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THE LONG ISLAND ECONOMY IN THE CONTEXT OF NATIONAL BUSINESS CONDITIONS

The U.S. economy came close to stalling in the first quarter of this year. First quarter GDP grew at an annual rate of only 0.6 percent, the slowest pace in four years. Only consumer spending, which expanded at an annual rate of 4.4 percent, kept the economy out of negative territory. There is some evidence that the economy grew faster in the second quarter. However, rising long-term interest rates threaten to dampen future economic growth. This article analyzes economic conditions on Long Island in the context of U.S. business trends.



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The National Economy

The U.S. economy came perilously close to stalling in the first quarter of this year, due largely to the persistent housing slump. The housing weakness is estimated to have subtracted a full percentage point from first quarter GDP growth. First quarter home prices declined for the first time in sixteen years. Homebuilders are slashing prices to eliminate their excess inventory of unsold homes, but the inventory adjustment is far from over. Much of the recent housing boom was predicated on subprime mortgage loans. Today, almost 19 percent of such loans are either delinquent by more than 30 days or in foreclosure. Another \$100 billion in subprime loans will be reset in the next several months. Rising mortgage interest rates, which will make it more costly to refinance these loans, could lead to additional foreclosures.

The National Association of Realtors expects new home sales to decline by 18.2 percent this year and existing home sales to fall by 4.6 percent. Most economists expect that the housing downturn, which started almost two years ago, will continue for some time. Permits for new home construction, a barome-

ter of future trends in residential construction, are currently at their lowest level in almost a decade. As yet, the subprime mortgage crisis has not significantly affected other credit markets. However, there are other credit problems on the horizon. For example, there is currently a very low interest rate spread between high-risk, high-yield debt and relatively safe Treasury securities. Lenders seem to have ignored the default potential of this high-risk debt. Should the high-yield debt market begin to unwind, the resulting adverse credit consequences would, in turn, prolong the housing

recession.

U.S. job markets appear to have shrugged off the housing recession and the generally sluggish economy. Preliminary figures indicate that employers added 157,000 payroll jobs in May. The willingness of the nation's businesses to keep hiring has provided major support for consumer income and spending. Rising wages have also kept consumers in a buying mood. May wages were approximately 4.1 percent higher than a year ago. Faster wage growth has made consumers more confident. Both the Conference Board's consumer confidence index and the

Table 1
Comparative Job Growth, Nassau-Suffolk vs. Nearby Labor Markets, May 2006-07

Labor Market Area	Net Job Change	Percent Change
<i>Nassau-Suffolk, NY</i>	<i>8,500</i>	<i>0.7</i>
New York City, NY	50,200	1.4
Putnam-Rockland-Westchester, NY	5,600	1.0
Poughkeepsie-Newburgh-Middletown, NY	2,800	1.1
Kingston, NY	1,200	1.8
Bergen-Hudson-Passaic, NJ	-2,400	-0.3
Newark-Union, NJ	2,600	0.2
Edison, NJ	7,000	0.6

Source: New York and New Jersey State Labor Departments

**Table 2
Non-Farm Employment Shifts on Long Island, by Industry, May 2006-07**

Industry	Number of Jobs, May 2007	Net Change, May 2006-07
Manufacturing	83,700	-2,400
Construction	72,200	1,800
Wholesale Trade	74,300	1,100
Retail Trade	159,700	700
Transportation, Warehousing, Utilities	35,500	-1,100
Information	30,100	600
Financial Activities	78,300	-1,300
Professional & Business Services	166,500	2,900
Educational & Health Services	207,200	5,000
Leisure & Hospitality	99,800	400
Other Services	52,500	100
Government	204,200	700
Total Non-Farm Employment	1,264,000	8,500

Source: New York State Labor Department

University of Michigan's consumer sentiment index rose in May and May retail sales surged by 1.4 percent, their biggest one-month advance since January 2006.

Manufacturing, which accounts for about one-third of the U.S. economy, is also on the mend. Unlike home-builders, manufacturers have already eliminated most of their excess inventories and are again ready to ramp up production. As a result, factory output is again rising. The manufacturing turnaround is being supported by increased demand for U.S. goods in Europe and Asia. U.S. exports have become more affordable abroad due to the declining U.S. dollar. Business investment, which accounts for approximately 17 percent of the nation's GDP, also appears to be back on track. Business spending declined at a 4.8 percent annual rate in the fourth quarter of last year but has since begun rising. Businesses are expected to invest significantly more in equipment and software in coming months, thereby helping to sustain the manufacturing rebound.

Inflation remains an ongoing threat to the economy. In the first five months of this year, consumer prices rose at a 5.5 percent annual rate, double that of 2006.

Wholesale prices rose 0.9 percent in May, reflecting the impact of higher food and energy prices. Higher energy prices are a result of tight supply-demand conditions in global energy markets. Higher food prices reflect higher transportation costs and higher prices for corn, more of which is being diverted to ethanol production. The sluggish economy has helped to contain inflation but any pick up in economic growth could worsen the inflation picture.

The U.S. Economic Outlook

The National Association of Business Economists projects GDP growth of 2.2 percent this year and 2.9 percent in 2008. In effect, economic growth this year would be the slowest since 2002, when the economy expanded by only 1.6 percent.

Consumer spending is expected to slow to the 2.5-to-3.0 percent range in the second half of this year as consumers deal with higher energy and food prices. Preliminary consumer sentiment figures for June suggest that consumers are becoming discouraged by higher long-term interest rates, which will increase their borrowing costs. Federal Reserve data show that consumers are already borrowing less and doing less "cash-out" mortgage refinancing. This appears to confirm that consumer spending will slow in coming months. Export growth and higher levels of business spending should partially offset any consumer pullback. Another inventory building cycle in the manufacturing sector will also support economic growth. However, the economy is not likely to receive much short-run help from the Federal Reserve. The Fed seems willing to tolerate slower economic growth in order to allow inflation to moderate. Aside from housing, demand has not yet cooled sufficiently to permanently ease inflationary pressures. Moreover, business costs are rising just as labor productivity growth is slowing. As a result, unit labor costs have risen significantly. If businesses try to pass these higher costs along to their customers, there could be another inflationary spiral. The falling dollar will also contribute to inflation by making imports more expensive. The dollar has already fallen by more than 30 percent since 2002 against a market basket of foreign currencies and further

**Table 3
Unemployment Rates in Selected New York State Labor Markets,
May 2007**

Labor Market Area	Unemployment Rate (%)
Nassau-Suffolk, NY	3.4
New York City, NY	4.6
Putnam-Rockland-Westchester, NY	3.3
Poughkeepsie-Newburgh-Middletown, NY	3.7
Kingston, NY	3.7
New York State	4.1

Source: New York State Labor Department

declines are expected. Recent interest rate increases by foreign central banks have made their investments more attractive relative to ours. If the foreign investors upon whom the U.S. depends to fund its budget and trade deficits decide to invest their money elsewhere, U.S. interest rates will have to rise to lure them back. These circumstances are keeping the Federal Reserve on hold with respect to interest rates. If anything, the Fed's next interest rate move could be up rather than down.

The Long Island Economy

The Long Island economy has performed reasonably well given the sluggishness of the U.S. economy. Long Island is continuing to experience moderate job growth, a historically low unemployment rate and flat to increasing home prices. Long Island gained 8,500 payroll jobs in the twelve months ending in May, an increase of 0.7 percent when compared with May 2006. During this period, jobs grew more slowly on Long Island than in New York City and in nearby suburban New York labor markets. However, Long Island's job growth exceeded that of labor markets in northern New Jersey. (See Table 1) Long Island's recent job growth was concentrated in professional and business services and in educational and health services. (See Table 2)

Long Island's May unemployment rate, 3.4 percent, was below that of neighboring New York City but similar to that in the Putnam-Rockland-Westchester labor market. (See Table 3) This is part of a good news/bad news scenario. It means that virtually all Long Islanders with appropriate skills can readily find a well-paying job. However, it also means that Long Island is suffering from an acute shortage of skilled workers, which is impeding local job growth.

Trends in sales tax revenues, a

Table 4
Recent Trends in Sales Tax Revenues, Nassau and Suffolk Counties
(Percent Change from Previous Year)

Month, 2007	Nassau	Suffolk	Nassau-Suffolk
January	-3.2	-0.1	-1.6
February	4.2	7.2	5.8
March	-6.3	9.0	1.3
April	1.0	7.0	4.7
May	1.0	9.3	6.8

Source: New York State Department of Taxation & Finance

measure of consumer spending, suggest that Suffolk consumers are still spending but that Nassau consumers have begun to retrench. April and May sales tax revenues in Nassau were barely above their year-ago levels while sales tax revenues in Suffolk increased by 7.0 percent and 9.3 percent respectively. (See Table 4) The reasons for these differences are unclear. It may be that Suffolk has younger households than Nassau and that younger households tend to spend more on consumer goods. Home prices are also lower in Suffolk than in Nassau so that monthly shelter costs may be less of a burden on household budgets in Suffolk. Since both Nassau and Suffolk depend on sales tax revenues for a significant portion of their total tax revenues,

any falloff in sales taxes can have serious fiscal consequences. If the consumer pullback in Nassau continues, there would be increased pressure to raise property taxes, cut public services or both.

Long Island home prices have held up reasonably well, given the nation's housing slump and the growing inventory of homes for sale in the two counties. The median price of Long Island homes closed in May was \$494,000 in Nassau and \$392,800 in Suffolk according to the Multiple Listing Service of Long Island. Median home prices increased by 3.2 percent in Nassau but declined by 0.6 percent in Suffolk between May 2006 and May 2007. (See Table 5) The fact that bi-county home prices are either flat or increasing moderately suggests that

Table 5
The Median Price of Newly Closed Homes on Long Island, by Month,
May 2006-07

Month 2006	Nassau (\$)	% Change*	Suffolk (\$)	% Change*
May	\$478,500	2.2	\$395,000	4.8
June	500,000	6.3	410,500	6.6
July	490,000	0.0	410,000	2.5
August	495,000	-1.0	415,000	3.8
September	495,000	-1.0	415,000	0.7
October	472,300	-5.5	390,000	-2.5
November	465,000	-5.0	395,000	1.3
December	470,000	-2.5	398,600	0.0
2007				
January	450,000	-6.2	397,500	1.9
February	460,000	-8.0	379,000	-1.0
March	470,000	0.0	394,000	-0.7
April	473,800	0.8	400,000	3.9
May	494,000	3.2	392,800	-0.6

* From previous year; Source: Multiple Listing Service of Long Island

Long Island's housing bubble is continuing to unwind gradually. If future home price adjustments remain moderate, there should be minimal disruption to the Long Island economy. By the same token, these statistics suggest that Long Island's housing stock will not become significantly more affordable unless specific actions are taken to increase the supply of affordable housing. Without such housing, Long Island's ongoing workforce shortages are likely to worsen as more young people choose to leave for lower-cost areas, taking their skills with them.

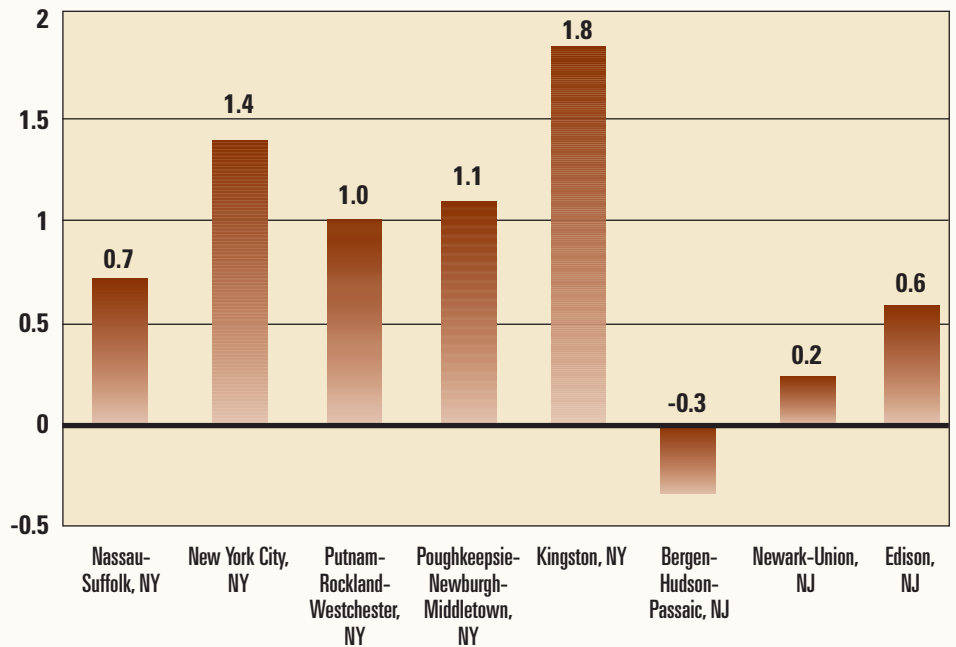
Long Island's Economic Outlook

The Long Island economy is continuing to grow, albeit slowly, despite the stresses caused by high home prices and property taxes and rising gasoline and food prices. However, there are clouds on the horizon. Home prices could fall more steeply as the rising inventory of homes for sale bumps up against tighter mortgage

lending standards. In the twelve months ending in May, the inventory of unsold homes increased from

10,491 to 12,711 in Nassau and from 14,837 to 18,749 in Suffolk, a 21 percent increase in Nassau and a 26 percent jump in Suffolk. Future foreclosures among subprime borrowers will add to this inventory. A softer housing market would have a negative impact on consumer spending at a time when consumers are already facing higher food and energy prices and rising long-term interest rates. Therefore, the strength of the Long Island economy in the second half of this year will depend in large measure on how well consumer spending holds up. If Long Island's tight labor market pushes up wages sufficiently to offset the economic drag caused by higher food and energy prices, consumers could continue to spend at a moderate pace. However, if the consumer pullback already evident in Nassau County extends to Suffolk, not only would Long Island retailers suffer, but both county governments could face new fiscal constraints.

Percent Change in Non-Farm Jobs, Selected New York Metropolitan Area Labor Markets, May 2006-07



Percent Change in Median Long Island Home Prices, May 2006-07

