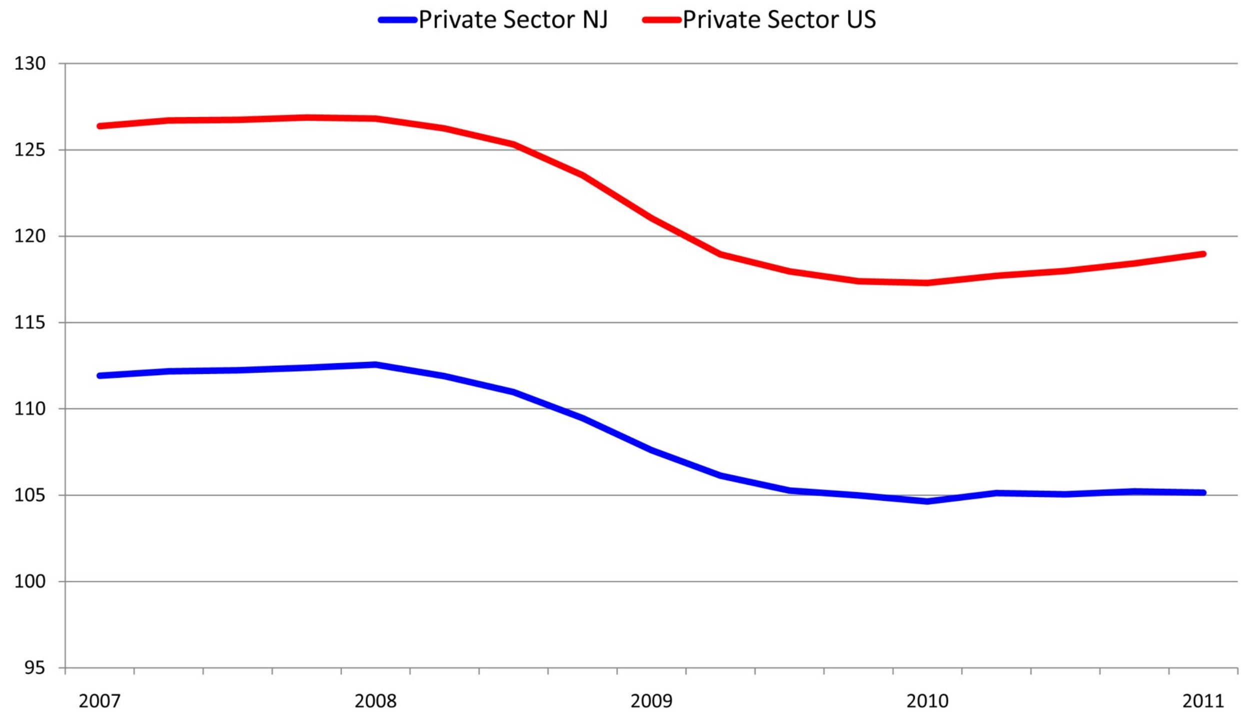
This chart compares the number of employed workers to the base year of 1990. The number 100 represents employment in 1990.



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

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