September 18, 2018

**Economics Group**

Special Commentary


**Mark Vitner, Senior Economist**
mark.vitner@wellsfargo.com • (704) 410-3277
**Charlie Dougherty, Economist**
charles.dougherty@wellsfargo.com • (704) 410-6542


# New Jersey Economic Outlook: September 2018

## A Rising Tide Lifts New Jersey

Strong U.S. economic growth is helping revive New Jersey's economy. The Garden State is still underperforming the nation but the gap has narrowed and overall growth is much stronger than it was a year earlier. The economic recovery took more time to materialize in New Jersey, which faces a number of longstanding challenges, including a tenuous fiscal situation, the continued loss of residents through out-migration and a housing market that remains in slow gear due to a number of delinquencies and foreclosures. New Jersey's relatively large and dense population of highly educated households remains a key competitive advantage, as does the state's extensive freight network and abundance of warehouses, which are key cogs in the supply chain for the Northeast. Ecommerce-fueled expansions and the growth in international trade have helped the logistics sector flourish, boosting several local economies. There may also be cause for cautious optimism elsewhere. Life sciences and manufacturing appear to be gaining strength. Stronger consumer spending should also provide a needed lift to the state's tourism sector, which has seen a reshuffling and cut to its casino offerings.

***New Jersey is still underperforming the nation but the gap has begun to narrow.***

Real GDP growth rose 2.5% in New Jersey on a year-over-year basis in the first quarter of 2018, the fastest rate of growth since 2012. While growth may be somewhat overstated due to relatively easy comparisons with last year's sluggish growth numbers, New Jersey's economy has been trending higher for much of the past year. Stronger economic growth has boosted hiring and led to a drop in the unemployment rate. Nonfarm payrolls are now rising roughly on par with the nation, while the unemployment rate has fallen to just 4.2%, the lowest since 2007. While recent employment growth places New Jersey roughly in the middle of the pack relative to all other states, payrolls have been expanding at a clip slightly faster than its regional peers Pennsylvania, New York and Delaware. Payrolls have risen in all of New Jersey's metros, notably in the smaller areas outside major job centers in Newark and Trenton. This is welcome news, as many areas in Central and South Jersey have lagged considerably throughout much of this expansion.

**Figure 1**

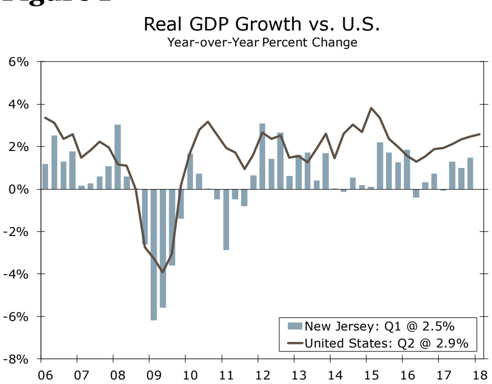
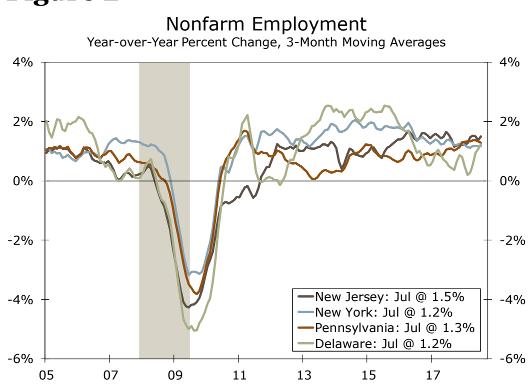



**Figure 2**




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

Together we'll go far

## Transportation and Warehousing Driving Growth

*Transportation and warehousing payroll growth was the strongest of any sector.*

Stronger consumer spending and ecommerce-fueled supply chain expansions have strengthened demand for logistics services, warehouses and distribution facilities. Given New Jersey's key Northeast location in proximity to several densely populated and wealthy consumer markets, the transportation and logistics sector has long been a key economic driver that uniquely positions the state to benefit from stronger national economic growth. Payrolls in New Jersey's transportation and warehousing sector have grown faster than any other major sector, accounting for roughly 31% of all new jobs created over the past year, and expanding 9% year-over-year nearly every month in 2018.

Higher cargo volumes at the Port of New York and New Jersey have bolstered nearby industrial markets in North Jersey, driving demand for warehouses and distribution facilities, and pulling vacancy rates down to near all-time lows. Demand should remain strong. The recent raising of the Bayonne Bridge to make way for larger post-Panamax container ships should keep cargo volumes growing and continue to attract new investment. With rents steadily rising, however, warehouse development may migrate down the turnpike toward Central and South Jersey. Industrial properties in the shadow of New York City are also enticing candidates for redevelopment, with many converted into higher-yielding apartments and mixed use projects.

Trenton has also seen a renaissance, as employment in the metro's transportation and warehousing sector has doubled since 2014. Sitting along I-95 between Philadelphia and New York City, Trenton continues to serve as a strategic location for logistics firms and ecommerce-driven retailers looking to access the Northeast corridor's wealthy consumer base. Trenton's vacancy rate for industrial buildings also continues to fall, as firms such as Amazon and FedEx have expanded in the area due to its regional connectivity but still lower rents compared to North Jersey. The sector is also doing well further south. A new marine terminal was recently added to the Port of Camden in Paulsboro, augmenting existing terminals in Salem and Camden. The Camden waterfront also continues to see a flurry of new office development amid several corporate relocations across the river from Philadelphia, spurred in part by tax incentives and relatively more affordable rents.

*Manufacturing has begun to pick up, further bolstering the transportation and logistics sectors.*

The resurgence in manufacturing activity that began in 2016 is another welcome development and appears to be gaining momentum. Manufacturing employment growth accelerated to 3.4% year-to-year in July, on a three-month moving average basis, the fastest rate of growth seen since the 1990's. Computer and electronic parts, food manufacturing and chemicals have seen notable gains.[1] Manufacturing payrolls are up in every New Jersey metro area and the improvement is helping bolster the transportation and logistics sectors.

**Figure 3**

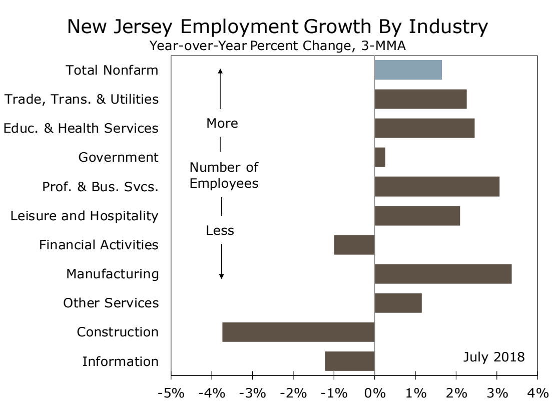
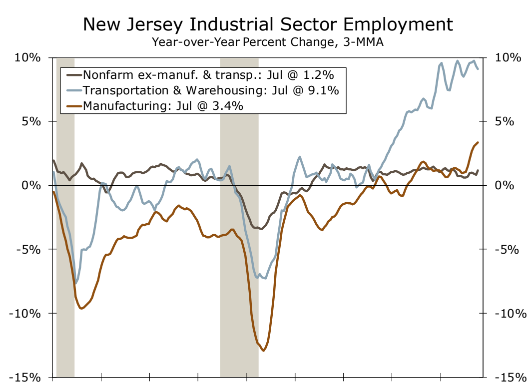



**Figure 4**




**Source: U.S. Department of Labor and Wells Fargo Securities**

**[1] A note of caution, however, is that much of the acceleration has been in the "miscellaneous" and "other" categories. The monthly employment estimates also rely on survey data that is prone to revision. A clearer picture will eventually be presented down the road with the release of the QCEW hard count of state payrolls.**

## Life Sciences Holding Its Own

The gains in the chemical manufacturing sector, which includes pharmaceuticals, also serve as a reminder that the New Jersey life sciences cluster appears to be regaining a bit of momentum following years of consolidations. This New Jersey mainstay scaled back heavily as a result of industry-wide consolidations and a shift from chemical to biological-based treatments. The life sciences sector, however, remains a key driver of economic growth. Employment in pharmaceutical and medicine manufacturing, biotech R&D and medical device manufacturing has recently shown signs of life after a steep decline in 2009 and several years of flat growth. The industry is benefiting from growing national investment in the healthcare and life science sectors. Approximately 50% of all new drug approvals in 2017 stemmed from a company with a footprint in New Jersey.

***New firms and investment dollars are flowing again into New Jersey's life sciences sector.***

Over the past decade, many large companies left the state in favor of areas with deep talent pools and flourishing research and innovation institutions, such as Boston and San Francisco. Rising demand in those areas has caused office rents and rents for labs and research facilities to surge. New Jersey may be poised to benefit in coming years, as the state's life sciences infrastructure is still largely in place and many experienced workers have remained in the area. While nascent industry clusters are emerging in Houston and Orlando, New Jersey should remain an attractive choice for companies looking to benefit from the state's well-established life sciences ecosystem as well as the spillover effects of Philadelphia's own burgeoning life sciences research sector and proximity to venture capital emanating from New York City. A recent example is the announced relocation of German biotech company Evotec to Princeton. Celgene has also recently expanded its footprint in North Jersey after purchasing the vacant campus left by Merck in 2015. And Israel-based Teva Pharmaceuticals, which is the world's largest producers of generic drugs, recently announced it is relocating its U.S. headquarters to Parsippany, New Jersey, from Pennsylvania, bringing with it over 800 high-paying jobs.

The service-providing sectors also continue to be a core asset of the New Jersey economy. Approximately 34% of all new jobs added over the past year were in the state's massive education and healthcare services sector. The professional and business services sector has also expanded payrolls. Hiring in financial services, however, remains sluggish. While financial services employment has picked up in New York City recently, conditions have taken longer to improve outside of major financial centers, particularly in North Jersey where many financial support functions are located. Many of these positions are vulnerable to automation or off-shoring. Newark, however, still represents an opportunity for firms to escape the high rents of Manhattan or Jersey City's "Wall Street West" directly across the Hudson, which has kept demand for office space and apartments fairly strong. While financial services have been a soft spot, growth in household and personal services remains solid, reflecting gains in job and income growth. The stronger stock market is also helping bolster household finances and consumer confidence.

***Education and healthcare services are key to the Garden State.***

**Figure 5**

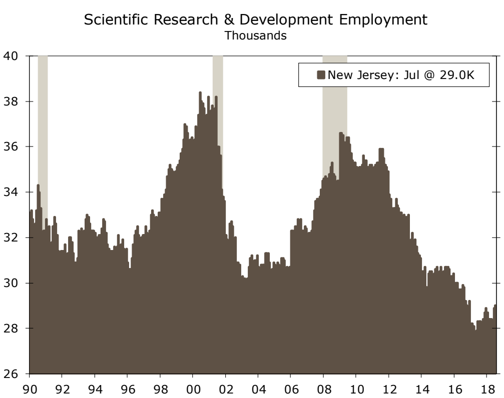
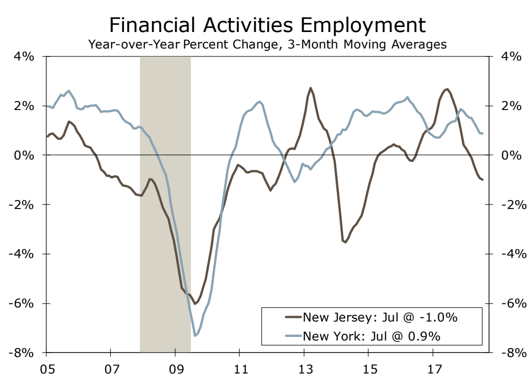



**Figure 6**




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

***We expect improving consumer spending to modestly boost hospitality and tourism.***

Stronger consumer spending should also boost New Jersey's hospitality sector, which has struggled to build significant momentum over the past few years. Tourism has struggled as the state's gaming industry has faced increased competition from neighboring states. Overall visitor spending increased 2.4% in 2017, which fell just short of the 2.9% gain registered a year earlier. While the state as a whole has struggled, the Shore Region remains a bright spot. Visitors continue to flock to the area's many beaches and nature preserves. The tourism industry has also diversified somewhat and is seeing more visitor dollars spent at wineries, breweries and distilleries. Atlantic City continues to struggle, but the opening of two new casinos in June has helped recoup some of the cuts in leisure and hospitality payrolls over the past few years. Legalized sports gambling should also support higher gaming revenues. Atlantic City remains a shadow of its former self and the metro remains one of the slowest growing economies on the East Coast. One of the byproducts of this sluggish growth has been the continued exodus of many high-end retailers, which have often been replaced by deep discount stores.

## A Demographic Low Tide

Demographic headwinds continue to be a major obstacle for New Jersey, as population growth remains among the slowest in the nation. The small increases in population that the state has seen in recent years is mostly the result of international migration. The state has long seen an outflow of residents to the South and West, a trend that continued, with over 57,000 leaving the Garden State in 2017. Competing states such as Florida, Georgia and the Carolinas have seen stronger employment growth and offer a lower cost of living. The outflow of residents has also made it tougher to recruit new industry, with employers preferring to locate in areas that younger workers are moving to. Moreover, this past year's tax reform may accelerate this trend, as many residents that have been contemplating moving to lower cost areas may decide to follow through on such plans.

***If not for international in-migration, New Jersey's population would be declining.***

Access to New York City and Philadelphia, which have seen an economic resurgence in recent years, remains a key competitive advantage for New Jersey. The rising popularity of downtown living has been a boon for some urban New Jersey areas, including Jersey City, Newark and New Brunswick. These cities owe their appeal to efficient transportation links, underscoring the necessity for New Jersey to invest in infrastructure. Connectivity is a major advantage and a significant draw for those looking to avoid the high rents of downtown living. Increased rail congestion and a lack of structural improvements to the connecting bridges and tunnels, however, may threaten New Jersey's reputation as a suburban escape. One project to improve accessibility has come under the political gun recently. The proposed Gateway Program infrastructure expansion includes updating many of the tunnels crossing into Manhattan from Newark, as well as the addition of two new tunnels that would effectively double train capacity and allow for additional high-speed rail service. The multiple levels of public funding needed to fund this ambitious project have added to its complexity and cast doubt about the viability of the project.

**Figure 7**

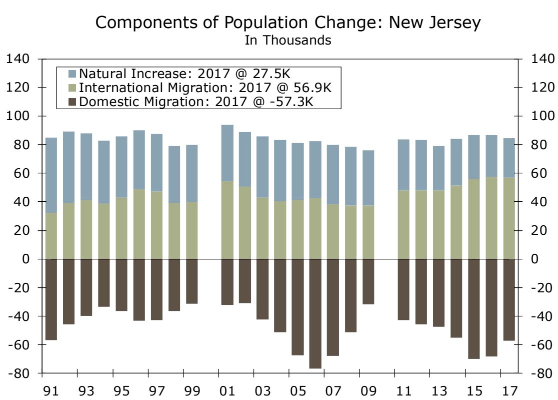
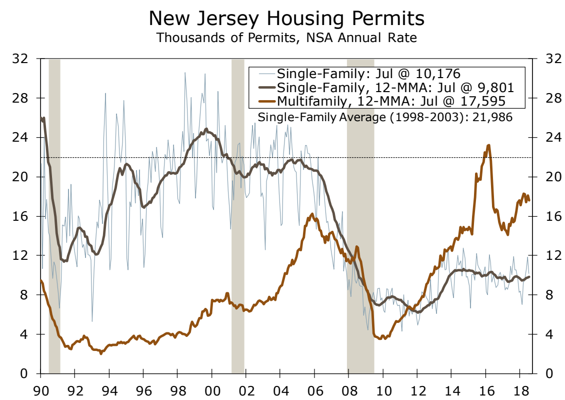



**Figure 8**




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

## Housing Still Stuck in Low Gear

Sluggish population growth throughout the state should continue to weigh on New Jersey's housing market, which remains challenged on several fronts. The share of mortgages that are 90 days or more past due over the past year remains the second highest of any state. Stubbornly slow progress at clearing foreclosures has also made it difficult to establish reliable prices and appraisals in some areas. As of June, 7.0% of homes with a mortgage in New Jersey were worth less than what is owed on their mortgage. Conditions are slowly improving, however. Sales of existing homes are trending higher. Homes are also selling more quickly, remaining an average of 55 days on the market in July compared to 62 days last year. Home prices also continue to increase in the state, with the median price of existing homes sold rising 4.2% over the past year.

***The fiscal outlook is dim.***

New Jersey's fiscal challenges may further impede a more meaningful housing market recovery. Tax revenues have not recovered as quickly as originally anticipated, given the subdued nature of the state's economic recovery. According to George Mason University's Mercatus Center, New Jersey recently ranked dead last among all other states in terms of long-run fiscal solvency, owing largely to its unfunded pension liabilities. In response, the state's already high tax burden was recently raised even further. Legislators passed a new budget agreement that increased the corporate business tax to 11.5%, the second highest in the country. The deal also included a new 10.75% top marginal tax on personal income over $5 million. While the agreement may improve the state's fiscal situation around the margin, higher tax rates may further diminish the incentive to live New Jersey, which would worsen the state's already challenging demographics.

***Tax reform will likely impede a fuller housing recovery.***

Tax reform at the federal level may also hinder New Jersey's housing market. The lowering of the mortgage interest deduction and the cap on state and local tax deductions enacted under the Tax Cuts and Jobs Act will slow home sales and price appreciation of homes in the $750,000-$1.5 million range more than what would have otherwise occurred. Given the high concentration of homes in that price range in North Jersey and along the coast in the Shore Region, the Garden State's housing market may be particularly impacted. The state and local tax (SALT) deduction is now capped at $10,000. Over 40% of New Jersey residents claim a SALT deduction, with an average $17,850 deduction, which provides some relief from the high property taxes in the state. This further limitation may induce residents to locate elsewhere and exasperate the demographic headwinds facing the state.

With New Jersey's housing market still on the mend, it is unlikely homebuilding will accelerate meaningfully over the next few years. The backlog of delinquent mortgages, continued inventory overhang and sluggish price appreciation will restrain new single-family construction. The lack of building in recent years should still allow for some low single-digit gains, however. Multifamily construction surged earlier in the decade and looks to be cooling off.

**Figure 9**

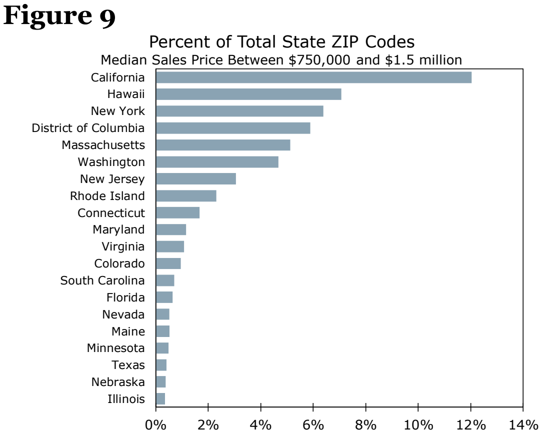
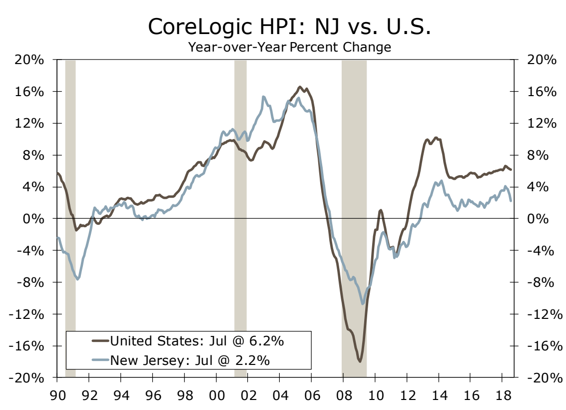



**Figure 10**




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

**Summary & Outlook**

***Economic growth should improve across the state over the next couple of years.***

New Jersey's economy has gained momentum over the past year, as stronger U.S. economic growth has fueled growth in the state's transportation and distribution sector. We are looking for New Jersey's real GDP to rise 2.4% this year, which is up from less than a 1% pace in each of the two prior years. Overall employment growth is now rising roughly in line with the nation and the unemployment rate has fallen half a percentage point over the past year. Commercial development has picked up across most of the state's metros, driven by growth in transportation and logistics and some recent success landing corporate relocations and expansions. There has also been an increase in mixed use development, reflecting growing demand for urban-style living. Single-family homebuilding has generally lagged, but is showing some nascent signs of improvement.

Sluggish population growth will continue to limit New Jersey's economic gains. The Garden State will add just under 30,000 residents a year over the next couple of years. Practically all of the state's population growth is coming from immigration from other nations. New Jersey continues to lose more than 50,000 residents a year to net domestic migration. With the labor market tightening up, slow population growth will make it harder for New Jersey businesses to find all the skilled workers they need, which will increasingly limit job growth. After rising 1.6% this year, we expect nonfarm payrolls to rise 1.5% in 2019. The bulk of that growth will come from New Jersey's service sector, particularly healthcare and education.

## New Jersey Economic Outlook

| | Actual | | | | | | Forecast | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
| Real Gross Domestic Product by State, $ Millions | 489,453 | 496,128 | 496,901 | 503,515 | 506,638 | 511,302 | 523,802 | 535,802 | 544,910 |
| Annual Rate | 1.9 | 1.4 | 0.2 | 1.3 | 0.6 | 0.9 | 2.4 | 2.3 | 1.7 |
| Nominal Personal Income, $ Millions | 490,611 | 494,040 | 514,382 | 538,220 | 549,836 | 563,339 | 583,338 | 607,021 | 632,516 |
| Nominal Personal Income, Percent Change | 3.6 | 0.7 | 4.1 | 4.6 | 2.2 | 2.5 | 3.6 | 4.1 | 4.2 |
| Real Median Household Income, $ | 69,717 | 65,692 | 66,143 | 69,221 | 68,468 | 69,563 | 70,816 | 72,232 | 73,640 |
| Population, Thousands | 8,882 | 8,914 | 8,943 | 8,960 | 8,978 | 9,006 | 9,034 | 9,060 | 9,083 |
| Change in thousands | 37 | 32 | 29 | 17 | 18 | 27 | 29 | 26 | 23 |
| Percent Change | 0.4 | 0.4 | 0.3 | 0.2 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 |
| Nonfarm Employment, Thousands | 3,891 | 3,935 | 3,968 | 4,013 | 4,074 | 4,127 | 4,191 | 4,252 | 4,285 |
| Change in thousands | 43.0 | 44.7 | 32.6 | 44.7 | 60.9 | 53.9 | 64.0 | 60.8 | 32.8 |
| Percent Change | 1.1 | 1.1 | 0.8 | 1.1 | 1.5 | 1.3 | 1.6 | 1.5 | 0.8 |
| Unemployment Rate, Annual Average | 9.3 | 8.2 | 6.7 | 5.8 | 5.0 | 4.6 | 4.3 | 4.0 | 4.1 |
| Total Housing Permits | 17,988 | 24,270 | 28,119 | 31,050 | 26,751 | 28,893 | 29,110 | 28,650 | 27,770 |
| Single-Family Permits | 7,290 | 10,434 | 10,907 | 10,411 | 9,639 | 9,997 | 9,810 | 10,100 | 10,340 |
| Multi-Family Permits | 10,698 | 13,836 | 17,212 | 20,639 | 17,112 | 18,896 | 19,300 | 18,550 | 17,430 |
| FHFA Home Price Index, Percent Change | (2.7) | 0.4 | 2.4 | 2.8 | 2.8 | 3.0 | 4.2 | 4.4 | 4.4 |

Sources: National Association of Realtors, Federal Housing Finance Authority, U.S. Department of Commerce, U.S. Department of Labor, Moody's Analytics & Wells Fargo Securities
Forecast as of: September 18, 2018

## Wells Fargo Securities Economics Group



| | | | |
|---|---|---|---|
| Diane Schumaker-Krieg | Global Head of Research, Economics & Strategy | (704) 410-1801<br>(212) 214-5070 | diane.schumaker@wellsfargo.com |
| Jay H. Bryson, Ph.D. | Global Economist | (704) 410-3274 | jay.bryson@wellsfargo.com |
| Mark Vitner | Senior Economist | (704) 410-3277 | mark.vitner@wellsfargo.com |
| Sam Bullard | Senior Economist | (704) 410-3280 | sam.bullard@wellsfargo.com |
| Nick Bennenbroek | Currency Strategist | (212) 214-5636 | nicholas.bennenbroek@wellsfargo.com |
| Azhar Iqbal | Econometrician | (704) 410-3270 | azhar.iqbal@wellsfargo.com |
| Tim Quinlan | Senior Economist | (704) 410-3283 | tim.quinlan@wellsfargo.com |
| Sarah House | Senior Economist | (704) 410-3282 | sarah.house@wellsfargo.com |
| Charlie Dougherty | Economist | (704) 410-6542 | charles.dougherty@wellsfargo.com |
| Erik Nelson | Currency Strategist | (212) 214-5652 | erik.f.nelson@wellsfargo.com |
| Michael Pugliese | Economist | (212) 214-5058 | michael.d.pugliese@wellsfargo.com |
| Ariana Vaisey | Economic Analyst | (704) 410-1309 | ariana.b.vaisey@wellsfargo.com |
| Abigail Kinnaman | Economic Analyst | (704) 410-1570 | abigail.kinnaman@wellsfargo.com |
| Shannon Seery | Economic Analyst | (704) 410-1681 | shannon.seery@wellsfargo.com |
| Matthew Honnold | Economic Analyst | (704) 410-3059 | matthew.honnold@wellsfargo.com |
| Donna LaFleur | Executive Assistant | (704) 410-3279 | donna.lafleur@wellsfargo.com |
| Dawne Howes | Administrative Assistant | (704) 410-3272 | dawne.howes@wellsfargo.com |





WELLS FARGO SECURITIES