New Jersey Economic Insights

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Outlook New Jersey

New Jersey's Jobs Growth Ended the Year with a Strong Kick

New Jersey

You can't keep a good state down. After the significant disruptions caused by Superstorm Sandy, December indicators showed New Jersey returning to its growth path. The most eye-catching indicator was, of course, the record 30,200 increase in jobs. The gain was broad-based across industries and ***was not*** rooted in workers being hired for relief and recovery after the storm.

- ***New Jersey comes back from Sandy with record job gain.***
- ***National economy turns into 2013 with some momentum, but risks linger in the near term.***

The full story is that Sandy disrupted, among other things, normal hiring in early and mid-November – the time of the month that the job numbers are collected. The December surge then reflected the hiring delayed from mid-to-late November as well as that month's own growth in jobs.

During 2012, the state added 46,100 private-sector jobs, its best showing since 2000. The increase in private-sector jobs since the February 2010 low now stands at 103,100, exceeding the 99,900 private jobs created during in the entire May 2003-January 2008 expansion.

The coincident economic indicators compiled by the Philadelphia and New York Federal Reserve Banks, which rely heavily on the job numbers, show that growth in the state's economy stepped up smartly in December. New car sales amounted to about 46,000 and were 23 percent higher than in December 2011. Certainly, some of the gain at the showrooms was due to the replacement of cars lost to the storm but even without this added kick, car sales have been moving up.

The unemployment numbers continue to show that the state's rate is quite high, with December's 9.6 percent only down slightly from November's 9.7 percent. As we have been noting, the unemployment figures are derived from a survey of households, while the job count comes from a survey of employers. Experience shows that the job numbers are much more accurate than the employment and labor force numbers derived from the household survey. Part of the reason the unemployment rate in New Jersey has not fallen in line with the nation's is the divergence between the household employment figures and the job count.

The more reliable job numbers have been very much stronger than the less reliable household employment estimates. The other reason the unemployment rate has stayed so high relative to other states is the trend in the labor force participation rate in New Jersey – the fraction of the population that reports that they are working or actively looking for work. New Jersey's participation rate has been moving up, while the national rate has been moving down. New Jersey came into 2012 with a noticeably higher participation rate than the rest of the country. In December 2011 our rate was 66 percent compared to the national figure of 64 percent.

(Continued on page 2)

That gap widened substantially last year, with our December figure of 66.2 percent more than 2.5 percentage points higher than the national mark of 63.6 percent. This upward move is generally viewed as a positive because it may suggest that more people in New Jersey are optimistic enough about the labor market to start actively searching for jobs.

In any event, our high unemployment rate does not reflect any marked weakness in New Jersey job growth compared to the nation as a whole. Our overall increase in jobs from December 2011 to December 2012 was 1.2 percent, while the national gain was only modestly higher at 1.4 percent. Naturally, job growth at December's pace is not sustainable. However, the conditions for ongoing increases over the course of 2013 are good: the national economic recovery is ongoing, and as we have seen in 2011 and 2012, our firms are participating in that and are gradually expanding their job count. The rebuilding process from Sandy will also work to spur job and spending growth.

Not everything is rosy. There is the question about whether Sandy's shadow will fall on Shore tourism. In other words, will there be adequate facilities to handle visitors, and will all the news coverage from the storm and its aftermath discourage business? Elsewhere, as is perfectly normal, not all the information will be good all the time. For instance, the Philadelphia Federal Reserve's manufacturing survey, which includes South Jersey producers, was downbeat in January. Finally, our concerns about the accuracy of the numbers from the household survey should not blind us to reality: even after adjusting for some of the problems in the data the numbers would still show that all too many people are looking for jobs. All in all, though, the balance is decidedly on the positive side of the ledger.

U.S. Economic Outlook

National economic indicators showed an ongoing, steady expansion as 2012 ended, despite the report of a small decline in GDP in the fourth quarter. Job growth averaged around 150,000 a month through the second half of the year. This rate is consistent with modest downward pressure on the unemployment rate, which has been below 8 percent since September. Auto and other retail sales were on the upswing late in the year after some softer numbers in earlier months. Housing indicators look to be trending up substantially, though with some month-to-month choppiness. Manufacturing output also appears to be gaining traction after weakness in the spring and summer. The fractional decline in GDP in the fourth quarter reflected business holding down growth in inventories, as well as a sharp but temporary drop in defense spending; overall private sector spending rose smartly. Price inflation remains very low.

"The labor force participation rate in New Jersey … has been moving higher, while the national rate has been moving

Long-standing trouble spots may be easing. Europe is in recession, but the financial situation there appears to be improving, suggesting that the downturn will be contained. Most significantly, in the aftermath of our presidential election, there are signs that, despite continued heated rhetoric, the decision-making atmosphere in DC has improved. Of course, not all the policies decided in Washington will result in immediate economic positives. As the accompanying piece notes, the set of major tax hikes enacted on Jan. 1 will probably have some inhibiting impact on the economy in the near-term. Indeed, the University of Michigan measure of consumer confidence fell substantially in January, possibly in response to the tax increases. However, the sheer fact that some long-standing policy disputes may be moving towards resolution will dispel some of the uncertainty that has impinged growth.

Every economic period has its surprises. The surprise of the current economic expansion, now midway through its fourth year, has been the lack of positive surprises. Virtually no indicator has come in better than expected, while some, notably housing, have been consistently worse than anticipated. Perhaps 2013 will be the year that breaks that streak.

Economic Analysis

Federal Taxes Take a Hike, Impact Likely To Be Mixed

Contrary to the impression created by much of the news coverage, the nation did go over a “fiscal cliff” on Jan.1 as substantial and widespread increases in federal taxes took effect. These increases had been legislated some time ago. The frantic activity in DC around New Year’s Day only modified them. There were three key components of the increase:

Payroll Taxes. The two percentage point cut in employee social security payroll taxes that was enacted in 2011 was allowed to expire on schedule on December 31. All wage earners are now seeing large increases in their payroll taxes. These taxes are levied on wages before tax. The two percentage point rise means that, for all people earning less than the $113,700 wage ceiling for Social Security tax liability, their take-home pay has been reduced by a very substantial two percent of their pre-tax income. For those earning more than the ceiling their take-home pay this year will be reduced by $2,274, or more than $40 a week.

“The payroll tax increase will likely hold down the growth of consumer spending.”

Upper Level Income Tax Rates. Under existing law, federal income tax rates had been scheduled to increase for all taxpayers on Jan. 1, 2013. After considerable debate, Congress and the Administration modified this so tax rates went up only for individuals earning more than $400,000 and couples making more than $450,000. The rates on incomes above those thresholds rose from 35 percent to 39.6 percent.

Higher Dividend and Capital Gains Taxes. As part of the legislation modifying general income tax rates the preferential tax rates on dividends and capital gains for upper-income taxpayers were boosted from 15 percent to 20 percent. Additionally, new 3.8 percent taxes on dividends, capital gains, and other types of “unearned” income for high-income taxpayers went into effect on Jan. 1. These new taxes, which were part of the Affordable Care Act, will be used to help fund Medicare. The upshot is that high income households saw their federal rate on dividends and capital gains jump from 15 percent to 23.8 percent on Jan.1.

There were some other significant tax changes, including the reintroduction of caps on deductions and exemptions, long-term changes in the Alternative Minimum Tax, and modification of the federal estate tax. But these pale in comparison to the tax increases noted above. Over the longer term, the tax increases will substantially boost federal revenue, with the payroll tax increase being the largest item, yielding well over $100 billion a year. It was highly unlikely that payroll taxes could have remained at their reduced 2011-2012 rates, since the money is needed to fund Social Security. Nonetheless, the immediate impact of the return to higher tax rates is quite substantial.

The payroll tax increase will likely hold down the growth of consumer spending. Consumer spending is more than $11 trillion a year, and has been moving up, so the tax increase is not large enough to lead to outright declines. Still, there is likely to be some impact, resulting in notably slower growth than otherwise would have been the case. The effect of the upper income tax increases is more diffuse. It’s not likely that spending by the people affected will be greatly inhibited. These tax increases had been in the works for quite some time. Spending by the well-to-do is typically based on long-term plans and will be little altered by a scheduled hike in taxes. Indeed, the size of the tax increase was probably smaller than anticipated, which would lessen any impact on spending.

There are concerns that the increases in upper income tax rates, both on overall income and on dividends and capital gains, will impede entrepreneurial activity and capital formation. While the debate on these issues is heated, any negative impacts will likely only emerge gradually and so will probably not have any significant effect on the near-term economic outlook.

"It appears that in November and December taxpayers made strenuous efforts to realize capital gains at the existing lower rate"

One important effect of the dividend and capital gains increases could be on near-term revenues. The results of the Presidential election pretty well confirmed that there would be increases in dividend and capital gains rates on Jan.1. It appears that in November and December taxpayers made strenuous efforts to realize capital gains at the existing lower rate, and some corporations paid out substantial special dividends. These efforts would have the effect of boosting tax liabilities from dividends and capital gains for tax year 2012 and thus increasing the stream of tax payments through the April 15 payment deadline. Also, some multi-year bonuses may have been paid to high-income employees prior to Jan.1. These actions were motivated by the federal changes, but the income is also taxable by states that have their own income taxes, including New Jersey. We are currently evaluating the impact of these actions on our revenues.

To conclude, 2013 started with a very marked increase in federal taxes. The payroll tax increase, the largest and most widespread of the hikes, will likely have some negative effect on growth this year. The economic impact of the other tax hikes will be less immediate, but efforts to realize income in advance of the Jan.1 effective date could provide some immediate boost to revenues.

— *Charles Steindel*

New Jersey Business Pulse Survey

Sandy and National Politics Influence Business Confidence

Fifty-six firms responded to the November Business Pulse survey and forty-two responded to the December survey. The survey includes 14 questions about current and perspective conditions and allows respondents to give their views on other topics of their choice. Detailed results may be found at http://www.state.nj.us/treasury/economicsurveyresults.shtml. This page also contains charts and tables summarizing the results and an explanation of how indexes were constructed from the answers to the questions.

Superstorm Sandy: Results Were as Expected

In November's survey, a few questions were added to assess the immediate and near-term impact of Superstorm Sandy. The results of a cross tabulation by geographic region are in line with expectations. Coastal businesses reporting that they were the hardest hit stated that they were substantially negatively impacted immediately and expect to continue to see moderate and substantial challenges over the next few months. Northern businesses that had the longest power outage problems, and central non-coastal firms also reported immediate negative impacts. But while they also expected to have continued struggles, they were less concerned than coastal companies that may have suffered physical damage to their place of business. Southern noncoastal companies reported some moderately negative impacts immediately following the storm. But the majority of respondents stated that they were not impacted at all in the short term and do not expect to be in the long term.

Few companies reported being positively impacted by the storm except those in the construction, retail, professional services and consulting industries. In fact, construction firms were the only ones who actually reported no negative impacts – only positive expectations for rebuilding affected areas, which shows New Jersey's overwhelming optimism that we will not only recover from the storm but rebuild and return to prosperity.

General Conditions: December Improves Slightly After November's Hard Hit Uncertainties about the short-term impact of Superstorm Sandy, the presidential election, and the looming fiscal cliff materialized into the

perfect storm in November, driving the view of overall business conditions in New Jersey to its lowest level since October 2011. December's outlook rebounded slightly for New Jersey conditions, but fears over fiscal cliff kept general expectations for the state's economy level or perhaps slightly weakening. This contrasted with the consensus view for the U.S. as a whole which did not rebound in December but further declined, providing evidence that business in New Jersey would expect to fare better than the nation as a whole in the face of federal fiscal ambiguity. Further, the majority view for future business conditions in both New Jersey and the United States in general returned to being optimistic in December after being mixed with a slight bias towards pessimistic in November.

National Politics Influences Employment and Investment Plans

Leading up to the presidential election in November, firms were leanings towards cutting employment modestly with a few planning substantial cuts. Yet the post-election December survey seemed to suggest that no plans to change employment levels or capital commitments would be made until the fiscal cliff worries were settled. Everyone, it seems, was waiting for the national picture to become clearer. — *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.

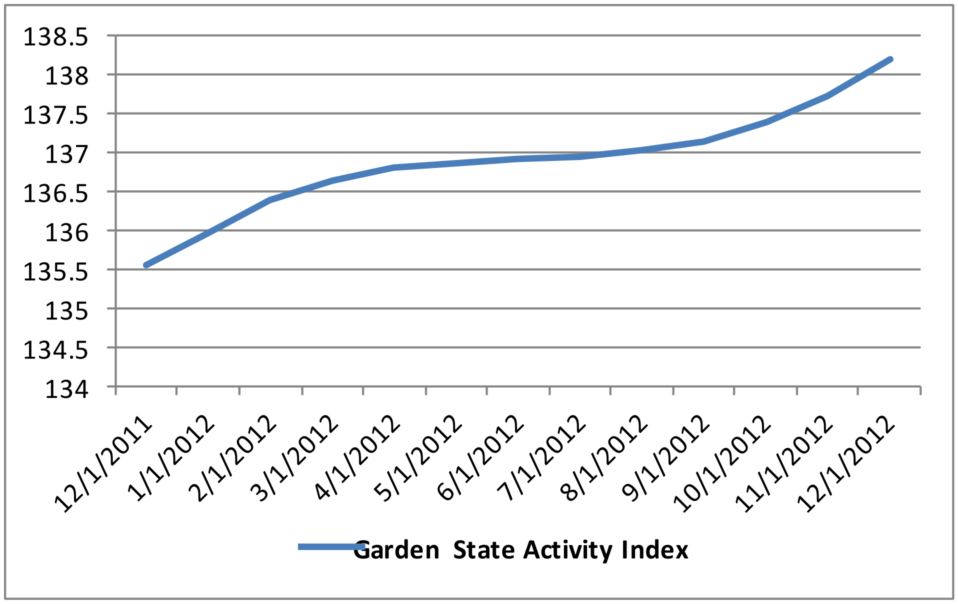
Garden State Activity Index

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.

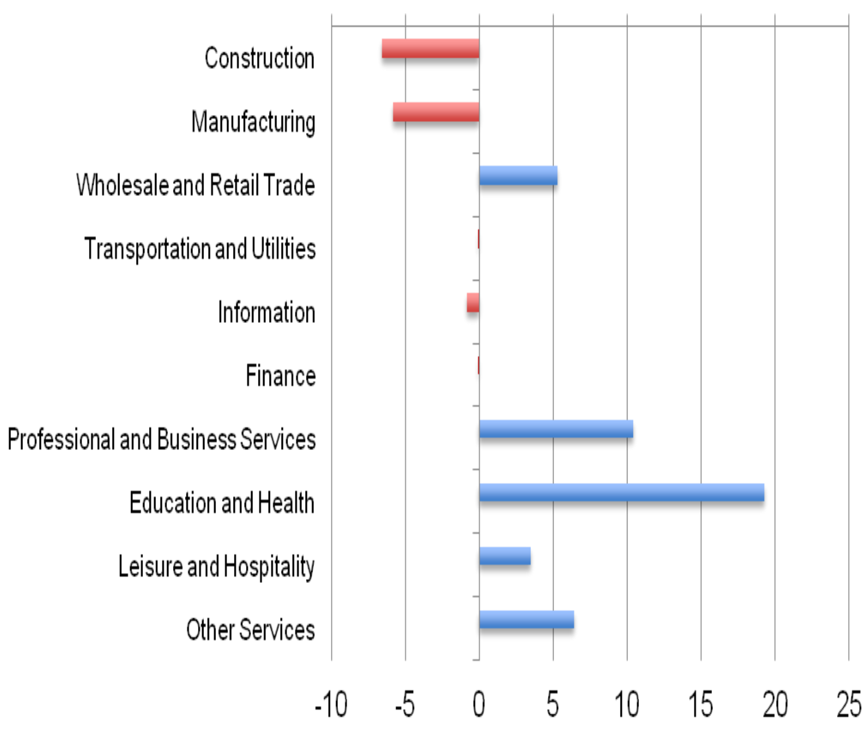
To construct the *Activity Index* we use principal components analysis, which takes a weighted average of the three Fed indicators. The composite index reflects the current state of the New Jersey economy.

The most recent data suggest that the growth of the state's economy has strengthened in recent months. This past December, New Jersey's economy reached an index level 1.9 percent higher than in December 2011.

-Andrew Lai



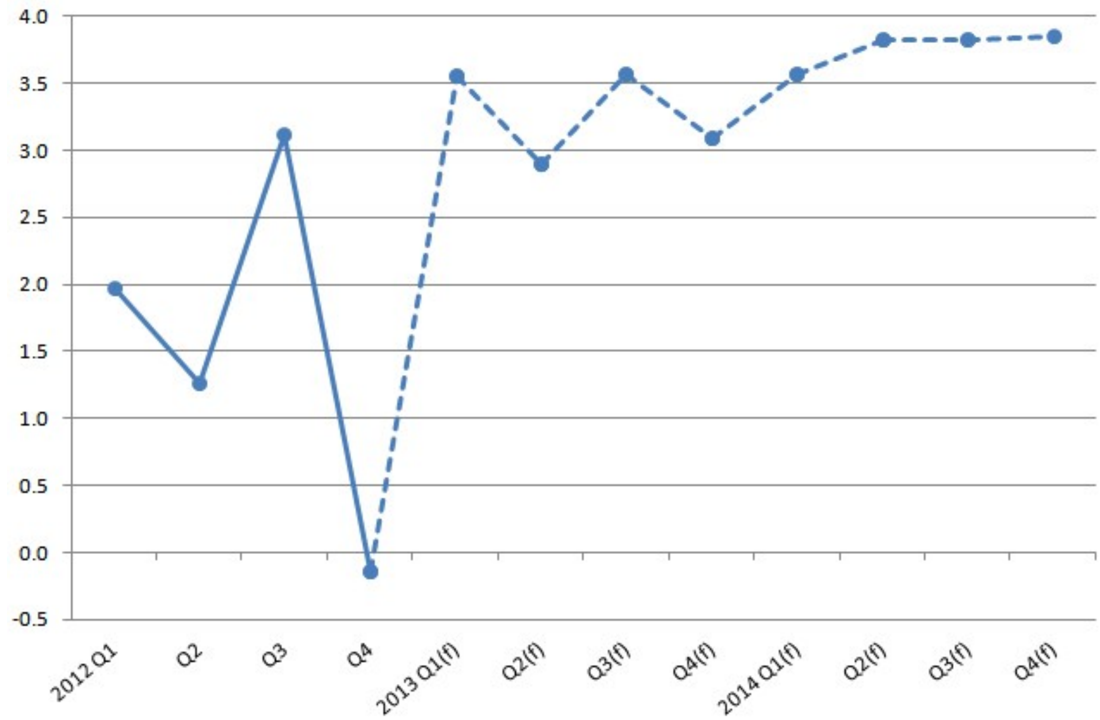
Private Industry Employment Trends



Change in Thousands of Jobs
October - December 2011 to October - December 2012

Data source: New Jersey Department of Labor

Real U.S. GDP Growth



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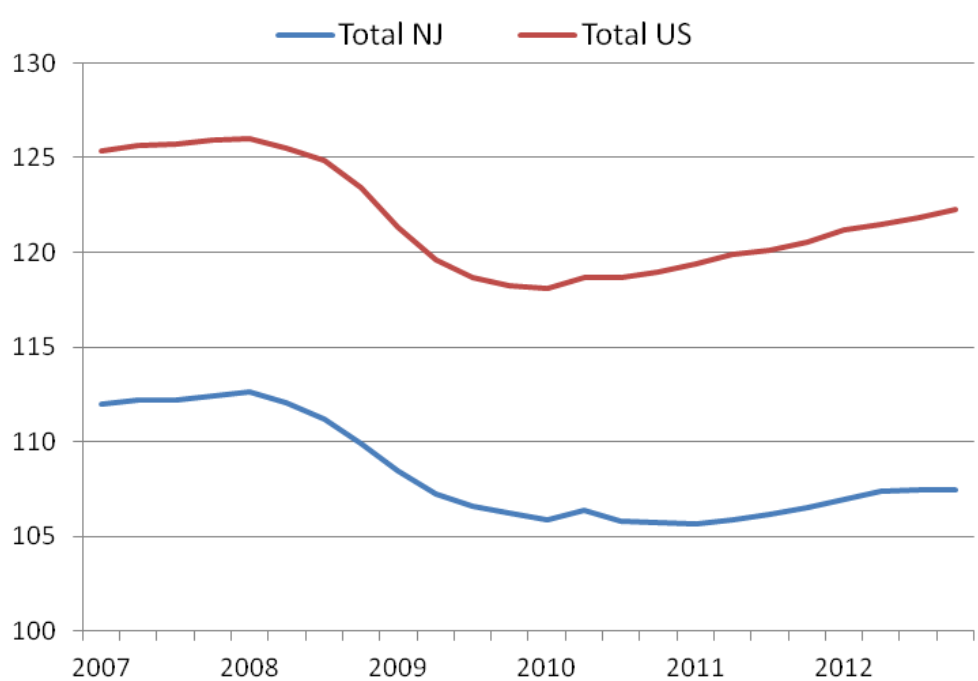
Data source: U.S. Bureau of Economic Analysis

State & National Job Trends

Total Employment *(Relative Employment 1990=100)*

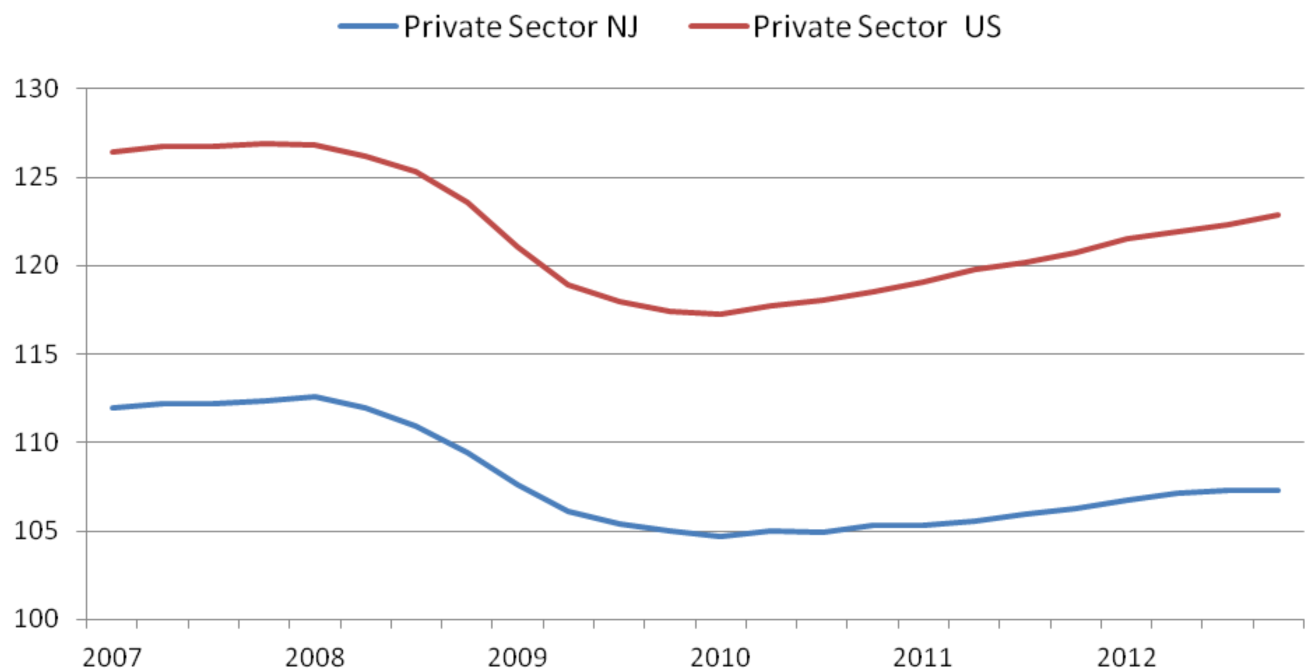
This chart compares the number of employed workers to the base year of 1990. The number 100 represents employment in 1990.



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

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