
March 2002

Analysis of the Mayor's Preliminary Budget for 2003

Economic Outlook



Ronnie Lowenstein, Director
110 William St., 14th Floor • New York, NY 10038
Tel. (212) 442-0632 • Fax (212) 442-0350
e-mail: ibo@ibo.nyc.ny.us • <http://www.ibo.nyc.ny.us>

Economic Outlook

OVERVIEW

- The U.S. economy fell into recession in March 2001 and then was further weakened by the September 11 attacks. The Bureau of Labor Statistics reports that job losses for the national economy exceeded 1 million between December 2000 and December 2001.
- It appears that the New York City economy started to contract at approximately the same time as the national economy, but then plunged deeper after September 11. The New York State Department of Labor reports that 132,000 jobs were lost between December 2000 and December 2001.
- Both the U.S. and New York City economies are expected to emerge from recession early this year, but the initial recoveries are expected to be slow. Brisk growth is not expected until 2003.

RECENT DEVELOPMENTS

In March 2001, the U.S. economy ended a 10-year expansion, the longest on record according to the National Bureau of Economic Research. As the economy shifted from growth to contraction, payroll employment declined sharply in both the second and third quarters, primarily in manufacturing, and then dropped dramatically following the September 11 attacks. The Bureau of Labor Statistics reports that job losses between December 2000 and December 2001 exceeded 1 million. Transportation, hotels, and other travel-related businesses were affected directly by the September 11 attacks, while trade, business services, and manufacturing suffered indirect hits. The seasonally adjusted unemployment rate rose to 5.8 percent in December 2001, up from a low of 3.9 percent in October 2000. IBO estimates that corporate profits dropped by 16 percent between 2000 and 2001. The Commerce Department estimates that real gross domestic product (GDP) declined by 1.3 percent in the third quarter and grew by 1.2 percent for the year as a whole, a sharp contrast to GDP growth of 4.1 percent in 2000. Had it not been for surprisingly strong consumer demand and a large boost in military spending, the picture for 2001 would have been considerably worse.

It now appears that New York City entered the recession at approximately the same time as the nation. Then, on

September 11, the New York City economy suffered a devastating blow. In addition to the many lives so tragically lost, approximately 30 percent of the supply of prime commercial office space in the downtown market was destroyed or damaged in the World Trade Center attack, displacing an estimated 100,000 workers in 6,000 firms. Businesses in the immediately surrounding area came to a full halt for several days to several weeks. Tourism and business travel slowed dramatically.

The New York State Department of Labor reports that 132,000 jobs disappeared from the city between December 2000 and December 2001. Job losses in finance, insurance and real estate (FIRE) exceeded 30,000 during this period, while losses in business services approached 39,000. Manufacturing employment dropped by 17,500. Employment in transportation, communications, and utilities (TCU) fell by 15,000, as did employment in retail trade.

Other indicators showed weakness, as well. The seasonally adjusted unemployment rate for the city stood at 7.3 percent in December, up from 5.3 percent last March. Securities industry profits plunged from \$21 billion—an all-time high—in 2000 and to an estimated \$8.5 billion in 2001. IBO estimates that fourth-quarter real gross city product (GCP) was 8.1 percent less than its level a year earlier.

NATIONAL ECONOMIC OUTLOOK

IBO—consistent with most other forecasters—is projecting that the national recession will end early this year, but the recovery to follow will be sluggish.

IBO expects total payroll employment to grow very slowly throughout most of 2002, pick up some steam in 2003, and then maintain slow but steady growth through 2006. In turn, the unemployment rate is expected to be 6.1 percent in 2002, fall to 5.7 percent in 2003, 5.3 percent in 2004, and then reach 5.2 percent by 2006. IBO projects real GDP growth to turn up in the second half of this year, grow by 4 percent in 2003, and then settle down to an annual growth rate of about 3 percent. Due to the resilience of consumer demand throughout most of the recession, a major boost in consumption is not anticipated. Given this moderate growth scenario, IBO anticipates the U.S. inflation rate to be just 1.4 percent in 2002 and then stay in the 2.3 to 2.5 percent range through 2006.

Economic Forecast: IBO and City OMB

	2001	2002	2003	2004	2005	2006
National Economy						
Real GDP Growth						
IBO	1.1	1.2	4.0	3.2	3.1	3.0
OMB	1.0	0.5	4.1	3.6	3.0	2.9
Non-farm Employment Growth						
IBO	0.4	-0.6	1.9	2.0	1.2	1.3
OMB	0.4	-0.3	1.1	1.6	1.3	1.0
Inflation Rate (CPI-U)						
IBO	2.8	1.4	2.3	2.3	2.5	2.4
OMB	3.0	1.8	2.4	2.7	2.7	2.8
Personal Income Growth						
IBO	4.9	2.0	4.4	5.3	4.8	4.7
OMB	4.9	2.7	5.7	5.5	5.0	5.2
Unemployment Rate						
IBO	4.8	6.1	5.7	5.3	5.3	5.2
OMB	4.8	6.2	5.7	5.1	5.0	5.0
10-Year Treasury Bond Rate						
IBO	5.0	5.2	5.7	6.2	5.9	5.9
OMB	5.0	5.2	5.8	6.0	5.9	6.0
Federal Funds Rate						
IBO	3.9	2.0	4.7	5.5	5.3	5.1
OMB	3.9	2.5	4.5	5.0	5.0	5.0
NYC Economy						
Non-farm New Jobs (thousands)						
IBO	8.9	-93.0	54.2	53.1	31.5	30.5
OMB	19.7	-116.0	22.1	53.8	42.4	44.8
Employment Growth						
IBO	0.2	-2.5	1.5	1.4	0.8	0.8
OMB	0.5	-3.1	0.6	1.5	1.1	1.2
Inflation Rate (CPI-U-NY)						
IBO	2.8	2.6	2.7	2.5	2.6	2.4
OMB	2.8	2.1	2.5	2.7	3.0	3.0
Personal Income (\$ billions)						
IBO	318.8	322.4	335.7	351.5	366.9	382.4
OMB	310.6	305.6	316.5	333.9	352.5	372.1
Personal Income Growth						
IBO	6.8	1.1	4.1	4.7	4.4	4.2
OMB	3.4	-1.6	3.5	5.5	5.6	5.6
Manhattan Office Rents (\$/sq. ft.)						
IBO	58.92	55.46	55.72	56.55	56.84	57.19
OMB	58.86	55.93	58.38	61.43	63.95	65.85

SOURCES: IBO; OMB.

NOTES: All rates reflect year-over-year percentage changes except for unemployment, 30-year Treasury Bond, and Federal Funds. The local price index for urban consumers (CPI-U-NY) covers the New York/Northern New Jersey region. Personal income is nominal. This forecast is based on data available in February 2002.

LOCAL OUTLOOK

IBO projects that New York City also will move slowly out of recession this year. A brisk rebound is not expected until 2003, and growth beyond 2004 is expected to be moderate.

Employment. After anemic growth of less than 1 percent through most of 2002, payroll employment will grow by 1.4 to 1.5 percent through 2004 (adding 54,000 jobs in 2003 and another 53,000 in 2004), and then settle down to a growth rate of 0.8 percent (about 31,000 jobs per year). IBO does not expect the city to reach its pre-recession employment peak—3.8 million jobs—until late 2006.

IBO projects construction employment to rise significantly this year and remain high, as the cleanup continues at ground zero, rebuilding in the World Trade Center area gets underway, and many other projects that were already in the pipeline before September 11 proceed. Employment in non-cyclical industries—education, social services, and particularly health—is also expected to grow steadily. Retail trade and business services are expected to resume steady employment growth in 2003.

The outlook for employment in FIRE, manufacturing, and TCU is less optimistic. IBO projects employment in FIRE to start growing again in 2003, but remain more than 20,000 below its previous peak throughout the forecast period. Security industry profits are expected to rise this year and next, but decline in 2004 and then average about \$14.3 billion (about two-thirds the 2000 profit level) in subsequent years. Although the recent decision by American Express to consolidate its operations in Lower Manhattan is encouraging, the number of American Express employees to return to Lower Manhattan will be about 1,000 less than the number displaced because of earlier layoffs. Moreover, other major financial firms also appear to be moving ahead with plans to move jobs out of the city. Manufacturing is expected to add nearly 7,000 jobs in 2003, but remain essentially

fixed thereafter below its pre-recession level. TCU is expected to regain just a few thousand jobs during the forecast period.

Income Growth. Overall, IBO expects personal income to grow by just 1.1 percent this year, and then average 4.3 percent growth starting in 2003. A sharp 22 percent drop in personal income tax withholding in February suggests that Wall Street bonuses for 2001 were down significantly. Investment earnings are also expected to decline through mid-2002 and not show significant growth until late 2003. Wage and salary earnings are expected to follow the path of employment, growing strongly in 2003 and much of 2004 and then more moderately thereafter.

After growing slightly in each quarter of 2002, IBO forecasts that real GCP will grow by 4.4 percent in 2003 and then by roughly 3 percent annually through 2006. The city's unemployment rate is expected to remain above 7 percent through the first half of 2003 and then stay at or above 6 percent through 2006.

On balance, IBO's forecast is more optimistic than the Mayor's Office of Management and Budget (OMB) forecast of the timing of the recovery. In particular, IBO projects much greater gains in employment and personal income in 2003 than OMB. OMB expects higher growth rates than IBO in the years beyond 2004, however.

IBO's forecast assumes that the city's recovery from the current recession will track the recovery in the national economy quite closely. A risk for the city is that the local recovery will not be similar to the national recovery and instead follow the pattern of the early 1990s. The local economy badly lagged the national recovery from the 1991 recession. One factor that could propel the city out of recession faster this time is the boost to the local economy from the Lower Manhattan rebuilding efforts.

