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IN ECONOMICS AND FINANCE

SECOND DISTRICT HIGHLIGHTS

New York City's Economy before and after September 11

Jason Bram

An analysis of employment and income trends suggests that the economic impact of the September 11 attack on New York City was somewhat less severe than originally thought. The attack created sizable job and income losses, but the city's current downturn appears to stem largely from other, cyclical factors—namely, the national economy and the financial markets.

The late 1990s boom enjoyed by New York City—driven by a strong national economy and growth in the city's financial sector and other key industries—subsided toward the end of 2000. In January 2001, just two months before the national recession began, the city entered a protracted downturn. That contraction was made even more evident by the economic disruption that followed the September 11 attack on the World Trade Center.

Although September 11 clearly affected New York City's economy, the magnitude of the attack's role in the downturn is open to question. In this edition of *Second District Highlights*, we consider whether the job and income losses after September 11 were largely the result of the attack itself or attributable instead to cyclical movements in the city's economy. Our analysis of employment and income trends before and after September 11 suggests that the attack's disruptive effect on the city's economy was somewhat less severe than first thought. Using the New York State Department of Labor's comprehensive tabulation of insured employment, which is available up to second-quarter 2002, we estimate that the economy was in worse shape *prior* to the attack than was indicated by preliminary employment data.[1] Accordingly, we conclude that the current downturn stems largely from cyclical factors—namely, the national economy and the financial markets, the same forces that gave rise to New York City's late 1990s boom—and that the attack exacerbated an already weak economy.

More recently, there have been some small signs of stabilization in New York City's financial sector and in wages and salaries more generally, while some positive secular, or longer term, trends have given no indication of fading. Still, renewed signs of cyclical weakness in the local labor market toward year-end suggest that the city's economy has yet to bottom out, and persistent sluggishness in the equity markets and a slowing of growth at the national level remain cause for concern.

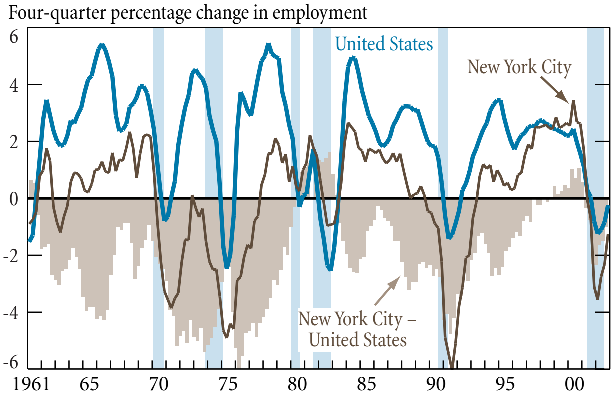
The Late 1990s Boom: 1996 to 2000

To appreciate more fully the current state of the city's economy, as well as the effect of the terrorist attack, it is helpful to explore the forces underpinning the late 1990s boom. If this unusually strong period were entirely the result of transitory events and financial market cycles, New York City's recent slump could be viewed as a pullback from an unsustainably high level of economic activity. In such a case, the medium-term outlook would appear middling at best because the city's economy, which had already been performing above its long-run potential, could not rise very far. Yet if the boom partially reflected positive secular trends that still exist, the outlook could be viewed as more favorable because the city's economy could still have a good deal of upward potential.

In the late 1990s, New York City experienced its strongest economic boom of the past half-century, both in absolute terms and relative to the United States. Between 1996 and 2000, private-sector employment grew at a 2.6 percent average annual pace (Chart 1). Not only did this growth represent the strongest four-year run in more than four decades, it represented the first time, aside from the 1982-83 national recession, that the city's job growth exceeded that of the nation.

The city's boom was equally strong on the income side. Wage and salary earnings in the private sector expanded at a 9.6 percent average annual pace between 1996 and 2000, compared with 7.6 percent nationally. In inflation-adjusted terms, this growth represents a 7 percent pace—also about two points above the adjusted national rate—as well as the strongest four-year performance in more than three decades (Chart 2).

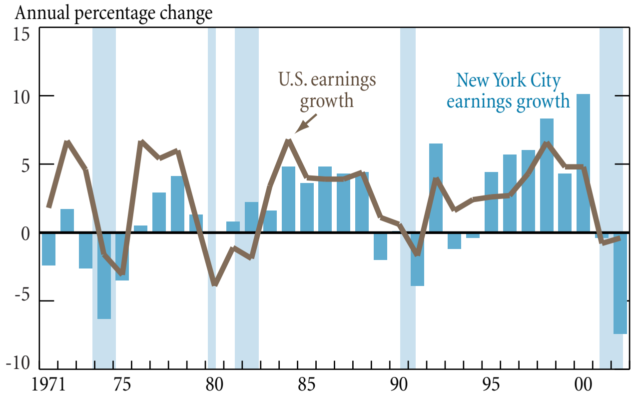
Chart 1
Job Growth: New York City and the United States



Sources: New York State Department of Labor; U.S. Department of Labor, Bureau of Labor Statistics.

Notes: The shaded area indicates the growth differential between New York City and the United States. The bands indicate periods designated national recessions by the National Bureau of Economic Research.

Chart 2
Real Growth in Private Wage and Salary Earnings: New York City and the United States



Sources: New York State Department of Labor; U.S. Department of Commerce, Bureau of Economic Analysis; Federal Reserve Bank of New York estimates.

Notes: Estimates for 2002 are based on data for the first three quarters. The bands indicate periods designated national recessions by the National Bureau of Economic Research.

Much of the income growth was driven by dramatic increases in Wall Street earnings, reflecting the bull market in place then. Significantly, the earnings upsurge on Wall Street began even before 1996: wages and salaries in the securities industry, adjusted for inflation, expanded at a 16 percent average annual pace from 1994 to 1996 and maintained that pace through 2000. This earnings growth is consistent with the finding that the securities industry tends to lead the New York City economy (Bram and Orr 1999).

Of course, the securities-industry boom was also a national phenomenon. However, New York City's economy benefited disproportionately because the industry's local shares of employment and income are eight times its national shares.[2] Moreover, the city's boom was not limited to the financial sector: advertising, motion pictures, publishing, media, tourism, and business and computer services all registered sturdy growth in the late 1990s. This expansion was presumably not attributable entirely to multiplier effects from Wall Street.

The 2001-02 Downturn

As 2000 drew to a close, however, the boom ended and New York City's economy slipped into a recession in January

2001, just two months before the national economy, according to the Federal Reserve Bank of New York's index of coincident indicators.[3] Less than nine months later, the city was traumatized by the World Trade Center attack.

Clearly, the human and emotional toll of September 11 is beyond measurement. Nevertheless, there is reason to believe that the attack's economic impact on New York City was not as severe as originally estimated. Preliminary data—released monthly in 2001 and 2002 by the New York State Department of Labor—indicate that private-sector employment in the city at the time of the attack had fallen from its January 2001 peak by 55,000, or 2 percent. However, a more complete tabulation of employment, released separately last year by the same agency, suggests that the 2001 job-loss figure prior to the attack will be increased when benchmark revisions are released by the New York State Department of Labor in March 2003 (Chart 3). Furthermore, at the end of August 2001, sharp declines in the equity markets were foretelling further weakness in the city's financial services industry, and hence the local economy.

There is no doubt that job losses intensified after September 11: private-sector employment in the city fell by 51,000 in October 2001 and by 41,000 more through March 2002, according to New York State Department of Labor preliminary data. In subsequent months, however, employment was relatively stable. And while more complete New York State Department of Labor data suggest that the post-attack level of employment will be revised downward (Chart 3), the net job loss in the six months following the attack is not expected to be revised substantially.

Data on wage and salary earnings also point to a weakness in the New York City economy prior to September 11. These figures—currently available only through mid-2002—indicate that income growth slowed sharply beginning in second-quarter 2001 (Chart 4). By fourth-quarter 2001, private-sector wage and salary earnings were down 6.2 percent compared with fourth-quarter 2000, as well as down 13.7 percent in the first quarter of 2002 from first-quarter 2001. These drops were most pronounced in the securities industry, where earnings tumbled 16 percent and 27 percent in the respective quarters.[4]

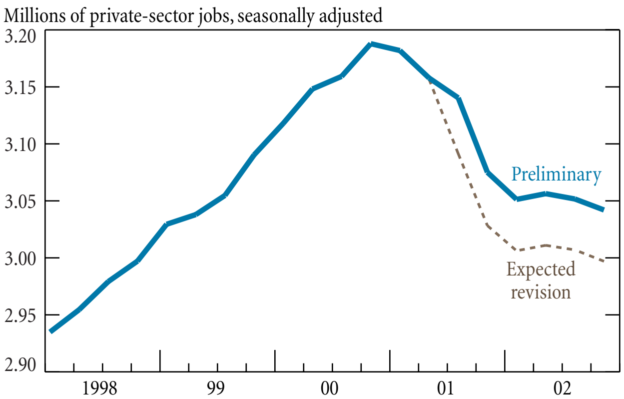
However, it is worth noting that these declines, while large, came on the heels of extraordinary income growth in 2000: 13.5 percent overall and 36.2 percent in the securities industry. Furthermore, much of the run-up and subsequent drop reflected swings in bonus payments, which are tied to financial market performance. By the second quarter of 2002, though, earnings were down only 5 percent overall and 3 percent in the securities industry. Still, given the volatility and general weakness in the equity markets in 2002, reduced financial-sector income is likely to remain a problem for the local economy, as well as for city and state tax revenues, at least for the first half of 2003.

Gauging the Effects of September 11

To separate the effects of the attack from those of the business cycle, the Federal Reserve Bank of New York recently conducted a statistical simulation of how New York City's economy would have performed had there not been an

Chart 3

Recent Trends in the Level of New York City Private-Sector Employment

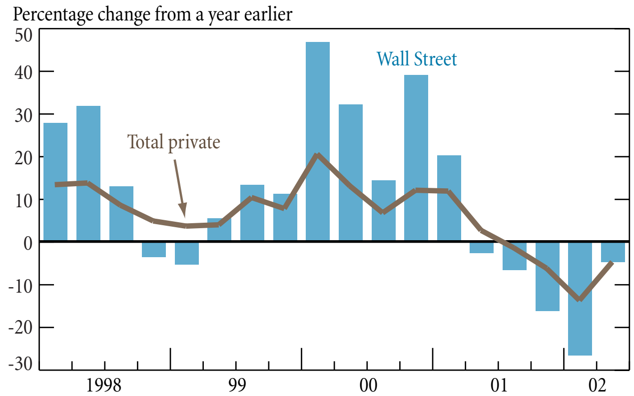


Sources: New York State Department of Labor; author's calculations and estimates.

Note: The author's calculations and estimates are described in endnote 1.

Chart 4

New York City Earnings Growth: Total Private and Wall Street



Source: New York State Department of Labor.

attack (Bram, Orr, and Rapaport 2002). Using private-sector employment as its benchmark, the study produced a range of counterfactual scenarios based on local employment trends immediately before the attack. It estimated that the cumulative "job gap" associated with the attack—the difference between actual employment and an estimate of employment if no attack had occurred—reached its highest level in February 2002, and receded gradually in the subsequent months.

However, as Chart 3 illustrates, it now appears that the downward trajectory in employment in the months leading up to the attack was steeper than originally thought. In other words, a simulation identical to that of the New York Fed study, based on rebenchmarked pre-attack data from the New York State Department of Labor, would likely attribute more of the post-attack job loss to preexisting trends in the local economy and less of it to the attack itself.[5]

Signs of Stabilization?

At year-end 2002, it remained unclear whether the negative employment and income patterns in the city had ended. In particular, some trends were not very encouraging. For one, private-sector employment in the city, which had leveled off in the second and third quarters of 2002, declined fairly sharply in the fourth. Similarly, the New York Fed's index of coincident indicators, which is designed to identify turning points, resumed its downward trend in late 2002, offering no clear indication that the city's economy has indeed bottomed out.

Trends in securities-industry employment—another key indicator of New York City's economic outlook—present a more mixed picture. Bram and Orr (1999) suggest that cycles in this industry historically have foreshadowed employment movements in the city and that, in terms of employment and earnings, the securities industry plays a more prominent role in the city economy than ever before. Thus far, according to New York State Department of Labor figures, job losses in the current cycle have been less severe than they were in the late 1980s, and industry employment was little changed in the last four months of 2002. Still, there is scant evidence that the securities industry is on the verge of a rebound.

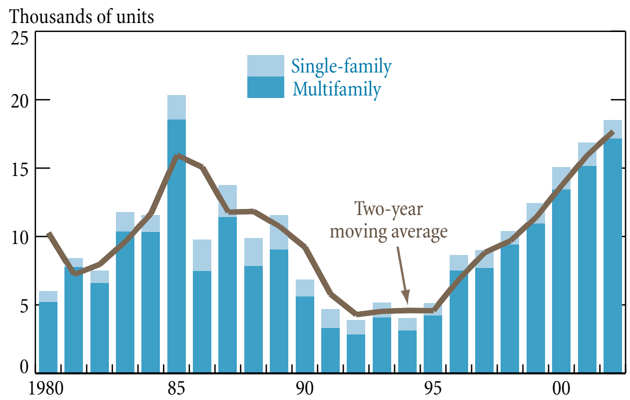
Despite these cyclical trends, there is no evidence that the positive secular trends of the past two decades have been derailed, either as a result of the September 11 attack or other factors. These secular trends are most evident in terms of quality-of-life indicators. For example, New York City's crime rate declined for the thirteenth consecutive year in 2002, despite the recession and despite an increase in crime nationwide; also, crime in the city was more than 50 percent lower than it was at the previous business cycle peak, in 1989.[6]

Furthermore, housing in the city has shown persistent strength—not only in absolute terms, but relative to the United States. In general, the trend in housing permits has been much stronger locally than nationally. Moreover, in the two years since the recession began, more housing units have been authorized in the city than in any two-year period since the early 1970s (Chart 5)—a remarkable feat, given that the terrorist attack occurred in this period. In addition, prices of Manhattan co-ops and condominiums resumed their upward trend in 2002, despite a modest pullback in the fourth quarter.[7] Similarly, prices of single-family homes in New York City, as well as in surrounding areas, have risen at a double-digit rate since September 11 and have exceeded the nationwide rate of appreciation (Chart 6).

In terms of the commercial real estate market, office vacancy rates across much of the metropolitan area continued to edge higher in late 2002, but Lower Manhattan has proved an exception. As this area's infrastructure and services have gradually been restored and as various tax incentives have been offered, the office vacancy rate has retreated from its mid-2002 peak.

Finally—and perhaps most significantly—there are indications that personal income in the city may have stabilized. Despite long lags in the release of local earnings data, it is possible to infer recent income trends from monthly tax

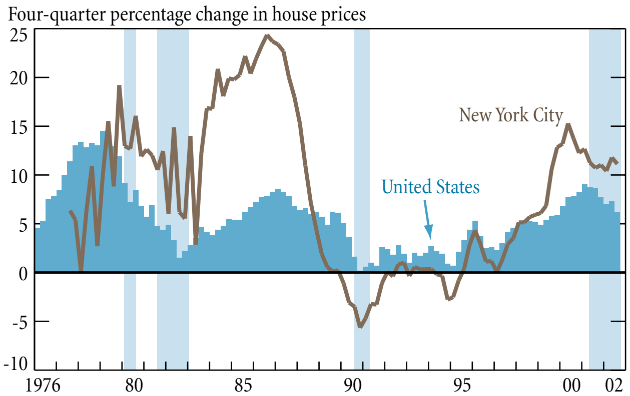
Chart 5
New York City Housing Units Authorized



Source: U.S. Department of Commerce, Bureau of the Census.

Chart 6

Local and National House Price Appreciation



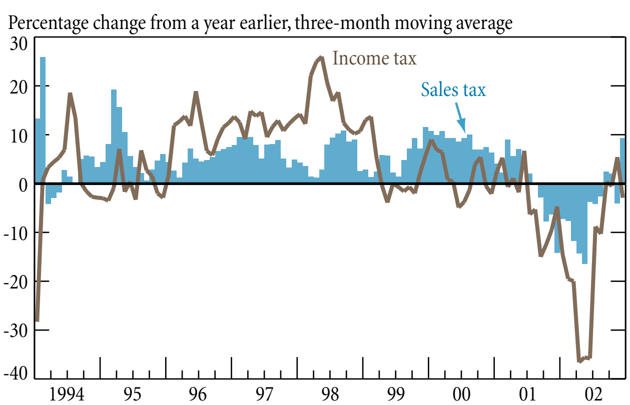
Sources: Office of Federal Housing Enterprise Oversight; Freddie Mac; Fannie Mae.

Notes: The New York City metropolitan area also includes Westchester, Putnam, and Rockland Counties. The bands indicate periods designated national recessions by the National Bureau of Economic Research.

revenue data, which the city releases on a timely basis. In the first half of 2002, personal income tax collections had been running more than 25 percent below the prior year's level (Chart 7). This unexpectedly sharp shortfall was a major factor in the city's budget gaps in fiscal years 2002 and 2003. In the second half of the year, however, income tax collections were only slightly down from 2001 levels. Although some of this improvement can be attributed to attack-related distortions in the year-ago period, a significant part likely reflects a recent stabilization in the tax base, and thus in personal income.[8]

Chart 7

New York City Tax Revenues



Source: New York City Department of Finance.

Conclusion

Thus far, New York City's most recent economic downturn, although steep, has been milder than the 1989-92 recession and considerably less severe than the contraction in the early-to-mid-1970s. Moreover, the downturn came on the heels of an economic boom that was, by most measures, the strongest in half a century.

Our analysis suggests that the cyclical factors that sustained the boom—namely, the national economy and the financial markets—contributed to the bust. The September 11 attack, while creating sizable job and income losses, served to exacerbate the downward cycle.

Looking ahead, we note that New York City's near-term outlook will likely be driven largely by the national business cycle and trends in the U.S. and global financial markets. On the one hand, recent developments indicate that these areas will continue to bear watching. On the other hand, the economic fallout from September 11 generally appears to have ended, and—despite the cyclical downturn—crime rates remained low and the housing market strong in 2002, suggesting that the positive secular trends in the local economy are still intact.

Notes

1. Each March, the New York State Department of Labor revises its employment statistics for the preceding two years by rebenchmarking them to a more comprehensive tabulation of insured employment (a full description of this process can be found at <http://www.bls.gov/sae/790notes.htm>). Because this tabulation is available with an approximately nine-month lag, the employment data being released in March 2003 are rebenchmarked based on insured employment data up to March 2002, and the revisions affect the data from April 2001 forward.

For this analysis, to estimate quarterly rebenchmarked employment data (for second-quarter 2001 through first-quarter 2002), we apply the percentage change from a year earlier in the level of quarterly insured employment to the seasonally adjusted establishment employment data from a year earlier. Estimates for the final three quarters of 2002 assume that employment trends after March 2002 remain parallel to those currently reported, resulting in a fixed level shift.

2. According to data from the New York State Department of Labor and the U.S. Bureau of Labor Statistics, the securities industry represented 5.0 percent of city employment in 2001, compared with 0.6 percent nationally; Bureau of Economic Analysis data indicate that income in this industry accounted for 19.7 percent of city earnings in 2001, compared with 2.4 percent nationally.

3. The index, first developed in Orr, Rich, and Rosen (1999), is designed to track the current state of the local economy. It is computed from a number of data series that move systematically with overall economic conditions:

employment, real earnings, the unemployment rate, and average weekly hours worked in manufacturing. For a complete description of the index, see <http://www.newyorkfed.org/rmaghome/regional/cei/main.html>.

4. First-quarter earnings typically are volatile because Wall Street pays most of its bonuses for the prior year in the first quarter.

5. Note that this type of simulation analysis cannot differentiate between the September 11 attack and other unanticipated "shocks" that may have affected employment, such as accounting scandals and bankruptcies.

6. Crime statistics are from the New York State Division of Criminal Justice Services (<http://criminaljustice.state.ny.us/crimnet/ojsa/crmtrnd01/ctrtdesc.htm>) and the New York City Office of the Mayor (<http://www.nyc.gov/html/om/html/2003a/pr014-03.html>).

7. These estimates are from the appraisal firm Miller Samuel (<http://www.millersamuel.com>).

8. The distorting effects of September 11 can be eliminated by using comparable 2000 (rather than 2001) levels as a base.

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About the Author

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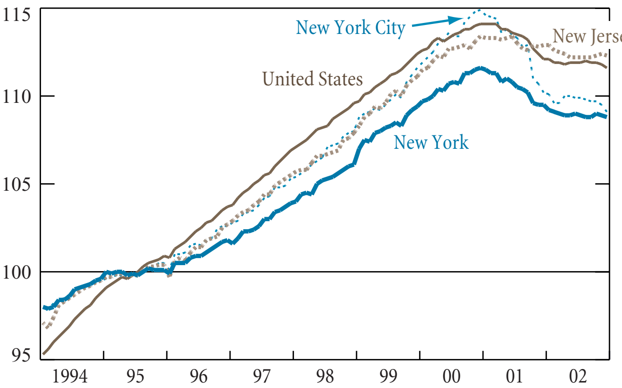
Economic Trends in the Second District

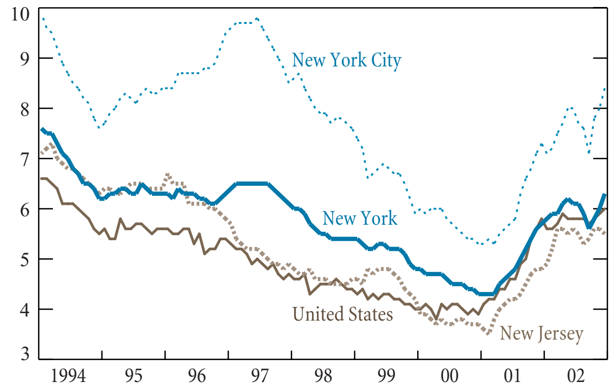
Payroll Employment

Index: 1995 = 100 (seasonally adjusted)



Unemployment Rates

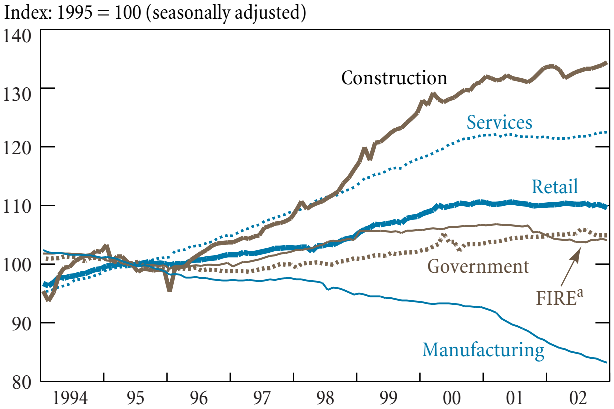
Percent (seasonally adjusted)



Payroll Employment in Selected Sectors

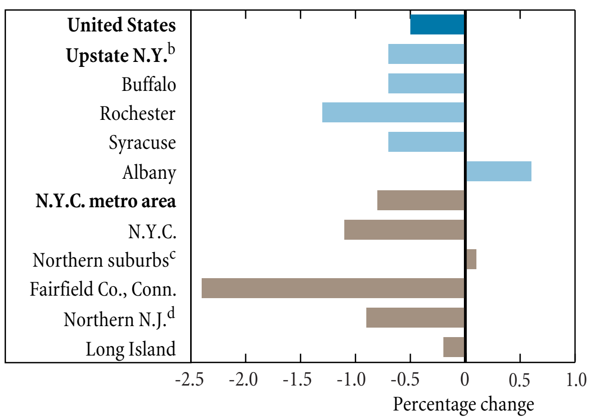
New York and New Jersey Combined

Index: 1995 = 100 (seasonally adjusted)



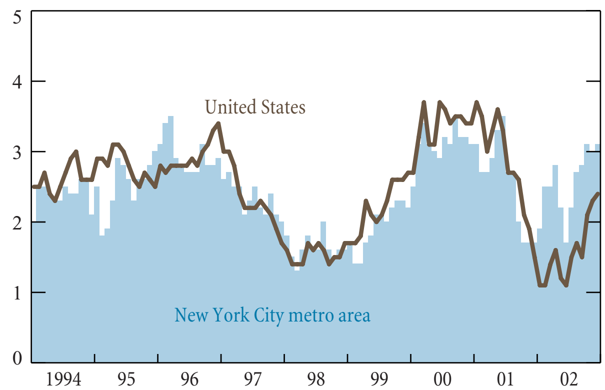
Job Growth in the Nation and Selected Metropolitan Areas

Fourth-Quarter 2001 to Fourth-Quarter 2002



Regional and National Inflation

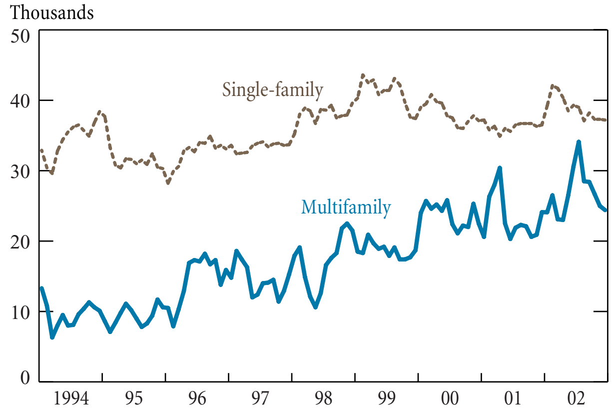
Twelve-Month Percentage Change in Consumer Price Index



Housing Permits in New York and New Jersey Combined

Three-Month Moving Average, Seasonally Adjusted

Thousands



Sources: New York, New Jersey, and Connecticut Departments of Labor; U.S. Department of Labor, Bureau of Labor Statistics; U.S. Department of Commerce, Bureau of the Census; Federal Reserve Bank of New York.

[a] FIRE is finance, insurance, and real estate.

[b] Upstate New York comprises the four metropolitan areas listed as well as Binghamton, Elmira, Glens Falls, Jamestown, and Utica-Rome.

[c] The northern suburbs of New York City comprise Dutchess, Orange, Putnam, Rockland, and Westchester Counties, New York, and Pike County, Pennsylvania.

[d] Northern New Jersey comprises Bergen, Essex, Hudson, Hunterdon, Mercer, Middlesex, Monmouth, Morris, Ocean, Passaic, Somerset, Sussex, Union, and Warren Counties.