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State economy shows cracks in its armor

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New Jersey's work force should keep growing slowly, and there's no recession on the horizon, but the housing slump and "subprime" mortgage crisis could rattle the state's large and wealthy economy for many months to come.

That was the view offered by a trio of economists -- Rae Rosen of the Federal Reserve Bank of New York, James Hughes of Rutgers University and Joel Naroff of Commerce Bank -- during a forum yesterday at the Newark Regional Business Partnership.

"We entered August in a good and robust manner, with fairly rapid growth in output, and then the subprime crisis hit," Rosen said. "We don't think there's going to be a recession, but we think growth is going to decelerate and be slower. The risk has increased on the downside."

The New Jersey economy is already functioning at or near record levels of employment and output, she noted. So while job growth may be sluggish, that doesn't necessarily mean employers aren't willing to hire.

"The unemployment rate has remained close to 4 percent, and as you push it lower and lower, it gets harder to match the skills the employers want," Rosen said. "Maybe you need doctors and auto mechanics, but you have a lot of typists."

Indeed, New Jersey's work force sits on an impressive economic plateau. According to Hughes, if the state's 11 northern and central counties were a distinct metropolitan area, it would rank fifth nationwide, with 3.6 million jobs -- more than the metropolitan areas of Atlanta, Miami, Boston and Dallas.

"But employment has totally and absolutely refused to grow at a pace anywhere near that which usually accompanies an economic expansion," Hughes said.

During the previous two expansions -- 1982 to 1989 and 1992 to 2000 -- New Jersey created an average of 74,000 private-sector jobs a year. Yet during the expansionist period of 2004 to 2006, the state added an average of 24,000 jobs a year. New Jersey, which has about 4 million jobs, is on track to add only 23,000 jobs in 2007.

"New Jersey is experiencing competition from North Carolina and Georgia, where housing affordability and lower business costs make them the destination of the knowledge jobs that in the 1980s and the 1990s would have settled in New Jersey," Hughes said.

Both the real estate and finance sectors are critically important for New Jersey, and both are under pressure right now as home sales plummet and financial institutions announce huge write-offs.

"Housing is the major weakness in the region and the national economy, and subprime defaults have percolated through the economy in ways that we really hadn't thought would happen," Rosen said. "It has slowed the turnover in housing sales. It has gotten hard to write a jumbo mortgage, which is the kind of mortgage that you need for most homes in New Jersey. So home prices will probably continue to soften for another couple of quarters; it's hard to move those houses."

Hughes said it could take New Jersey a decade to recover from the home-price slump, if history is a guide. New Jersey home prices rose 145 percent, on average, from 1980 to 1988, then fell 8 percent from 1988 to 1992. Hughes said it took until 1998 for prices to return to the 1988 level.

The key to economic growth, Naroff said, is consumer spending, which accounts for two-thirds of economic activity. But consumers are beset by declining home values, which discourage home equity loans, and oil prices approaching \$90 a barrel.

Given the slowing economy and the problems with housing and energy, the Federal Reserve is likely to continue to lower interest rates, Naroff said.

"I would not be surprised to see some significant easing by the Fed in December, January and March to ease the economic slowdown," Naroff said.

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