Office of the New York City Comptroller

William C. Thompson, Jr., Comptroller

ECONOMIC NOTES

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NYC Economy Continues to Grow Briskly in 1Q06

Overview: **The City's economy began 2006 on a strong note. The number of employed City residents hit a record high, payroll jobs registered the biggest increase in over five years, unemployment was the lowest in five years, and the City's inflation rate fell below the national rate.**

- **Real Gross City Product (GCP), a measure of the overall City economy, grew 4.3 percent in 1Q06,** below the 5.3 percent U.S. rate (preliminary estimate). Nonetheless, an economic slowdown during the coming year is widely anticipated, as the effects of recent interest rate hikes begin to be felt.

- **NYC payroll jobs grew at a seasonally adjusted annualized rate of 2.7 percent** or by 23,900 jobs in 1Q06, the biggest gain in over five years. The City's job growth was more than the U.S. payroll employment growth of 1.8 percent. In NYC, the private sector added 23,900 jobs while the number of government jobs was unchanged. As of 1Q06, the City has gained half (118,700) of the 235,100 jobs it lost between 4Q00 and 3Q03.

- **Personal income taxes withheld from paychecks were 4.4 percent greater in 1Q06 than in 1Q05.** Estimated tax payments on interest income, rental income, and capital gains rose 45.6 percent. The rise in estimated tax payments is likely due to capital gains realized from increasing housing prices.

INSIDE FOCUS:

NYC's Labor Force Participation Bucks National Trend; Dissecting Housing Inflation

- **NYC's inflation rate was less than the national average for the first time in over four years in 1Q06.** The City's inflation rate was 3.4 percent in 1Q06 compared with 4 percent in 4Q05. Core inflation, which excludes food and energy prices, fell to 2.2 percent in 1Q06 from 2.7 percent in 4Q05. Meanwhile, the U.S. inflation rate was 3.6 percent in 1Q06 compared with 3.7 percent in 4Q05. U.S. core inflation rate was 2.1 percent in 1Q06, the same as in 4Q05.

- **NYC's unemployment rate fell to 5.4 percent in 1Q06, the lowest in five years.** The U.S. unemployment rate fell to 4.7 percent, also the lowest in nearly five years. The City's labor force, employed residents, labor-force-participation rate, and employment-population ratio were all at a record high in the first quarter.

- **The average Manhattan commercial vacancy rate fell to 8.4 percent in 1Q06, from 10.4 percent in 1Q05.** The average commercial asking rent in Manhattan rose to $43.20 per square foot in 1Q06 from $40.28 in 1Q05.

- **Leading economic indexes indicate a continued, but cautious, expansion.** On a year-over-year basis, the NYC business-conditions index increased 13.6 percent and the number of building permits authorized rose 8 percent in 1Q06. On a quarter-over-quarter basis, online ad volume rose 1 percent according to the Monster Local Employment Index and rose 24.3 percent according to the Conference Board.

Summary Table. *Five Key Economic Indicators, NYC and U.S., 1Q06 vs. 4Q05*

		1. GCP/GDP Growth, SAAR	2. Payroll-Jobs Growth, SAAR	3. PIT Withheld, Growth, NSA	4. Inflation Rate, NSA	5. Unemployment Rate, SA
1Q06 vs. 4Q05	NYC	2.6% **Better**	2.7% **Better**	4.4% **Worse**	3.4% **Better**	5.4% **Better**
	U.S.	5.3% **Better**	1.8% **Better**	8.0% **Better**	3.6% **Better**	4.7% **Better**

NSA means Not Seasonally Adjusted. SA means Seasonally Adjusted. SAAR means SA Annualized Rate. PIT means Personal Income Tax. Comparisons for "Better" or "Worse" are with the prior quarter.

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More New Yorkers Join the Workforce

Summary: **The number of New York City residents holding jobs reached its highest level ever during the first quarter of 2006, as did the City's labor force participation rate. The number of employed residents has been growing most rapidly in Queens.**

Recent employment data were full of good news for New York in the first quarter of 2006. The City's labor force, the number of employed residents, the labor-force-participation rate, and the employment-population ratio all hit record highs.

The City's seasonally adjusted labor force–which consists of people who are employed or looking for work–reached a record high of 3,793,400, an increase of 33,700 from the fourth quarter of 2005. It was the biggest increase in the City's labor force in four years. As a result, the labor force participation rate rose to a record 60.2 percent. The City's participation rate remains lower than the nation's, but the difference of 5.8 percentage points is the lowest on record.

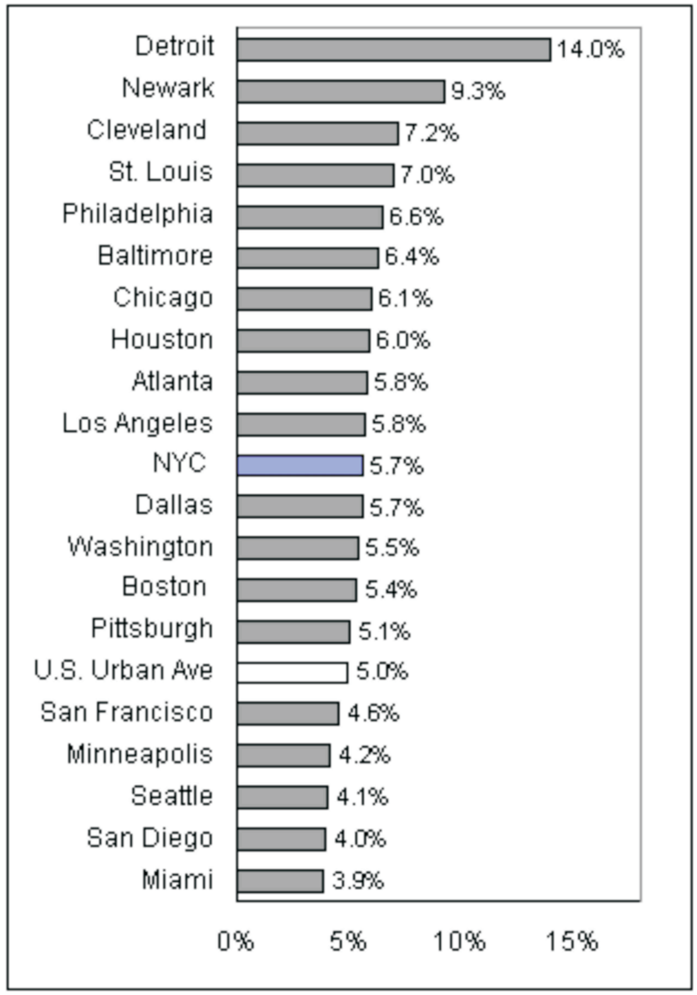
Even better, civilian employment–which measures the number of City residents who are employed–increased by 48,600, reaching a record 3,588,500, after adjusting for seasonality. During the first quarter of 2006, nearly 57 percent of all New York City residents were employed. Nevertheless, the 204,900 City residents remained unemployed, a decrease of only 14,900 compared to the fourth quarter of 2005.

Increases in employment have been partially offset by rapid growth in the size of the labor force, which may indicate that as more residents are finding jobs, previously discouraged workers are rejoining the labor force. In fact, while on a quarter-over-quarter basis, labor force and employment grew in the city, the city's population is estimated to have declined by 13,700 in the first quarter of 2006.

Despite the growth of the labor force, the City's unemployment rate fell to 5.7 percent in the first quarter of 2006, the lowest in five years and a reduction of more than three percentage points from its cyclical high in the first quarter of 2003. On a year-over-year basis, the unemployment rate fell in all boroughs by 0.5 of a percentage point in the Bronx, by 0.4 of a percentage point in Brooklyn, Manhattan and Staten Island, and by 0.2 of a percentage point in Queens.

In a comparison of unemployment rates among the 20 largest cities, NYC ranked in the middle of the pack. Detroit had the highest unemployment rate and Miami had the lowest in the first quarter of 2006. (See Chart 1.)

Chart 1. *Unemployment Rates for NYC, the 20 Largest Cities, and the U.S. Urban Average, 1Q06*

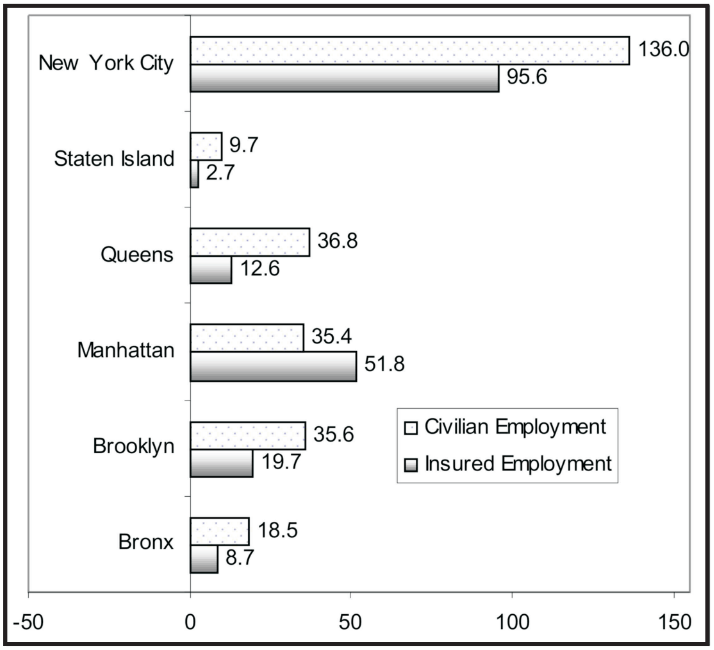


Source: Bureau of Labor Statistics. Numbers are not seasonally adjusted.

During the past decade, the City's labor force participation rate has increased by an impressive 3.5 percentage points and its employment-population ratio has increased by about 5 percentage points, while the nation's rates have declined. In fact, between 1995 and 2005, the City's population grew 6.8 percent while its labor force grew 13.5 percent. Over 415,000 people have been added to the City's labor force since 1996, with the fastest growth rate occurring in Staten Island. Queens has added the greatest number of workers, 177,000, over the past ten years.

The data indicate that since the City's recent economic expansion began in September 2003, resident employment has grown even faster than the number of jobs located within the City. There are several possible explanations for that surprising trend. The obvious explanation is that more City residents are finding employment outside the City. It could also mean that City residents are replacing commuters in local jobs, or that some job creation in the City is going undetected.

Chart 2. *Changes in NYC Civilian Employment vs. Insured Employed, in thousands, September 2003 to September 2005*



Note: "Civilian Employment" represents the number of city residents who are employed. "Insured Employment" represents the number of jobs that are located within the city or the respective borough. Source: NYS Department of Labor.

Figures on civilian employment are based on the Current Population Survey (CPS), a national monthly telephone survey of households. About 3,000 New York State households are surveyed. The CPS is supplemented by a national survey of employers and unemployment insurance claims data to generate the labor force and employment estimates. In contrast, the insured employment figures are generated from a census of employers liable for unemployment insurance. The former data include self-employed and several other categories of workers the latter does not, so some of the divergence in the two measures may be due to methodological or definitional differences.

As Chart 2 shows, all of the boroughs other than Manhattan have added more jobholders than they have jobs. However, Manhattan's job creation has not been strong enough to account for all of the inter-borough discrepancy. From September 2003 through September 2005 the number of employed City residents increased by 136,000 while the number of jobs in the five boroughs grew by 96,000.

Among all the boroughs, Manhattan had the highest increase in the number of jobs, but Queens had the highest increase in residential employment. Although the City has not regained all the jobs it has lost since the peak in early 2000, job creation since then has been more dispersed through the boroughs than was previously the case. ●

Housing Drives the Cost of Living in New York

Summary: **For households as well as businesses, New York City is a high-cost location. Evidence suggests that New York has become relatively more expensive during the current economic expansion. The City's inflation rate is driven primarily by changes in housing costs, which are best analyzed with a series of specialized price indexes.**

For the first time in several years, the prospect of rising inflation has become the primary concern of investors and economic policy makers. In the three weeks following the Federal Reserve's May 10 announcement of another quarter-point increase in the federal funds rate target, the Standard & Poors 500 index dropped by nearly 5 percent. A Consumer Price Index (CPI) report on May 17 heightened fears of inflation and the possible need for further interest rate increases. According to the Bureau of Labor Statistics (BLS), inflation increased at an annual rate of 5.1 percent during the first four months of 2006. Contributing to the relatively rapid increase in prices were soaring energy costs and an unexpectedly strong rate of economic growth.

Ironically, renewed concern about the national inflation rate developed at the same time the inflation rate in the New York metropolitan area appeared to be easing. During the first quarter of 2006, the metropolitan area inflation rate was 3.4 percent, compared to a 4.0 percent rate during the fourth quarter of 2005. It was the first quarter since the fourth quarter of 2001 in which the local inflation rate was lower than the national rate.

A comparison of the national inflation rate with those of the 27 metropolitan areas the BLS tracks shows that inflation is a national phenomenon. The price indexes for individual metropolitan areas tend to trace reliably the rises and falls in the national inflation rate. Nevertheless, small differences in inflation rates among cities, compounded over time, gradually alter the relative cost of living among them.

Inter-city living cost differentials can be difficult to interpret. While it may seem to most residents that lower prices are a good thing, high relative prices can also be interpreted as a measure of a city's prosperity, and rapid price increases as an indicator of a growing economy. Whether high prices can be seen in such a favorable light depends, however, on the context in which they occur. They can also be reflective of constraints on the supply of housing or other locally produced items, or of inefficiencies in the distribution of goods or services. If that is the case, high prices could be damaging to the City's economy and injurious to its consumers.

Furthermore, it is difficult to account for inherent difference in urban amenities when comparing inter-city living costs. For example, residents of other cities do not have the public transportation options that New Yorkers enjoy, so direct comparisons of automobile or gasoline prices can be misleading. Similarly, the quality and diversity of New York's cultural life cannot be compared on a simple price basis to the same services elsewhere.

Given these complications, it is difficult to judge whether the slowdown of New York's inflation rate during the first quarter of 2006, relative to the national average, is cause for cheer or alarm. It could signal a slowing of the City's economy, creating an environment where suppliers find it more difficult to raise prices. In general, however, it seems to be a positive development, as other indicators of the City's economic momentum, such as job creation and personal income growth, remained strong.

New York City and the Nation

New York is known as an expensive place to live. According to the ACCRA Cost of Living Index*, Manhattan is the most expensive location in the country, with a cost of living more than twice the national average. While housing costs are the primary reason living in Manhattan is so expensive, even grocery items cost about one-third more than the national average. The other boroughs are comparable to other large cities. The cost of living in Queens, for example, is about 37 percent higher than the average, according to ACCRA. Still, it is lower than in Boston, Washington, and San Francisco.

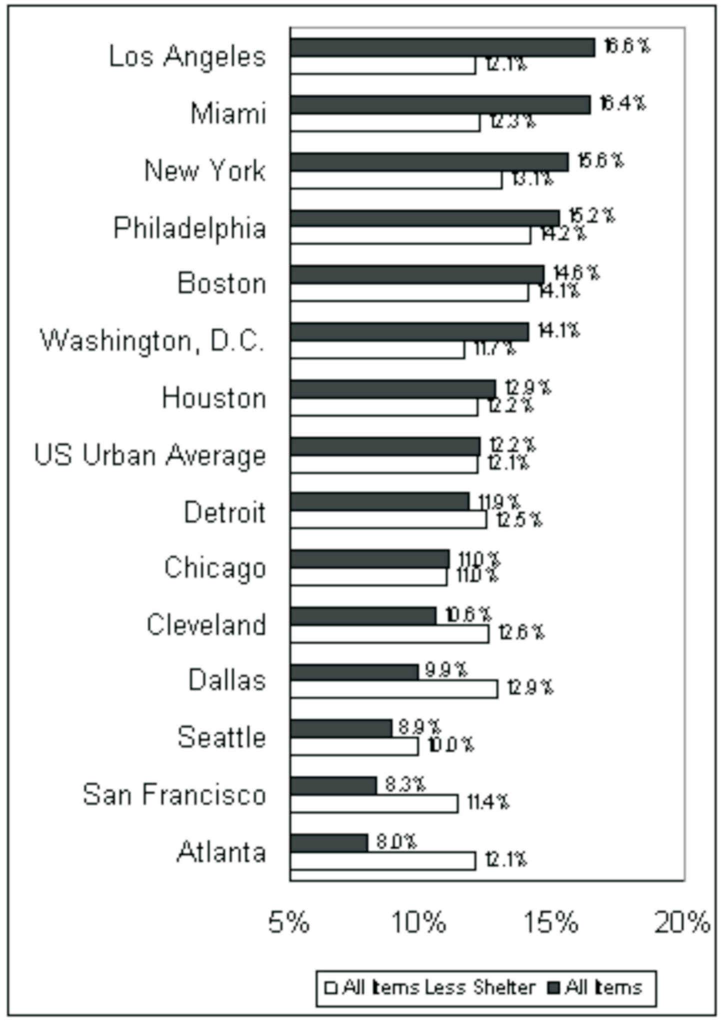
Since the early 1980's, the CPI for the New York metropolitan area has risen about 120 percent, compared to about 100 percent for the nation as a whole. Only Boston has had a long-term inflation rate in excess of New York's. The cost-of-living gap between New York and Boston and many sunbelt cities, which already existed two decades ago, consequently widened. Prices in Atlanta and Dallas, for example, increased by 94 percent and 88 percent, respectively, over that same period of time

Much of the increase in New York's relative prices has come since the last national recession ended. Since October, 2001, consumer prices in the NYC metro area have increased about 30 percent faster than the national average. Except for medical care and private transportation, prices in our region have increased more rapidly across the board, with the CPI for food consumed at home rising 40 percent faster than the national average. Nevertheless, the biggest factor behind New York's relative cost-of-living increase has been housing, the cost of which has grown by 22 percent since late 2001, according to the BLS.

When housing is subtracted from the CPI calculations, New York's price trend looks much more like that of the rest of the nation. Since the early 1980s, New York's prices net of housing track the national inflation rate quite closely, having increased only 4 percent more over that time. Moreover, the metro area's non-housing inflation rate has been comparable to those of Atlanta and Dallas, and much less than Boston's.

* The ACCRA Cost of Living Index is compiled by ACCRA-The Council for Community and Economic Research, a membership organization located in Arlington, Va.

Chart 3. *CPI Changes for Major Metropolitan Areas, 3Q01 to 1Q06*



Source: Bureau of Labor Statistics

Measuring Housing Inflation

That New York City has grown more expensive relative to other places is not surprising. If economic opportunities and the quality of life have improved faster than elsewhere, and many indicators suggest that they have, the greater appeal of living in the City should be reflected in higher housing prices and a higher cost of living. Exactly how much housing costs have increased, however, and how they have affected different types of households, is difficult to determine.

Housing accounts for nearly 40 percent of the Consumer Price Index. Rent for primary residences is weighted at about 6 percent of the index and homeowner costs at about 22 percent. Those weights are intended to be representative of the country as a whole; in the New York metropolitan area, rental units comprise a much larger proportion of the housing stock. Also included in the "housing" category of the CPI are items such as lodging away from home, tenant's and household insurance, fuels and utilities, and household furnishings and operations.

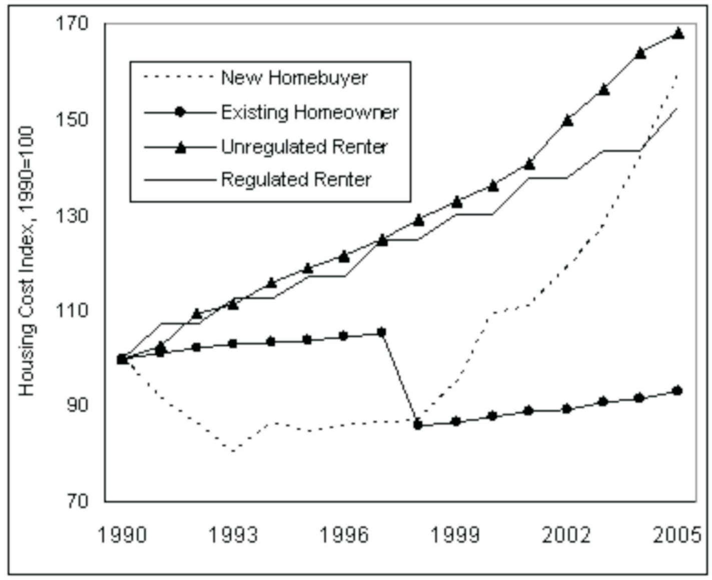
The CPI housing cost indexes are derived from data collected monthly from about 50,000 landlords and tenants. In an area with a large renter population such as ours, the survey is relatively straight forward. In a study released in 2003, Jonathan McCarthy and Richard Peach of the Federal Reserve Bank of New York compared rent trends in the CPI with those they estimated from the American Housing Survey, and concluded that the CPI overestimated national rent inflation during the 1989-97 period but underestimated it between 1997 and 2001. Nevertheless, they found that rent trends as measured in the CPI were broadly consistent with their estimates. However, the index for our local area covers 24 counties, including northern New Jersey, the northern suburbs, and Long Island, and it does not distinguish between rent-regulated and unregulated units.

The CPI for homeowner costs is more problematic and less intuitive. Since 1983, the BLS has used a "rental equivalence" approach to gauge the cost of homeownership. This approach treats a home as a bundle of shelter characteristics and its price as the cost the owner would have to pay to rent an identical or equivalent house. It is, in effect, the change in the price of shelter service provided by owner-occupied housing, and is estimated from data on comparable rented homes. The rental equivalence approach has a number of analytical and computational advantages over other methods, but it does not capture accurately the changing "barriers to entry" faced by the aspiring homeowner, nor the actual changes in housing costs experienced by the existing homeowner.

In order to get a better sense of how rising housing prices have affected New York and its residents, we constructed separate housing cost indexes, one each for existing homeowners, new homeowners, and rent-stabilized renters. We plotted these indexes against the metro area CPI for homeowner costs which, due to the BLS' rental equivalence approach, can be interpreted as an index of unregulated rents.

The chart shows that unregulated renters have experienced the fastest growth in their housing costs during the past 15 years. A household that has lived in an unregulated rental unit, paying market rents as measured by the CPI, has experienced a 68 percent increase in its housing costs since 1990. This compares to a 53 percent increase for rent-stabilized New York City renters who have stayed in the same apartment since 1990 and have renewed their leases biennially at the maximum increase permitted by the Rent Guidelines Board. The indexes for regulated and unregulated rents remained close until 2001, when unregulated rents began to increase more rapidly. Since our measure of unregulated rents is based on the BLS' regional survey of rental units comparable to owner-occupied homes, it is possible that smaller rental units, or those in the City, increased at a different pace.

Chart 4. *Estimated New York City Housing Cost Indexes, 1990 to 2005*



Source: Bureau of Labor Statistics, NYC Department of Finance; NYC Rent Guidelines Board; Office of the NYC Comptroller

Existing homeowners have fared best. Assuming the household purchased a median-priced single-family home in New York City in 1990 and has remained in the same uni since then, its monthly housing costs have decreased by approximately 7 percent, providing it has refinanced its mortgage at least once. This is calculated from an index representing the composite of mortgage debt-service costs, property taxes, water and sewer fees, maintenance costs, insurance premiums, and heating costs. The index assumes a refinancing in 1998, by which time average 30-year fixed mortgage rates had fallen by more than three percentage points from their 1990 levels. The decrease in the existing housing index cost is produced primarily by fixed debt-service costs, with mortgage refinancing providing a one-time reduction.

If the household owns its home free and clear, its monthly costs would have increased by about 54 percent since 1990, slightly faster than the rate of increase for stabilized renters. This is the case for many elderly owners. In contrast, if a stabilized renter was an eligible low-income senior, the SCRIE program would have insulated them from all rent increases during that time.

The index for new homebuyers is based on the median sales price of single-family homes in New York City, with monthly mortgage costs estimated using average annual 30-year mortgage rates for each respective year. As with the index for existing homeowners, realistic values for property taxes, water and sewer fees, maintenance expenditures, insurance, and heating costs are factored in. Whereas the other indexes can be interpreted as the housing cost inflation households actually experienced given their housing circumstances, this index cannot be, as virtually no one would buy a new home each year. Rather, it reflects the monthly housing cost a potential homebuyer in New York City was faced with in each succeeding year, if they desired to purchase a median-priced home at prevailing mortgage interest rates.

Our computations show that, despite a near doubling of the median home price in the City between 2000 and 2005, the "user cost" of a home purchase did not increase nearly so rapidly, increasing 45 percent during that time. This is because higher purchase prices were partially offset by lower mortgage rates. From 1990 to 1999, the annual user cost of purchasing the median priced home in New York City actually declined. It wasn't until 2005 that the annual costs of a new home purchase exceeded the relative cost of renting a regulated apartment, using 1990 as a reference period. Through 2005, the relative cost of a new home purchase still had not caught up with the price increases shown in the unregulated rental market since 1990.

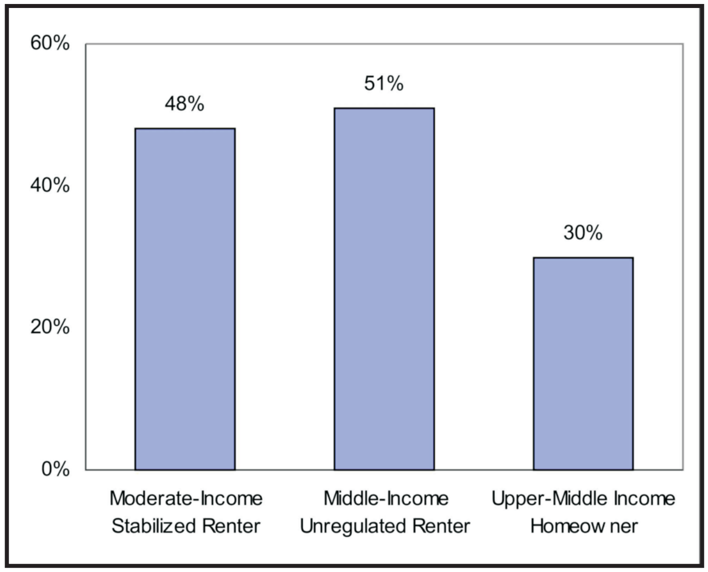
Cost Of Living Experiences

The Consumer Price Index is intended to measure, each month, the cost of achieving the same standard of living attained by a typical household during the base period. In order to construct a single measure of living costs, however, the BLS must make assumptions about the spending patterns of the typical household and weight each item in the CPI accordingly. Of course, no two households will have exactly the same spending patterns, so the actual experience of inflation will differ from household to household. A person who commutes to work by car, for example, will have experienced a much different cost of living trend during the past two years than one who commutes by subway.

In general, most specific consumer expenditures represent a relatively small portion of a household's annual income and their relative price changes don't affect the overall cost of living a great deal. Housing, accounting for a significant portion of the average household budget, is very different. Changes in its price can have a significant impact on the cost of living, and it can vary significantly with the housing circumstances of a particular family.

Using the price indexes discussed above, we can get a better sense of how changes in the cost of living in the City have been experienced by different types of households. While endless comparisons among families with different incomes and spending patterns can be made, we will limit the discussion to three cases: a moderate-income renter, a more affluent homeowner, and an aspiring homebuyer with an annual income midway between the other two. A family with a $25,000 annual income in 1990 and a rent-stabilized apartment costing 30 percent of its gross income would have experienced a 48 percent increase in their cost of living through 2005. In other words, its income would have needed to rise to $37,100 for the initial standard of living to be maintained. That cost of living change reflects a 53 percent change in their housing costs and a 47 percent change in all other expenditure. In contrast, a family earning $75,000 in 1990 that purchased a median-priced home that year would have experienced a 30 percent increase in the cost of living. That increase reflects a 7 percent decrease in their housing costs and the same 47 percent change in all other items.

Chart 5. *Estimated Change in Cost of Living for Typical NYC Households, 1990-2005*



Source: NYC Comptroller's Office

Consider, finally, a young family earning $50,000 in 1990, living in a market rate apartment that cost them 20 percent of their gross income. They would have experienced a 51 percent increase in their cost of living over the subsequent 15 years, requiring a 2005 income of $75,400 to maintain their initial standard of living. If they aspire to buy a home, they would find that the annual cost of doing so had risen by 57 percent over that time period, slightly more than their unregulated rent.

These calculations are a reminder that the CPI is an abstract indicator that is designed to measure very broad trends. Real households, however, may experience inflation very differently than is suggested by the CPI, depending on their spending patterns and, especially, their housing circumstances. When evaluating the economic well-being of New York's residents, it is as important to understand variations in the cost of living among groups as it is to understand variations in their income growth. ●