New Jersey Economic Outlook: July 2017

New Jersey Faces Challenges on a Number of Fronts

New Jersey’s economy continues to gradually gain momentum after lagging for much of this recovery. The improvement is most evident in the labor market, with job growth broadening across more industries and the unemployment rate trending lower. The Garden State continues to face numerous challenges, including working painfully slowly through a mountain of home foreclosures and a fiscal predicament that ranks among the most challenging in the nation. Demographic tides are also working against the state. Population growth has stagnated as more residents flee to lower costs states in the Sun Belt. In addition, New Jersey’s long-held niche as a suburban escape from the higher-priced hustle and bustle of the city has run up against shifting preferences by young, college-educated workers to live closer to large urban employment centers.

New Jersey’s location in the heart of the Northeast Corridor is one of its greatest assets. Proximity to the large and relatively wealthy population in the Northeast supports one of New Jersey’s most dynamic employment sectors: transportation & logistics. Significant investment has flowed into this sector, as e-commerce has led to a surge in development of warehouse and distribution facilities. Highways, bridges and port facilities have also seen increased capital outlays, boosting construction and providing some much needed room to accommodate future growth. New Jersey’s health care and education sectors are another key asset. Financial and business services have long been important contributors to the region. Both had generally underperformed earlier in the recovery, as businesses opted to follow younger workers back to the big cities or to lower cost Sun Belt locations. Hiring in financial and business services has improved more recently.

We are looking for continued modest improvement in New Jersey’s economy during the second half of this year and 2018. While the state faces many challenges, the broadening national economic recovery should help boost growth within the state.
New Jersey’s Labor Market Joins the Expansion

The Garden State surpassed some important labor market milestones during the past year. Nonfarm employment, which measures the number of jobs in the state, finally surpassed its pre-recession level and the state’s unemployment rate fell below the national rate. The jobless rate now stands at 4.1 percent, falling a full percentage point over the past year to its lowest point since June 2001. The improvement is tempered somewhat by the decline in the labor force participation rate, which recently fell to an all-time low. Resident employment, which measures employed persons living in New Jersey regardless of which state they work in, continues to expand, underscoring the importance of thriving job markets just across New Jersey’s borders.

Nonfarm employment finally returned to its prerecession level in September 2016, officially entering expansion territory some two years later than the nation as a whole. New Jersey employers added jobs at the strongest pace in over two decades. Nonfarm employment rose 1.5 percent higher in 2016, which equates to 59,700 net new jobs. Total payroll employment ended 2016 at an all-time high. Jobs were added across New Jersey’s economy, with education & health, warehousing & logistics, finance and business services posting the strongest gains. New Jersey’s transportation & warehouse industry added an impressive 17,600 jobs in 2016, the strongest year yet for this sector. Momentum continued into 2017, highlighted by both Amazon and Blue Apron announcing plans to expand operations in New Jersey in 2017. Notably, some sectors that had lagged for several years saw the tide turn in 2016.

The manufacturing sector added jobs on an annual basis for the first time since consistent data were reported back in 1990. Food product and chemical manufacturers led the rebound, which has continued well into 2017. Through May, New Jersey manufacturing payrolls have added 3,800 jobs over the year, on a three month average basis. Leisure & hospitality and retail also posted solid job gains, which comes as a welcome surprise following the loss of another casino in Atlantic City last October. Gains outside the gaming industry have been fairly strong, helped along by lower gasoline prices and improving job and income growth throughout the region.

New Jersey’s vital education & health and transportation & logistics sectors continue to lead job growth. Health care added the most new positions, 11,400 jobs, followed by administrative services, transportation & warehousing and education. Office-using employers also added jobs at a brisk pace. Finance & insurance added 4,800 jobs and professional & tech services added 3,500 positions. Finance employment had declined from early 2014 until turning around mid-2016, a positive development, as much of this can be traced to depository institutions which tend to provide high-paying jobs. The only key employment sectors losing jobs over the year were government and construction. The two sectors were impacted by state budgeting issues and public highway construction work stoppages back in 2016.

Figure 3

New Jersey Employment Growth By Industry
Year-over-Year Percent Change, 3-MMA

Figure 4

New Jersey vs. U.S. Unemployment Rate
Seasonally Adjusted

Source: U.S. Department of Labor and Wells Fargo Securities
State of Suburbia as Economic Activity Moves Downtown

Demographic headwinds have intensified for much of New Jersey. The Garden State has long seen a significant outflow of residents and businesses to the South and West. These outflows have continued, including the loss of corporate headquarters for Mercedes Benz USA and Sealed Air.

While New Jersey has steadily lost residents to the Sun Belt, it has generally feasted off its accessibility to more expensive areas in New York City and Philadelphia. This past decade has seen a bit of a reversal, as Millennials and empty nesters have shown a greater preference for living in urban environments, often preferring to rent. Businesses have followed workers back into Manhattan and Philadelphia, slowing the recovery in many of New Jersey’s suburban areas. The impact has been felt most acutely at sprawling corporate facilities that populate central New Jersey. New Jersey’s larger urban areas have captured some of this growth. Suburban counties, which led population growth in the early 2000’s, are now the ones losing residents while more urban counties gain. Figure 5 uses population density as a proxy for “suburbia,” but the same conclusions can be generally be drawn from simply looking at a map. Growth over the past six years has been led by those areas closest to New York City or urban cores—a reversal of the trend prior to the Great Recession.

Suburbs across the nation face similar challenges, but New Jersey’s geographic location in the Northeast, which sometimes resembles a giant suburb, puts a thumb on the scale. Competitive pressures are coming from multiple sources. New Jersey’s cost of living is still much higher than competing areas in Florida, Georgia or the Carolinas, all of which also enjoy a more temperate climate and less pressing fiscal issues. Key industries that had long buoyed the state, including manufacturing, have been in structural decline. More recently, the sore spot has been support operations for financial services and other businesses, where jobs are vulnerable to automation or off-shoring. Other major employment drivers are largely those that cater to the local population, including health care, household and personal services, retailing and tourism. Many of these positions pay far less than the jobs that are being lost, which is one reason labor force participation has fallen as much as it has.

The rising popularity of downtown living has been a boon for some urban New Jersey areas, including Jersey City, Newark, Elizabeth, New Brunswick and Camden. These cities offer a lower cost urban alternative with easy connectivity to NYC or Philadelphia. These regions owe their appeal to efficient transportation links, underscoring the necessity for New Jersey to invest in infrastructure. Even without physical proximity to an urban setting, some suburban developments are repositioning themselves by becoming more urban. The redesign of Bell Labs to a co-working space brings some urban amenities to this suburban market and has seen some impressive results. Similar repurposing opportunities exist in other suburban New Jersey markets, particularly those located near key transportation corridors.

**Figure 5**

Population Growth by New Jersey County

Source: U.S. Department of Commerce and Wells Fargo Securities

**Figure 6**

Residential Building in New Jersey

Suburban counties, which led population growth in the early 2000s, are now the ones losing residents.
Challenged New Jersey Fiscal Outlook

New Jersey’s precarious fiscal position remains a key risk to the outlook. One of the state’s most formidable challenges continues to be the state’s ability to come up with funding to make the contributions necessary to keep the underfunded portion of the state pension plan from growing. New Jersey’s weak fiscal position led to yet another downgrade in its credit rating from Moody’s, which lowered the state’s rating to A3 in March 2017. Moody’s attributed the downgrade to continued negative impact of pension underfunding, growth in long-term liabilities, persistent structural imbalances and weak fund balances. The state has made some progress addressing its structural imbalances but continues to rely on optimistic revenue projections to balance its budget, while its underfunded pension liabilities continue to increase.\(^1\) New Jersey did make a larger pension contribution in FY 2017 and plans for an even larger one in FY 2018, though both are below actuarial recommendations.

George Mason University’s Mercatus Center recently ranked the fiscal solvency of the 50 states by assessing the extent to which states can meet short-term bills and long-term obligations. New Jersey ranked 50. New Jersey came in last for the analysis’ measure of long-run solvency and 49th for budget solvency. The former gauges ability for assets to cover long-term liabilities and the latter measures the state’s ability to cover fiscal year spending with current revenues. New Jersey’s revenues in fiscal year 2015 covered just 91 percent of expenses.\(^2\)

A recent PEW analysis showed that New Jersey could operate for only six days with its current reserve balance, which is closely watched by credit rating firms to gauge the severity of an unexpected shortfall in revenues. The state has zero dollars in its rainy day fund, an account every state other than New Jersey and Nevada has been able to replenish since the Great Recession.\(^3\) In an effort to locate funds to alleviate some of the pressure from the spiraling pension debt, New Jersey recently shifted the state’s lottery proceeds to the fund for 30 years beginning in FY 2018.\(^4\)

While this accounting method may help with immediate needs, it is far from the structural changes needed to improve New Jersey’s long-term creditworthiness.

In a May 2017 report, Moody’s cast doubt on the state’s ability to close its large structural budget gap through higher revenues derived solely through stronger economic growth, particularly given the likely need for further increases in pension contributions. They argue closing the deficit would likely require tax increases and structural spending cuts.\(^5\) New Jersey’s budget process is likely to remain contentious for some time to come.

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\(^3\) [www.njleg.state.nj.us/2016/Bills/S3500/3312_S1.PDF](www.njleg.state.nj.us/2016/Bills/S3500/3312_S1.PDF)


New Jersey Economic Outlook: July 2017
July 19, 2017

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ECONOMICS GROUP

Housing Makes Incremental Gains

New Jersey’s housing market remains challenged on several fronts. Sluggish population growth continues to weigh on demand while many homeowners are still struggling to shake off the effects of the housing crash. Many key housing metrics remain near crisis levels. The share of mortgages that are 90 days or more past due or in foreclosure is higher than in any other state and has declined only modestly from its post-crisis highs, while the U.S. measure rate has fallen all the way back to its pre-crisis level. On the bright side, New Jersey has pushed its serious delinquency rate down by a full percentage point over the past year to 7.4 percent but it still remains 4.2 percentage points higher than its pre-recession level. Stubbornly slow progress at clearing foreclosures casts a dark cloud over New Jersey’s housing market, making it difficult to establish reliable prices and appraisals. As of March, 10.2 percent of homes with a mortgage in New Jersey were worth less than what was owed on their mortgage, according to CoreLogic.

The CoreLogic data show home prices rose 2.4 percent on a year-over-year basis in the Garden State, well below the 6.6 percent growth posted nationwide. Gains have been uneven across New Jersey metro areas. Home values appreciated 3.6 percent in the New York City-Jersey City-White Plains area, while Ocean City posted the largest increase of 6 percent in May. Home values depreciated in Atlantic City and Trenton, while Camden and Newark saw essentially no change. Though the CoreLogic HPI data certainly disappoints for some of New Jersey’s metro areas, it has improved compared to this time last year.

The New Jersey Realtors Association also reported more upbeat market conditions through May 2017. Single-family home sales in New Jersey are up by 13.9 percent and inventory of available homes declined by 19.3 percent to a 5.8-month supply. New Jersey’s housing trends are running counter to the nation, where increasingly tight supply makes it so the typical home was on the market for less than a month before being sold. New Jersey is far less competitive, with homes on the market for about 80 days. Through May, the typical home in New Jersey sold for $285,000 which was about the same as in 2016, and ranked 8th among states, down from 7th last year.

We doubt New Jersey’s homebuilding will accelerate meaningfully, given its demographic and financial hurdles. The backlog of troubled mortgages, continued inventory overhang, and sluggish price appreciation are restraining single-family starts. Multifamily permits show a more meaningful rebound, even after coming off the 2015-16 surge in apartment building in Hudson and Essex counties. The state’s fiscal challenges are a major impediment to the housing market because the state’s already high tax burden will likely rise even further. New Jersey’s housing stock is also not in high demand today, given that many younger, college-educated workers are choosing to live closer-to or in the city. Immigrants are providing some relief, however, with larger suburban family homes often being converted into multi-generational homes.

Figure 7

CoreLogic HPI: NJ vs. U.S.
Year-over-Year Percent Change

- United States: May @ 6.6%
- New Jersey: May @ 2.4%

Source: U.S. Department of Commerce, CoreLogic and Wells Fargo Securities

Figure 8

New Jersey Housing Permits
Thousands of Permits, Seasonally Adjusted Annual Rate

- Single-Family, May @ 9,240
- Single-Family, 12-MMA: May @ 9,320
- Multifamily, 12-MMA: May @ 15,180

Source: U.S. Department of Commerce, CoreLogic and Wells Fargo Securities
Summary & Outlook

New Jersey’s economy has gained a bit of momentum over the past year and a half but still trails behind the nation in terms of overall economic growth. The Garden State has taken longer than most neighboring states and the nation as a whole to put the Great Recession behind it. The slow recovery was not unexpected. Much of the state’s housing market remains mired in the aftermath of the housing bust, with foreclosures still well above long-term norms. Hurricane Sandy, which devastated much of the state’s coastline in late 2012, dealt a huge setback to the state’s recovery. Atlantic City’s important casino industry has seen a huge rise in gaming competitors in nearby states amid a soft patch for the gaming industry in general. The state’s underlying demographics have also been less supportive, as a larger share of younger, college-educated residents have opted to move closer to key urban employment centers, which undermines New Jersey’s long-term competitive advantage of offering a lower-price suburban refuge to commuters from New York and Philadelphia.

The tide appears to have turned during the past year and a half. Job growth has picked up across most key industries. While growth still trails the nation as a whole, the differential is now more in line with its long-term norm. Moreover, the drag from the state’s leisure and hospitality sector appears to be subsiding. Tourism has actually been a bright spot this summer, with lower gasoline prices fueling more local travel. Health care and education continue to expand in the state and hiring has also rebounded in business and financial services.

We expect New Jersey to hold onto its recent momentum. We look for the state’s real GDP to rise 1.8 percent this year and look for employers to add roughly 57,000 new jobs. The unemployment rate, which recently fell to a new cycle low, is expected to average 4.2 percent for the year. The jobless rate is a bit of a wild card, having fallen due to a combination of stronger job growth and a decline in the labor force. We expect the labor force to rebound, however, as improved employment prospects draw job seekers back into the workforce. Residential and commercial construction activity also appears poised for better days. Sales of existing homes have risen solidly through the first five months of this year. Commercial building continues to be driven by demand for warehouse and industrial space, fueled by rapid growth in online retailing.
### New Jersey Economic Outlook

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<tr>
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<th>Actual</th>
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<tr>
<td></td>
<td>2012</td>
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<td>Real Gross Domestic Product by State, $ Millions</td>
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<td>Percent Change</td>
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<td>Percent Change</td>
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<td>FHFA Home Price Index, Percent Change</td>
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Forecast as of: July 19, 2017