Office of the New York City Comptroller

William C. Thompson, Jr., Comptroller

Economic Notes

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City's Economy Outpaced the Nation's in 2007, But Slump Looms

Overview: *The City's economic growth outpaced the nation for the third consecutive year in 2007. The national economy was haunted by slumping housing prices, the sub-prime mortgage crisis, and high oil prices. The City's economy performed well, but signs of slowdown emerged late in the year.*

● **Real Gross City Product (GCP) grew 1.1 percent in 4Q07,** the slowest rate in 3 years, but the gain was higher than the 0.6 percent real Gross Domestic Product (GDP) growth (advance estimate) for the US for the same quarter. For the full year, NYC's real GCP increased by 3.0 percent, while the nation's economy expanded by 2.2 percent.

● **NYC payroll jobs grew 1.5 percent in 2007 over 2006 with the addition of 54,500 new jobs.** In the fourth quarter, the City's job creation rate slowed to 1.2 percent, down from a 1.7 percent rate in the third quarter; nevertheless, NYC's job growth in 2007 was stronger than the nation's. The leading job-creating sectors locally were: Professional and Business Services, which added 15,000 employees; Health Services, with 12,100 new jobs; and Finance and Insurance, with 10,700 new jobs. In 2007, US payroll jobs grew at 1.1 percent. Payroll employment figures will be revised in March.

Inside Focus: Wall Street Cycles

● **NYC's unemployment rate averaged 5.1 percent in 2007, a slight increase from the 4.9 percent annual rate seen in 2006.** The US unemployment rate remained unchanged at 4.6 percent for 2007. The City's labor force participation rate rose to 59.4 percent for the year, its highest level since data were collected, while the national rate declined to 66 percent.

● **Personal income taxes withheld from NYC workers' paychecks, an indicator of resident income growth, rose 12.3 percent in 2007.** Boosted by record Wall Street bonuses, taxes withheld grew 14.7 percent in the first half of 2007 compared to the first half of 2006, and 9.4 percent in the second half of the year. Estimated tax revenue, based on taxpayers' estimates of interest earned, rental income, and capital gains, rose 16 percent.

● **General sales tax collections rose 5.3 percent in the second half of 2007 over the same period of 2006.** Sales taxes rose only 3.6 percent in the fourth quarter after surging 7.3 percent in 3Q07, possibly a sign of weakening consumer spending. Retail jobs rose 5,300 in 2007, the same as in 2006, but were down by 1,400 in the fourth quarter.

● **Manhattan's office vacancy rate remained unchanged at 5.7 percent in the fourth quarter of 2007,** after rising slightly in the third quarter, according to Cushman & Wakefield. The average asking rent in Manhattan office buildings continued to rise, reaching $65.08 per square foot (psf) in the fourth quarter compared to $53.43 psf in 1Q07.

● **Manhattan apartment sales prices continued to rise in 2007, but housing prices in other boroughs softened.** On a square-foot basis, Manhattan condo prices rose 17 percent in 4Q07 over 4Q06, but Queens home prices declined 3 percent in the third quarter from a year earlier, according to MillerSamuel. The Case-Shiller Home Price Index for the NY metro area was down 4.8 percent in November 2007 compared to November 2006, while the OFHEO Home Price Index (based on mortgages purchased by Fannie Mae and Freddie Mac) showed existing home prices in the metro area up 1.7 percent in the third quarter of 2007 compared to 2006.

● **Building permits issued for new residential units in NYC increased 3.2 percent** in 2007 to 31,902, the third consecutive year new housing permits exceeded 30,000 units.

● **Transit ridership, an indicator of NYC's economic activity, continued to grow.** According to the Metropolitan Transportation Authority (MTA), for the 10-month period ending in October, subway ridership increased by 4.5 percent over the same period in 2006, LIRR ridership grew 5.3 percent, and Metro-North passengers increased 4.2 percent. MTA bus ridership declined by 0.2 percent.

Summary Table. *Five Key Economic Indicators, NYC and U.S., 2007 vs. 2006, 3Q07 vs. 2Q07 and 4Q07 vs. 3Q07*

	1. GCP/GDP Growth, SAAR		2. Payroll-Jobs Growth, SAAR		3. PIT Withheld, Growth, NSA		4. Inflation Rate, NSA		5. Unemployment Rate, SA	
	NYC	*U.S.*	*NYC*	*U.S.*	*NYC*	*U.S.*	*NYC*	*U.S.*	*NYC*	*U.S.*
2007/2006	3.0% Worse	2.2% Worse	1.5% Worse	1.1% Worse	12.3% Better	10.0% Better	2.8% Better	2.9% Better	5.1% Worse	4.6% No Chng
3Q07/2Q07	3.1% Worse	4.9% Better	1.7% Better	0.8% Worse	10.5% Better	8.5% Worse	2.3% Better	2.4% Better	5.5% Worse	4.7% Worse
4Q07/3Q07	1.1% Worse	0.6% Worse	1.2% Worse	0.8% No Chng	8.4% Worse	10.5% Better	3.5% Worse	4.0% Worse	5.3% Better	4.8% Worse

NSA: Not Seasonally-Adjusted. SA: Seasonally-Adjusted. SAAR: SA Annualized Rate. PIT: Personal Income Tax. Comparisons for "Better," "Worse" or "No Change" are with the prior quarter.

Is Wall Street Heading for Another Cycle?

Summary: *It is well known that New York City's economic fortunes are closely tied to Wall Street. With the recent turmoil in credit markets and a softening stock market, many New Yorkers are wondering how Wall Street's woes will affect their lives. A look at recent job trends indicates that, nationally, financial industry job losses thus far have not been primarily in activities concentrated in New York City. A review of past episodes of financial turbulence indicates that the City's financial sector tends to contract most severely during periods of national recession and prolonged stock market slumps.*

The recent worldwide financial turmoil, starting in the US subprime mortgage market but rapidly spreading to other mortgage markets, corporate bonds, and the stock market, has raised the prospect of an impending cyclical downturn in New York's financial industry. With the financial services sector accounting for about 11 percent of the City's private payroll employment but for almost 35 percent of all private sector salaries and wages paid, cycles within the industry have a pronounced effect on the City's economy and on the fortunes of virtually all New Yorkers.

Since the first pangs of a significant financial crisis were felt last August, financial firms have collectively written off over $100 billion in lost loan values.[1] The pre-tax profits of NYSE reporting firms fell from $4.2 billion in the second quarter of 2007 to a loss of $3.8 billion in the third quarter[2], and large banks and securities firms have announced approximately 16,000 intended layoffs since August.[3] Though few of the firms have disclosed where the layoffs will occur, most maintain a significant presence here and many jobs in the City are considered vulnerable.

After peaking in 2001, employment in New York City's financial services industry reached a low point of 317,900 in May 2004, reflecting the lingering effects of the stock market decline, industry deregulation and consolidation, the terrorist attack and, according to some analysts, diminishing local competitiveness. Through July 2007 the City's financial services sector made a steady recovery, adding about 34,700 jobs in a little over three years and approaching August, 2001 employment levels. The recovery was led by the securities industry, which added approximately 26,500 workers.[4] Banking and insurance firms also added to their employment rolls, though at a slower pace.

Through the first half of 2007, basic indicators for the City's financial sector looked highly positive. Interest rates were at levels consistent with continued growth, the stock market had risen 18 percent during the previous 12 months, underwriting and merger and acquisition activity had reached new highs, and profits of the City's seven largest financial firms were up by nearly 25 percent compared to the first half of 2006. One of the few clouds on the horizon was the troubling increase in subprime mortgage delinquencies, which was threatening the housing security of many families and deepening the nation-wide housing slump.

The outlook changed dramatically in August 2007 when investors began to appreciate the magnitude of the subprime mortgage problem and began a flight from mortgage-backed securities and other instruments perceived to represent high credit risk. As with many other financial crises, there is no single event from which the present problems can be easily dated. However, a useful marker is August 9, 2007, when LIBOR rates spiked in response to adverse reports of European bank exposure to US subprime mortgages defaults. A week later, the Federal Reserve unexpectedly cut its discount rate by 50 basis points in response to tightening credit markets. Since that point, financial conditions have worsened considerably, and economists have significantly increased their calculations of the probability of recession.

Financial Employment Since Midsummer

Nationally, about 6.2 million people work in the finance and insurance sector, representing about 5.4 percent of all private payroll employment. Reflecting New York City's traditional orientation toward trade and finance, some 350,000 people in the City are employed in finance and insurance, accounting for approximately 11.1 percent of the City's payroll employment.

From July through December, national financial employment decreased by about 52,500 workers on a seasonally-adjusted basis, with the "credit intermediation and related activities" segment contracting by 62,400 jobs. (Table 1) That segment contains commercial banking, savings institutions, credit card issuing firms, financial transactions processing establishments, and mortgage and

[1] "More Zeroes for Investors," *The Wall Street Journal*, January 18, 2008.

[2] *Research Report*, Securities Industry and Financial Markets Association, December 28, 2007.

[3] Tabulated from various press reports and company releases.

[4] "Securities industry" refers to the NAICS classification "Securities, Commodity Contracts, and Other Financial Investments and Related Activities." Since employees are classified according to the principal business of the establishment in which they work, there may be securities industry workers engaged in other financial services and banking or insurance employees involved in securities activities.

non-mortgage loan brokers. The securities, insurance, and "funds, trusts, and other financial vehicles" segments actually gained employment nationally from July through December.

Table 1: Change in US and NYC Finance Employment, July 2007–December 2007

	Job Change	% Change
US, Total Private	*301,000*	*0.3*
Finance & Insurance	*-52,500*	*-0.9*
Credit Intermediation, total	*-62,400*	*-2.1*
Depository Credit	*500*	*0.0*
Nondepository Credit	*-52,700*	*-7.1*
Other Credit Activities	*-16,200*	*-4.8*
Securities & Commodities	*6,000*	*0.7*
Insurance	*3,000*	*0.1*
Funds & Other Vehicles	*1,000*	*1.1*
NYC, Total Private	3,100	0.1
Finance & Insurance	-3,100	-0.9
Credit Intermediation, total	-1,000	-1.3
Securities & Commodities	200	0.1
Insurance	1,100	1.2
Funds & Other Vehicles	0	0.0

Source: BLS, NYC Comptroller's Office

Reflecting the housing origins of the present financial turmoil, nearly all of the national financial sector employment decline that has occurred since July 2007 is attributable to "real estate credit" and "mortgage and nonmortgage loan brokers" establishments, where employment collectively contracted by 111,000 workers from September 2006 to November 2007.[5] In New York City, these types of finance establishments are relatively rare; in 2005 there were 564, employing about 8,700 workers. The City hosts about 5.7 percent of the nation's financial jobs, but only 1.8 percent of the real estate credit and mortgage and non-mortgage broker jobs.

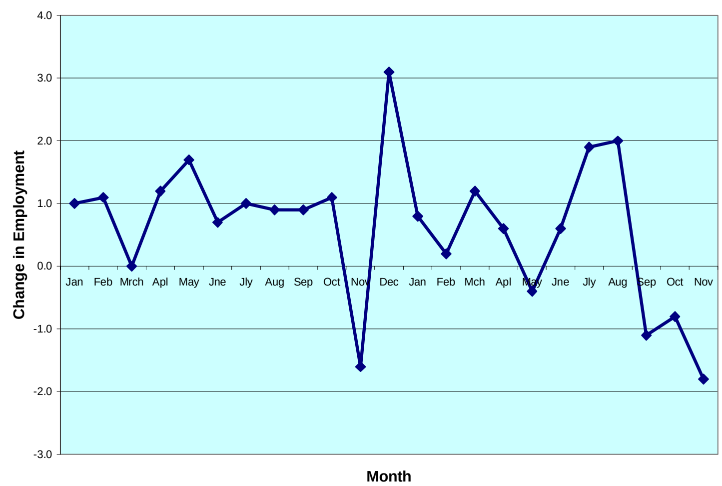
In part because the City has a low representation of the types of financial jobs most immediately affected by the housing slump, its financial sector overall has avoided the dramatic employment contraction seen in other parts of the country. On a seasonally-adjusted basis, industry employment in December was up by about 1,900 workers[6] compared to the midsummer total.

[5] Real Estate Credit establishments are primarily engaged in lending funds with real estate as collateral, while Mortgage and Non-mortgage Loan Brokers engage in arranging loans by bringing borrowers and lenders together on a commission or fee basis.

[6] The U.S. Bureau of Labor Statistics does not seasonally adjust local employment figures; NYC figures were seasonally adjusted by the Comptroller's Office.

However, the securities industry cut back on employment, on a seasonally-adjusted basis, in each of the last three months of the year, for a cumulative decline of about 3,700 jobs, as shown in Chart 1. Moreover, considering that during the past three years the industry had been adding about 750 jobs per month, the 4th Quarter divergence from trend totals approximately 6,000 jobs.

Chart 1: Monthly Change in NYC Securities Jobs, January 2006–December 2007 (seasonally adjusted in thousands)



Source: Bureau of Labor Statistics; NYC Comptroller's Office

Through the end of 2007, securities industry employment in other cities with significant industry clusters showed few effects of the credit crisis. Employment in San Francisco and Los Angeles was up slightly on a seasonally-adjusted basis and in Boston was holding steady. Only Chicago, which had slight securities employment declines during the last three months of the year, was displaying a pattern similar to New York City's.

The reader should recognize that the employment figures cited above are subject to significant revision. Often, the previous month's data are revised when the most current month's data are released. Also, every March, the monthly survey data are benchmarked to a full canvass of employers, sometimes resulting in substantial revisions.

The Pattern of Past Cycles

It would of course be useful to private investors as well as to government policy makers to predict where the current financial cycle is heading; unfortunately, no one knows for sure. It is useful, however, to review similar financial events from the recent past to help draw boundaries on the range of outcomes that might be possible.

1987 Stock Market Crash

One of the most memorable events in New York City's financial history was the stock market "meltdown" of 1987. During the two and one-half years ending in September

1987, stock prices enjoyed a period of healthy appreciation. The S&P 500 index rose about 81 percent, closing at 328.1 on September 28. Stock prices began to weaken thereafter, and the index had lost about 13 percent of its value by October 16. Then, on Monday, October 19, the stock market crashed, with the S&P index falling over 20 percent. The index fell further the following day but thereafter stabilized, finishing the year about 13 percent above its October 20 close. The underlying cause of the October 1987 crash continues to be debated, as there were no real or psychological shocks to the economy preceding the event that can be readily identified as triggers.

The crash had little apparent effect on the real national economy. US GDP grew by 2.9 percent in 1987, 3.8 percent in 1988, and 3.4 percent in 1989. The economy did not slip into recession until the third quarter of 1990, by which time the S&P index was well above its 1987 peak. However, the crash and subsequent reconfiguring of financial markets had a significant impact on Wall Street; profits of NYSE member firms dropped 80 percent in 1987 and remained at comparatively low levels for four years.

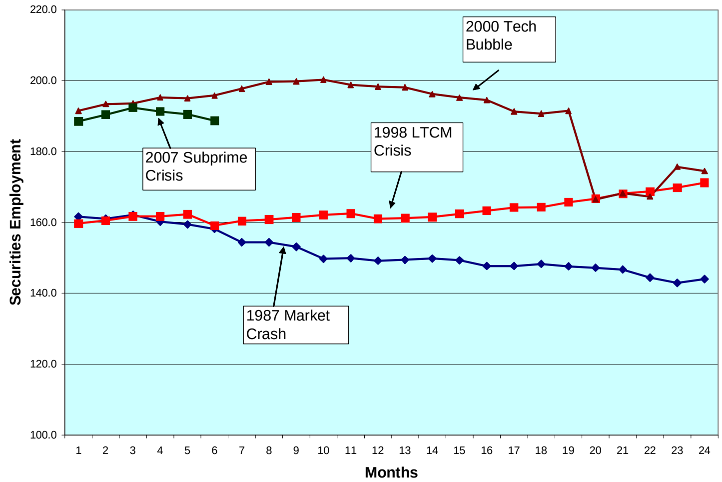
Financial employment in the City began to decrease within several months of the 1987 crash, and the trend continued through the 1990 recession. The City's financial employment did not bottom out until April 1993, by which time about 85,000 jobs had been lost, a decline of nearly 20 percent. The securities industry itself lost about 25,000 jobs, or about one-sixth of its peak employment, but the banking sector was ultimately more profoundly affected by a "capital crunch" that emerged in early 1990. The crunch was said to occur primarily because of the savings and loan crisis, tighter regulatory standards on banks, and the bursting of a commercial real estate boom. The crunch was, in turn, believed to be the principal cause of the 1990 recession, which had a profound effect on the economy of New York City and the entire region. Chart 2 shows the monthly pattern of seasonally-adjusted securities employment[7] during the 24 months following each of the four financial crises discussed.

1998 Asian Financial Crisis and LTCM

A financial episode that had a much happier conclusion for New York City was the market panic of 1998. There is still no consensus regarding the initial causes of the Asian financial crisis of the late 1990's but the ensuing financial contagion has been thoroughly documented and analyzed. The crisis began in Thailand in 1997 and spread to South Korea, Indonesia, the Philippines, Malaysia, and ultimately to Russia, which defaulted on its treasury bills in August 1998. The crisis spurred a "flight to quality" by international investors similar to that being experienced in 2007, causing spreads between risky debt and safer instruments to soar.

[7] Due to changes in industry classification, employment totals prior to 1990 are not directly comparable to later years.

Chart 2: NYC Securities Industry Employment Following Four Financial Crises



Source: NYC Comptroller's Office

One of the consequences of the financial crisis and, in particular, the Russian default, was the unraveling of Long Term Capital Management (LTCM), one of the largest and most prominent hedge funds of the 1990's. Although LTCM had only $5 billion in equity at the start of 1998, it had borrowed over $125 billion from banks and securities firms, and had entered into derivatives contracts with a notational value of over $1 trillion.[8] The firm had bet heavily on interest rate spreads decreasing, and when they widened to unprecedented levels in the summer of 1998, LTCM's capital based eroded quickly. Amid fears that a forced sale of LTCM's holdings could collapse securities markets and spread LTCM's problems throughout the financial system, the Federal Reserve Bank of New York orchestrated a $3.6 billion private bailout of the hedge fund in September 1998. The Fed's Open Market Committee also acted to increase liquidity in the financial system, cutting the federal funds target rate by 75 basis points over a seven-week period.

Although the crisis of 1998 can be seen clearly in financial market data (for example, the spread between Baa corporate bond yields and 10-year treasury bills widened by 94 basis points between May and October 1998), it had remarkably little impact on the real economy. Real GDP grew by 4.5 percent in 1997, 4.2 percent in 1998, and 4.4 percent in 1999.

The local economy also performed extremely well in the aftermath of the 1998 crisis. Real GCP grew by an estimated 6.6 percent in 1998, 5.2 percent in 1999, and 5.4 percent in 2000. The financial turbulence did, however, have some effect on the City's financial services sector. Pre-tax net income of NYSE member firms dropped $2.4 billion, or

[8] Edwards, Franklin. "Hedge Funds and the Collapse of Long-Term Capital Management." *Journal of Economic Perspectives*, Spring 1999.

20 percent, in 1998 but rebounded to a record $21 billion in 1999. Securities industry employment showed a slight dip about two months after the initial crisis, but then began a rise that lasted for another two years.

2000 Technology Stock Bubble

From December 1994 through March 2000 stock markets enjoyed a period of rapid and almost uninterrupted growth (the summer of 1998, discussed above, was the only period of significant decline). During that 68-month period the S&P 500 rose from a low of 442.9 to a high of 1552.9. After fluctuating near the top for about five months, the markets began a steady descent, with the S&P 500 losing nearly half its value by September 2002.

The long decline in stock values is usually associated with the bursting of a price bubble in technology-oriented stocks, however, there was no single event that triggered the sell-off. Persistently disappointing earnings, adverse legal developments, technical market factors, the Enron scandal, and a host of other factors may have played a role in taking the luster off technology stocks, with the downward momentum eventually spreading to other stock sectors. One fundamental factor which likely played a role, however, was Federal Reserve policy. The federal funds rate was increased from 4.75 percent in June 1999 to 6.50 percent in June 2000, in part in order to curtail what the Federal Reserve Chairman characterized as "irrational exuberance" in the stock markets.

Rising interest rates, combined with the falling stock market, contributed to the onset of the first national recession in nearly a decade. Real GDP contracted for three consecutive quarters, with the deepest decline, -1.6 percent, occurring in 2Q01. The 9/11 terrorist attack occurred towards the end of recession and intensified the regional slump.

As Chart 2 shows, Wall Street[9] employment continued to rise for a considerable time after the stock market initially turned down, peaking in December 2000. By August 2001, as the national recession was nearing its end, the industry had cut about 9,600 jobs, or nearly 5 percent of its workforce. The September attack caused an immediate loss of approximately 25,000 jobs, and an apparent long-term loss of 15,000 to 20,000 jobs. The total Wall Street job loss from peak to trough was about 40,000 jobs, of which as much as half may be attributed to the 9/11 tragedy.

[9] "Wall Street" is here used synonymously with NYC's NAICS industry "Securities, Commodity Contracts, and Other Financial Investments and Related Activities."

Conclusion

With financial innovation occurring at an unprecedented pace, each episode of financial turbulence has its own character and implications. Nevertheless, a review of three recent episodes suggests that market turmoil, even if accompanied by a severe drop in Wall Street profits, need not have a correspondingly severe impact on the City's financial industry employment, if the problems are quelled quickly and future opportunities appear plentiful. Conversely, if the turmoil is a harbinger of a prolonged stock market slump and a national recession, the City's financial sector job base could contract by as much as 15 percent. Thus far, the adverse employment effects of the subprime crisis have come primarily in financial activities that are not concentrated in New York, but if the Federal Reserve is unable to reassure investors and avert a national recession, that may change dramatically during 2008. ■

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Each issue of the newsletter includes a special analysis of an economic trend affecting New York City. Thompson's last four were:

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April 2007

Self-Employment Trend Identifies Boom Spurring Growth:
January 2007

New York City's Tourist Industry:
November 2006

Economic Notes
Office of New York City Comptroller
William C. Thompson, Jr.
1 Centre Street, New York, NY 10007
www.comptroller.nyc.gov/budget

PREPARED BY
Frank Braconi, Chief Economist
Farid Heydarpour, Principal Economist
Olayinka Olarewaju-Alo, Economist
Call us at (212) 669-2490.

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The New York City Comptroller's Office
Fiscal and Budget Studies
Marcia Van Wagner, Deputy Comptroller for Budget
Gayle M. Horwitz, First Deputy Comptroller