New Jersey Economic Insights

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Outlook New Jersey

New Jersey Employment Figures Take a Step Back But Other Indicators Suggest Continuing Growth

New Jersey

The state's seasonally adjusted job count fell by 8,600 in March. In the private sector, the loss totaled 11,600. These declines followed six straight months of increases. For the first quarter as a whole, the average number of jobs in the state was 14,600 more than the average in the fourth quarter of 2011. The gain in the private sector was 12,600 – the largest quarterly increase since the start of 2006. In retrospect, it appears that the unusually mild winter weather accelerated hiring in January and February and, as a result, the usual seasonal pickup in March hiring was low.

March numbers do not indicate an end to our uptrend in employment

Even though the actual number of jobs in the state was estimated to have increased by more than 18,000 in March, that fell short of the 27,000 jobs the state would pick up in a typical March, resulting in the seasonally adjusted shortfall.

Likewise, back in January the state is estimated to have shed over 103,000 jobs before seasonal adjustment. But since the seasonal adjustment factor had anticipated a decline of more than 112,000, we ended up with a sturdy seasonally adjusted increase of 8,800 jobs.

On balance, the March numbers do not indicate an end to our uptrend in employment. Aside from the seasonal problem, the half-year stretch of job increases every month was the longest such period since 2004. It's not terribly surprising or unusual to see the job count go down at times during an expansion. For instance, the state lost 7,400 jobs in October 2005, right in the middle of a period of fairly healthy gains. Of course, the March drop in jobs occurred in the context of the unemployment rate remaining at 9.0 percent, whereas that 2005 decline was in a period of much lower unemployment.

Other indicators of the state and local region suggest continuing growth. The Federal Reserve Bank of Philadelphia reports that its index of New Jersey activity rose in March despite the loss of jobs here. The Philadelphia measure takes a detailed look at the state's labor market and factors in longer-term trends in the state's economy. Over the past year the Philadelphia bank finds that activity in New Jersey grew slightly more than in the nation as a whole. The Federal Reserve Bank of New York also found New Jersey's economy grew in March. The manufacturing surveys of both the New York and Philadelphia Reserve Banks show factory activity in the region grew in April, though at a somewhat lower rate than in March.

U.S. Economic Outlook

National economic indicators also show somewhat mixed signals, but as is the case for New Jersey, on balance they suggest continuing growth. The number of jobs nationwide rose 120,000 in March, the smallest gain since November. Manufacturing output was unchanged, and housing starts and sales fell. It is quite likely that as seemed to be the case here, the national numbers were swelled in earlier months by the unusually mild weather and March saw some "payback."

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As in New Jersey, softer March numbers by themselves do not suggest that the recovery is coming to an end. Real Gross Domestic Product (GDP) rose at a 2.2 percent rate in the first quarter. This was less than the 3 percent rate of growth for the fourth quarter of 2011, but shows that the nation's economy continues to expand. Retail sales rose robustly in March, showing that consumers are willing to spend, despite high gasoline prices. If households are spending, the economy will continue to grow. Indeed, the members of the Federal Reserve's Open Market Committee have modestly increased their forecasts of growth in 2012 despite the recent cool-off in some indicators.

The European situation continues to cast shadows on the outlook for the world economy. As has been widely reported, Spain experienced some difficulty selling its debt, economic problems in France and the Netherlands are spilling into the political arena, and economic activity is contracting across Europe. Europe is a very large part of the world economy — much larger than China, which often seems to get more attention — and the continent's return to recession has some negative implications for the U.S. and New Jersey. Simply put, a recession lessens European demand for U.S. products and Europeans' interest in traveling to the U.S. The major risk, though, from the European problems is less the direct impact of a downturn than the risk that European financial problems will ignite a major financial crisis. So far, at least, the central banks and financial regulators of the world have prevented a runaway crisis, but the risk is still there.

Retail sales rose robustly, showing that consumers are willing to spend despite higher gasoline prices.

Economic Analysis

Is Higher Inflation on the Horizon?

The recent rise of gasoline prices to around $4 a gallon – a bit less in New Jersey, but more elsewhere in the nation – has raised concerns that inflation will take off, adding to the woes coming from continued high unemployment. While predicting inflation is as chancy a business as forecasting any other aspect of the economy, past experience, as well as basic economic logic, suggests that inflation should stay low for some time.

What is inflation?

Economists almost universally use the word "inflation" to refer to the *rate of growth* of an average of prices of a *group of currently produced goods and services*. An increase in the price of any one item, like gasoline, does not by itself measure inflation. Why not? Because when the price of one item goes up, the prices of other items in the group may go down. Notably, in recent months, while gasoline prices have soared, natural gas prices have plunged, blunting some of the impact of the gasoline price increase on overall inflation.

The word inflation is often associated with faster growth in the supply of money, and so is tied back to Federal Reserve actions affecting the money supply. As the late Milton Friedman, a celebrated Rutgers alumnus, noted: "Inflation is always and everywhere a monetary phenomenon."

What Creates Inflation?

A key determinant of inflation is what people and businesses expect it to be! So the psychology of expectations is a key factor. If prices are universally expected to increase about 2 percent a year, in the absence of anything disturbing, prices will on average increase about 2 percent a year.

In reality things don't work out this neatly. First, not everybody has the same view on what inflation is likely to be – that's a key reason that Federal Reserve members have recently gone to great lengths to give their views on where they think inflation is going to be in the long run.

High gas prices don't necessarily mean that inflation will stay high.

Also, the amount of slack in the economy affects inflation. The unemployment rate is a reasonable measure of slack, with a high unemployment rate meaning more slack. If times are booming, and the unemployment rate is low, businesses will probably be able to increase prices more rapidly than long-run expectations suggest. There has been a half-century long debate about the precise nature of the relationship between unemployment and inflation, but a good summary is that inflation consistently lessens when the unemployment rate is high and moves up when the unemployment rate falls below that consistent with "full employment" — probably someplace between 5 percent and 6 percent, or much less than it is today.

Finally, large movements in the prices of important products move the inflation numbers around. The surge in the prices of gasoline and other energy products pushed up the inflation numbers in 2007 and 2008. In late 2008 as energy markets collapsed in the Recession and fuel prices plunged, inflation rates turned negative. Many people seem to believe the recent rise in commodity prices, especially gasoline, is an infallible indicator that inflation will be moving up. However, the quick collapse of inflation after the 2008 surge in energy prices, and the failure of other prices to move up in

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tandem with gasoline when its price spiked last year, are merely the most recent examples showing that high gas prices don't necessarily mean that inflation will stay high .

However, the paradox is that if increases in the price of energy and other commodities boost inflation expectations, then those expectations by themselves may trigger inflation. The point is that the relationship between commodity prices and inflation is not set in stone.

The Federal Reserve's actions can also have a major impact on inflation. The Fed's influence works in two ways. First, through its control of short-term interest rates and other aspects of the financial system, the Fed exerts enormous influence on the level of economic activity, and thus on the amount of slack in the economy. Second, the Fed's *own view* on where inflation will go in the long run often has a major impact on expectations of inflation because of the agency's powerful influence on economic activity.

On balance, the most likely path for inflation over the next year or so seems to be little change from the recent past.

Statements by Fed Chairman Bernanke do not necessarily change the views of the average person on the street. However, financial markets obsessively watch what the Fed says and does. If lenders, such as banks, think that the Fed expects inflation to go up over the long run, borrowers will find it easier to get credit because inflation generally makes it easier to repay loans. While the resulting expansion of lending will spur economic activity, it will ultimately push up overall inflation.

The Current Situation and Outlook

The Federal Reserve has made it clear that it wants to hold inflation, as measured by the Personal Consumption Expenditures index (a price measure issued with the GDP numbers), to an average of around 2 percent over the long term. This figure is consistent with growth in the more familiar Consumer Price Index (CPI) of around 2 ½ percent. The CPI grew 1.6 percent in 2010 and 3.2 percent in 2011, which averages 2.4 percent. So taking a two-year perspective, inflation has been right where the Fed wants it to be.

Nonetheless, the 3.2 percent gain in the CPI in 2011 was a bit higher than the Fed's long-term target. Perhaps the Fed has not been doing its job correctly and is letting inflation move up. However, it's pretty clear that inflation last year was pushed up by the increase in gasoline prices. Inflation excluding food and energy (usually called, somewhat grandly, "core" inflation), was just 1 percent in 2010 and 1.7 percent in 2011 — below the Fed's target in both years. This suggests that even though food and energy prices popped up last year, price increases in other parts of the economy remained well-restrained by economic slack and inflation expectations remain stable at a fairly low level. Or in Fedspeak, "well-moored."

On balance, the most likely path for inflation over the next year or so seems to be little change from the recent past. To be sure, ups and downs in energy, food, and other prices will push the headline price indexes around in one direction or another.

It's always possible that inflation, excluding food and energy, will come in a bit higher than the Fed would like it to be over the long run. But even if that happens, it's unlikely the Fed will try to bring it down by raising interest rates unless the unemployment rate also moves down a lot. It would be very hard to make the leap from a slight increase in inflation tolerated by the Fed for a spell to the sort of problem that plagued the economy in the 1970s. In short, while nobody likes paying more at the pump, it's not likely to lead to a long spell of high inflation.

New Jersey Business Pulse Survey

A Step Up in Optimism

New Jersey businesses reported growing optimism about current economic conditions and the overall outlook in a March survey by the New Jersey Department of the Treasury.

The New Jersey Business Pulse Survey looks beyond conventional economic data and gather views in real time directly from a diverse group of businesses in the state. Nearly 90 firms representing a wide spectrum of industries and businesses of varying sizes responded to the survey which asked 14 questions about current and perspective conditions and gave respondents the opportunity to give their views on other topics of their choice. Detailed results may be found at: http://www.state.nj.us/treasury/pdf/marchsurvey.xls

General Conditions: Upbeat on Present and Future Prospects

As was the case in February, the overall assessment of current conditions is markedly tilted toward growth. Nearly half the respondents in March saw current conditions improving outside New Jersey, up from about a third of respondents who expressed that view in February. New Jersey conditions were not viewed quite as favorably, but as was the case in February, about a third of the respondents see growth in the state. Looking to the next year, about half the respondents anticipate growth inside and outside the state with less than one-tenth expecting deterioration.

Revenues, Hiring and Capital Spending: Outlook Is Positive

Respondents see their companies benefiting from growth. Almost half expect gains in their New Jersey revenues, and nearly two-thirds who responded to that question expect revenue growth in other locales. Nearly 30 percent of the firms plan to increase their New Jersey workforce, while only three anticipate job cuts. Responses to a question about employment outside New Jersey were similar. Nearly one in five of the firms are planning to expand employment in New Jersey — more than twice the fraction that is planning job cuts. Responses to the questions on capital spending were also largely weighted toward gains, both inside and outside the state.

A bit more than one-fourth of the firms report having moderate or strong problems in finding qualified workers for open positions in New Jersey, while roughly equal numbers report no problems in that regard. The portion having trouble hiring is somewhat less than has been reported in recent months. Virtually no respondents report any problems filling positions outside of New Jersey.

Product Prices and Input Costs

The responses to the price questions in March were similar to those received in the last several months: Close to one-third of respondents report recent increases in prices that they charge, while more than two-thirds of the panel have seen recent increases in their input costs.

Conclusion

The March results show ongoing improvements in the economy. They would appear to be at some odds with the weaker labor market numbers last month, especially in New Jersey. However, other indicators of activity continue to suggest that the expansion is ongoing, and it's plausible that firms have looked past one soft spell and are reporting that the economy is essentially firming. The open-ended responses included concerns over taxation, energy and regulatory policies, with one respondent noting that the mild winter weather had been helping business.

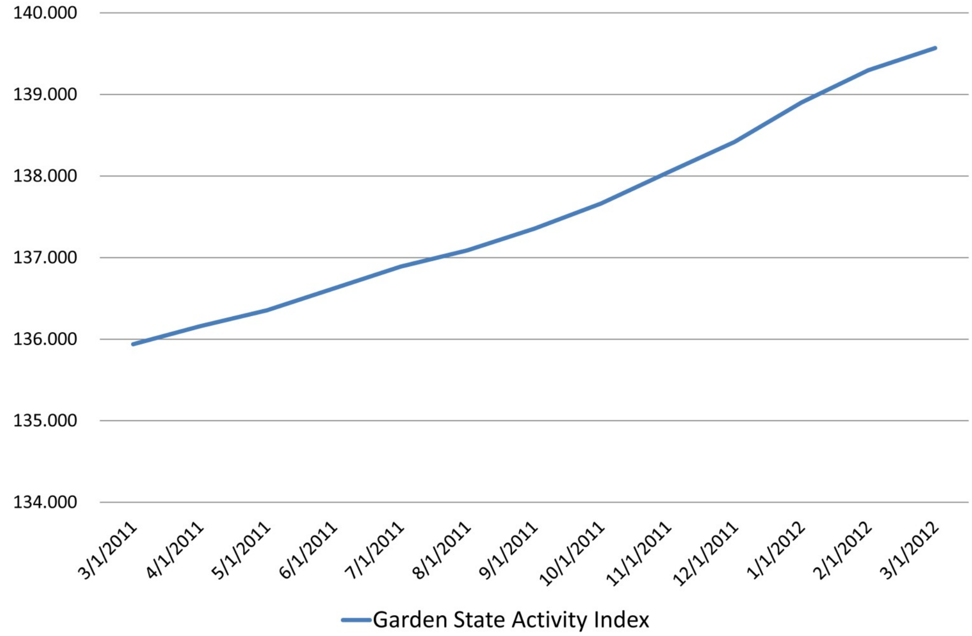
The New Jersey Business Pulse Survey has been created to look beyond conventional economic data and gather views in real time directly from a diverse group of businesses in the state. If your New Jersey firm is interested in participating in this monthly survey, please contact Mary Filipowicz at 609-633-6781.

Garden State Activity Index

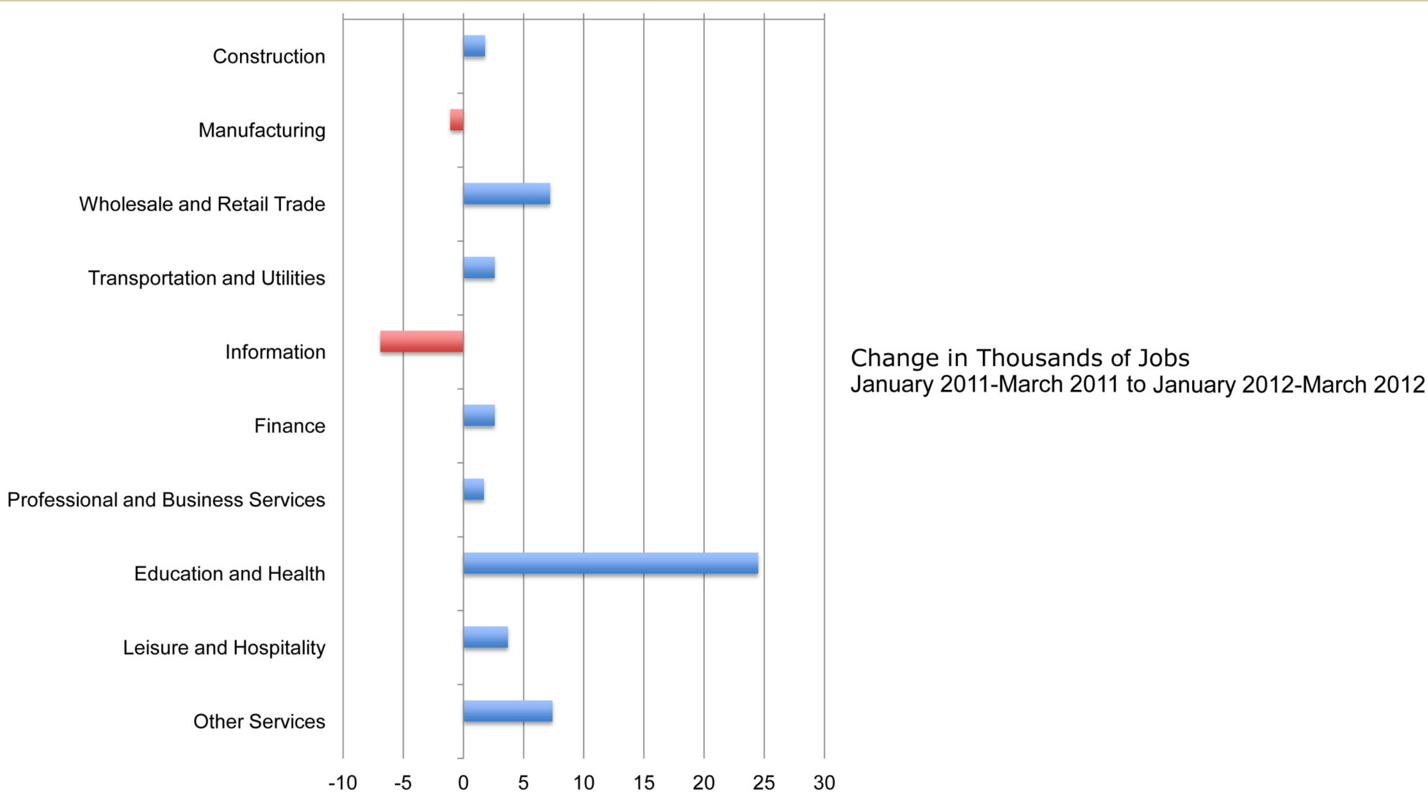
The *Garden State Activity Index* is our broad measure of monthly economic activity in the state of New Jersey. The index incorporates information from three sources: the Federal Reserve Bank of New York's coincident index, the Federal Reserve Bank of Philadelphia's coincident index, and the Philadelphia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

Last August, we began using principal components analysis to calculate the activity index. This statistical technique systemically constructs weighted averages of the three Fed indicators. The new weighted index more accurately reflects the state of the New Jersey economy.

Based on the most recent monthly data, the state's economy continues to grow at a well-maintained pace. This past March, New Jersey's economy reached an index level 2.7 percent higher than the level in March 2011, virtually matching February's 2.8 percent comparative period growth.
Joseph Mengedoth

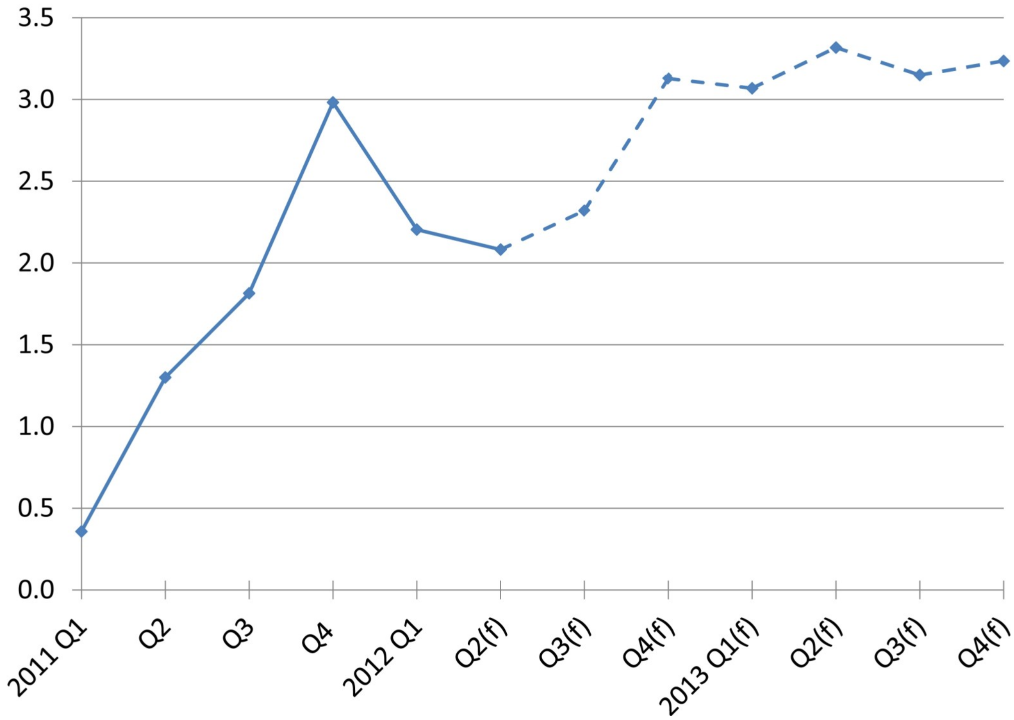


Private Industry Employment Trends



Data source: New Jersey Department of Labor

Real U.S. GDP Growth



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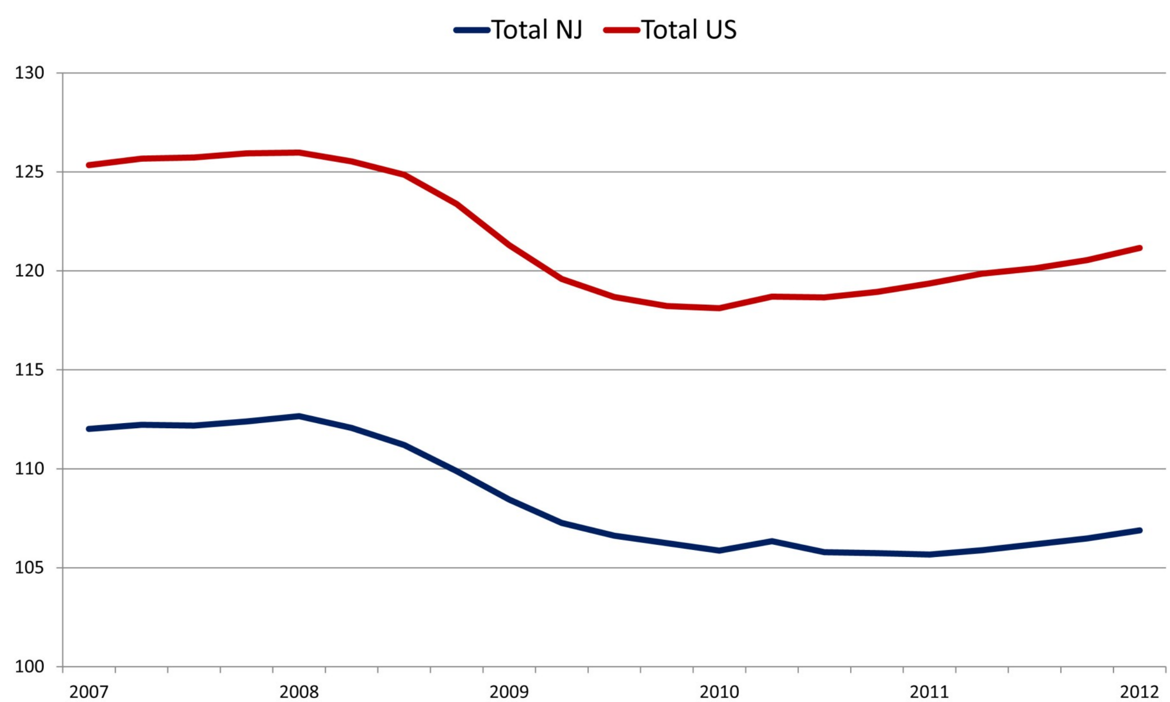
Data source: U.S. Bureau of Economic Analysis

State & National Job Trends

Total Employment *(Relative Employment 1990=100)*

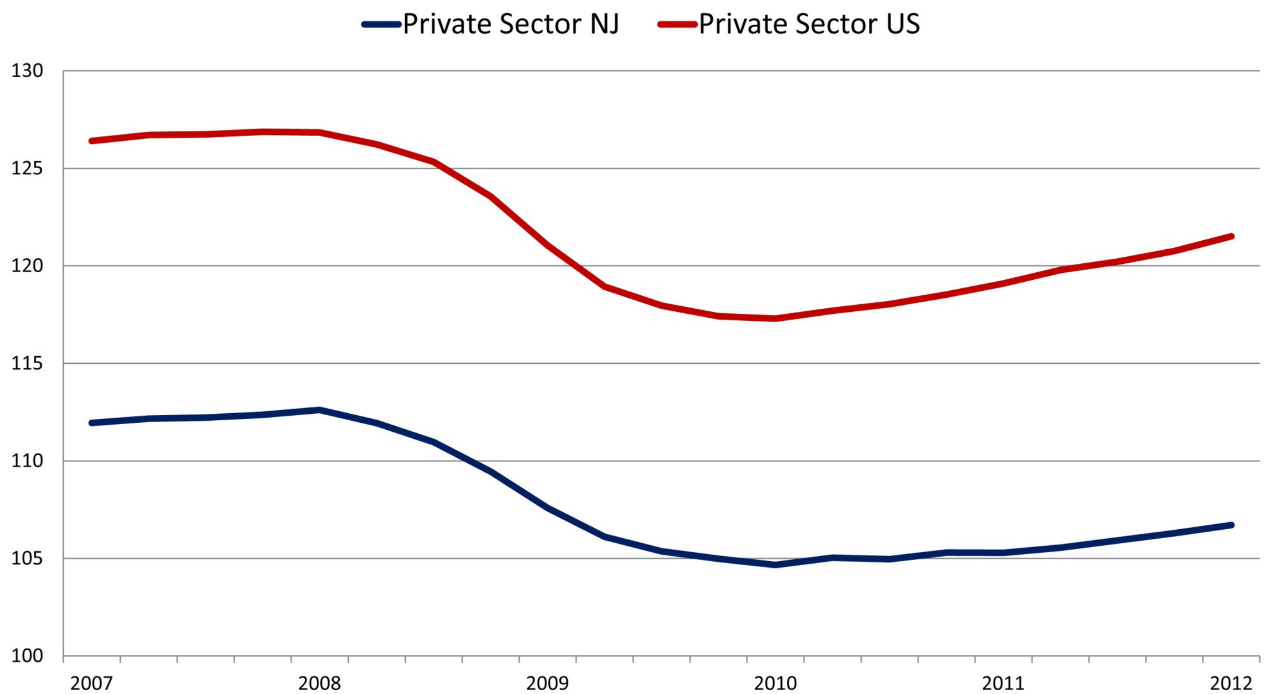
This chart compares the number of employed workers to the base year of 1990. The number 100 represents employment in 1990.



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.