Second District Update: A Moderate Recovery Is in Progress

by Rae Rosen and John Wenninger

A broad-based, moderate recovery is unfolding in the Second District. Revised employment data released in March show that the labor market turned up in late 1992—considerably earlier than indicated by the preliminary data. Nonetheless, the improvement in the regional economy still lags the national recovery, and jobs in all major sectors of the local economy have not developed as rapidly as in the rest of the nation. Despite the weak growth in employment, growth in personal income has picked up over the past two years, driven by robust gains in compensation in the securities industry. Other signs of expansion in the District include stronger retail sales, a greater volume of exports, growth in single-family home construction, and declining vacancy rates for commercial office space. Taken together, these economic indicators augur well for a continuing comeback in the Second District's economy.

Labor markets

Rising employment. Earlier this year, the annual "rebenchmarks" of the labor data for New York and New Jersey were released. These annual revisions correct for any miscount of employment in the preliminary data issued each month.[1] In this case, the revised data show that the District's nonfarm employment began to inch up as early as the third quarter of 1992, about one year earlier than was indicated by the preliminary monthly data (Chart 1). The basic picture of a weak labor market in this District has not been changed, however.[2] Relative to employment in the country as a whole, employment in the Second District peaked earlier and declined for a longer period. Thus far, it has not come close to recouping the jobs lost during the recession, while nonfarm employment at the national level exceeded its earlier peak by late 1993.

We can put this subpar performance in employment in some perspective by applying the national growth rates to each sector of the District's economy. This exercise shows how the actual level of jobs compares with the number of jobs that would have been achieved had the region's economic performance in every sector matched that of the nation. We find that the shortfall created by the slower local growth was about 500,000 jobs since the first quarter of 1991 (see table).

While goods-producing industries such as manufacturing and construction contributed to the weak performance of the region, service employment was the dominant factor in the overall shortfall. Underperformance pervaded all service categories, including industries considered District strongholds such as business services, legal services, and finance. Given this weak employment performance, both in absolute terms and relative to the national trends, it is not surprising that the District has suffered from relatively high unemployment rates and continued out-migration.

Declining unemployment. Since mid-1992, unemploy-

[1] The preliminary data are based on monthly sample surveys of establishment employment. If some industrial sectors are underrepresented in the sample (or, less frequently, overrepresented), then the release of more complete information can entail significant revisions. Similarly, if an unusually large increase in new business formations occurs, the job growth at those companies is unlikely to be captured in the preliminary monthly survey but will be incorporated in the rebenchmarked data.

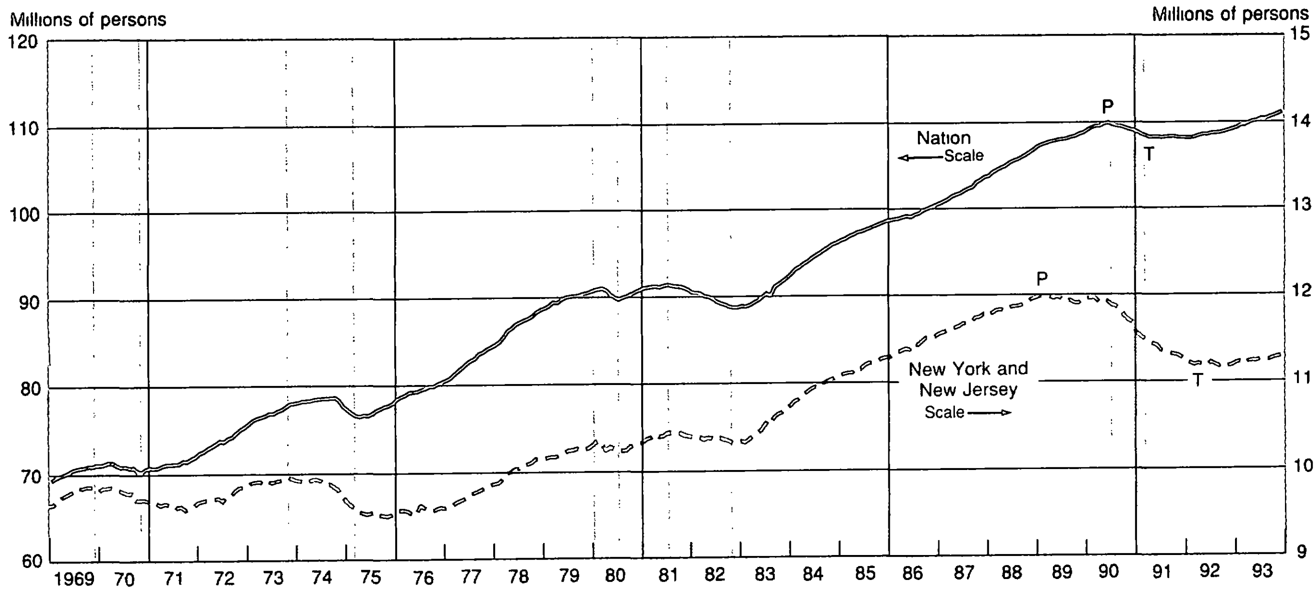
[2] The revisions had the greatest impact in New Jersey, adding 15,000 jobs in 1992 and 84,000 jobs in 1993 to the average level of employment. For New York, the job count did not change appreciably in 1992 but increased by 30,000 in 1993. For the two states combined, the upward revision of 114,000 jobs in 1993 means that the average level of employment increased 0.4 percent that year rather than declining 0.3 percent.

ment has declined in both the United States and the region. Nevertheless, unemployment rates in New York and New Jersey had peaked at much higher levels than the national rates before they began their fall, and today regional unemployment remains above the U S average (Chart 2) This winter, the downtrend in unemployment in New York and New Jersey was apparently interrupted by the unusually harsh weather, which disrupted retail sales activity and slowed construction work.[3]

[3] This departure from the 1993 trend in unemployment rates may also reflect discontinuities in the data The Bureau of Labor Statistics recently revised its method of data collection, incorporating information from the 1990 Census of Population in its 1994 household employment and unemployment data The revisions significantly increase the number of

Chart 1

Employment: New York, New Jersey, and the Nation



Sources Bureau of Labor Statistics, Federal Reserve Bank of New York

Notes "P" and "T" indicate the peak and trough of the national and local employment data Shaded areas indicate periods designated recessions by the National Bureau of Economic Research

Second District Employment Shortfall

	Percentage Distribution of Employment		Annual Percentage Growth (3/91–12/93)		Absolute Percentage Difference	Second District Shortfall (Thousands of Jobs)
	Second District	Nation	Second District Average	U S Average		
Employment						
Total	100.0	100 0	–0 6	1 0	–1 6	–521
Goods-producing	15 9	20 9	–3 8	–1 4	–2 3	–126
Service-producing	84 1	79 1	0 1	1 6	–1 5	–395
Retail trade	14 7	17 9	–0 9	1 1	–2 0	–98
Wholesale trade	5 4	5 5	–1 8	0 2	–2 0	–39
Business services	8 3	5 2	3 4	6 3	–3 0	–54
FIRE†	9 4	6 0	–1 2	–0 2	–1 0	–26
Other services	46 4	44 5	0 4	1 6	–1 2	–176

Sources Bureau of Labor Statistics, Federal Reserve Bank of New York

† FIRE is the acronym for finance, insurance, and real estate

The longer run decline in the regional unemployment rates since mid-1992 may not stem entirely from improved labor market conditions. The sluggish growth in jobs has encouraged out-migration from the region, and the region's labor force has contracted (Chart 3). If the labor forces in New York and New Jersey had maintained their 1990 levels, unemployment rates for 1993 would have averaged 1.6 percentage points higher in New York and 1.4 percentage points higher in New Jersey [4]

Income and consumption

Personal income. Despite the subpar employment situation, nominal personal income has followed the national pattern of more rapid growth in 1992 and 1993, accelerating from relatively weaker growth in 1991 (Chart 4). The low-to-moderate gains in compensation in most sectors of the District's economy in 1992 and 1993 have been augmented by unusually strong compensation growth in the securities industry. This broader based expansion in compensation over the past two years contrasts sharply with the pattern in 1991, when compensation in most sectors other than securities was stagnating or declining.

In the second half of 1993 (fourth quarter over second quarter), nominal personal income rose at a 2.7 percent annual rate in New York and New Jersey, an increase well below the national gain of 5.2 percent during the same period. Nevertheless, the regional performance for the second half of 1993 may have been stronger than the available data suggest. The personal income figures for the region are still preliminary and are almost always revised upwards in subsequent periods, sometimes significantly so. The

Footnote 3 continued

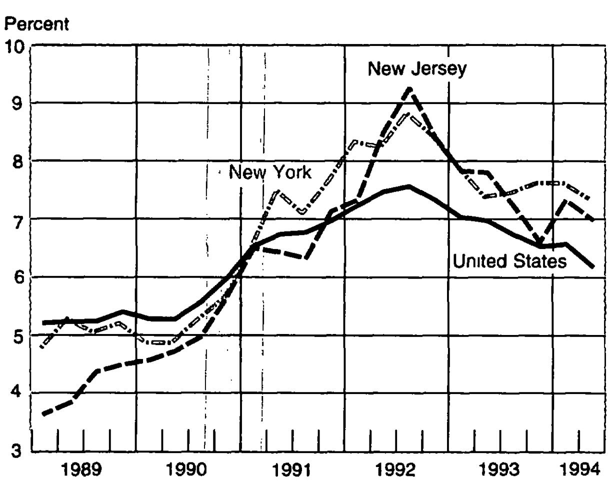
working and nonworking people in the labor force in New York and New Jersey However, the Bureau of Labor Statistics did not adjust the data before 1994 for the changes in the size of the labor force or the changes in the method of data collection, nor did it develop new seasonal factors for the new 1994 data As a result, the unemployment rates from 1993 and 1994 are not strictly comparable and the longer run trend may be the better indicator

[4] The regional labor force grew moderately in the fourth quarter of 1993, but it is too soon to know whether this uptick is a turning point or simply a pause (comparable to that in the second quarters of 1991 and 1992) in the longer run decline of the regional labor force

Chart 2

Unemployment Rates

Seasonally Adjusted Data



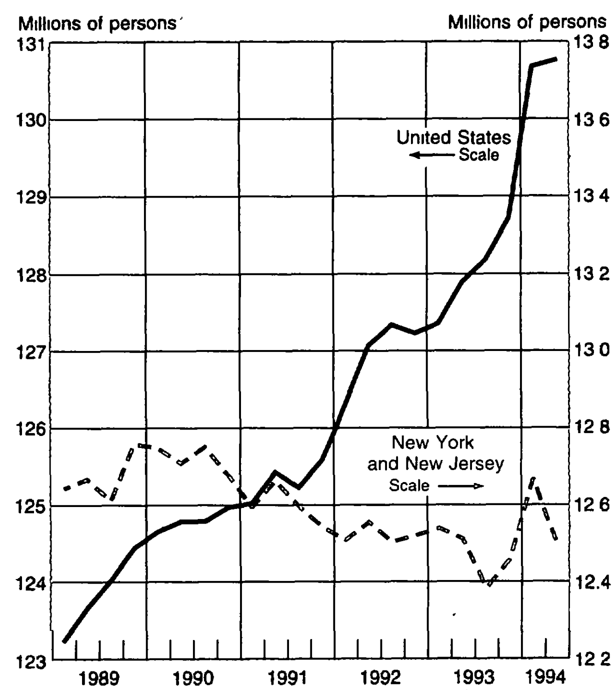
Sources Bureau of Labor Statistics, Household Employment Survey, Federal Reserve Bank of New York

Notes The recent redesign of the household survey limits the comparability of data before and after January 1994 Second- quarter 1994 values for New York and New Jersey are based on April-May data Shaded area indicates period designated a recession by the National Bureau of Economic Research

Chart 3

Labor Force: New York, New Jersey, and the Nation

Quarterly Average



Source Bureau of Labor Statistics, Household Employment Survey

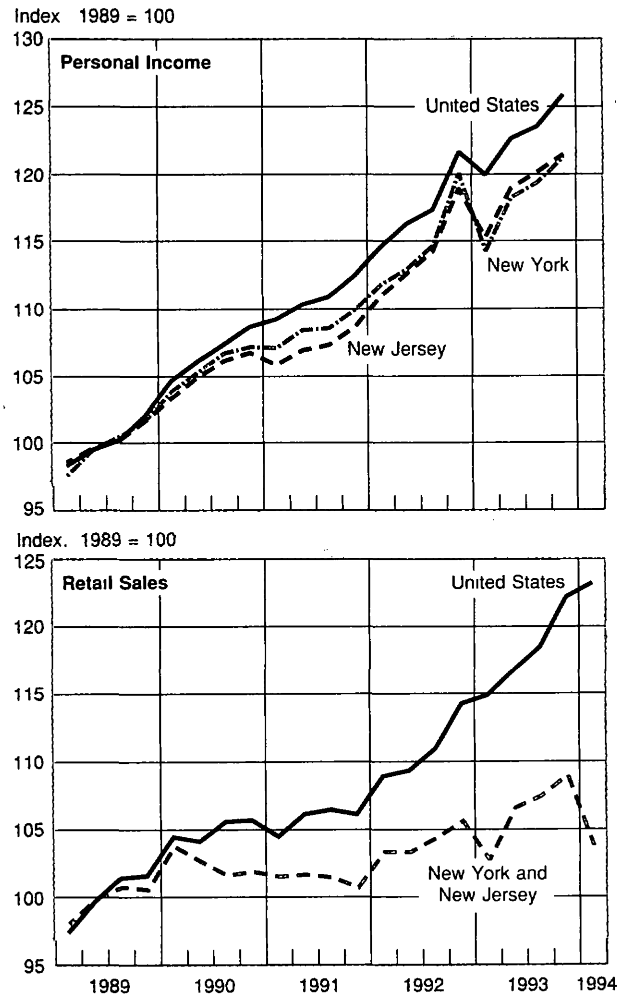
Notes The recent redesign of the household survey limits the comparability of data before and after January 1994 Second-quarter 1994 values for New York and New Jersey are based on April-May data revisions will reflect not only more complete data on insured payroll employment, but also more precise information on bonus payments in the securities industry, a major source of regional income [5]

[5] These bonuses are typically paid out over the December-January period, but in 1992 the payments were accelerated to avoid the anticipated federal tax rate increase in 1993 The earlier payments caused personal income to spike at the end of 1992 and to drop substantially in the first quarter of 1993, making it difficult to discern the underlying trends in personal income during this period

Chart 4

Trends in Income and Sales

Seasonally Adjusted Data



Sources: Bureau of Economic Analysis; Bureau of the Census

Note First-quarter 1994 values for retail sales in New York and New Jersey are based on January-February data

Retail sales. More widespread and rapid growth in nominal personal income over the past two years has supported somewhat stronger gains in nominal retail sales. Like the advances in employment and personal income, however, the gains in the District's retail sales are well below the national gains On a year-over-year basis, retail sales in the region rose 3 percent in the last six months of 1993, while sales at the national level advanced nearly twice as fast—about 6 percent—over the same period (Chart 4).

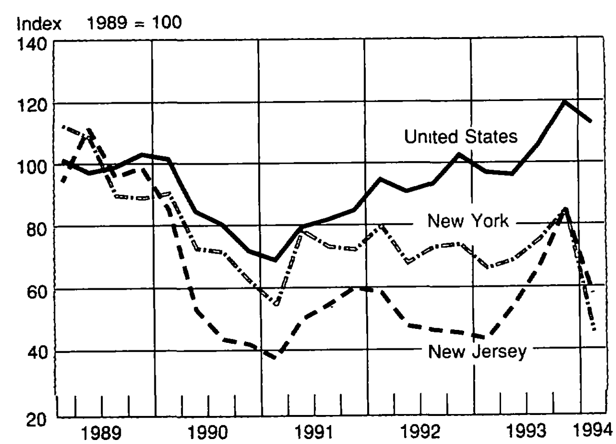
This year, despite unusually poor weather in New York and New Jersey, sales in the District and the nation maintained this differential performance through the first two months of 1994 In March, however, anecdotal evidence presented in the Federal Reserve "Beige Book" suggested that the District's sales accelerated considerably. Area merchants had anticipated good year-to-year comparisons this March because of the weak sales in 1993 and the early Easter in 1994. However, most merchants reported that sales were significantly stronger than these developments had led them to expect

Housing and construction

Permits for new construction. The District's construction of new housing has also been lagging behind the national trend. At the national level, permits for one-to-four-family homes have been growing since early 1991 In contrast, at the District level, permits were relatively flat from early

Chart 5

Permits for One-to-Four-Family Homes

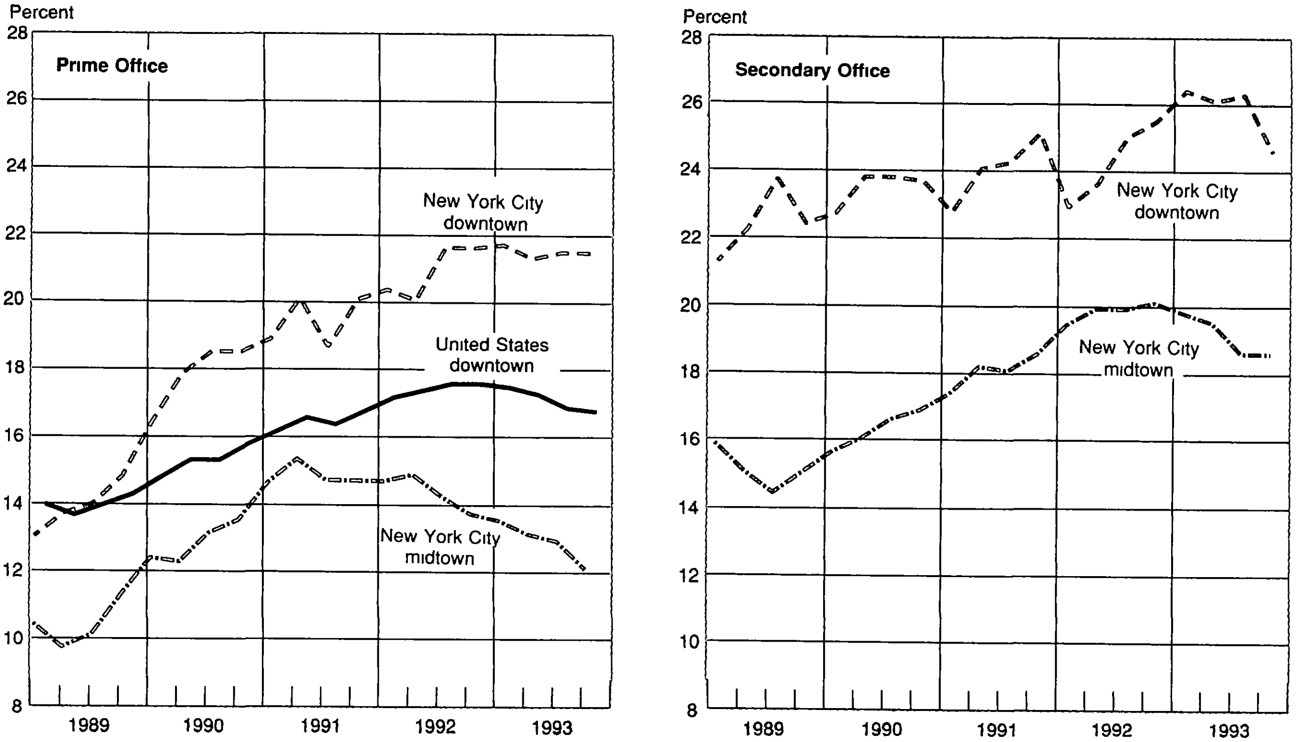


Source: Bureau of the Census

Note First-quarter 1994 values for New York and New Jersey are based on January-February data

Chart 6

Office Vacancy Rates



Source Cushman and Wakefield, *Marketrend*

1991 to early 1993, but accelerated sharply during the remainder of 1993 (Chart 5) [6] Existing home sales also quickened in the last six months of 1993, rising 27 percent in New Jersey and 14 percent in New York from second-quarter 1993 to fourth-quarter 1993 Severe winter weather reduced permit activity in the first quarter of 1994, but the cumulating economic data suggest that the underlying uptrend remains intact.

Commercial office construction. Although no regional recovery in commercial office construction is in sight, the market for existing office space may be improving Sales of large office buildings are taking place again in Manhattan, and vacancy rates are beginning to decline throughout the metropolitan area, including Manhattan (Chart 6), northern New Jersey, Long Island, and Westchester.

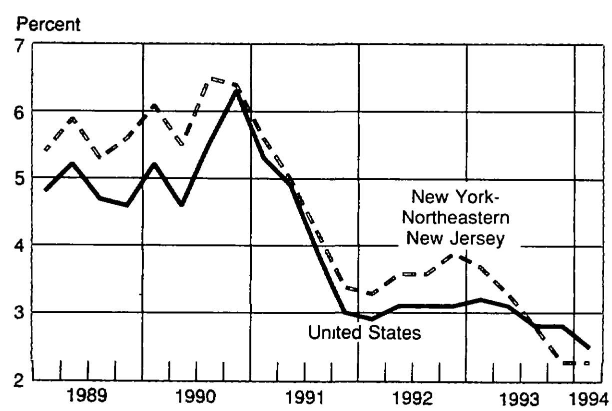
The vacancy rate for prime commercial office space in mid-Manhattan is actually below the national rate for central business districts, but the rates in the metropolitan area

[6] This increase still leaves the region's home building about 20 percent below its early 1989 level, while for the nation, permits are 20 percent above their 1989 level

Chart 7

Declining Inflation Rates

Year-over-Year Percentage Change in the Consumer Price Index



Source Bureau of the Census

as a whole remain quite high by historical standards[7] Furthermore, overall vacancies still stand well above the 7 percent rate recognized by the real estate industry as sufficiently low to prompt new construction of prime commercial office space. Hence, we can expect little office construction in the coming quarters, and the absence of this activity will differentiate the current regional recovery from the preceding one, when office construction triggered a period of relatively strong growth

Similarly, vacancy rates for secondary office space appear to have peaked, but the levels remain high. Because facilities in secondary office buildings are frequently obsolete and the office work force is growing slowly, many in the real estate industry expect a significant number of these buildings to remain vacant until they are razed to make way for new construction.

Consumer price inflation

As a result of the relatively weaker performance of the Second District's economy, regional inflation plummeted from a level well above the national one in late 1992 to a rate below that of the nation by the end of 1993, and the relative improvement has carried over into the early months of 1994 (Chart 7). During the prior expansion, the greater New York-New Jersey metropolitan area experienced consumer price inflation well in excess of the nation's, and its competitive position consequently declined

High costs for shelter were largely responsible for the differential between the regional and national rates of inflation during the 1980s.[8] More recently, the weakness in existing home prices and rental rates for apartments has moderated the cost of shelter in the greater New York metropolitan area (Chart 8). The resulting improvement in the region's overall relative price performance should help to promote growth in the future.

Prospects for growth

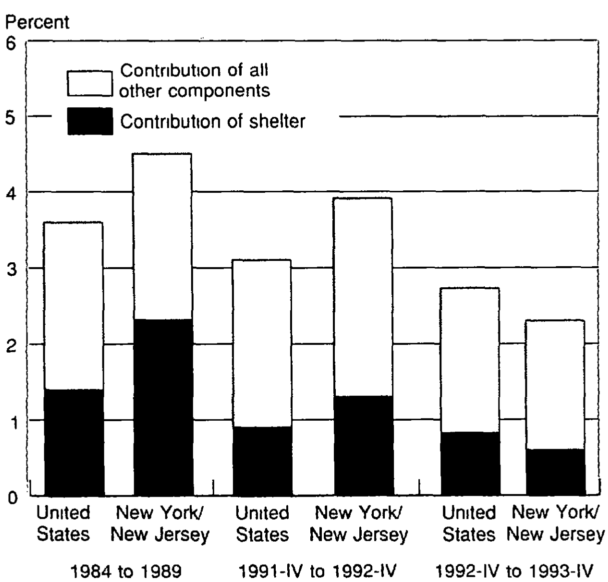
Except for commercial office construction, the economic indicators discussed in this article suggest that the regional decline has ended and that a broad-based, moderate

[7] Demand for midtown Manhattan's prime office space has increased with relocations from lower Manhattan and tenant upgrading from secondary space to prime office space Elsewhere in the nation, many firms have moved from central business districts to suburban locations, a pattern that has raised the vacancy rate of central business districts

[8] Rae D Rosen, "Recent Developments in New York City's Economy," FRBNY Quarterly Review, Summer 1993

Chart 8

Shelter Cost and the Consumer Price Index

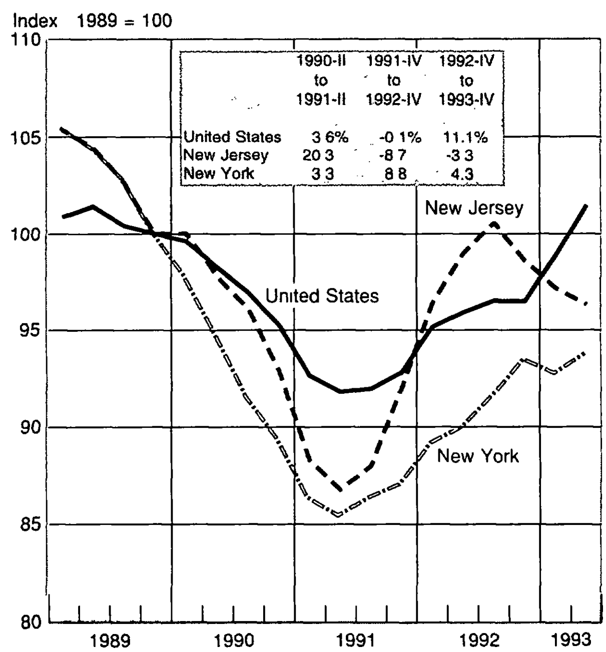


Source Bureau of the Census

Chart 9

New Business Incorporations

Four-Quarter Moving Average



Source Dun and Bradstreet

Box: Sources of Job Growth in New York State

Table A1

Job Growth by Firm Size

Thousands of Jobs

Number of Employees in Firm	Net Job Growth 1984	1985	1986	1987	1988	Summary 1984–88: Gains at New Firms	Net Loss at Existing Firms†	Net Growth	Net Growth (Percentage Distribution)
Less than 10	47	57	53	67	66	534	- 244	290	35
10 to 25	46	49	56	55	51	469	- 212	257	31
25 or more	155	92	11	12	7	1289	-1012	277	34
Total	248	198	120	134	124	2292	-1468	824	100

Source: New York State Department of Labor, Covered Employment and Wages.
Note: All data are as of March.
† Jobs lost because of firm failures plus changes in jobs at firms remaining in business. Represents changes in jobs at firms existing in base year.

We wish to thank Jay M. Mooney and the New York State Department of Labor for their help and cooperation in developing the data for the following analysis.

What kinds of firms are generating the jobs—new firms or old firms, large or small companies? With New York's labor market beginning to recover, a look at the sources of job growth over a five-year period during the previous expansion (1984-88) might tell us where the jobs will most likely be created in the current recovery. Tracking the creation of jobs, however, is not a straightforward exercise. New firms start up as old firms fail. Firms grow and contract, changing their size classification. In addition, some firms have multiple locations, each counted as a separate establishment in many data sets. Finally, the results derived from an analysis of one industry may not be applicable to other industries or the overall regional economy.

To obtain some estimates of job growth by firm size and age that would be free of these difficulties, we asked the New York State Department of Labor to derive employment by firm size from the insured employment data base—a data base that covers almost all private nongovernment employment. The data were consolidated at the firm (not establishment) level on a year-by-year basis into three firm-size classifications: fewer than ten employees, ten to twenty-five employees and more than twenty-five employees. For each year and each size category, we then calculated the drop in employment due to failure of existing firms plus any changes in employment at firms remaining in business. This figure represents the net change in employment at firms that had been operating in each base period. Sufficient business failures occurred each year to cause net employment at firms in business in the base period to decline from year to year. Next, for each size category, we calculated the difference between total employment and employment at the firms in business in the base year. This difference can be interpreted as net job growth at newly created firms. Finally, before doing the calculation for the next year, we reclassified those firms that had grown (or contracted) by large enough amounts to change size classification.

Table A2

Failure Rate by Firm Size

Percent

Number of Employees in Firm	1984	1985	1986	1987	1988
Less than 10	15.9	16.4	16.3	16.4	16.9
10 to 25	7.3	7.7	7.7	7.8	8.1
25 or more	5.4	5.9	6.3	6.0	6.9

Source: New York State Department of Labor, Covered Employment and Wages.
Note: All data are as of March.

Table A1 shows that job growth in the 1984-88 period was concentrated in firms belonging to the first two size categories, that is, firms with twenty-five or fewer employees (extreme right column). Although these firms accounted for only about 25 percent of total private employment, they added over 60 percent of the new jobs. Within this group, the job growth was about evenly split between firms with fewer than ten employees and firms with ten to twenty-five employees. As noted, job growth at firms remaining in busi-

Box: Sources of Job Growth in New York State (*Continued*)

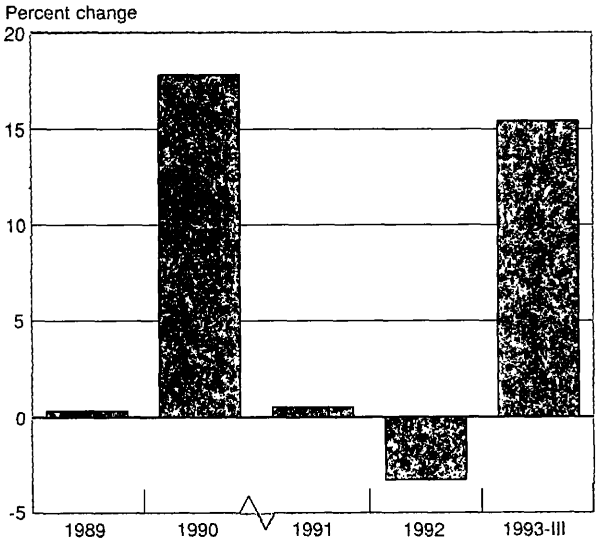
ness was not large enough to offset the losses at firms that failed, resulting in a net reduction in total jobs at firms operating in the base year (Table A1, third column from the right) However, this negative impact on jobs was more than counterbalanced by the growth in jobs in new firms for each size category (Table A1, fourth and second columns from the right)

New small firms are clearly a dynamic part of the job creation process in this District Nevertheless, the smallest firms may provide jobs that are less stable than those at large firms Firms with fewer than ten employees failed at a rate two to three times that for firms with ten to twenty-five employees, or firms with more than twenty-five employees (Table A2) Hence, while smaller firms with less than twenty-five employees contributed more than half of the job gains in 1984-88, the jobs at the smallest of these firms were quite vulnerable to business failure, creating considerable churning in this segment of the labor market

With many of the large firms in this region downsizing and outsourcing work, it appears likely that job growth in the current recovery will again be dominated by job creation in smaller firms And if the past is any guide, these smaller firms will probably have a higher failure rate, making the jobs created less stable than those at large firms. Nonetheless, jobs at many large corporations are also becoming less secure as these firms reduce employment to contain costs Hence, the District's labor market in general will probably enjoy less employment stability during the 1990s than it did in the 1980s.

Chart 10

Recovery in Exports of Goods Manufactured in New York and New Jersey

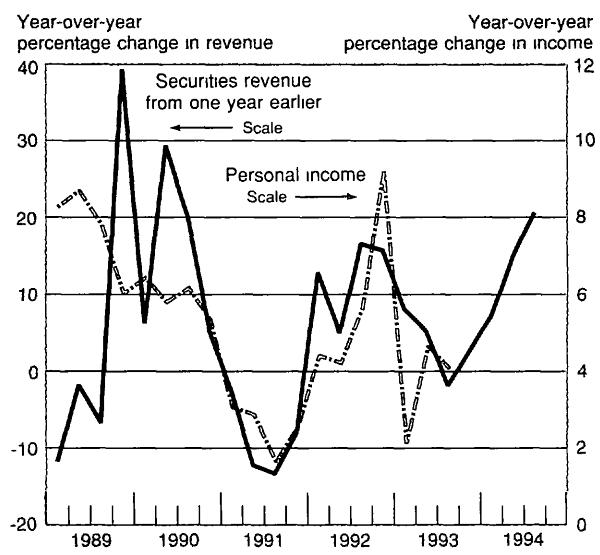


Source Massachusetts Institute for Social and Economic Research, University of Massachusetts, Amherst

Note. Pre-1991 data are not strictly comparable with more recent data

Chart 11

Securities Industry Revenues Relative to Personal Income in New York State



Sources. Securities Industry Association, Bureau of the Census; Federal Reserve Bank of New York

Note Industry revenues are plotted with a four-quarter lead For example, the first-quarter 1993 observation is plotted as a first-quarter 1994 value.

expansion is in progress Can the expansion be sustained? Three factors suggest that the momentum is unlikely to falter in the period immediately ahead.

First, improving business confidence points to support for sustained growth in the District. Since mid-1991, new business formations have been developing in the region quite rapidly on average, although in New Jersey formations have slowed slightly over the past year (Chart 9). In addition to signaling changes in business confidence, the more rapid emergence of new firms means expanded job opportunities. Our analysis of employment data in New York suggests that new business formations have been a primary source of job growth in New York State (see box on page 51). However, since many of the new firms are small, these new jobs are probably less secure than jobs at large companies because small firms have significantly higher failure rates

Second, the regional economy has benefited from the recent growth in exports to Canada—the single largest export market for New York and New Jersey—and from increased exports to the United Kingdom and Switzerland, respectively the second and fourth largest export markets for the District (Chart 10).[9] If these markets continue to expand, their demand for exports from the Second District will help sustain the region's recovery.

Third, the vigorous performance of the securities industry in 1993 should contribute to income growth in the District during the next several quarters [10] In recent years, a fairly consistent lagged relationship has prevailed between growth in personal income in New York State and the revenues of the securities industry, with the current income numbers reflecting the performance of the securities industry four quarters earlier (Chart 11).[11] A somewhat looser relationship, with a slightly longer lag, exists between personal income in New Jersey and the revenues of the securities industry

Over the longer run, the securities industry may also provide a relatively more stable source of income than it has in the past. Once largely dependent on the income from commissions, which is driven by volatile stock market volumes, the securities industry now derives an increasingly larger share of its revenues from fees and product-related income. During the past ten years, fees and product-related income as a share of revenues have increased from 17 to 28 percent, while commissions as a share of revenues have fallen from 28 to 19 percent.[12]

Summary

For the most part, the economic indicators show that a moderate, broad-based recovery is under way throughout the Second District. Recent revisions in the labor data indicate that the District's employment began to grow in late 1992, while most other indicators suggest that the region's economic recovery may have begun somewhat later, probably during the second half of 1993 Even though the region's comeback trails that of the nation in most respects, it does appear sustainable. A higher volume of exports, increased business formations, and the strong performance of the securities industry all point to a continuing recovery for the period ahead.

[9] New York State is the second or third largest exporter of goods in the nation (New Jersey ranks thirteenth) If services were included in the calculation, New York would be first by a large margin

[10] For the third consecutive year, the Securities Industry Association reported record revenues and profits In fourth-quarter 1993, total revenues reached $19 5 billion and total compensation rose to $8 billion, respective gains of 24 and 27 percent over fourth-quarter 1992 levels

[11] Although the industry employs a small fraction of the labor force in New York and New Jersey, it can account for a significant share of the growth in compensation In 1991, for example, fully 40 percent of the increase in total compensation in New York State was paid to the securities industry—which represented just 2 percent of the state's work force Compared with the construction or manufacturing industries, the securities industry has a narrow employment base and limited nonlabor factors of production, features that would tend to make the income multiplier for the securities industry comparatively low and slow

[12] Securities Industry Association, Securities Industry DataBank Other sources of revenue such as trading and underwriting have maintained relatively constant shares of revenue over this ten-year period