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LONG ISLAND'S ECONOMY SPUTTERS BUT STAYS AFLOAT: THE ROAD AHEAD

The latest economic data portray a national economy that is stagnant but not yet collapsing under the weight of higher food and energy prices, falling home prices and an ongoing credit crunch. Long Island's economy, which historically has been the last to slip into recession and the first to recover, is clearly feeling the effects of the national slowdown. Consumers are being battered by higher food and fuel prices at a time when many of them are struggling to make their monthly mortgage payments. This article assesses the status of the Long Island economy in the context of national business trends.



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The National Economy

U.S. GDP grew by an anemic 0.9 percent in the first quarter of this year, a slightly faster pace than the 0.6 percent initially reported. The upward revision reflected some strength in nonresidential construction and a narrower trade deficit. However, the underlying data portray an economy that is struggling to keep its head above water.

Although the manufacturing sector is being helped by the weaker dollar, which makes U.S. exports more affordable abroad, manufacturing nevertheless remains weak. Industrial production fell 0.2 percent in May after plunging 0.7 percent in April. U.S. industrial plants are operating at only 79.4 percent of capacity, the lowest rate of capacity utilization since September 2005. The Institute for Supply Management's index of manufacturing activity remains below 50, a sign that the manufacturing sector is still contracting albeit slightly.

Construction, the nation's other major goods-producing industry, is also being weighed down by the ongoing housing slump. U.S. housing starts fell 3.3 percent in May to their lowest level in 17 years. Housing starts have fallen 32 percent in the

past year. Builders are cutting production to whittle down the growing overhang of unsold homes. There is currently an eleven-month supply of unsold single-family homes, the highest backlog in more than two decades. Collapsing buyer demand and rising mortgage interest rates have exacerbated the housing slump. Permits for new residential construction, a harbinger of future building activity, fell 1.3 percent in May. This means that further declines in housing starts are likely.

Home prices are also continuing on their downward trajectory. They posted their sharpest first quarter decline since the government began tracking home price data 17 years ago. Some 43 states experienced home price declines in the first quarter of this year, with California and Nevada experiencing the steepest price reductions. Moreover, the rate of home foreclosures and past due payments is at the highest level since 1979. Default rates could worsen if job losses accelerate in coming months.

The job market, which held up relatively well until this year, has also run into trouble. Payrolls fell by 49,000 jobs in May, with the largest

job losses in professional and business services. This relatively well-paying job category includes such occupations as lawyers, accountants, architects and management consultants. May job declines brought total job losses to 324,000 for the January-to-May period. The nation's unemployment rate rose from 5.0 percent to 5.5 percent between April and May, a relatively large increase for a one-month period. However, this increase may be misleading because it includes the flood of high school and college students seeking summer jobs. Nevertheless, the higher unemployment rate accompanied by a surge in inflation pushed the "misery index", which combines the inflation and unemployment rates, to 9.4. This is the highest it's been since the early 1990s recession.

How the job market performs in coming months will be critical to the economy's ability to recover because jobs generate the income needed to sustain consumption. Today, rank and file workers are experiencing an erosion of purchasing power. Their average weekly earnings were 1.2 percent below year-ago levels in May after adjusting for inflation. Moreover, an estimated 5.23 million workers were employed part-

time in May because they could not find full-time work.

Despite falling consumer confidence and \$4-a-gallon gasoline, U.S. retail sales rose by one percent in May. This suggests that consumers are spending at least part of their economic stimulus checks. Moreover, the sales gains were broadly based. May retail sales were up by 0.8 percent even when sales by gasoline stations are excluded. The seeming resilience of retail sales has generated slightly more optimism concerning the strength of the economy. The consensus seems to be that GDP will remain in positive territory in the second quarter of this year.

Perhaps the biggest challenge facing economic policymakers is how to keep inflation in check. The May producer price index, which measures price changes at the wholesale level, rose by 1.4 percent, its fastest rate of increase in six months. Wholesale gasoline prices were up by a whopping 9.3 percent in May. For the twelve months ending in May, wholesale prices rose by 7.2 percent. The news concerning consumer prices was scarcely better. May consumer prices rose by 0.6 percent, the single largest monthly gain since last November. The May consumer price index was 4.2 percent above year-ago levels. In May, consumers paid 17.4 per-

cent more for energy and 5.0 percent more for food than they did a year ago. Higher airline fares and added fees caused transportation costs to rise by 8.1 percent in the twelve months ending in May. This pace of inflation has not been seen since the early 1990s. Thus far, businesses have not had enough "pricing power" to pass on their higher fuel and commodity costs to their customers. As a result, inflation has remained largely confined to the food and energy sectors. However, this could change if inflationary expectations persist and spread. The resurgence of inflation in the wake of a slowing economy has put the Fed in a tight corner. It can't lower interest rates further without worsening inflation. Nor can it begin to raise interest rates to combat inflation without harming the extremely fragile economy. Therefore, the Fed's benchmark interest rate could remain at the current 2 percent for some time.

The U.S. Economic Outlook. Much of our attention has been focused on whether or not the nation is currently in recession. Some analysts define a recession as two consecutive quarters of negative GDP. Yet, in the 2001 recession the economy posted two quarters of negative GDP, but they were not consecutive. The National Bureau of Economic

Research is charged with defining when recessions begin and end. According to the NBER definition, to qualify as a recession, the depth of the decline must be significant, it must last for more than a few months and it must be spread across the economy. The NBER uses broader criteria, including GDP, income, employment, industrial production and retail sales, in defining recessions. There is a strong likelihood that when the NBER finishes analyzing the data, they will in fact confirm that a recession occurred this year.

Thus far, the economic slump has been relatively narrow and confined primarily to housing and automobile manufacturing. Tight credit has contributed to the housing slump. Soaring gasoline prices have affected the demand for automobiles and trucks. However, these two hard-hit sectors account for only 7 percent of GDP and 3 percent of payroll employment. By contrast, the service sector accounts for almost 60 percent of GDP. The service sector has continued to expand. It grew by 3.5 percent in the first quarter of this year. This suggests that if the nation is indeed in recession, it is likely to be a relatively shallow one.

The economic stimulus checks that were mailed out in May should provide a financial cushion, albeit a temporary one, to harried consumers. However, rising oil prices, falling home prices and the continuing credit crunch pose significant downside risks to the economy. There is also the risk of an "adverse feedback loop" in which a deteriorating economy causes more mortgages defaults, which worsens losses among lenders and exacerbates the credit crunch. These considerations suggest that the U.S. economy could remain on thin ice for some time.

The Long Island Economy

Long Island's economy is clearly being battered by higher food and fuel prices, falling home prices and a slowing job market.

Trends in Long Island Payroll Employment

Industry	Employment, May 2008	Net Change, May 2007-08
Manufacturing	82,400	-1,700
Construction	74,000	1,100
Wholesale Trade	73,200	-200
Retail Trade	161,600	0
Transportation, Warehousing, Utilities	37,300	-600
Information	28,200	-300
Financial Activities	77,500	-2,700
Professional & Business Services	165,300	-500
Educational & Health Services	216,300	3,900
Leisure & Hospitality	103,400	2,500
Other Services	53,700	400
Government	209,800	3,200
Total Employment	1,282,700	5,100

Source: New York State Labor Department

Trends in Long Island Home Prices

Month	Nassau Median Sales Price	% Change From a Year Ago	Suffolk Median Sales Price	% Change From a Year Ago
2007				
June	\$485,000	-3.0	\$420,000	2.3
July	495,000	1.0	405,000	-1.2
August	502,500	1.5	409,900	-1.2
September	475,000	-4.0	388,000	-6.5
October	474,000	0.4	385,000	-1.3
November	461,500	-0.8	387,300	-2.0
December	447,500	-4.8	385,000	-3.4
2008				
January	440,000	-2.2	373,500	-6.0
February	458,800	-0.2	359,500	-5.2
March	445,000	-5.3	365,000	-7.4
April	447,000	-5.7	370,000	-7.5
May	438,500	-11.2	360,000	-8.4

Source: Multiple Listing Service of Long Island

Moreover, the cumulative impact of these negative forces is magnified on Long Island because of its unique land use patterns and government structure. The combination of low-density land use patterns and a lack of public transportation alternatives means that Long Island residents have no alternative but to use their cars for work and leisure trips. Therefore, they have no buffer against sky-high gasoline prices. Moreover, Long Island's many overlapping taxing jurisdictions are contributing to rising property taxes at a time when the ability-to-pay of most Long Island households has been diminished.

Long Island's job market experienced an anemic recovery from the 2001 recession and is again faltering. Job growth has slowed dramatically in recent months and net year-to-year job losses have become more likely. In the twelve months ending in May, Long Island gained only 5,100 payroll jobs and most of these occurred in government. Private sector employment grew by only 1,900 jobs, suggesting that the private-sector economy has virtually ground to a halt.

The loss of manufacturing jobs, a

long-term phenomenon, is continuing. However, manufacturing losses have been compounded by employment declines in wholesale trade, transportation, warehousing and utilities, information services, professional and business services and especially in finance, insurance and real estate. Many of the jobs being lost pay relatively high wages. Job gains have been concentrated in educa-

tional and health services, tourism and government, industries that in general pay somewhat lower wages. Local unemployment rates have also been rising. However, unemployment rates are notoriously unreliable around May and June because of the influx of high school and college students entering the labor force in search of summer jobs. A more accurate measure of Long Island's unemployment rate should be available by September, when these students return to school.

Slower job growth has been accompanied by accelerating declines in Long Island home prices.

According to the Multiple Listing Service of Long Island, the median price of a newly sold Nassau home was \$438,500 in May, down 11.2 percent from a year ago. The comparable Suffolk median home price was \$360,000, down 8.4 percent from a year ago. Further price declines are expected as the inventory of homes for sale is augmented by newly foreclosed properties. This will put addition-

The Consumer Price Index in the New York Metropolitan Region

Item	% Change, May 2007-08
All Items	4.0
Food & Beverages	5.5
Food at Home	5.9
Food Away From Home	5.5
Housing	3.2
Shelter	2.6
Fuels & Utilities	12.3
Apparel	-4.0
Transportation	9.6
Motor Fuel	25.7
Medical Care	2.8
Education	3.8
All Other	2.3

Source: U.S. Bureau of Labor Statistics

al downward pressure on homes in all price categories. Average home price declines of 25 percent or more are a real possibility before the Long Island housing market stabilizes in late 2009 or early 2010. The greatest price declines are likely to occur at the high end of the housing market where sellers have more leeway to lower sales prices.

Long Island consumers are being battered by a combination of rising food and fuel prices. The overall inflation rate in the New York Metropolitan Region, which includes Long Island, was 4.0 percent in May. This is the highest it's been since 1991, when the inflation rate hit 4.5 percent. The overall inflation rate understates the toll that higher food and fuel prices are taking on household budgets. For example, the index for household fuels and utilities was up by 12.3 percent between May 2007 and May 2008. The index for food and beverages rose 5.5 percent during this period. The index for transportation costs was 9.6 percent higher than a

year ago and the index for motor fuel was up by 25.7 percent.

The financial strains caused by higher food and fuel prices explain the anemic performance of sales tax revenues accruing to Nassau and Suffolk County governments in recent months. May sales tax revenues, a barometer of consumer spending, increased by only 1.8 percent in Nassau and by 1.0 percent in Suffolk when compared with last May. Moreover, these revenues include the higher sales taxes associated with higher priced gasoline. The recently-mailed Federal economic stimulus checks could spur higher levels of consumer spending in coming months. However, this temporary "shot in the arm" may not be enough to offset rising inflation and falling home prices in the long run. This means that both Nassau and Suffolk County governments could experience flat to declining sales tax revenues for a prolonged period of time.

Long Island's Economic Outlook.

Although the current national economic downturn may be relatively shallow it could last for a while because housing and credit market cycles are relatively long cycles. It will take at least several years for lenders to determine their loan losses and liquidate the bad debt from their balance sheets. Credit markets cannot regain their health until this happens. Likewise, it will take several years for housing markets to regain the balance between supply and demand. In order for this to happen, home prices must fall to the point that potential buyers feel confident enough to return to the market. Given these circumstances, the Long Island economy is likely to be in for a prolonged period of slow economic growth if not actual recession. The pace of inflation, the rate of job growth, the severity of home price declines and the impact of these trends on consumer spending will determine the future strength of the Long Island economy.

**May 2008 Unemployment Rates,
Selected Long Island Towns and Villages**

