The Comptroller's Comments on The Economic Assumptions Underlying the Executive Budget for Fiscal Year 2003

The City of New York
Office of the Comptroller
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EXECUTIVE SUMMARY

The City's economy entered a recession in 2001. Real gross city product fell, the number of payroll jobs declined, and unemployment rose after three years of decline. Before September 11, however, economic indicators pointed toward a soft landing followed by an early recovery, with the City recovering in tandem with the nation.

All that changed on 9/11. The impact of the terrorist attacks on the world's greatest city will be felt for years. Even though, in the first quarter of 2002 the nation appears to be on the road to recovery, the City continues to suffer job losses and a declining economy. As of March 2002, job losses that began in January 2001 continue, commercial real estate is weak, tourism and the hotel industry are soft, and the help-wanted advertising index is down.

The City Comptroller has analyzed the Mayor's economic assumptions underlying the Executive Budget for FY 2003. While on the whole the Comptroller finds them reasonable, significant differences remain between the Comptroller's and the Mayor's methodologies and conclusions. Essentially, on both the City and national levels, the Comptroller is generally less optimistic than the Mayor regarding 2002 through 2004 and is more optimistic in assessing 2005 and 2006.

The reason for the Comptroller's lower gross city product estimates in 2002-2004 is that the Comptroller believes that the City will again take significantly longer than the nation to recover from recession. While prosperity will return to New York City, it will not happen in the current year and the budget and financial plan must reflect this reality.

I. THE U.S. ECONOMY

According to the group responsible for dating recessions, the National Bureau of Economic Research (NBER), the U.S. economy is said to have entered a recession in March 2001 after nine years of growth. However, at the time of its announcement the NBER noted that the dating of the onset of this recession was hard to call. Key indicators on which dating is based turned negative at different times and many cyclical factors that ordinarily characterize a recession were still absent.[1] For instance, gross domestic product (GDP) is normally the most important single indicator of a recession and two quarters of negative growth are required for a recession to be declared. However, the 2001 data showed negative growth (-1.3 percent) only in one quarter, the third quarter. In the fourth quarter GDP grew 1.7 percent, the strongest gain in the entire year. Job losses and the stock market declined early in 2001. Consumer spending was up, however, especially in the fourth quarter of 2001, the housing sector was strong, and in the end, after revisions, only one quarter of GDP was negative. These factors raised questions about whether the nation was in a full fledged recession at all.[2]

Nonetheless, a recession can be fairly ascribed to the national economy in 2001 if attention is focused on the U.S. labor market and corporate profits. Although total jobs were up by 0.3 percent in 2001, they were on a steady monthly decline after August. Over the course of the year, the stock market declined dramatically. Corporate profits were down, with seasonally adjusted pretax corporate profits off 17.4 percent in 2001, a big change from their gain of 8.9 percent in 2000. Furthermore, the NASDAQ lost 15 percent of its value and the S&P 500 lost 11 percent of its value during 2001.

Whether it is in the end called a recession or just a slowdown, the 2001 U.S. downturn has fortunately so far been a mild setback and a recovery now seems to be under way. Fourth-quarter GDP was the year's strongest and other economic indicators have been improving in the first quarter of 2002. Jobs rebounded in March 2002 after seven months of decline, and promising increases were recorded in the help-wanted advertising index, the Institute for Supply Management (ISM) index, and in consumer confidence. The Comptroller’s Office therefore approaches its forecasts for 2002 with some optimism, expecting modest growth in 2002, followed by stronger growth in 2003-2006. Risks, however, are associated with this outlook as with any other forecast. Private investment has been negative in the past six quarters. Also, while interest rates are low, actual credit is tight, making it more difficult for companies to raise funds, thereby contributing to continued weak private investment. Overall, however, the nation seems to have weathered what threatened to be a storm, achieved a soft landing, and is poised for a rebound.

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[1] This call is therefore still controversial. One problem for the NBER is that continuing Federal data revisions change the picture after the NBER's business cycle dating committee, the so-called six "Wise Men", make their call.

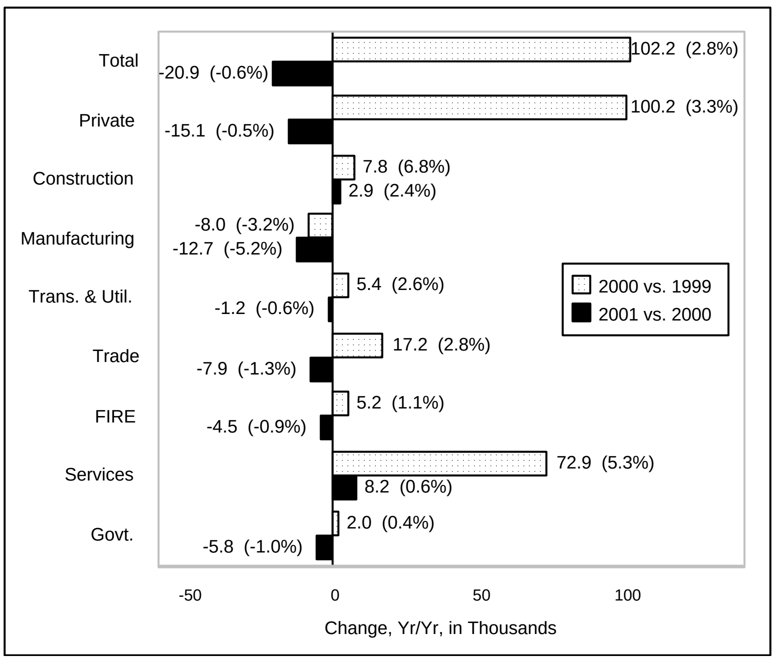
[2] For the full year 2001, GDP grew 1.2 percent, of which consumer spending contributed the most, 2.1 percent, to GDP growth. In fact, the surprisingly strong 6.1 percent growth in consumer spending in the fourth quarter of 2001 was the biggest rise since the 6.2 percent gain in the second quarter of 1998.

II. THE NEW YORK CITY ECONOMY

The City's economy had a far worse year than the nation and has a much gloomier outlook. A City recession definitely occurred in 2001, by any measure, and is still with us. The September attacks put extra strain on the City's economy and deepened the recession. Current economic data make it clear that the City's recovery is still not yet under way.

The City's economy entered a recession in the first quarter of 2001 after nine years' growth. Real gross city product (GCP) fell 0.2 percent in 2001, in contrast with a very strong gain of 5.2 percent in 2000. As shown in Chart 1, the City's payroll jobs, which were up by 102,200 in 2000, the best year on record, fell back by 20,900 in 2001, the City's first decline since 1992.[3] The private sector lost 15,100 jobs and the government sector lost 5,800.[4]

Chart 1. *Change in Jobs by Industry Sector, 2001 and 2000, in thousands, Year-over-Year*



Source: NYS and U.S. Departments of Labor.

Within the private sector, construction added 2,900 jobs, services were up by 8,200 jobs, the securities industry gained 1,200 jobs and real estate added 400 jobs. But business services lost 13,200 jobs, manufacturing lost 12,700 jobs, wholesale and retail trade lost 7,900 jobs, banks lost 4,600 jobs, insurance companies lost 1,400 jobs, transportation and public utilities lost 1,200 jobs, and engineering and management lost 1,200 jobs.

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[3] Payroll jobs are positions on payrolls of NYC-based establishments. These positions may be filled by NYC residents or nonresidents; they are reported by a large number of companies and governments.

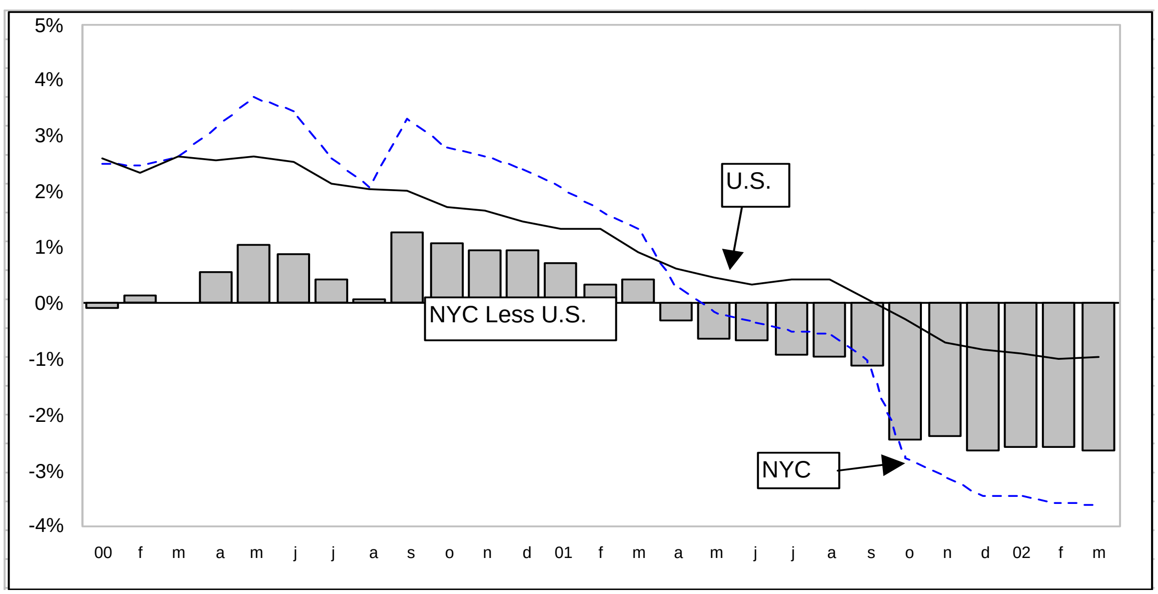
[4] Table A1 on page 10 contains the seasonally adjusted month-to month changes in job numbers between December 2000 and March 2002.

Household employment data also showed weakness in 2001.[5] Civilian employment, which was up by a record 139,200 in 2000, fell by 61,200 in 2001. The number of unemployed residents also increased by 8,800 in 2001 after three years of decline. As a result, the civilian labor force shrank by 52,400, in contrast with an increase of 111,800 in 2000. The City's unemployment rate jumped up to 6.1 percent from 5.7 percent in 2000, the labor-force participation rate fell to 58.1 percent from 59.7 percent in 2000, and the employment/population ratio fell to 54.6 percent from 56.3 percent in 2000.

Job losses continued to mount disturbingly in 2002. The City is now in its fifth quarter of a jobs recession. Total jobs, seasonally adjusted, were down 22,400 in the first quarter, compared to the prior quarter, as the private sector lost 22,700 jobs and government gained 300. Total jobs were down by 5,200 in March 2002 continuing a 15-month decline.[6] Since December 2000, New York City has lost 146,800 jobs, of which more than two-thirds, or 99,200, have been lost since September 2001.

The number of City residents with jobs has also fallen. Civilian employment, which has been in continuous decline since October 2000 (except for two months, September 2001 and January 2002) continued to fall through March. Since December 2000, City residents have lost 129,500 jobs, of which one-third, or 39,800, has been since September 2001. The number of unemployed residents has also been rising.

Chart 2. *Monthly Payroll-Jobs Growth, NYC and the U.S., Year-over-Year, Percent Change, January 2000 – March 2002*



Source: NYS and U.S. Departments of Labor. March 2002 data are preliminary.

[5] Civilian employment numbers estimate the number of NYC residents who are employed, whether in NYC or outside NYC, whether working for a company or self-employed. The numbers are based on monthly surveys of NYC households.

[6] Payroll jobs have declined in every month since December 2000 with the exception of September 2001.

Year-over-year comparisons of monthly job losses since September 2001 show that the decline in City jobs is 3.6 times greater than the nation's as illustrated in Chart 2 on page 3. For example, the number of jobs in the City in March 2002 fell, or 3.6 percent, 135,100 below the number in March 2001. U.S. jobs, on the other hand, fell by only one percent in March 2002 from the same month in 2001.

In 2001, the City's hotel industry had its weakest year in almost a decade. The average hotel occupancy rate fell to 74 percent in 2001 from a peak of 84.2 percent in 2000. The 2001 rate was the lowest since 69.9 percent in 1993. The average daily room rate was $205 in 2001 compared with $233 in 2000. Also, according to NYC & Co., the City's convention and visitors bureau, the estimated number of visitors for 2001 was 14.3 percent fewer than 2000 and the number is expected to increase by only 0.8 percent in 2002.

The commercial real estate market is also losing its luster. Manhattan's overall average vacancy rate was 10.4 percent in the first quarter of 2002, more than double the rate in the first quarter of 2000.

III. FORECASTS OF THE U.S. AND CITY ECONOMIES 2002-2006

The Comptroller and the Mayor have both prepared economic forecasts for the nation and the City for the years 2002-2006. The Comptroller's forecasts generally expect a slower recovery, in both the City and the nation, than the Mayor's. The Comptroller's analysis, especially for the City, places more emphasis on certain significant factors that will hinder restoration of prosperity to the local economy.

A. United States

The Comptroller projects that U.S. GDP will grow 2.7 percent in 2002 and then by three percent or more in each year 2003-2006. As shown in Table 1, these numbers are slightly higher than those of the Mayor through 2004, and are slightly higher in 2005-2006.

Table 1. *Forecast of GDP, Year-over-Year Change, Percent, 2002-2006*

	2001	**2002**	**2003**	**2004**	**2005**	**2006**
Comptroller	1.2	2.7	3.0	3.4	3.3	3.1
Mayor	1.2	2.5	3.8	3.7	3.0	2.8

Sources: Comptroller=Forecast by the NYC Comptroller's Office.
Mayor=Forecast by the NYC Office of Management and Budget.
Data for 2001=actuals published by the U.S. Department of Commerce, Bureau of Economic Analysis.

The Comptroller projects that the number of U.S. jobs will grow slightly in 2002 and will continue to grow in 2003, reaching a peak growth of 2.1 percent in 2005 and then slightly declining in 2006. The Mayor is much more pessimistic about national jobs growth in 2002 despite a more optimistic GDP projection. In contrast, the Mayor's job numbers are consistent with his GDP projections in 2003-2006. Overall, the Mayor is more optimistic in 2003-2004, and the Comptroller is more optimistic in 2005-2006 as illustrated in Table 2.

Table 2. *Forecast of Payroll Jobs, Year-over-Year Change, Percent, 2002-2006*

	2001	**2002**	**2003**	**2004**	**2005**	**2006**
Comptroller	0.3	0.4	1.2	1.8	2.1	1.9
Mayor	0.3	-0.4	1.5	2.2	1.6	1.1

Sources: Comptroller=Forecast by the NYC Comptroller's Office.
Mayor=Forecast by the NYC Office of Management and Budget.
Data for 2001=actual jobs numbers as released by the NYS and U.S. Departments of Labor.

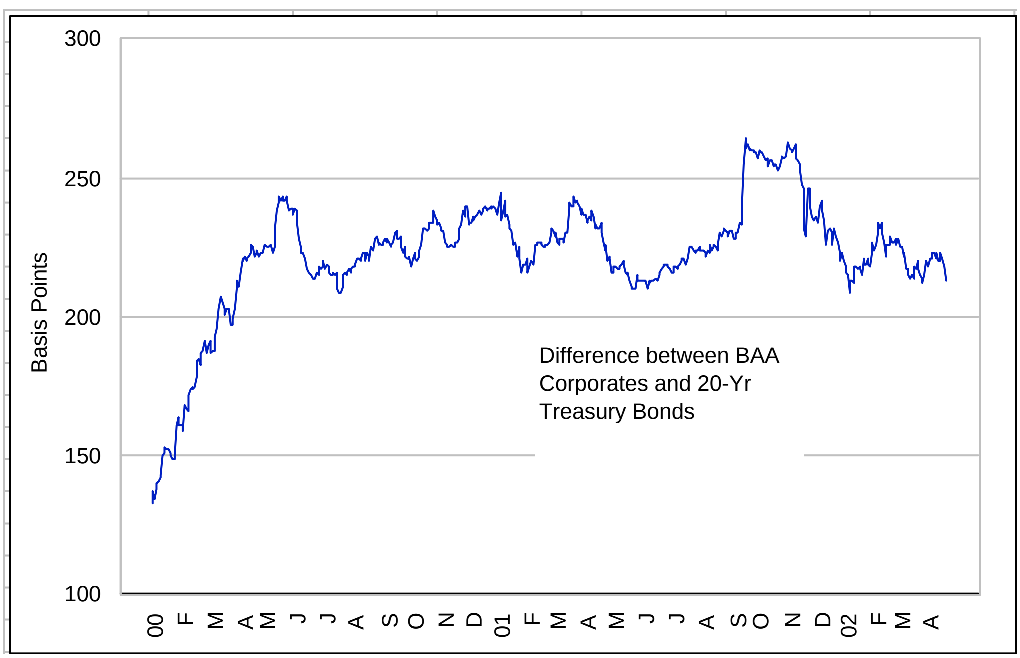
The Comptroller sees major risks to the U.S. economy from a possible continuing decline in private investment, which fell by 23.5 percent in the fourth quarter of 2001. This was the sixth consecutive quarter of declining investment, and was the largest decline since the 24.9 percent drop in the mid-recession fourth quarter of 1990.

However, private investment is expected to turn up again as excess inventory diminishes and the quality yield spread declines.[7]

A positive sign for the U.S. economy is that continued high consumer spending and lower private investment imply a reduction in excess inventories. The Bureau of Economic Analysis reports that private businesses further reduced inventories, by $119.3 billion, in the fourth quarter after a decrease of $61.9 billion in the third quarter. A drop in business inventories with continued high consumer spending may force an increase in private investment.

At the same time, the Federal Reserve cut its target interest rates 11 times in 2001 to a Fed funds rate of 1.75 percent and discount rate of 1.25 percent. The lowest level in more than 40-years. However, long-term interest rates have been rising, creating an upward sloping yield curve, which is a signal of economic recovery. Also, the quality yield spread, using the difference between the yield on private debt (Baa corporate bonds) and government debt (20-year Treasury bonds) is improving (declining) slightly from its peaks in September-November 2001, indicating less fear in the marketplace as shown in Chart 3.

Chart 3. *Yield Difference between Private and U.S. Debt, Basis Points, Daily, January 3, 2000 – April 17, 2002*



Source: Federal Reserve Board of Governors.
Private debt=yield on Baa-corporate bonds. U.S. debt=yield on 20-year Treasury bonds.

Low energy costs have contributed to keeping down consumer prices, which in turn have helped maintain consumer spending. The Mayor, in the Executive Budget,

[7] The quality yield spread is the difference between the yield on private debt and government debt. It is an indicator of investor concern with the riskiness of their investments.

properly notes an overall risk of "a sharp increase in oil prices, further escalation in world crises, and continued job losses". Higher energy costs would affect consumer sentiment and the shape of the yield-difference curve. If this curve turns up again, it means resurgence of the fears that drove it up at the end of 2001. It would be bad news for consumer spending and private investment.

B. New York City - Comptroller's Forecast

The Comptroller projects that the City will have much slower recovery in 2002-2003 than the nation. In 2001, the City's jobs fell by nearly 0.6 percent while the nation's jobs rose by 0.3 percent. In March 2002, as was shown in Chart 2 on page 3, the year-over-year loss of jobs in the City was more than three-and-a-half times the loss for the nation. The City is still struggling with a jobs recession.

Similarly, the City's leading economic indicators are mixed. The average help-wanted-advertising index during January and February 2002 fell on a year-over-year basis 45.8 percent to 22.5, the biggest drop since 1992 when this series first became available for the City. Although the U.S. index also fell by 34.2 percent, its average was much higher, 49.[8] On the other hand, the number of City building permits authorized, on a year-over-year basis, was up 3.5 percent in the first quarter of 2002, a positive sign.

On balance, the Comptroller expects the City's recession to continue through 2002. While the Comptroller anticipates that GCP will increase in the second quarter, jobs are expected to decline until the second half of 2002, and possibly even for several months longer. In 2003-2006, the City's economy is expected to grow at a slow but positive pace, as Table 3 illustrates.

Table 3. *Forecast of NYC's GCP and Payroll Jobs, Year-over-Year Change, 2002-2006*

	2001	**2002**	**2003**	**2004**	**2005**	**2006**
Real GCP, %	-0.2	-1.0	2.0	2.8	3.2	3.5
Payroll Jobs, '000	-20.9	-94.0	30.0	40.0	50.0	55.0

Source: NYC Comptroller's Office. Data for 2001 = actual.

C. New York City – Comments on the Mayor's Forecast

The Mayor's forecast is more optimistic in 2002-2004 than the Comptroller's. For gross city product, the Mayor is showing positive (0.1 percent) growth for 2002, whereas the Comptroller's forecast is for a decline for the year of 1.8 percent. The Mayor's projections then show a rapid increase in GCP in 2003, followed by another strong year in 2004, with two slightly less strong years in 2005 and 2006. The contrast with the Comptroller is greatest in 2003, as Table 4 on page 8 demonstrates, with the Comptroller seeing a slow start prior to a steady upward climb out of the recession compared with the Mayor's view of a rapid and very strong recovery.

[8]In February it went up to 51, from 47 in January.

Table 4. *Forecast of GCP, Year-over-Year Change, Percent, 2002-2006*

	2001	**2002**	**2003**	**2004**	**2005**	**2006**
Comptroller	-0.2	-1.8	2.0	2.8	3.2	3.5
Mayor	-0.5	0.1	4.7	3.5	3.0	3.2

Sources: Comptroller=Forecast by the City Comptroller's Office.
Mayor=Forecast by the Mayor (Office of Management and Budget) in the Executive Budget.
The Mayor and Comptroller have different estimates of the change in GCP in 2001.

The Mayor's strong forecast for 2003 rests on two premises:

- A strong stimulus from the downtown rebuilding efforts.
- A rebound on Wall Street after the correction in 2001.

The Comptroller does not believe that these premises are justified. Downtown rebuilding will indeed be a stimulus to the City's economy, but the office space and activity that were at the World Trade Center have disappeared and will not be fully replaced for many years. The latest projections of the Lower Manhattan Development Corporation are that downtown rebuilding efforts are likely to be spread out over several years. The large number of organizations involved in the downtown planning process means that the final outcome will have had ample input, but the price to be paid may be delays in the start of rebuilding and a longer time horizon for completion than the Mayor envisions.

Similarly, the prediction that Wall Street will rebound in 2003 is heartening but may not be something that the City should count on. Layoffs on Wall Street continue suggesting that individual securities firms are not betting on a rapid turnaround. The risks that the Mayor has observed at the national level, including the possibility of another oil shock or major confidence-destroying incident related to global crises, bear directly on the future of Wall Street and on the City's economic future.

These concerns are underscored by the projections of payroll jobs for the years 2002-2006. As shown in Table 5, the Comptroller's projections are less optimistic than the Mayor's in 2002-04 and more optimistic in 2005-06.

Table 5. *Forecast of Payroll Jobs, Year-over-Year Change, in Thousands, 2002-2006*

	2001	**2002**	**2003**	**2004**	**2005**	**2006**
Comptroller	-20.9	-94.0	30.0	40.0	50.0	55.0
Mayor	-20.9	-81.2	35.3	46.4	36.8	31.0

Sources: Comptroller=Forecast by the NYC Comptroller's Office.
Mayor=Forecast by the NYC Office of Management and Budget.

The Comptroller believes that his forecasts for the City's gross product and jobs are more reasonable than the Mayor's for the following reasons:

- In the past 40 years, except for 1982, the City has lost more jobs during recession than the nation and has had a slower rate of recovery. When the City's jobs and GCP recover, the upward path may therefore be expected to be weaker than the nation's. The relevant comparison is not with the timing of recovery after the City's last recession but with the nation's likely slow recovery from a mild downturn.

- While in time the reconstruction of the World Trade Center may indeed provide a significant stimulus to the City's economy, in the short term recovery will be hindered by the loss in infrastructure from the World Trade Center attacks, especially the interference with transportation and the loss of downtown activity.
- Business psychology felt a negative impact along with the physical loss. The City has lost jobs to neighboring counties and states, as shown by the recent rise in City commercial real estate vacancy rates while vacancy rates have declined in some suburban areas. While some jobs will return to the City, others will not, as companies seek to hedge their office-location bets. On balance, the Comptroller does not believe that jobs recovery will occur as rapidly in 2003 as the Mayor believes, especially if the Mayor is right about a loss of more than 81,000 jobs in 2002.
- The City has a service-industry-oriented economy in which the new media and dot-com industries played a big role in the second half of the 1990s. Unfortunately the high-tech industries imploded in 2000-2001 and are not yet recovering in a significant way, other than in the biotech industry. The Comptroller's "Alley 30" index of companies in "Silicon Alley" has had to be cut back to an "Alley 20" index because of a lack of qualifying businesses.
- Most of the national jobs recovery has been in the manufacturing sector, where the City is weak and continues to be weak. The City has been shedding manufacturing jobs for the past 17 consecutive quarters.

The Comptroller therefore believes that the Mayor’s forecast is unfortunately premature in projecting an end to the current recession. While prosperity will return to the City it will not happen in the current year and the budget and financial plan must reflect this reality.

IV. APPENDIX

Table A1. *Seasonally Adjusted Month-to-Month Changes in Jobs, December 2000 to March 2002*

	Dec. 00 - Sept. 01		Sept. 01 - Mar. 02		Dec. 01 - Mar. 02	
	’000	**%**	**’000**	**%**	**’000**	**%**
Total	**-47.6**	**-1.3**	**-99.2**	**-2.7**	**-16.7**	**-0.5**
Private	**-46.1**	**-1.4**	**-98.7**	**-3.1**	**-15.6**	**-0.5**
FIRE	-2.7	-0.5	-33.6	-6.8	-5.9	-1.3
Securities	0.2	0.1	-16.7	-8.9	-3.1	-1.8
Banking	-1.3	-1.2	-11.1	-10.3	-1.6	-1.6
Services	-21.4	-1.4	-25.4	-1.7	-5.8	-0.4
Business	-28.8	-8.2	-16.3	-5.1	-7.2	-2.3
Educational	5.6	4.5	-2.3	-1.8	-2.2	-1.7
Medical	4.3	1.3	2.3	0.7	1.6	0.5
Manufacturing	-12.8	-5.3	-7.0	-3.1	-2.3	-1.0
Construction	-1.4	-1.1	-1.2	-1.0	-0.2	-0.2
Trade	-3.8	-0.6	-17.6	-2.8	1.6	0.3
Retail	0.6	0.1	-13.9	-3.1	0.7	0.2
Wholesale	-4.4	-2.4	-3.7	-2.0	0.9	0.5
Transp + PU	-4.0	-1.8	-14.0	-6.6	-3.1	-1.5
Government	**-1.5**	**-0.3**	**-0.5**	**-0.1**	**-1.1**	**-0.2**

Source: Seasonally adjusted data from the City Comptroller's Office based on unadjusted data from the NYS and U.S. Departments of Labor.

GLOSSARY OF ACRONYMS

NBER National Bureau of Economic Research

GCP Gross City Product

GDP Gross Domestic Product

ISM Institute for Supply Management

NYC New York City

NYS New York State

S&P Standard and Poors