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A Slowdown Showdown:

Government Employee Benefits to Take a Bite

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EXECUTIVE SUMMARY

R/ECON's New Jersey forecast for February 2019 shows that the relatively strong growth over the last two years begins to weaken relative to the nation in 2019. [1] Growth rates for employment and real GDP in 2018 were stronger than the prior year, while the growth rate for personal income, which had outpaced that of the U.S. in 2017, is forecast to have slowed to nearly a point below the national rate. More moderate growth is expected in 2019, with employment growth slowing to 1.1 percent from a 1.5 percent growth rate in 2018. This possibly presages the national slowdown forecast by Moody's in 2020, while state GDP growth remains relatively strong at 2.2 percent (versus 2.7 percent forecast for the U.S.) and personal income growth holds at 3.5 percent. Moody's national forecast points to a significant drop-off in growth beginning in the fourth quarter of 2019 and lasting through 2020. National GDP growth will drop from 2.7 percent in 2019 to 1.1 percent in 2020, and then rebound to 2.4 percent in 2021. The GDP trajectory for New Jersey diverges somewhat, with a less severe initial decline from 2.2 percent to 1.1 percent growth in 2020. But a longer downturn is expected as the growth rate further weakens to 0.9 percent in 2021 before rebounding slightly to its projected long-term average annual growth rate of 1.2 percent from 2018 through 2028 – about a point lower than the average growth rate for the U.S. over the period.

After nine years of growth, many new signs of an aging business cycle continue to crop up. Volatility and sluggishness in credit and equity markets are prime examples. Federal Reserve Chairman Jerome Powell further notes that the bond market is sending recessionary signals: the spread, or yield curve, between the three- and ten-year Treasury notes just fell under 10 basis points. (Of course, not all economists concur; and a more bullish former Federal Reserve Chairman Janet Yellen is among the dissenters.) The yield curve last achieved this notorious mark in September 2007. For now, strong consumer spending (about 70 percent of GDP) can compensate for any such weakness from Wall Street or elsewhere. And all leading indicators to date tend to point to a recession that ought not to arrive in less than six months. Still, if the Fed pulls too hard on the reins of the economy or if rhetoric with China gets tougher, the nation's economy could become sluggish very quickly. For now, however, the Federal Reserve is expected to hold off on any more action through midyear, and most trade partners with the U.S. have become calloused to the cries of "Wolf!' emanating from the White House, which they take as a spectacle for a strictly domestic audience.

As expected the federal government fiscal situation is weakening due to deficit-financed tax cuts. The budget deficit will rise close to $1 trillion this fiscal year

1 The current forecast is based on the Moody's Economy.com national baseline forecast as of February 2019, state employment data through December 2018, state GDP data through Q3 2018 (February 26, 2019 release) and state income data through Q3 2018 (December 20, 2018 release).

(nearly 5 percent of GDP), up more than $300 billion from fiscal 2017. Rising deficits in economically good times are quite uncommon. Economic prosperity is typically a time to pay down debt rather than bolster corporate returns and pad accounts of a few. The 2018 tax cuts have enabled insufficient positive growth, only about 0.8 percentage points in real GDP. Moody's estimates that fiscal policy will add about 0.5 percentage points to real annual GDP growth this year as well. But starting in 2020, growth will falter as the costs of the mounting debt overcomes the benefits of a lower marginal tax rate. This will not be moderated much by what is likely to be a soft Brexit outcome.

Despite all of the uncertainty spawned by Washington and Trenton, we offer little change in the outlook for the state's economy since a year ago. New Jersey's economic future remains fairly bleak **(Chart 1)**, and changes to government numbers since we produced the present forecast in no way improve the outlook. A lack of population growth, which in part is due to the state's general high cost-of-living due to its role as a bedroom to two large metropolitan areas, remains a prime symptom of the sluggishness. Still, New Jersey remains one of the wealthiest states and contains a high-skilled, highly educated workforce.

State employment growth is expected to drop to 0.3 percent in 2020 and turn to a decline of 0.2 percent in 2021, before recovering to a long-term average of between 0.2 and 0.3 percent. Real GDP growth will continue to be relatively strong through 2019, before dropping by about half to 1.1 percent in 2020 and to 0.9 percent in 2021. Real output will expand at a rate of 1.3 percent over the longer term, slower than the U.S. forecast of about 2 percent. At the end of 2018, New Jersey's unemployment rate fell below 4 percent for the first time since 2001, and is forecast to remain low over the next two years before beginning a sharp rise in the fourth quarter of 2020.

Consumer price increases remained stable in 2018 at 1.8 percent (the same as 2017), and the rate of increase is forecast to rise only moderately, averaging about 2.2 percent over the next decade. Personal income, which grew at a stronger-than-national rate of 4.6 percent in 2017, slowed to 3.5 percent in 2018 and is forecast to slow further through 2021, averaging 3.3 percent through 2028.

New Jersey's population count continues to rise, but at a rate significantly slower than that of the U.S. Population growth will average 0.1 percent a year from 2018 to 2028, compared to 0.6 percent a year for the U.S. The state will add nearly 131,000 residents over that period. Since New Jersey's population growth will continue to be slower than that nationwide, the state's share of U.S. population will fall from its current 2.75 percent share to 2.64 percent by 2028, though its shares of national employment, real output, and personal income will remain slightly higher than its share of the national population.

New Jersey's labor force declined for the third consecutive year and for the fifth out of the last six years, though it has grown slightly since hitting a seasonally adjusted low of 4,416,691 in July of 2018. New Jersey continued to have strong job growth in 2018, with a very strong first quarter, followed by a slower second quarter and then a strong second half. The 1.5 percent year-over-year total nonfarm job growth statewide exceeded the previous year's rate, but is expected to slow to 1.1 percent in 2019 and to 0.3 percent in 2020 as the national economy slows. Growth is forecast to average about 0.3 percent over the next decade, weakening to 0.2 percent thereafter.

In real estate, prices of new homes continued to rise in 2018, though the slowing demand for residential permits—which declined by more than 25 percent year-over-year in the third quarter of 2018 to 6,061 permits issued—may portend a slowdown in the market.

The market for nonresidential space softened over the year, with permitted space declining by 3.6 million square feet compared to 2017, while prices edged up by about 8 percent.

NATIONAL FORECAST

Consistent with its recent forecasts, the current Moody's baseline (50 percent probability) economic forecast for the U.S. continues to show strong growth in 2018 and 2019, followed by a significant slowdown and possible recession in 2020, and then a resumption of more modest growth in 2021. Overall, the outlook is for a modest real GDP growth rate of 2.1 percent annually over the next ten years. The longer-term forecast also projects continued average annual real GDP growth of 2 percent from 2028 through 2046.

Real GDP growth was 2.9 percent in 2018 and will tail off somewhat to 2.7 percent in 2019. Employment continues to expand at a rate of about 200,000 jobs

Table 1
SUMMARY OF U.S. ECONOMIC FORECAST

Annual Percentage Change	2017	2018	2019	2020	2021	2018-2028	2028-2046
Non-Agricultural Employment	1.6%	1.7%	1.6%	0.6%	-0.1%	0.6%	0.5%
Real Gross Domestic Product	2.2%	2.9%	2.7%	1.1%	2.4%	2.1%	2.0%
Personal Income	4.4%	4.4%	4.5%	4.2%	3.7%	4.1%	4.1%
Population	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%	0.4%
Consumer Prices	2.1%	2.4%	2.1%	2.2%	2.2%	2.2%	2.2%
Percentage							
Unemployment Rate (average)	4.4%	3.9%	3.6%	3.7%	4.6%	4.5%	4.8%

Source: Global Insight U.S. Forecast, February 2019 per month (an annual average rate of about 1.7 percent) through the first half of this year. About 2.1 million new jobs will be added in 2019. Correspondingly, the unemployment rate is expect to reach 3.5 percent by the third quarter of 2019. Note that Moody's suggests such artificially supported "boom phases" late in business cycles often foreshadow recessions. Inflation will tick upward due to labor market pressures (wages will rise by 3 percent by the end of 2019), and the Fed is expected to raise its fund rates to 3.25 percent by the end of 2019. The ten-year Treasury bond rate is expected to rise to 3.33 percent by the fourth quarter. The unemployment rate will rise to 4 percent then as well.

The weakening stock market, inflation-inducing labor market, and rising cost of Treasury bonds will reduce investment. This will stall productivity and, hence, income growth and spending. Growth and earnings will be stronger in Europe, Japan, and emerging markets. But the effects of Brexit on trading-partner countries could be more detrimental than anticipated, which could induce international trade volumes to slacken. The corporate tax breaks granted by Congress are expected to set off a mild burst in investment that could encourage job growth through productivity enhancements. This will put some upward pressure on wages and therefore, spending.

The federal government's fiscal situation is expected to weaken. The budget deficit will rise to close to $1 trillion this fiscal year (nearly 5 percent of GDP), up more than $700 billion from fiscal 2017. After years of austerity and now fiscal policy that is enabling meager positive growth, Moody's estimates that mounting debt over the past three years has trimmed about 2 percent from real annual GDP growth. Despite the tax cuts in 2018, spending increased; the spending mostly benefitted the nation's military complex, very little of which is in New Jersey. By the end of the decade, the U.S.'s debt-to-GDP ratio will be about 5 percent higher, impinging heavily on the nation's growth prospects. That is, tax cuts and spending should enhance real GDP growth again in 2019 but after that, the benefit of lower marginal tax rates will be canceled out by the heavier debt load.

The Federal Reserve hiked the federal funds to 2.4 percent by the beginning of 2019; no further rises are expected until late in the second quarter of 2019. But the tight labor market and resulting inflation will then force the Fed's hand, which will raise the rate to 3.25 percent by the year's end. The Brent oil price is close to $55/barrel, a price achieved earlier than expected by Moody's forecast from one year ago. As a consequence, Moody's has upped the long-run price from $55 to $60/barrel, with much of the rise due to rising costs of adding newly tapped reserves via U.S. shale oil producers. Nonetheless, natural gas remains the marginal fuel for most fossil fuel users.

The real trade-weighted dollar appreciated rather than weakened against other currencies over the past year. Much of this is due to a struggling Chinese economy caused by tight credit conditions there. The Trump Administration's domestically focused agenda will help, at least temporarily, to support the dollar. But it will be the dollar's role as the world's principal reserve currency that will help it to maintain its comparative resiliency.

The count of U.S. jobs enhanced by about 2.4 million in 2018 (1.6 percent annually), roughly similar to growth experienced in 2017, but down from somewhat from the prior two years. Job growth continues to be propped up by buoyant wages and rising government debt. But, as Moody's notes, by the middle of 2020 the heavy cost of our nation's debt will cause the U.S. economy to falter and, as a result, job growth to wane precipitously in 2020 (0.6 percent annually) and then go slightly negative by 2021 (-0.1 percent annually). Moody's forecast suggests that a paradigmatic shift in U.S. employment growth will ensue, in which 0.5 percent annual growth will be the new normal.

A long-term decline in the rate of population growth (from 1.0 percent to 0.6 percent annually over the past decade) appears to be the prime cause of slowed GDP growth, though an inevitable rise in unemployment rates surely plays a major role as well, once productivity improvements relax to normal rates. In essence, then, output growth will track employment growth, averaging 2 percent a year through 2027. Since wage pressures in the labor market also loosen somewhat in Moody's forecast, personal income growth slows to 4.1 percent per year over the forecast period (for the first quarter of 2019 over the same quarter a year prior Moody's reports 4.2 percent growth).