THE ASSEMBLY
STATE OF NEW YORK
ALBANY

February 27, 2013

Dear Colleagues:

I am pleased to provide you with the New York State Assembly Ways and Means Committee's Economic Report for 2013. This report continues our commitment to providing clear and accurate information to the public by offering complete and detailed overviews of outlooks for the national and State economies.

The Ways and Means Committee staff's assessments and projections presented in this report are reviewed by an independent panel of economists. Assembly Speaker Sheldon Silver and I would like to express our appreciation to the members of this Board of Economic Advisors. Their dedication and expert judgment continue to be invaluable in helping to refine and improve our forecasts. While they have served to make the work of our staff the best in the State, they are not responsible for the numbers or views expressed in this document.

I wish to also acknowledge the dedicated and talented staff of the Assembly Ways and Means Committee and the many hours of work that went into producing this report. They play a vital role in our State's budget process.

As we continue our efforts toward enacting an on-time budget that is fair and equitable for all New Yorkers, I look forward to working with each of you.

Sincerely,

Herman D. Farrell, Jr.
Chairman

NEW YORK STATE

ECONOMIC REPORT

February 2013

Sheldon Silver
Speaker
New York State Assembly

Herman D. Farrell, Jr.
Chairman
Assembly Ways and Means Committee

Prepared by the
Assembly Ways and Means Committee Staff

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EXECUTIVE SUMMARY

United States

- The pace of the **economic recovery** that began in June 2009 continues to be slow. Although there are some key indicators pointing to an improving growth outlook, weaknesses evidenced in several indicator readings in recent months will have more influence over the near-term outlook before the national economy returns to an above-trend rate of 2.8 percent growth in 2014.
- The NYS Assembly Ways and Means Committee staff's forecast for **overall national economic growth** in 2013 is 1.9 percent. The staff's forecast is 0.1 percentage point above the Division of the Budget. The staff's forecast is 0.2 percentage point below Moody's Economy.com, and 0.1 percentage point below Macroeconomic Advisers. The staff's forecast is equal to IHS Global Insight and the Blue Chip Consensus.

U.S. Real GDP Forecast Comparison (Percent Change)

	Actual 2011	Forecast 2012	Forecast 2013	Forecast 2014
Ways and Means	1.8	2.2	1.9	2.8
Division of the Budget	1.8	2.2	1.8	3.1
Blue Chip Consensus	1.8	2.2	1.9	2.8
Moody's Economy.com	1.8	2.2	2.1	4.0
Macroeconomic Advisers	1.8	2.2	2.0	3.1
IHS Global Insight	1.8	2.2	1.9	2.8

Sources: NYS Assembly Ways and Means Committee staff; NYS Division of Budget, FY 2014 Executive Budget Financial Plan, February 2013; Blue Chip Economic Indicators, February 2013; Moody's Economy.com, February 2013; Macroeconomic Advisers LLC, February 2013; IHS Global Insight, February 2013.

- Consumer spending is expected to remain subdued over the forecast period. **Personal consumption spending** growth, adjusted for inflation, slowed to an estimated 1.9 percent in 2012 as weakness in the labor market persisted and the slow economic recovery weighed on consumers. Furthermore, some demographic changes have surfaced since the Great Recession with many segments of the population appearing to make long-term adjustments to their spending patterns. In 2013, consumer spending is forecast to increase by another 1.9 percent, restrained by the expiration of Social Security payroll tax cuts and the exhaustion of unemployment benefits for many of the long-term unemployed. Relatively low inflation, however, will help keep consumer's purchasing power from weakening. By 2014, a stronger economic recovery with a better

employment and wage outlook will lead to a projected 2.5 percent growth in consumer spending. In the expansions prior to the 2001 and 2007-09 recessions, consumer spending rose at average annual rates of 4.1 percent and 3.1 percent, respectively.

- As the housing market improved, construction of commercial buildings maintained positive growth, and spending on equipment and software moderated, total **business spending** grew an estimated 9.6 percent in 2012. Even as balance sheets remain strong, uncertainty over domestic budget issues and a slowdown in the global economy are weighing on business confidence. The NYS Assembly Ways and Means Committee staff forecasts that overall business spending growth will slow to 5.8 percent in 2013, and improve to 8.9 percent in 2014 as global growth strengthens.
- As spending cuts persist at all levels of government, total **government spending**, adjusted for inflation, declined an estimated 1.7 percent in 2012 and is forecast to fall another 1.3 percent in 2013. In 2014, state tax collections are anticipated to be more aligned with expenditures, but will be outweighed at the federal level by spending caps and reductions. Hence, total government spending is projected to decline further by 1.0 percent. Risks to the government spending forecast stem mainly from uncertainties associated with the automatic spending reductions required by the Budget Control Act of 2011 effective in March 2013.
- The European debt crisis continues to weigh on global growth and world trade. As several European countries were in recession in 2012, U.S. trade growth is estimated to have slowed. The outlook of global recovery remains weak, due to the European debt issue. However, the world economy is anticipated to grow faster in 2013 and 2014, while the U.S. dollar is expected to remain weak. **Exports** are expected to continue to grow faster than imports in 2013 and 2014. Exports are forecast to grow by 2.8 percent in 2013, before growing further by 5.3 percent in 2014. **Imports** are expected to increase by 2.0 percent in 2013 and 5.0 percent in 2014.
- The slow employment recovery remains a critical issue for the national economy. Of the 8.7 million jobs that were lost during the recession, just 5.5 million have been regained. In 2012, payroll employment grew 1.7 percent, reflecting the slow pace of the economic recovery and the hesitancy businesses continue to display in hiring. Total **national payroll employment** is forecast to grow 1.4 percent in 2013 and 1.7 percent in 2014.
- In 2012, **personal income** grew an estimated 3.5 percent after growing 5.1 percent in 2011. The slowdown in personal income growth was due to growth in all components of personal income decelerating except for transfer payments. The Social Security payroll tax cuts expired at the end of 2012, increasing employees' contribution to government

social benefits programs, resulting in personal income growth being forecast to slow further to 2.6 percent in 2013. In 2014, personal income is projected to grow by 4.7 percent as a more resilient economy encourages stronger employment and wage growth.

- The **consumer price index** increased 2.1 percent in 2012. In 2013 consumer prices are expected to grow 1.8 percent as slow economic growth keeps pricing pressure in check. Prices will continue to grow relatively slow in 2014 at 2.0 percent. In addition, slow growth in unit labor costs will help keep growth in prices modest. Energy and food prices represent two areas of risk to the inflation outlook, and increases in either would have an adverse effect on consumers.

- **Corporate profits** growth is estimated to have decelerated to 5.1 percent in 2012 as productivity and financial markets grew steadily but the global economy slowed. Corporate profits growth is forecast to slow down in 2013 and 2014 to 4.6 percent and 3.4 percent, respectively.

- Given a slow U.S. economic recovery, stagnant labor market, low inflationary outlook, and risks concentrated on the downside, the Federal Reserve has indicated that it will likely maintain the **federal funds rate** at a low level through mid-2015. Thus, the current forecast assumes that the Fed will maintain the rate within the current target range of 0.0 to 0.25 through the end of 2014. The federal funds rate is forecast to average 0.2 percent in 2013 and 2014. The **10-year Treasury rate** is forecast to average 2.0 percent in 2013 and 2.6 percent in 2014.

- Despite the setbacks as a result of global events that raised uncertainty (such as the European debt crisis and unrest in the Middle East and North Africa), the stock market continues to gain steadily. While most other sectors remain well below pre-recession levels, stock market indices have almost reached their previous peaks. The stock market is expected to continue to improve throughout the forecast period. The **Standard & Poor's 500 Composite Stock Price Index (S&P 500)** averaged 1,379.6 points in 2012, a growth of 8.7 percent from 2011. The index is forecast to grow further by 9.0 percent in 2013 and another 5.7 percent in 2014.

- Serious **risks to the economic outlook of the nation** remain. Many of the risks to the economic outlook of the nation that were present during and at the end of the recent recession persist. In addition, uncertainty surrounding the federal spending reductions holds a significant downside risk for the outlook. However, if a bargain is negotiated to avoid the sequestration, and businesses and consumers see a clear path to a better economic situation, there would be potential upside for consumer and business

spending. The growth rate of the world economy remains a concern and presents considerable risk to the outlook presented in this report. The European debt crisis and the overall health of the eurozone remain a risk to the global recovery, and deterioration beyond what is assumed in this report may negatively affect the U.S. economy.

New York State

- As with the nation's economy, **New York's economic outlook** is one of modest growth throughout the forecast period. Unlike early in the recovery, however, some components of the State economy will grow slower than the nation as states that were harder hit during the recession regain momentum and start to recover at a faster rate. Employment in the State is expected to grow at a modest pace, returning to growth levels below the nation after outperforming the nation after the recession. Both components of wages (variable and base) are expected to grow.
- The NYS Assembly Ways and Means Committee staff's forecast for **total nonfarm payroll employment** growth in the State in 2013 is 1.2 percent. This forecast is equal to the Division of the Budget. The staff's forecast for **State wage growth** in 2013 is 4.2 percent. This forecast is 0.9 percentage point above the Division of the Budget.

New York State Forecast Comparison (Percent Change)

	Actual 2011	Estimate 2012	Forecast 2013	Forecast 2014
Employment				
Ways and Means	1.2	1.4	1.2	1.3
Division of the Budget	1.2	1.4	1.2	1.2
Wages				
Ways and Means	3.7	2.2	4.2	4.8
Division of the Budget	3.7	3.1	3.3	5.0

Sources: NYS Assembly Ways and Means Committee staff; NYS Division of Budget, FY 2014 Executive Budget Financial Plan, February 2013.

- **Variable wage growth** is not expected to reach the high levels attained in 2006 and 2007 when securities industry firms had huge profits and bestowed large bonuses on staff members. Variable wage growth is expected to be 8.8 percent in 2013 and 8.4 percent in 2014, as firms continue to benefit from the recovery. Base wages are expected to continue to recover in 2013 and 2014, reflecting an expectation of a slow, but continuing, recovery in employment. The growth in base wages will remain relatively slow, reflecting firms' continued cautiousness about hiring workers. In addition, upward pressure on

wages continues to be mild given the slack in the labor market, indicating that firms are generally able to hold off on raising wages while still attracting workers.

- On a State Fiscal Year (SFY) basis, the NYS Assembly Ways and Means Committee staff estimates that total **variable wages** will grow by 5.3 percent in SFY 2012-13. Securities industry variable compensation will grow 7.2 percent as firms recover from the financial difficulties faced during and after the financial crisis. In SFY 2013-14, as the economic environment improves, variable compensation (both overall and in the securities industry) is forecast to continue to grow.
- **Capital gains** are estimated to have grown to $72.8 billion or by 52.3 percent in 2012, partly attributed to gains being shifted from 2013 to 2012 as a result of the anticipation of an increase in the capital gains tax rate in 2013. Historical data suggests that investors are inclined to take gains when anticipating higher tax rates in the future. Consequently, capital gains are forecast to fall by 33.8 percent to $48.2 billion in 2013 due to this shift. With home prices expected to appreciate further and equity prices likely to accelerate, taxable capital gains are forecast to grow by 35.0 percent or to $65.1 billion in 2014.
- The current global and national economic climate presents particular challenges and **risks to the New York State forecast**. Highly volatile financial markets, responding to several factors including the European sovereign debt crisis, an overall weak economic climate, and low business and investor confidence have a direct negative impact on Wall Street. Furthermore, the extent to which the Wall Street landscape has permanently changed continues to unfold. Hence, there is great ambiguity surrounding the State outlook. The financial sector plays a central role in the State economy, and drastic cuts to or changes in the composition of Wall Street compensation (including bonuses) have critical implications for the economic health of the State.

UNITED STATES FORECAST

The pace of economic recovery that began in June 2009 continues to be slow. In the three-year period since 2009, the U.S. economy grew an average of 2.1 percent per year. By historical standards the average yearly growth rate was 3.4 percent during the three-year period after the end of 1990-1991 recession and 2.6 percent even during the slowest post-WWII recovery period after the 2001 recession. The sluggishness in recovery is more pronounced in the labor market. With 12.3 million workers jobless, the unemployment rate still remains elevated (see Figure 1). The pace of payroll job creation is painfully slow with 3.2 million jobs still remaining to be recouped to reach the pre-recession peak level.

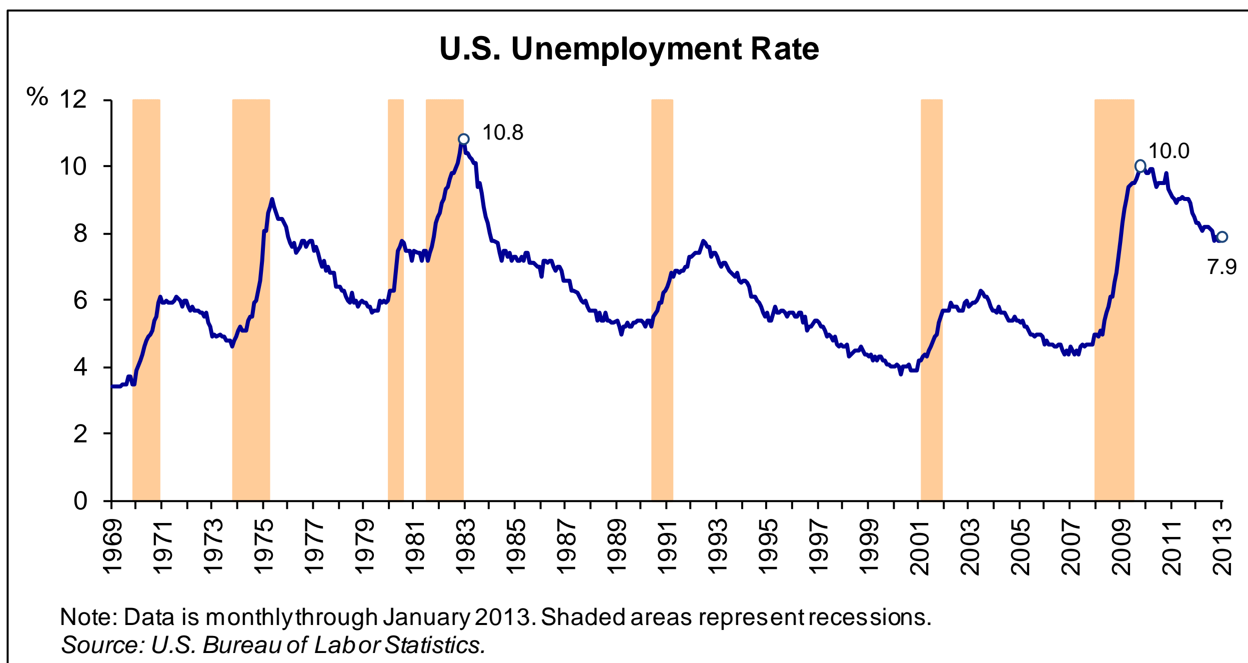


Figure 1

There are some key indicators, nonetheless, pointing to an improving economic outlook. For example, household balance sheets have steadily improved, and the ratio of household debt to disposable income is approaching the 2003 level after peaking in 2008 (see Figure 2). The Federal Reserve Senior Loan Officer Opinion Survey shows that loan demand has been improving. Even in the housing market, which was the main contributing factor to the Great Recession and slow recovery since then, homebuilders are becoming more optimistic, and housing starts and sales are firming with a clear upward trend under way (see Figure 3). The Federal Reserve's program of purchasing mortgage-backed securities also helps support the recovery in the housing market.

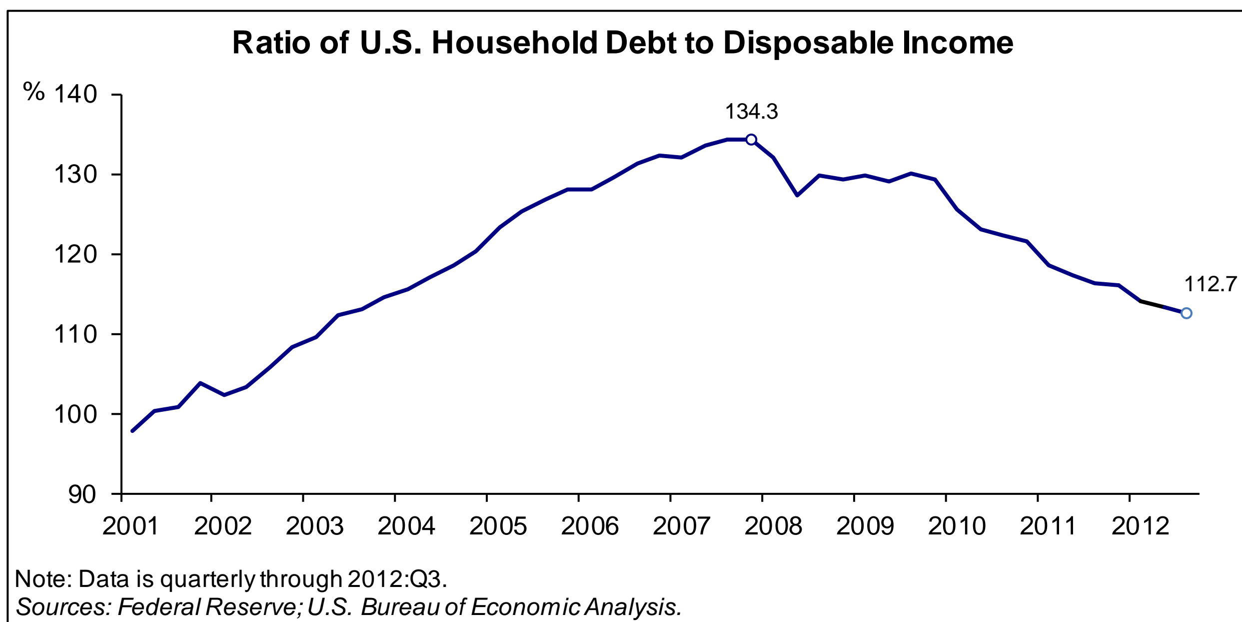


Figure 2

Before the U.S. economy begins to more fully benefit from these improving fundamentals, however, fiscal policy changes as well as weaknesses evidenced in several indicator readings in recent months will have more impact on the near-term outlook. As the payroll tax cut that was in place for the past two years expired at the end of 2012, consumer spending will be negatively impacted in 2013. The Conference Board's Leading Economic Indicator Index has been alternating ups and downs since April 2012, signaling a bumpy recovery ahead. The Institute of Supply Management (ISM) Manufacturing Index has been at levels close to the contraction territory. Even though pent-up demand has helped consumer spending increase in recent quarters, the increase has been more or less limited to spending on durables such as automobiles and electronics at the expense of spending on services. The move by the European Central Bank to buy, open-ended, the government bonds of Spain and Italy has seemingly helped calm the financial markets, but the debt crisis in Europe fundamentally still remains unresolved.

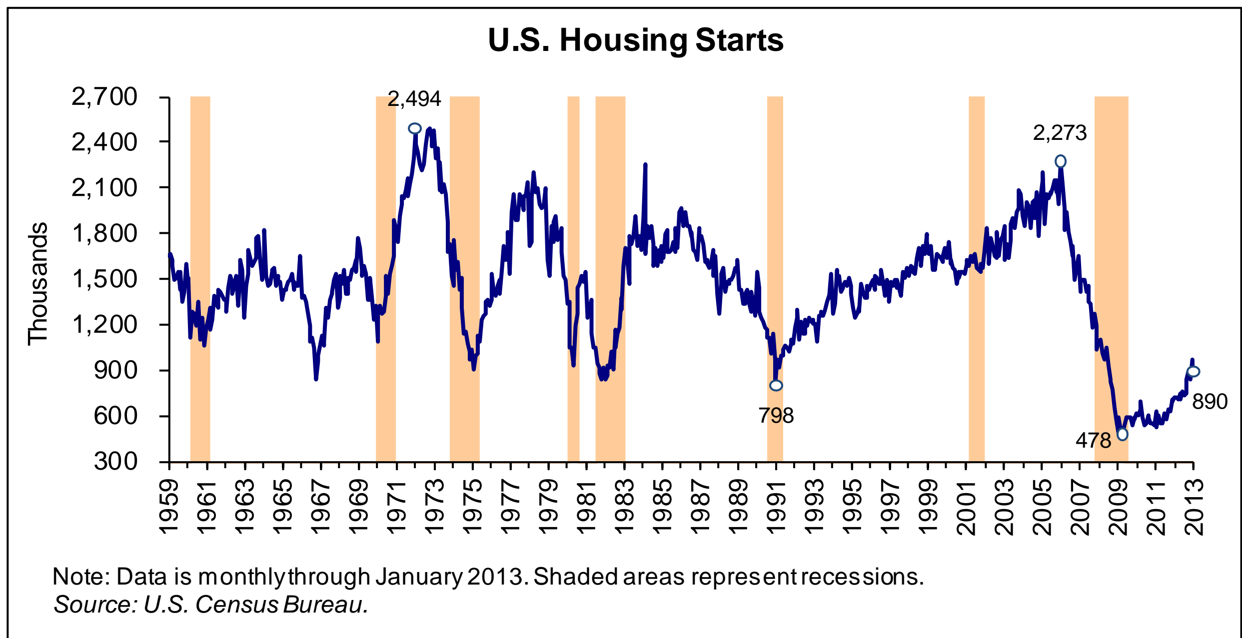


Figure 3

Although the current forecast calls for the U.S. economy to continue to recover from the Great Recession, the recovery is likely to be sub-par. Supported by slow yet steady improvement in employment and earning opportunities, recovery in personal consumption spending is expected to continue in the coming months. Consumer spending growth, however, will likely remain at a measured pace, as hiring and income growth remains weak, energy prices remain elevated, and the extensive financial and job losses experienced during the Great Recession continue to force households to make behavioral changes. Businesses have accumulated cash from healthy earnings and remain keen on updating equipment and software in order to remain efficient in the face of global competition. But businesses will likely invest less aggressively in 2013 given uncertainties regarding domestic fiscal policy and a slowdown in overall growth rates. Unsure how the future course of the economy will play out, businesses are reluctant to hire more aggressively. With mortgage rates at record low levels, ongoing recovery in the housing market is expected to continue in 2013. Given relatively weak demand and still sizable excesses in the market, however, the pace of the housing recovery is likely to be slow by historical standards. As the federal government continues to tighten spending and state and local governments are strained by revenue shortfalls, the public sector will continue to be a drag on economic growth during 2013. With the global economy expected to remain weak, foreign demand for U.S. exports will likely slow down in 2013 before picking up more strongly in 2014.

Against this backdrop, the U.S. economy will likely remain on an expansion path during 2013 but at a sub-par rate of 1.9 percent. With fundamentals expected to improve further and uncertainties at home and abroad to be reduced, economic growth is expected to return to an above-trend rate of 2.8 percent growth in 2014 (see Figure 4).

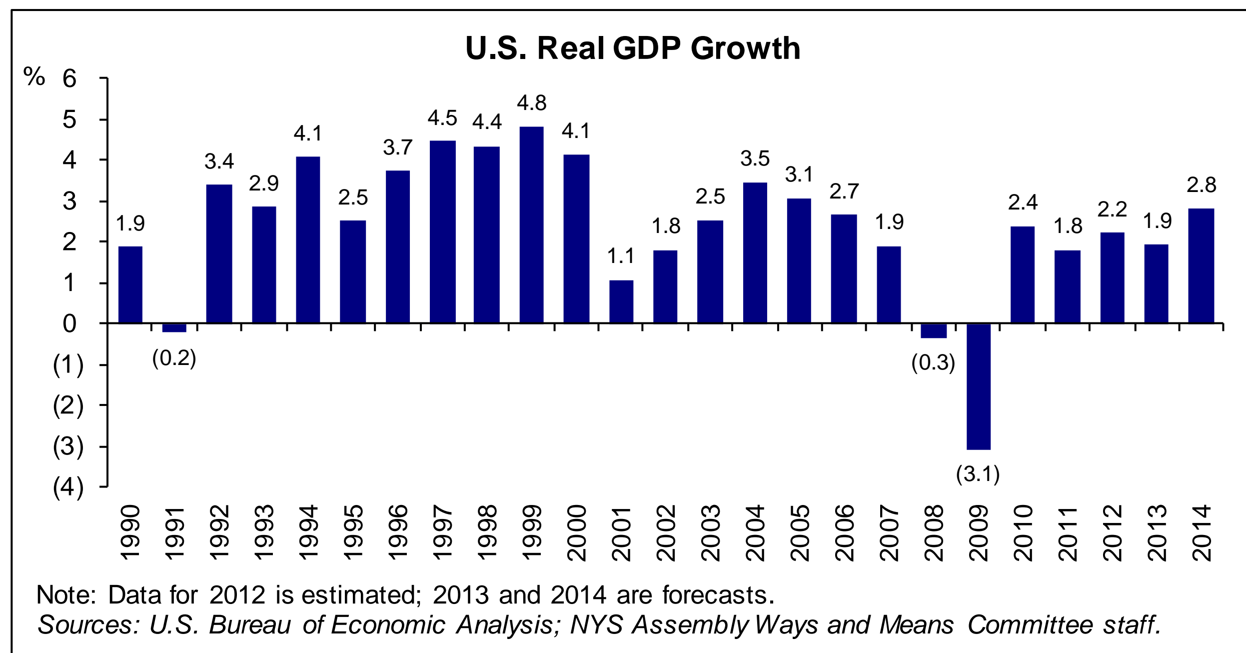


Figure 4

After losing 8.7 million jobs during the recent Great Recession, U.S. firms have been cautious of restoring those jobs. Faced with not only uncertain demand for their products but also the intensifying global forces of competition, U.S. firms have been looking for ways to economize on costs. The fact that business spending on equipment and software has increased strongly since the end of the recent recession may reflect their efforts to substitute capital input for labor input in their production processes. Given this cost-saving trend, the pace of recovery in U.S. payroll employment is likely to remain relatively slow. On net, just 1.9 million jobs are expected to be created from the fourth quarter of 2012 to the fourth quarter of 2013. With an average monthly net gain of 205,000 jobs expected during 2014, the U.S. economy will reach the pre-recession peak employment level in the fourth quarter of 2014.

There is some evidence of elevated energy and commodity prices being passed through to retailers and consumers. Also the persistently negative yield on Treasury Inflation Protected Securities, especially in the wake of the additional quantitative easing (QE) actions

taken by the Federal Reserve indicates a rising fear of inflation among investors. However, the large slack in the labor market and the recent trend in labor costs indicate that inflationary pressures from the labor market are minimal. In addition, the relatively stable dollar value in the midst of global uncertainties will help neutralize some of the worries related to the potential inflationary effects of the monetization of U.S. national debts. These inflation-stabilizing forces will largely remain in place in the next two years, helping to keep inflationary pressures in check. The Consumer Price Index is forecast to advance 1.8 percent in 2013 after rising 2.1 percent in 2012. As economic growth is expected to pick up in 2014, CPI inflation is forecast to gain another 2.0 percent (see Table 1).

Table 1

U.S. Economic Outlook (Percent Change)					
	Actual 2010	**Actual 2011**	**Estimate 2012**	**Forecast 2013**	**Forecast 2014**
Real GDP	2.4	1.8	2.2	1.9	2.8
Consumption	1.8	2.5	1.9	1.9	2.5
Investment	13.7	5.2	9.6	5.8	8.9
Exports	11.1	6.7	3.4	2.8	5.3
Imports	12.5	4.8	2.4	2.0	5.0
Government	0.6	(3.1)	(1.7)	(1.3)	(1.0)
Federal	4.5	(2.8)	(2.2)	(2.6)	(2.5)
State and Local	(1.8)	(3.4)	(1.3)	(0.4)	0.0
Personal Income	3.8	5.1	3.5	2.6	4.7
Wages & Salaries	2.1	4.0	3.2	3.5	4.8
Corporate Profits	26.8	7.3	5.1	4.6	3.4
Productivity	3.1	0.7	1.3	1.1	1.5
Employment	(0.7)	1.2	1.7	1.4	1.7
Unemployment Rate*	9.6	8.9	8.1	7.7	7.3
CPI-Urban	1.6	3.1	2.1	1.8	2.0
S&P 500 Stock Price	20.3	11.4	8.7	9.0	5.7
Treasury Bill Rate (3-month)*	0.1	0.1	0.1	0.1	0.1
Treasury Note Rate (10-year)*	3.2	2.8	1.8	2.0	2.6

* Annual average rate.

Note: Personal income and corporate profits are nominal.

Sources: U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics; Federal Reserve; Standard & Poor's; NYS Assembly Ways and Means Committee staff.

Automatic federal spending cuts, which are scheduled to take effect on March 1, 2013, would have a significant negative impact on the economy unless a bargain were negotiated to avoid them. According to Congressional Budget Office, under the current law, the automatic spending cuts will amount to around $87 billion per year for the next ten

years. Defense spending cuts alone will amount to $53 billion per year. The annual growth rate of national output will likely slow from 2.2 percent in 2012 to 1.4 percent in 2013, before improving to 2.6 percent in 2014. The unemployment rate will average 7.9 percent in 2013 and 7.8 percent in 2014.

Consumption

Personal consumption spending, adjusted for inflation, grew a modest 2.5 percent in 2011, up from 1.8 percent in 2010. In 2011, growth in consumer spending was attributed to an improvement in households' wealth, overall low inflation, the easing of credit standards, and some gains in employment and real disposable income. These factors continue to play a significant role in the pace of the consumer spending recovery.

Consumer spending is expected to remain subdued over the forecast period. While households have recouped some of the losses in wealth they sustained during the recession, their wealth is still below pre-recession levels partly because home prices remain low. Though credit conditions have eased, terms for loans are tighter than before the financial crisis. Despite households somewhat reduced debt burdens, debt load remains relatively high. Even though employment has improved, the unemployment rate is still high and employment growth remains sluggish. In addition, slow income growth continues. More importantly however, is the high degree of uncertainty that exists in the broader economy that has contributed to the thriftiness of consumers. Hence, while consumer spending will continue to contribute to overall economic growth, consumers do not have the resources to sustain the pace of economic growth prior to the recession of 2007.

Accordingly, personal consumption spending growth, adjusted for inflation, slowed to an estimated 1.9 percent in 2012 as weakness in the labor market persists and the slow economic recovery weighs on consumers (see Figure 5). In 2013, consumer spending is forecast to increase another 1.9 percent restrained by the expiration of Social Security payroll tax cuts and the exhaustion of unemployment insurance benefits for many of the long-term unemployed. Relatively low inflation, however, will keep income from further weakening. In 2014, a stronger economic recovery with a better employment and wage outlook will lead to a projected 2.5 percent growth in consumer spending.

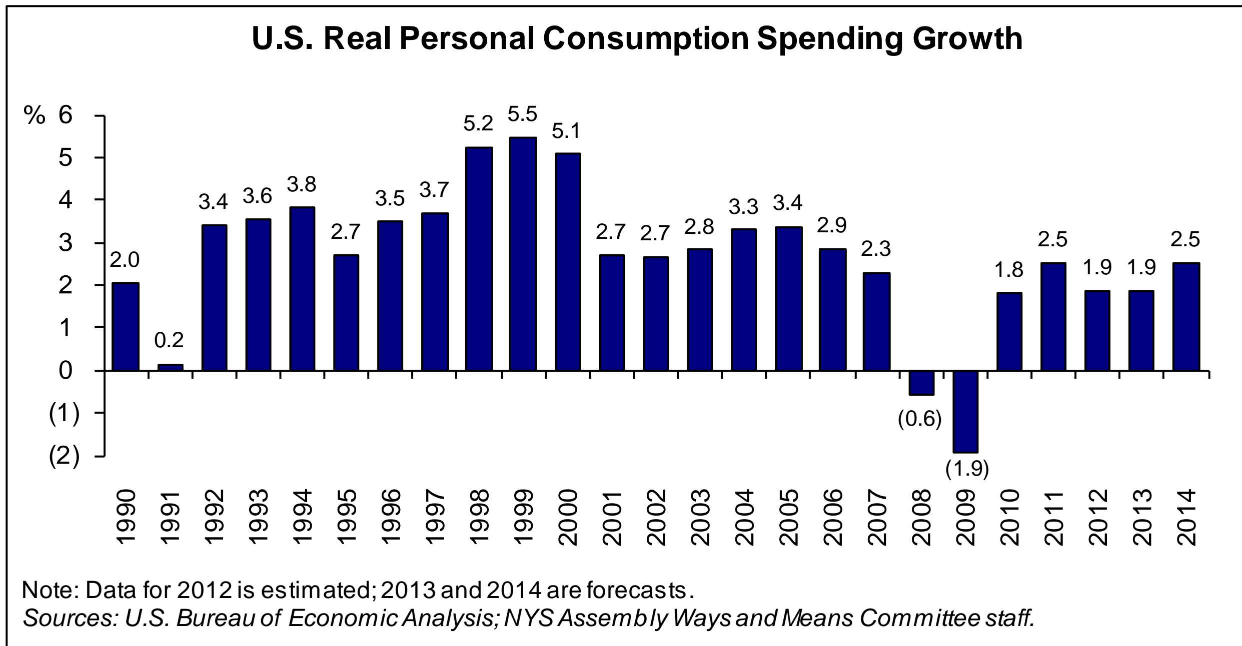


Figure 5

In 2012, disposable income, adjusted for inflation, increased an estimated 1.6 percent, after growing 1.4 percent in 2011 due mainly to slow growth in wages (see Figure 6). So far, many jobs created in the employment recovery have been in low wage sectors and the pace of employment growth in high wage sectors has been modest, contributing to the weakness

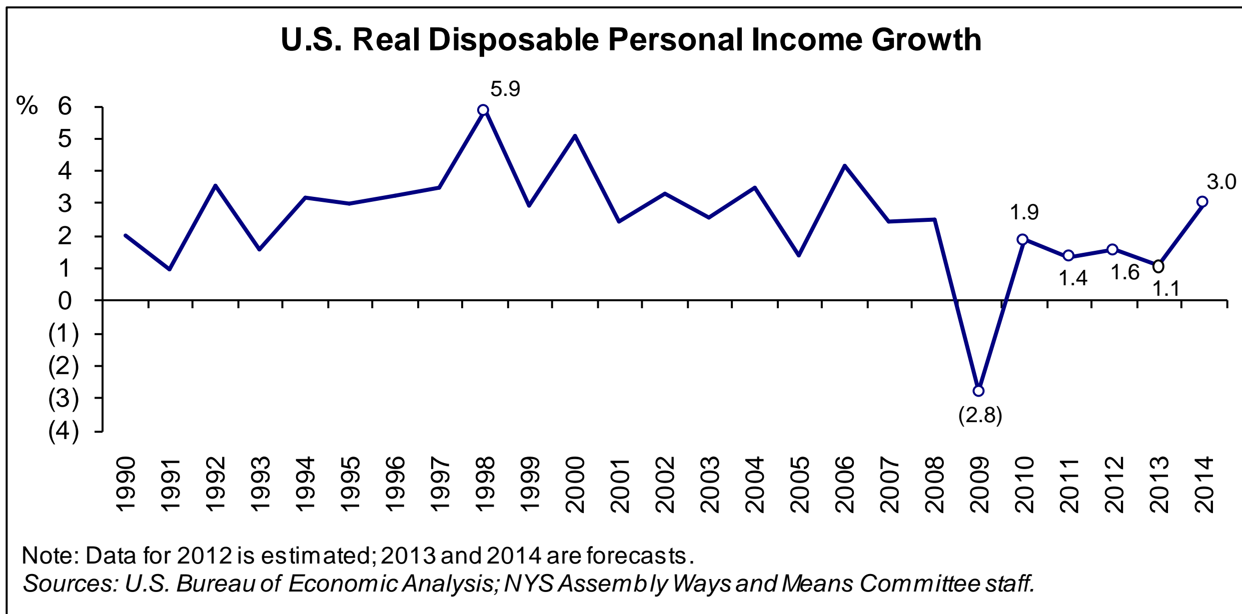
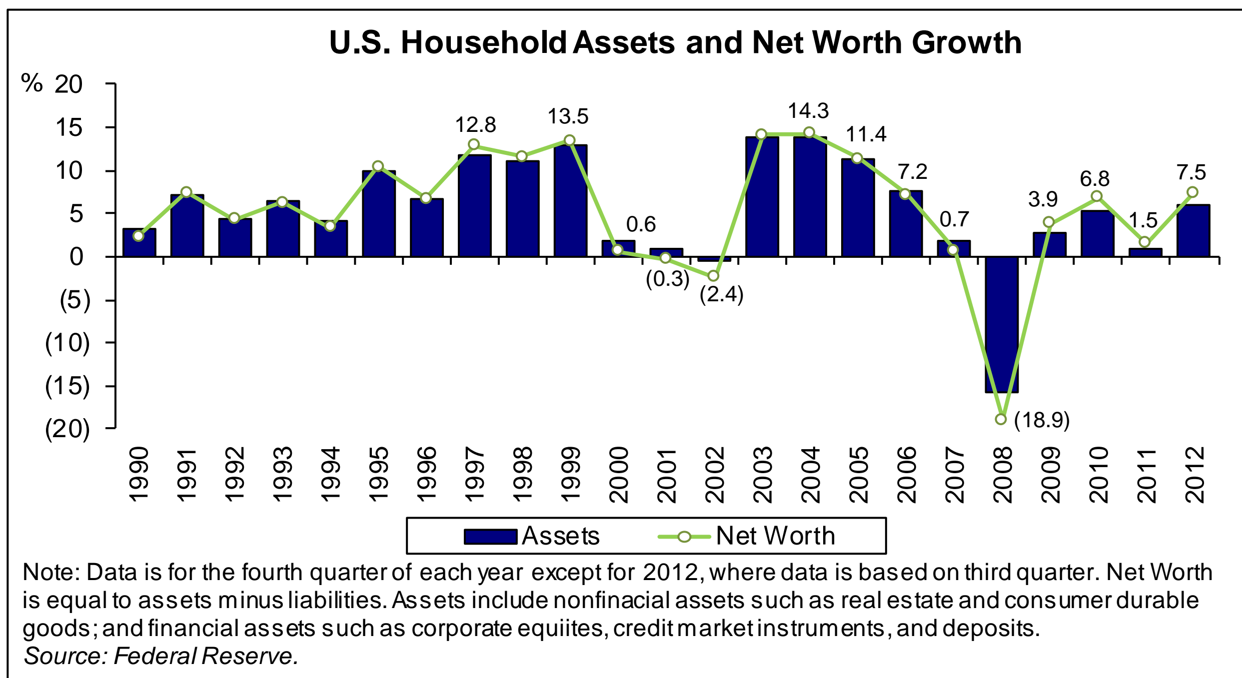


Figure 6

in wages (see Table 3 on page 35). Low inflationary pressures have kept real disposable income from growing more slowly. Real disposable income grew strongly in the first half of 2012, as a result of higher wages and salaries in the first quarter. Consumption spending increased somewhat but savings were also boosted. Weaker growth in wages and salaries for the rest of 2012 dampened the growth from the first half. The weakness in real disposable income is expected to continue into 2013 as unemployment benefits expire for many people, and personal taxes increase due to the expiration of the payroll tax cuts. Subsequently, lackluster growth in disposable income translates to inhibited consumer spending.

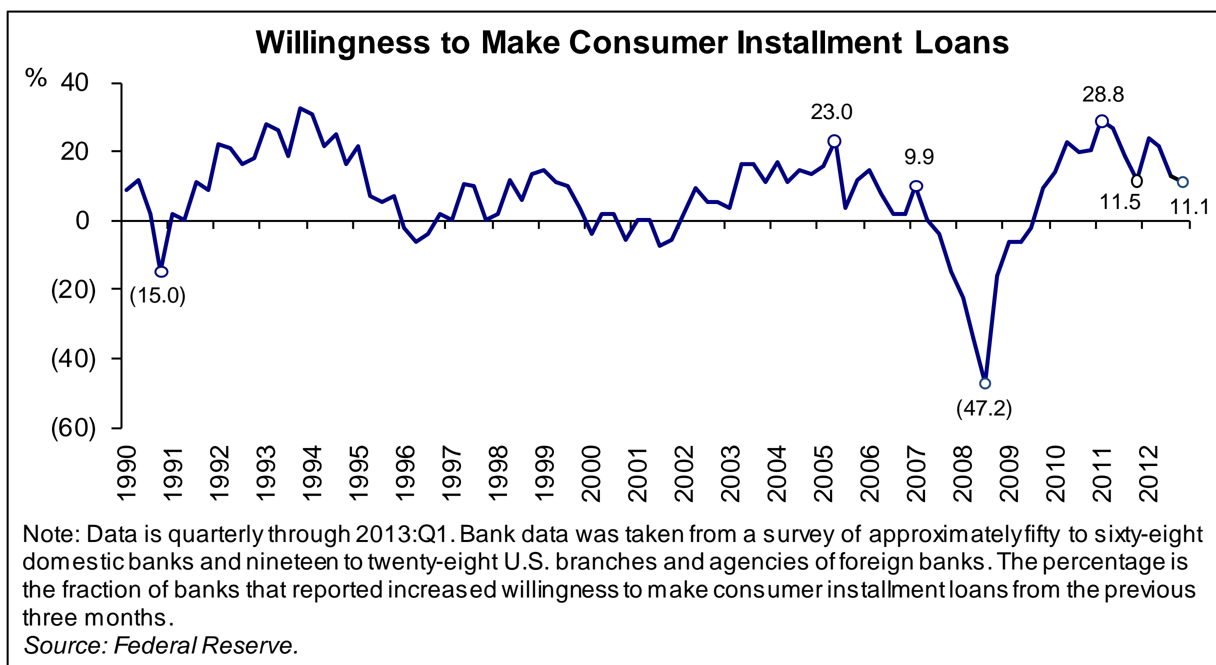
As of the third quarter of 2012, households had regained $13.5 trillion of the $16.1 trillion in net worth lost between the third quarter of 2007 and the first quarter of 2009. Though households' wealth has improved, their balance sheets remain precarious as low home prices and heightened uncertainties in the overall economy linger (see Figure 7). Most of the gains in wealth have come from financial assets, such as corporate equity, pension fund reserves, and mutual fund shares; while non-financial assets such as real estate continue to struggle because of the beleaguered housing market. As a result, the wealth of households is susceptible to variations in the stock market. With the equity markets expected to increase over the forecast period, the net worth of households will likely expand. However, the improvement in wealth may not result in significantly higher consumer spending as consumers appear to be more cautious about spending decisions.



Note: Data is for the fourth quarter of each year except for 2012, where data is based on third quarter. Net Worth is equal to assets minus liabilities. Assets include nonfinacial assets such as real estate and consumer durable goods; and financial assets such as corporate equiites, credit market instruments, and deposits.
Source: Federal Reserve.

Figure 7

Though banks' willingness to make loans to households has improved since drastically falling between the second quarter of 2007 and the fourth quarter of 2008, loan terms remain tight relative to those prior to the recession (see Figure 8). Demand for all consumer loans has increased; however, more stringent credit requirements by banks, especially on home mortgage loans, imply that many households still face difficulty acquiring a loan. Furthermore, new government regulations and uncertainties about their impact on current banking practices have exacerbated banks' reluctance to make certain loans to consumers with less than stellar credit history. As banks err on the side of caution and the new lending standards possibly become the norm, the current pace of consumer spending recovery may become the rule.



Note: Data is quarterly through 2013:Q1. Bank data was taken from a survey of approximately fifty to sixty-eight domestic banks and nineteen to twenty-eight U.S. branches and agencies of foreign banks. The percentage is the fraction of banks that reported increased willingness to make consumer installment loans from the previous three months.
Source: Federal Reserve.

Figure 8

Consumer confidence has improved from recession levels as consumers became more optimistic about employment prospects and financial situations. However, the indices still remain below pre-recession levels as consumers continue to be apprehensive about their falling standard of living as rising food prices reduce their purchasing power and wage growth remains slow (see Figure 9).[1] Additionally, the uncertainty of U.S. regulations surrounding the debt ceiling and automatic spending cuts have left consumers in a

[1] Thomson Reuters/University of Michigan Surveys of Consumers, "Payroll Tax Hike Narrows Gains in Confidence" *Press Release*, February 1, 2013, http://thomsonreuters.com/content/press_room/financial/2013_02_01_payroll_tax_hike_narrows_gains_in_confidence.

conundrum as these issues have an impact on short- and long-term financial decisions of households. As a result, consumers' spending behavior remains cautious.

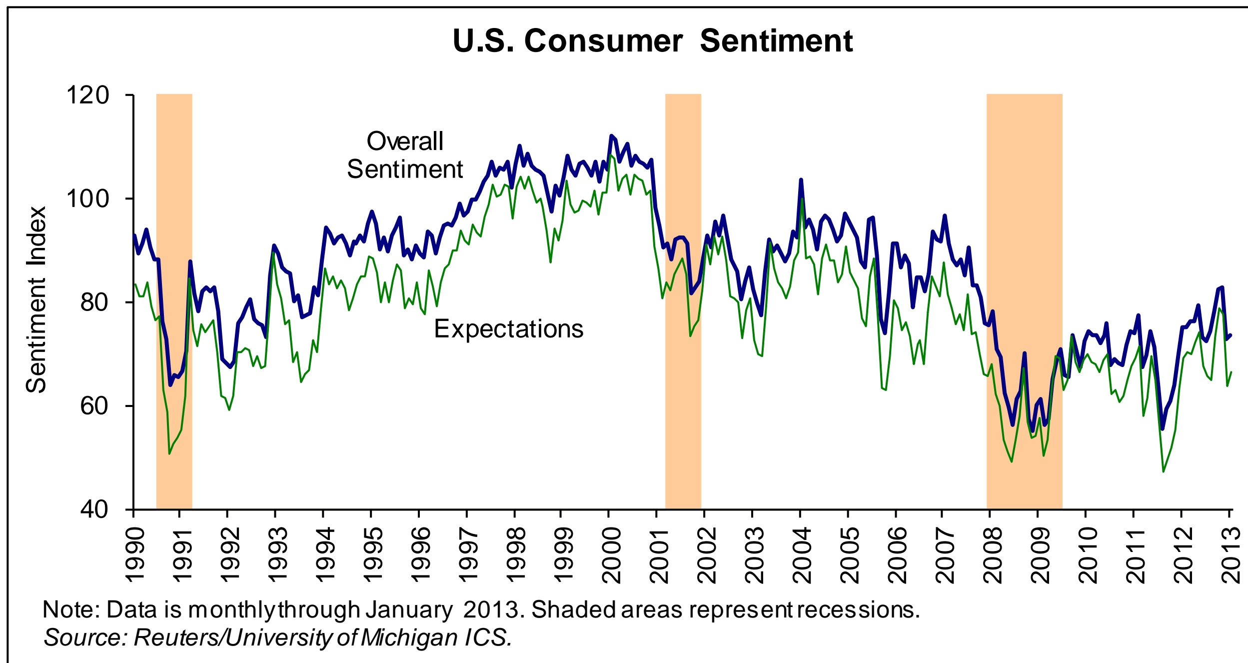


Figure 9

One of the main factors that have negatively affected consumer spending is the significant reduction in home equity withdrawals by homeowners. Consumers had been financing purchases by extracting money from the value of their home as home prices escalated in the few years prior to the recent recession. However, as real estate prices plummeted, home equity withdrawals rapidly declined and have remained low compared to pre-recession levels as low home prices persist (see Figure 10). In fact, many homeowners are taking advantage of historically low mortgage rates by refinancing, but are reducing their principal instead of making withdrawals.[2] Therefore, as home prices remain low, home equity withdrawals will be curbed thereby providing little support to consumption spending.

[2] In the fourth quarter of 2012, an estimated 84 percent of borrowers who refinanced their first lien mortgage lowered their principal or maintained the same loan amount. Of these borrowers, 46 percent kept their loan amount the same, while 39 percent reduced their principal. Freddie Mac, "84 Percent of Refinancing Homeowners Maintain or Reduce Mortgage Debt in Fourth Quarter," *Freddie Mac/Marketwire*, (McLean, VA) February 4, 2013, http://freddiemac.mw newsroom.com/press-releases/84-percent-of-refinancing-homeowners-maintain-or-r-pinksheets-fmcc-981668.

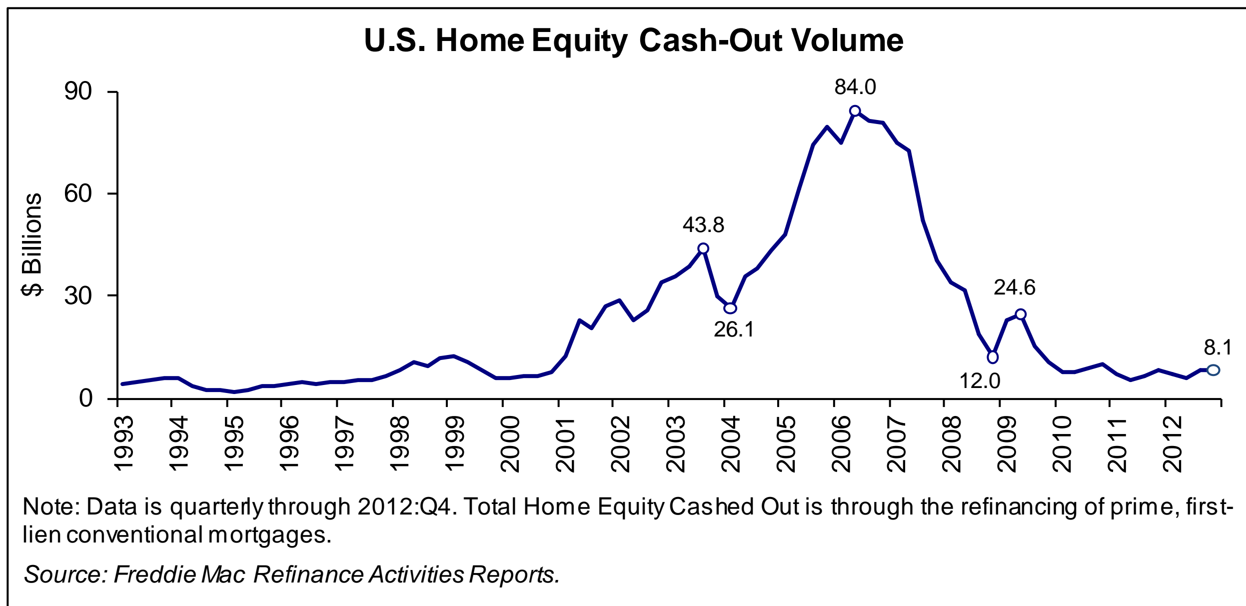


Figure 10

Household leverage increased consistently between the early 1980s and the third quarter of 2007. At its peak, household debt was 134.3 percent of disposable income. The ratio of household debt to disposable income fell to 112.3 in the third quarter of 2012, approaching the 2003 ratio (see Figure 11). Another measure of household de-leveraging is the financial obligation ratio which measures the percent of household disposable income obligated to debt payment. Debt payments consist of payment on outstanding mortgage and consumer debt. The financial obligation ratio has declined sharply from its peak in the third quarter of 2007 of 18.9 percent as households have lowered their debt and interest rates have fallen. Lower debt is also attributed to debt cancellation through charge-off and foreclosure.[3] This recent decline in debt burdens can help enhance personal consumption spending as the funds once used to make debt payments become available to make purchases. On the other hand, consumer spending may be hampered as some households continue to deleverage in an effort to bolster their financial future.

[3] See Board of Governors of the Federal Reserve System, "Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks," n.d., www.federalreserve.gov/releases/chargeoff/chgallsa.htm (accessed November 16, 2012).

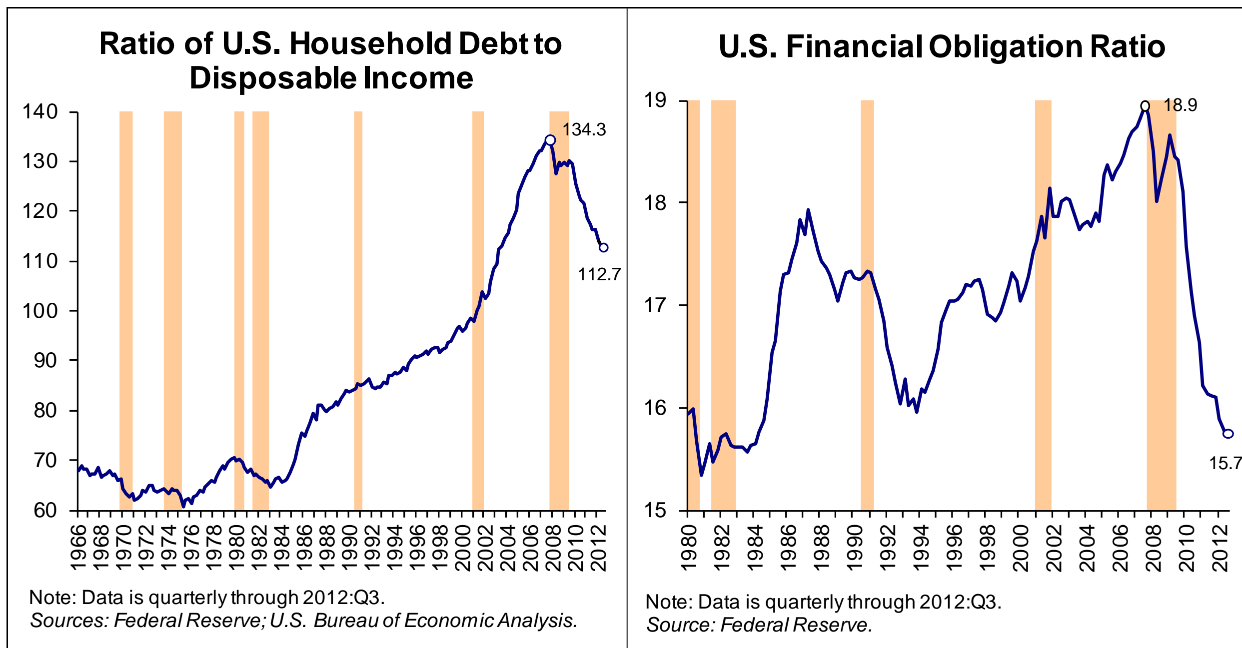


Figure 11

The growth paths for the components of consumption spending suggest that consumers possibly have permanently changed their spending patterns since the recent recession. Consumer spending has been mainly driven by spending on durable goods, the most volatile component of personal consumption spending over the business cycle. In particular, consumers increased spending on motor vehicles, and parts and electronics boosted overall consumer spending in 2012. However, spending growth in durable goods has been tempered by weakness in spending on nondurable goods and services. Expenditures on services have been hampered by weak spending on housing, given the beleaguered housing market and slow spending on healthcare services.

All the components of consumer spending have grown slower in the current recovery compared to previous recoveries. Spending on services grew at an average annual rate of 3.5 percent and 2.5 percent in the expansion periods leading up to the 2001 and 2007-09 recessions, respectively; durable goods expenditures rose 6.1 percent prior to the 2007-09 recession and by 8.6 percent prior to the 2001 recession; and spending on nondurable goods increased at an average annual rate of over 3.0 percent. With spending on services and nondurable goods anticipated to remain sluggish over the forecast period and both goods accounting for more than 80 percent of consumer spending, weakness in personal consumption spending will persist (see Figure 12).

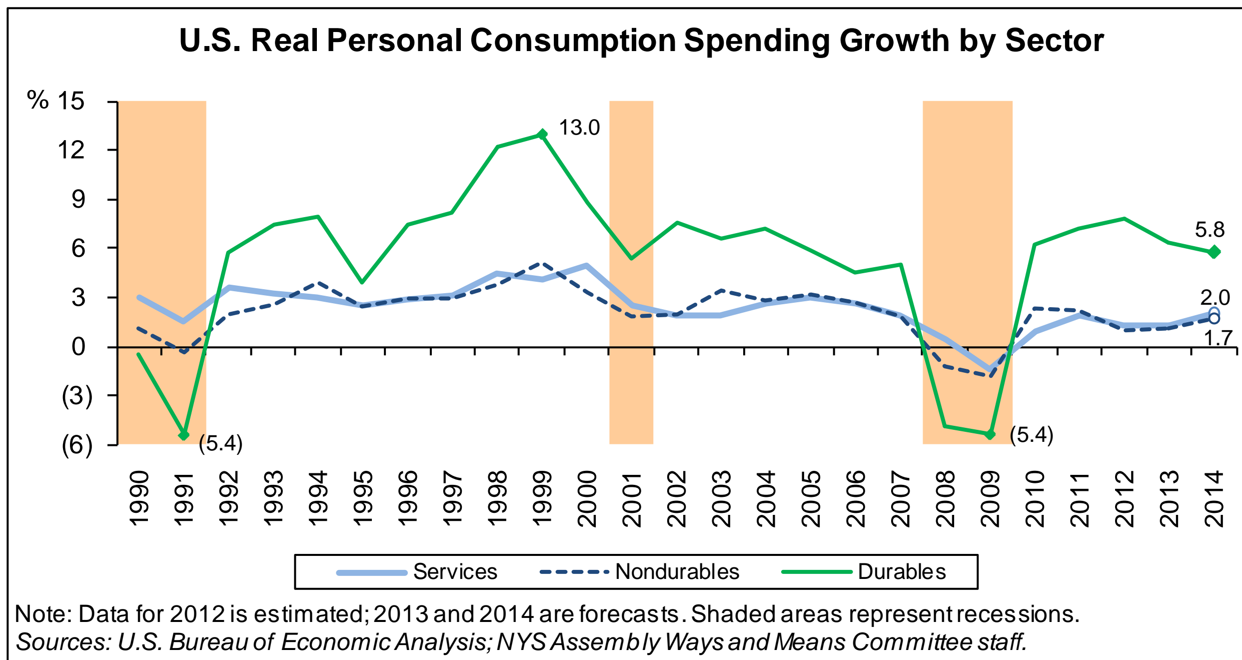


Figure 12

Part of the narrative regarding consumer spending patterns changing is that challenges seemingly nonexistent prior to the recession surfaced. In particular, workers close to retiring or retirees have had to delay exit or reenter the labor force because their retirement savings were decimated from losses in the financial markets and the decline in the value of their homes. Many of these retirees who have reentered the labor force are competing with a large pool of unemployed workers, many of whom are younger and are willing to accept lower pay. In addition, the savings of retirees have been hammered by persistently low interest rates. On the other hand, younger employees face high unemployment rates, high student loan debts, and more stringent credit standards. As a result, household formations are changing. Many younger employees are delaying the start of their family. Younger workers are saving more, planning for retirement earlier, restraining credit card debt, and spending less than before the recession.[4] These underlying factors clearly have an adverse effect on the components of consumer spending, and thus on overall personal consumption spending.

[4] E.S. Brown, "New Wave of Workers Try Novel Approach: Save More," *Wall Street Journal*, September 24, 2012.

Investment

Though accounting for only about fifteen percent of gross domestic product, business spending was one of the main forces that propelled the United States out of the recent recession. In 2010, the year following the end of the most recent recession, business spending rose 13.7 percent solely off of gains in spending on inventories and equipment and software (see Figure 13 and Figure 14). In 2011, spending on equipment and software remained positive, and spending on nonresidential construction began to register improvements; however, with tempered growth in inventories and continued declines in home construction, business spending growth slowed to 5.2 percent.

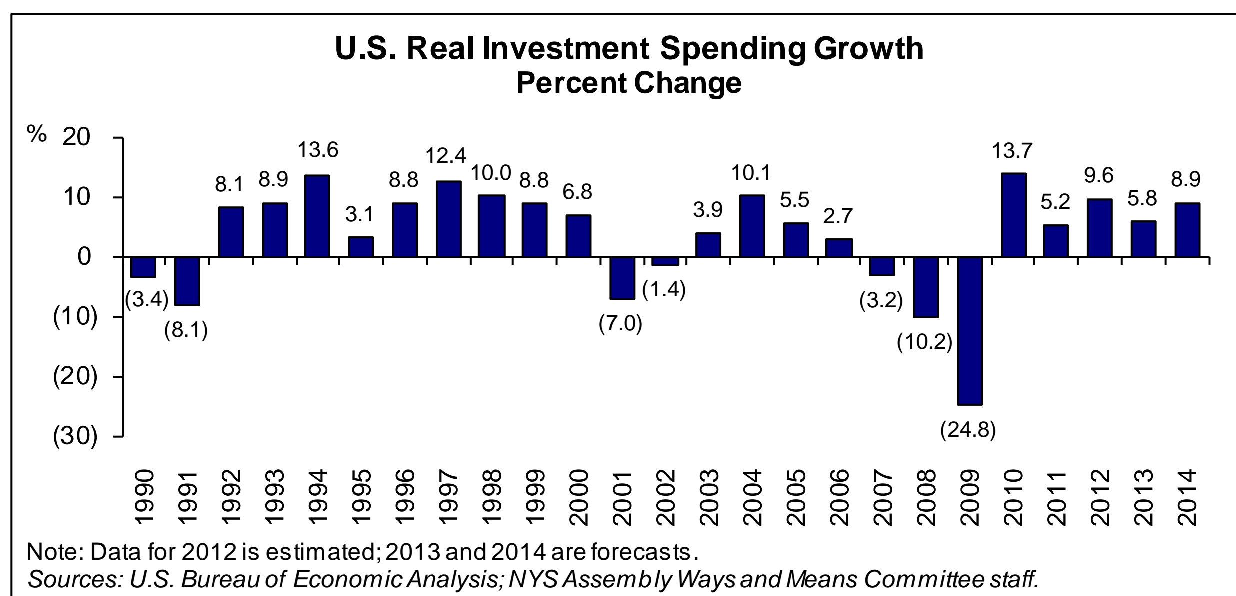


Figure 13

Spending on the construction of new homes declined for six consecutive years, from 2006 through 2011. The period of decline in housing marked a massive correction in what had become an overleveraged market, driven by years of poor lending practices and unsustainable growth in home prices. When the housing market collapsed from 2006 through 2009, home prices fell dramatically, leaving millions of household mortgages underwater and forcing many homeowners into foreclosure. During the housing correction, distressed homes were slowly worked off the market, as banks became more willing to make loans on mortgages following a period of extreme credit tightness. Depressed, but increasing, home prices and historically low mortgage rates are slowly attracting buyers back into homeownership. With confidence returning to the housing market, 2012 marked the first time in six years that business spending on residential construction was positive on an

annual basis (see Figure 14). Residential construction is forecast to gain momentum in the forecast period as fundamentals continue to improve and mortgage rates remain low. With the housing market having gained momentum, construction of commercial buildings having maintained positive growth, and spending on equipment and software having moderated, business spending is estimated to have grown 9.6 percent in 2012. Inventory accumulation is also estimated to have contributed positively to 2012 business spending; however, inventory accumulation is expected to slow in 2013 before gaining in 2014 as consumer spending improves.

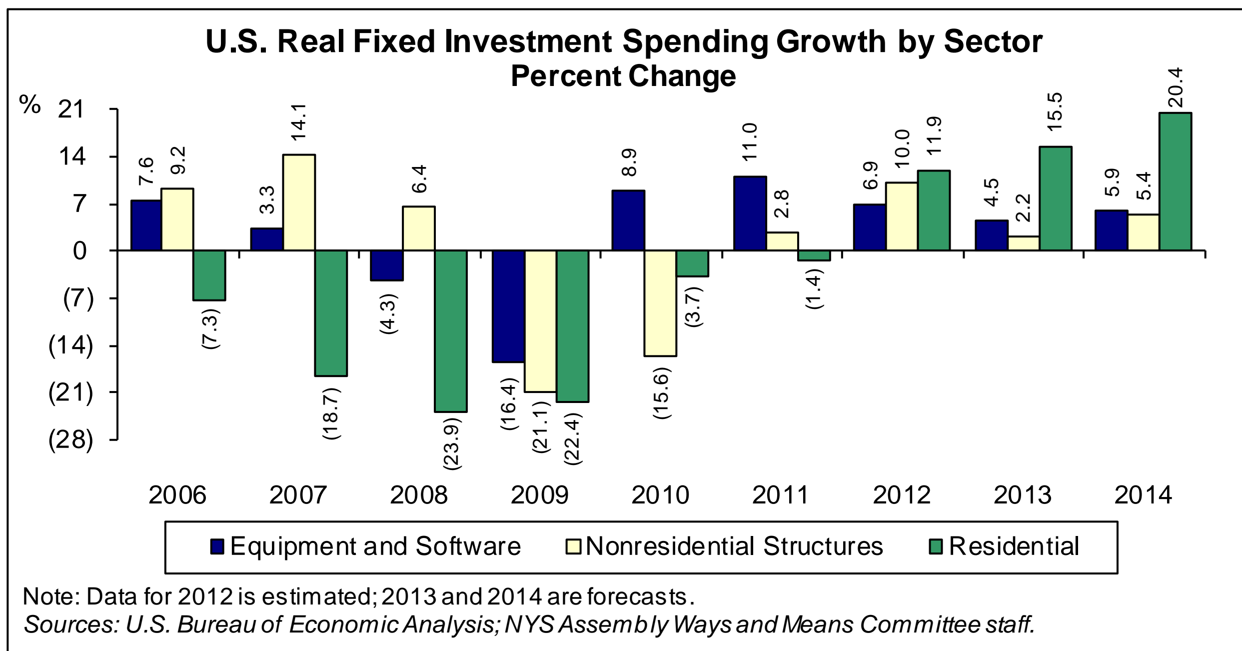


Figure 14

Even as business balance sheets remain strong, concerns over the eurozone debt crisis and slowdown in the global economy are weighing on business confidence. There are significant concerns about drawn-out discussions over sequestration of the federal budget under current law. The NYS Assembly Ways and Means Committee staff's forecast assumes that sequestration will be avoided and the economy will continue on a stable path. As such, the Committee staff forecasts that overall business spending will grow 5.8 percent in 2013, and improve to 8.9 percent in 2014 as global growth strengthens. Should fiscal reform not take place before then, business spending could be disrupted, and the forecast would prove to be too optimistic.

Nonresidential Fixed Investment Spending

Nonresidential fixed investment spending is estimated to have grown 7.8 percent in 2012, slightly slower than growth of 8.6 percent in 2011. Following the recent recession, business spending on equipment and software experienced strong gains. The increased spending on equipment and software over this period was largely driven by a need for businesses to replace old equipment and update old software, following two years of cutbacks. The need to remain competitive in the global market, combined with improvements in commercial real estate, has kept growth in business spending on a solid path. Nonresidential fixed investment is forecast to remain positive in the forecast period; however, recent indicators signal that it is cooling.

Advanced new orders of nondefense capital goods excluding aircraft and parts, a leading indicator of business investment spending, although improving, had declined significantly in recent months (see Figure 15). The uptick in the last part of 2012 can be attributed to the expected expiration of the 50 percent depreciation bonus on equipment and software, which was extended in January 2013, and pulled orders forward into 2012. Therefore, it is likely that orders will slow again in the first half of 2013, tempering equipment and software growth in the first half of the year. A temporary dip in late 2012 in

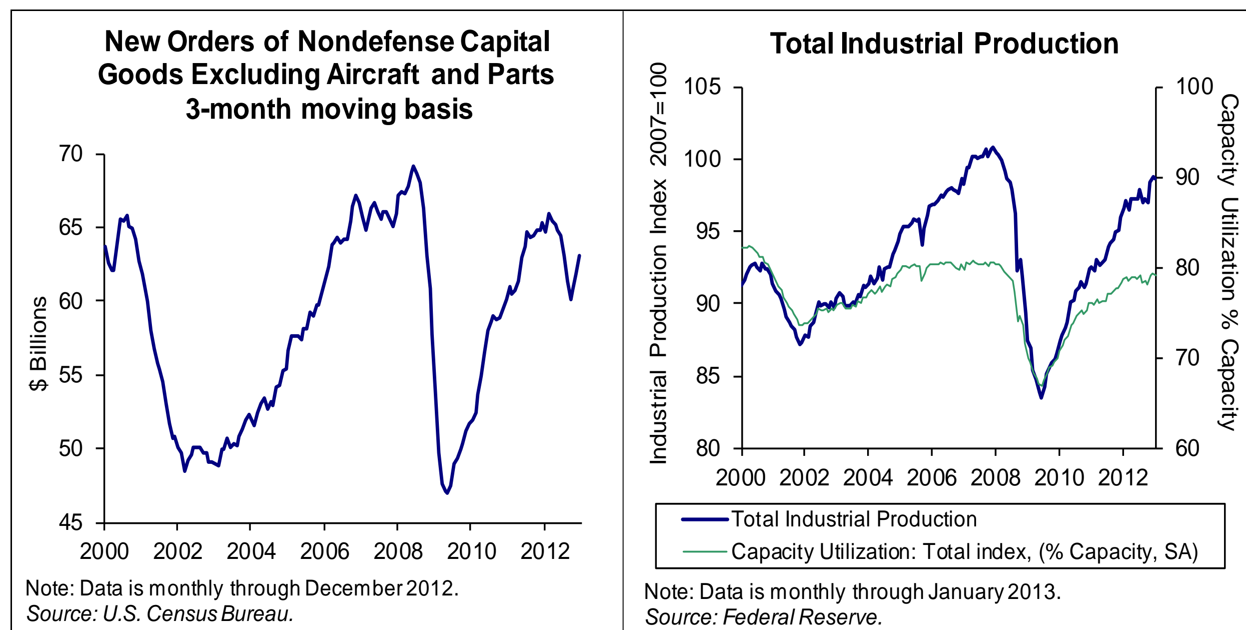


Figure 15

capacity utilization and in industrial production indicates that uncertainty regarding the current business climate exists; the concerns are likely related to the national budget discussions.

Despite the momentary hiccup in spending on equipment and software, conditions remain favorable for businesses. Loan rates are near zero and banks indicate that they are willing to make commercial and industrial loans. Furthermore, businesses are sitting on record amounts of liquid assets and cash flow is exceeding capital expenditures (see Figure 16). While uncertainty in domestic policy and concerns in the global economy are currently keeping businesses on the sidelines, strength in their balance sheets means that businesses have the money to spend when conditions become more favorable. In the short-term, uncertainty resulting from the lack of resolve over the implementation of the Budget Control Act of 2011 will continue to cause hesitation among businesses. For these reasons, the Assembly Ways and Means Committee staff forecasts business spending growth on equipment and software to slow to a rate of 4.5 percent in 2013 and strengthen to 5.9 percent in 2014 as global demand improves and the domestic economy continues on a stable path of recovery.

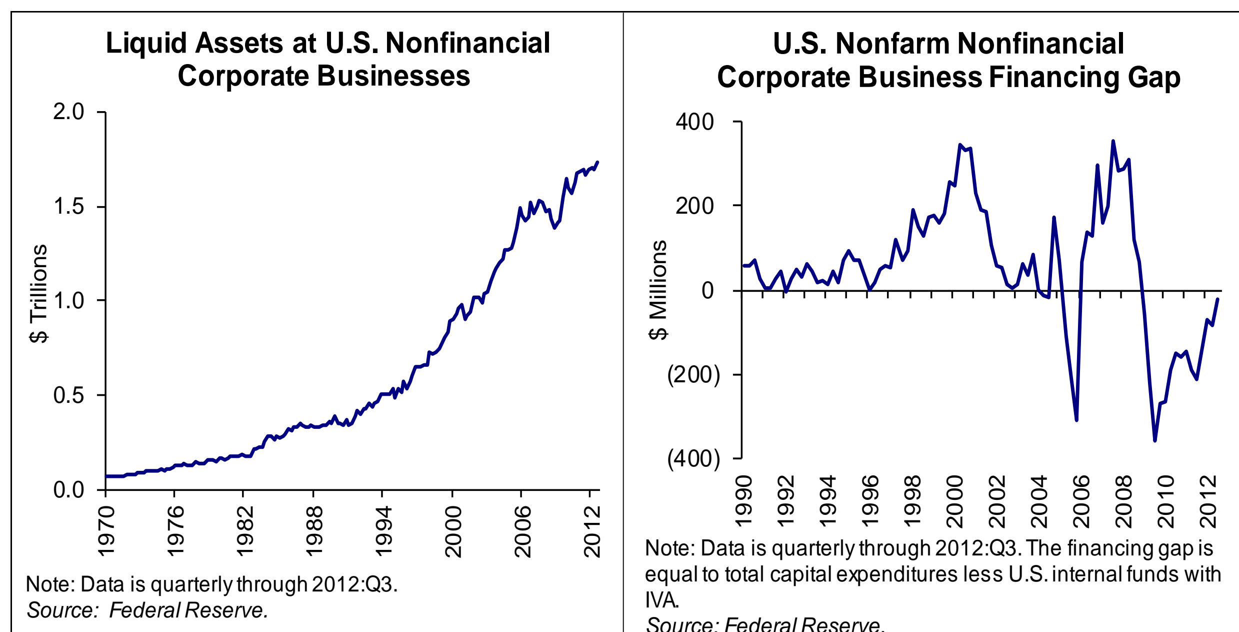


Figure 16

Following two consecutive years of declines, business spending on nonresidential structures returned in 2011 driven by spending in mining and petroleum. Two thousand twelve had broader growth in the sector, with strong gains in spending on commercial,

health care, and industrial buildings. Quantitative easing has helped commercial real estate significantly, with lower interest rates making it possible to refinance and restructure a larger portion of potentially problematic loans. The drop in Treasury yields has also aided commercial real estate markets (CRE), with investors gravitating towards CRE in a search for higher returns. As a result, default rates have come down to near normal levels and operating fundamentals for all major property types have improved.

Though the commercial real estate markets have been making significant strides, there are still several headwinds moving forward as indicated by a contraction in spending in the fourth quarter of 2012. Among the concerns is the pull back in manufacturing as indicated by the ISM manufacturing index and slowing new orders, which will weaken demand for new industrial space. International trade was also a driver of expanding industrial real estate, but has cooled as the global economy has slowed. Employment growth remains slow, keeping demand for new office space tempered.

Furthermore, gains from building in the energy sectors—including power and communication, and mining and petroleum—have begun to cool after posting tremendous growth over several quarters. Given the pullback in these sectors and the improving but weak fundamentals in the commercial real estate market, the Assembly Ways and Means Committee staff forecasts business spending on nonresidential construction growth to slow to 2.2 percent in 2013. As market fundamentals strengthen, spending on nonresidential construction is forecast to improve 5.4 percent in 2014.

Residential Investment

Construction spending on new homes and home improvements is estimated to have grown 11.9 percent in 2012, marking the first time since 2005 that spending on residential construction has grown over the year. The decline in residential construction over the past six years was dramatic. Falling home prices, especially on overleveraged homes, and the rapid tightening of credit standards caused spending on new single-family homes to fall 80.0 percent from its peak of $465.6 billion in 2006 to $92.9 billion in 2009 (see Figure 17). Ongoing deleveraging, slow job growth, and tight credit standards have kept new growth in residential spending tempered, but the sector is gaining traction. Home prices are strengthening, and new home inventory is near an all-time low. As housing market fundamentals continue to improve, the Assembly Ways and Means Committee staff forecasts that spending on total residential construction will strengthen in the forecast period, growing 15.5 percent in 2013, and accelerating by 20.4 percent in 2014.

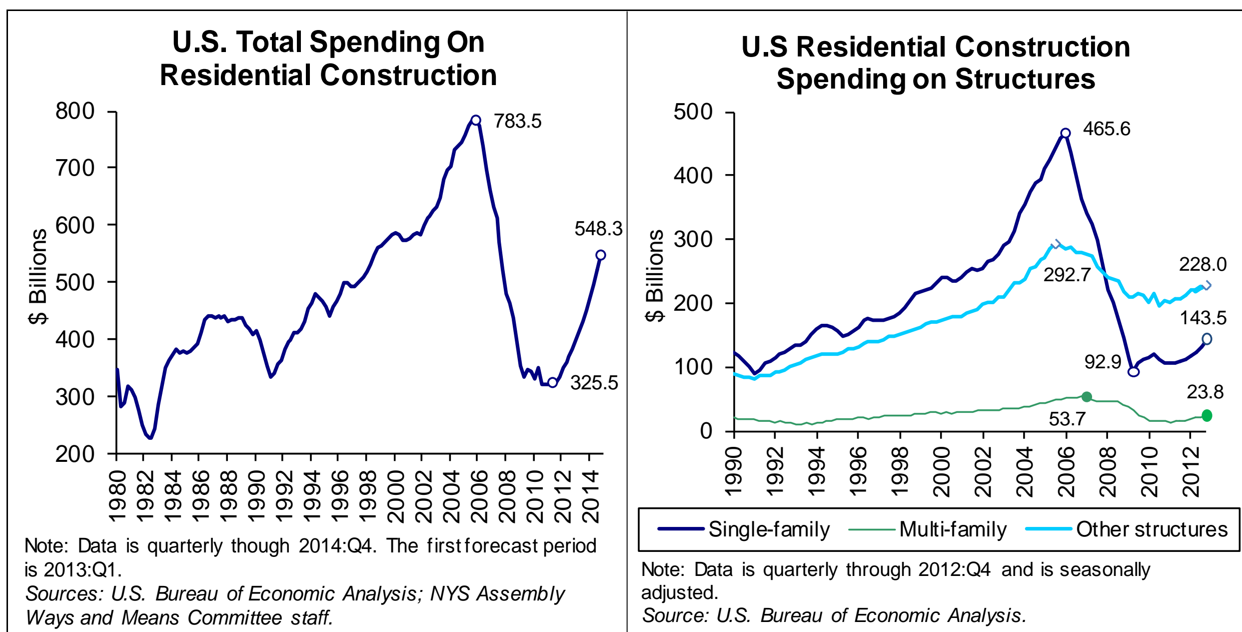


Figure 17

It has been a long, bumpy road to a turnaround in the housing sector and though growth is forecast to accelerate, the sector still has a long way to go before it begins to resemble its former size. The S&P/Case-Shiller Composite Index (Case-Shiller) dropped by over 30 percent from the second quarter of 2006 to the second quarter of 2009, with the highest depreciation rates in the areas that experienced the fastest growth during the boom period. Both the Case-Shiller and the Federal Housing Finance Agency (FHFA) home price indices began to stabilize in early 2009 but still suffered small losses until early 2012 (see Figure 18). As a result, household assets still remained almost 25 percent below their peak value in the third quarter of 2012.

The housing market showed signs of improvement in 2012. After a period of slight decline, home prices have started to rebound. Both Case-Shiller and the FHFA House Price Index marked their tenth consecutive monthly gain in November 2012, with more areas experiencing a gain in home prices than a loss. Case-Shiller home prices have also grown compared to those of a year ago since June 2012, which was the first year-over-year gain since September 2010.

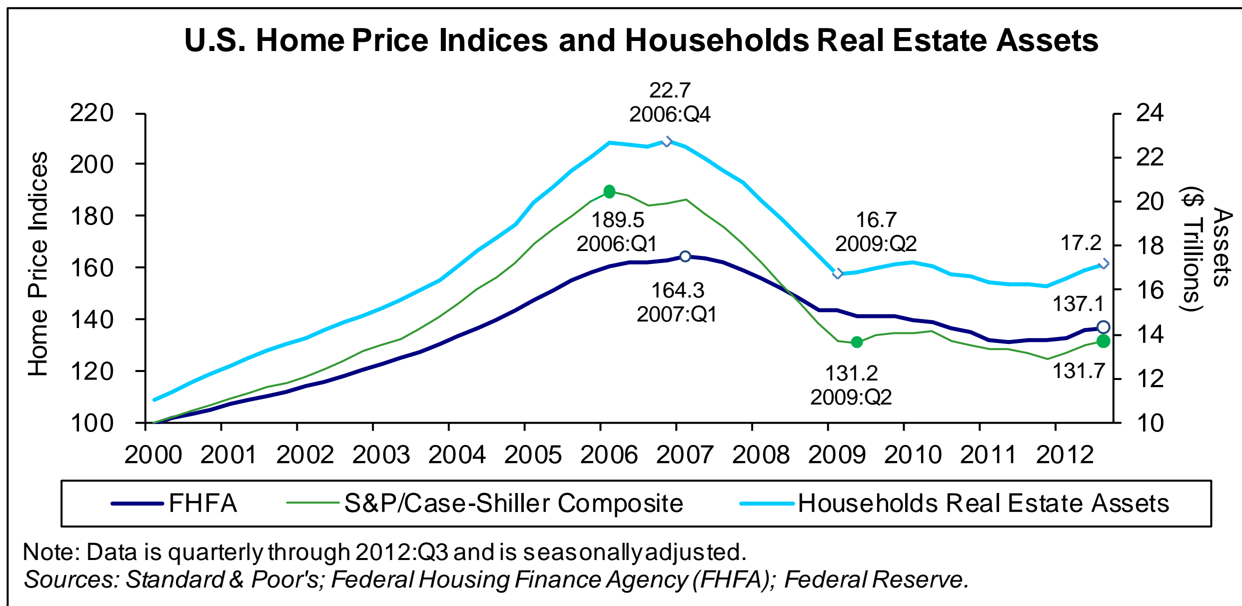


Figure 18

Similarly, after years of stagnant sales, both new and existing home sales have been on an upward trend during the last several months, with new home sales growing almost 20 percent over the year in 2012,[5] and existing home sales growing 12.8 percent in 2012. The share of distressed homes to total existing home sales also declined from over one-third in 2010 to 22 percent in November 2012.[6]

Increasing sales coupled with a slowdown in foreclosures, as a result of documentation and legal issues, have caused a decline in the number of existing homes available for sale. After reaching a record high of 3.3 million existing homes available for sale in early 2008, existing home inventory had declined to 2.8 million in October 2010, before the documentation issues arose. Existing home inventory then continued to decline and stood at just under two million homes in December 2012. As a result, inventory of new and existing homes that are available for sales has declined to the level below the long-term average in the recent months (see Figure 19).

[5] U.S. Census Bureau, *New Residential Sales in December 2012*, January 25, 2013.

[6] National Association of Realtors, "November Existing-Home Sales Slip in December, Prices Continue to Rise, 2012 Totals Up," *News Release*, December 2012 (Washington).

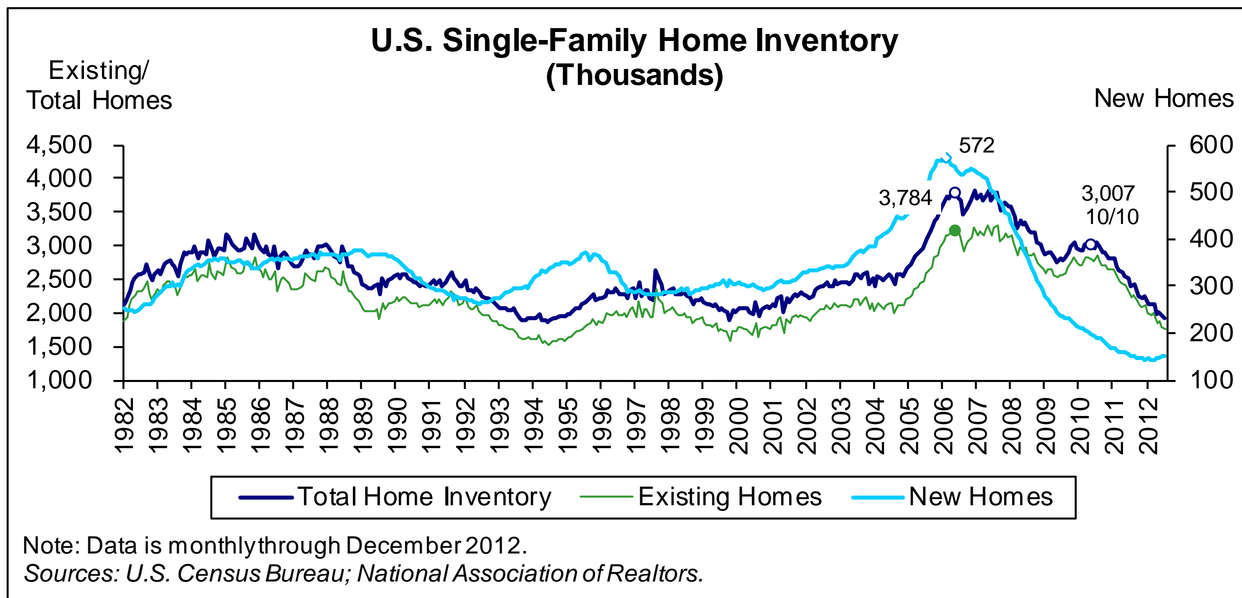


Figure 19

Housing starts and permits also improved in 2012 (see Figure 3 on page 3). After hitting a record low in early 2009, both housing starts and building permits became stable and then started to improve in 2012, rising over 25 percent in 2012 from 2011.

Despite the improvement, the housing market remains depressed. Currently, home prices are close to 2003-04 levels, while housing starts stand at less than one-half of their recent peak of over two million in 2006. In addition, even though inventory of new and existing homes has come to long-term average levels, total housing inventory including shadow inventory remains high due to the high level of housing units that are being held off the market (see Figure 20).

Moving into 2013, housing demand as well as credit problems are expected to improve as the economy continues to recover. However, the speed of improvement will rely heavily on employment and wage growth. As employment and wages are expected to grow slowly, home prices are likely to increase gradually in 2013, while housing starts are expected to rise but remain below their previous peak throughout the forecast period. As the overall economy continues to improve in 2014, activities in the housing market as well as home prices are likely to improve at a faster pace.

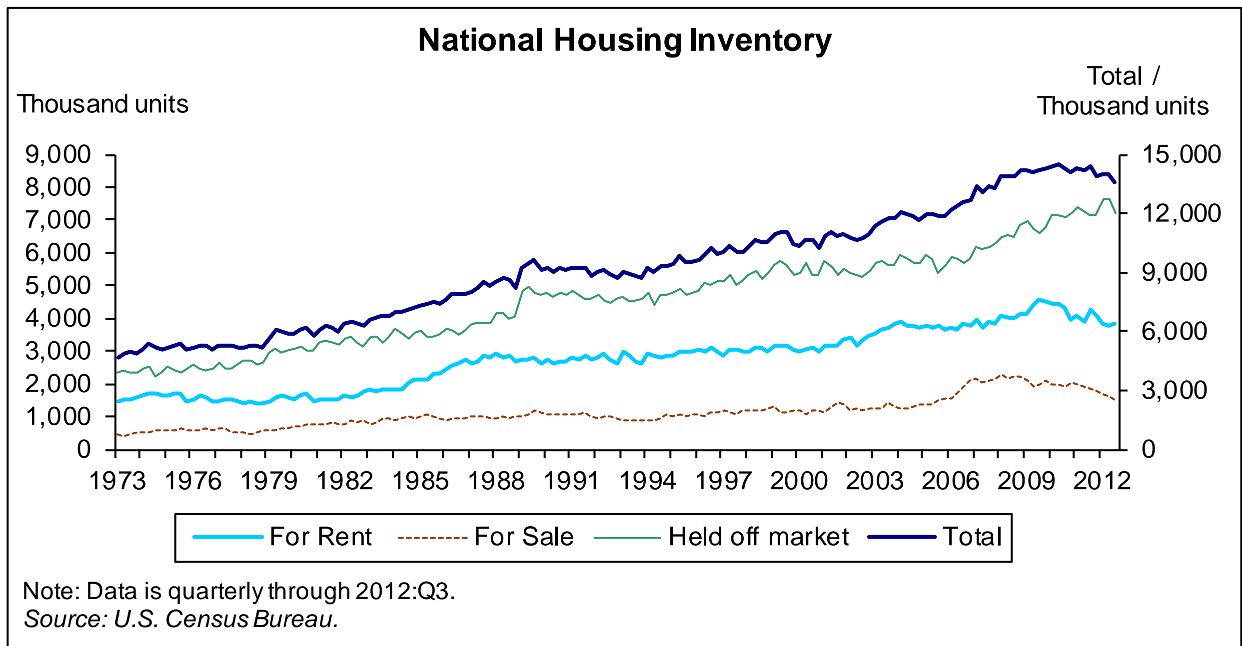


Figure 20

Government Spending

After increasing 0.6 percent in 2010, total government spending, adjusted for inflation, fell 3.1 percent in 2011 as the federal government reduced spending on war related activities in Iraq and Afghanistan and funds waned from the American Recovery and Reinvestment Act of 2009 (ARRA). At the state level, statutory obligations required continued cuts as spending obligations outpaced revenue collections. As spending cuts persisted at all levels of government, total government spending declined an estimated 1.7 percent in 2012 and is forecast to fall another 1.3 percent in 2013 (see Figure 21). In 2014, state tax collections are anticipated to be more aligned with expenditures, but will be outweighed at the federal level by spending caps and reductions. Hence, total government spending is projected to decline another 1.0 percent.

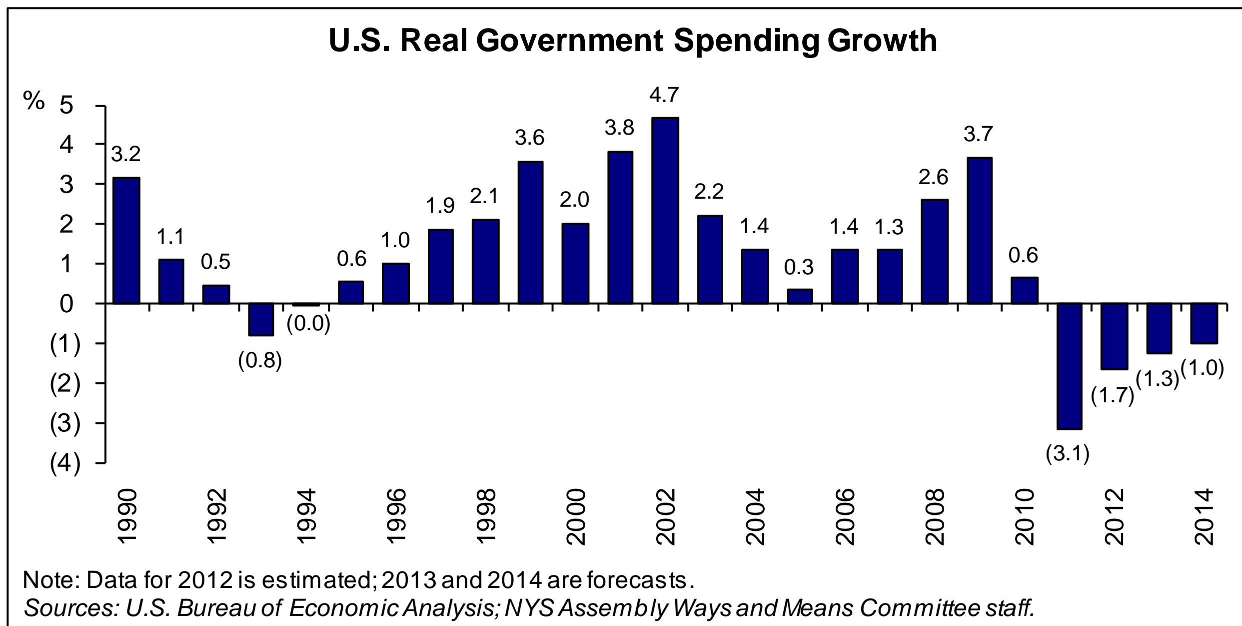


Figure 21

Risks to the government spending forecast stem mainly from uncertainties associated with automatic spending reductions required by the Budget Control Act of 2011 that take effect at the beginning of March 2013, and debt ceiling negotiations.[7] Expenditures related to disaster preparedness such as flood insurance, disaster relief, and agricultural programs remain a constant risk.

Federal Government Spending

After increasing at an annual average rate of 3.9 percent between 1998 and 2010, federal government spending, adjusted for inflation, fell 2.8 percent in 2011 as both defense and non-defense expenditures declined (see Figure 22). However, defense spending accounted for most of the reduction. Defense outlays fell primarily as a result of a decrease in spending on goods and services and investments in structures and equipment and software. The decline in non-defense spending was due to cutbacks in compensation, public investments on structures, and spending on goods and services.

[7] See *The Budget Control Act of 2011*, Public Law 112-25, 112th Congress, August 2, 2011. Also, see *The American Taxpayer Relief Act of 2012*, Public Law 112-240, 112th Congress, January 2, 2013.

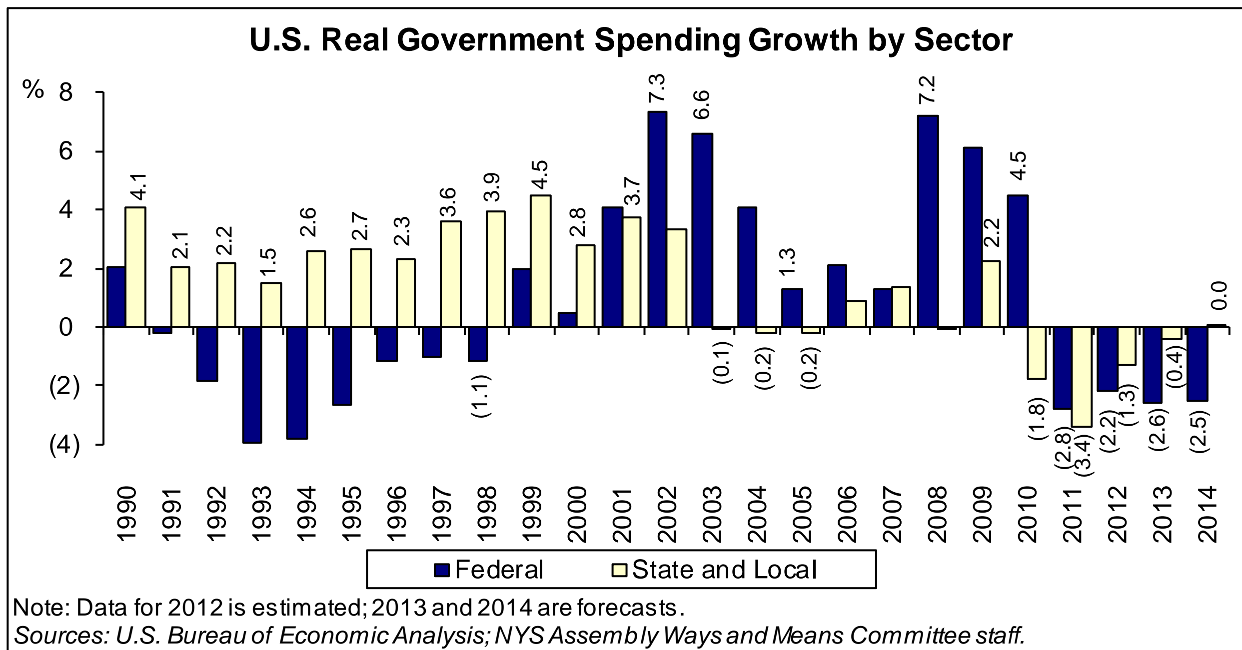


Figure 22

Current laws have ensured that outlays by the federal government will continue to decrease. Automatic spending reductions initiated by the Budget Control Act of 2011 (BCA) are set to take effect in March 2013. The spending cuts are allocated over ten years. Spending caps also set forth by the BCA have already taken effect and are distributed over the next ten years. In 2012, the impact of the cuts was small compared to subsequent years as only $20 billion in mandatory spending was slated to be cut and appropriation caps took effect. In 2013, most of the spending reductions take effect.[8] Further pressures to reduce spending can be expected as negotiations proceed for impending federal budgets and the necessity arises for another increase in the debt ceiling. In addition, outlays for overseas contingency operations have fallen and are expected to decline further over the forecast period.[9]

[8] Immediate actions of the initial $917 billion in cuts included spending caps that should reduce outlays by $741 billion and achieve $156 billion in savings on debt servicing over ten years. Part of the debt ceiling agreement was the creation of a "Supercommittee," or the Joint Select Committee of Congress, that included six democrats and six republicans from the House and Senate. The committee was charged with reducing the deficit by $1.2 trillion to $1.5 trillion by November 23, 2011. The committee failed to agree to a deficit reduction by the deadline; hence, automatic spending cuts were triggered totaling $1.2 trillion split evenly between defense and nondefense spending. Cuts in spending for nondefense will be mostly limited to discretionary spending, though reductions to specific parts of Medicare are possible. The cuts are set to take effect in March 2013 due to the enactment of *The American Taxpayer Relief Act of 2012* (ATRA). However, the current forecast does not assume that automatic sequestration will take effect. See *The Budget Control Act of 2011*, Public Law 112-25, 112th Congress, August 2, 2011; and *The American Taxpayer Relief Act of 2012*, Public Law 112-240, 112th Congress, January 2, 2013.

[9] Total discretionary overseas contingency operations expenditures fell an estimated 27.5 percent in 2012 and are estimated to fall 23.3 percent in 2013. In particular, outlays for Operation New Dawn in Iraq fell 25.8 percent in 2011 to

Consequently, federal government spending fell an estimated 2.2 percent in 2012, and is forecast to fall an additional 2.6 percent and 2.5 percent in 2013 and 2014, respectively.

The federal deficit in fiscal year 2012 was $1.1 trillion or 7.0 percent of GDP. The federal budget deficit for fiscal year 2012 was $207.4 billion less than the shortfall in 2011 (see Figure 23). In fiscal year 2011, the federal deficit was 8.7 percent of GDP compared to 9.0 percent in 2010. Revenues increased by 6.4 percent or $146.6 billion due to all major components of receipts rising in fiscal year 2012; while outlays by the government declined

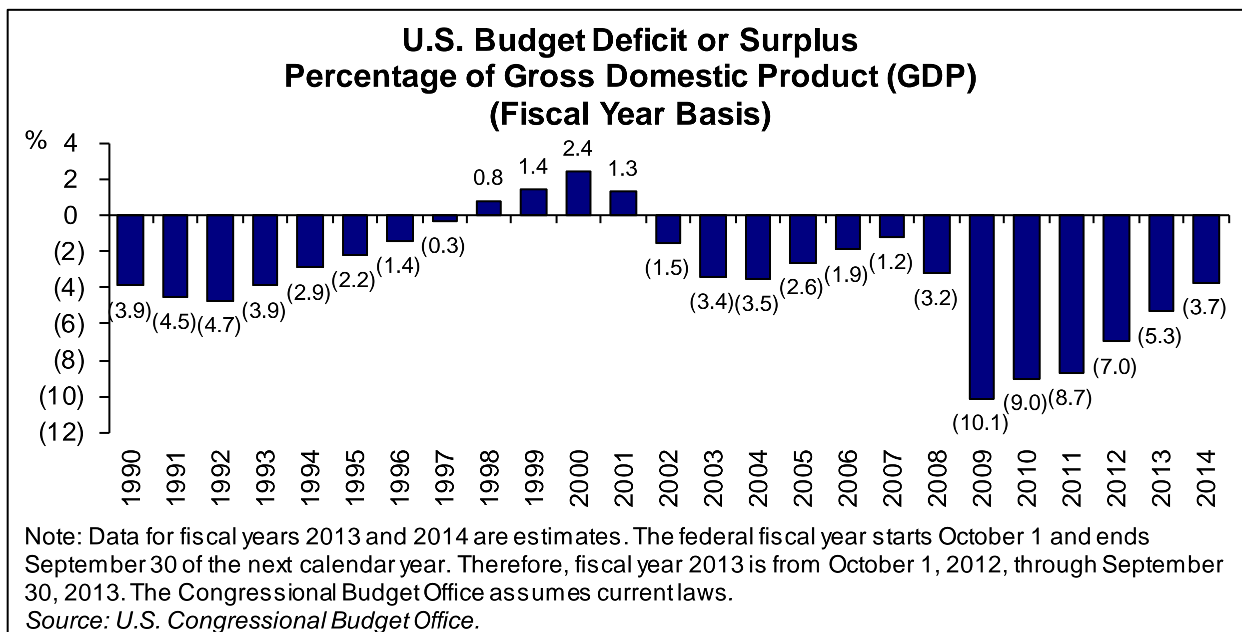


Figure 23

$45.0 billion, and fell by an estimated 78.7 percent to $9.6 billion in 2012 and are estimated to decline 70.2 percent to $2.9 billion in 2013. However, spending for Operation Enduring Freedom in Afghanistan rose to $114.0 billion in 2011, though it was expected to have declined 7.2 percent to $105.7 billion in 2012, and is expected to decline further to $85.6 billion in 2013. While spending on combat missions in Iraq is falling, expenditures on the diplomatic side were anticipated to increase $4.8 billion in 2012 and by another $4.0 billion in 2013. Outlays for the Department of State and the U.S. Agency for International Development (USAID) are expected to fall slightly for Afghanistan and Pakistan in 2013. See Executive Office of the President, Office of Management and Budget, *Federal Year 2013 Budget of the United States Government, "Overseas Contingency Operations," February 2012*, http://www.whitehouse.gov/sites/default/files/omb/budget/fy2013/assets/overseas.pdf.

by 1.7 percent or $60.8 billion during the same period in the prior fiscal year.[10] In fiscal year 2013, the budget deficit is projected to be 5.3 percent of GDP.[11]

State and Local Government Spending

In 2011, state and local government spending, adjusted for inflation, fell 3.4 percent. This was the second consecutive annual decline (see Figure 22 on page 24). States and their localities continued to make deep cuts as spending outpaced revenues. The pain was exacerbated as significant fiscal assistance from the federal government receded.[12] Since most states have statutory balanced budget requirements, many states and local governments continued to rein in spending, raised taxes, or tapped into reserve funds.

More than three years since the end of the last recession and after closing more than $500 billion in deficits, states are anticipated to face more budgetary shortfalls for fiscal year 2013 though the gaps are much smaller than in the prior few years.[13] The slow economic recovery is the primary cause for the fiscal situation of state and local governments. In particular, though state revenues surpassed their pre-recession levels in the third quarter of 2012, growth in state tax collections remains relatively weak;[14] high unemployment adversely affects personal income tax collections, and also lowers sales tax collections since less income is available to make purchases; and low home prices reduce property tax collections. Local governments especially have been affected by the drop off in property taxes and local sales taxes as these are their main source of funding. Weak economic growth has contributed

[10] See U.S. Department of Treasury, Financial Management Service, *Final Monthly Treasury Statement of Receipts and Outlays of the United States Government for Fiscal Year 2012 through September 30, 2012, and Other Periods,* September 2012, http://fms.treas.gov/mts/mts0912.pdf.

[11] See U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2013 to 2023,* February 2013.

[12] See *The American Recovery and Reinvestment Act of 2009,* Public Law 111-5, 111th Congress, February 17, 2009.

[13] Preliminary findings suggest states' budget shortfalls for fiscal year 2013 to be $44 billion. See Phil Oliff, Chris Mai, and Vincent Palacios, "States Continue to Feel Recession's Impact," Center of Budget and Policy Priorities, updated June 27, 2012, http://www.cbpp.org/files/2-8-08sfp.pdf.

[14] In the first quarter of 2012, state tax collection rose 4.7 percent from a year earlier, but was 4.8 percent lower than in the first quarter of 2008. Personal and corporate income taxes rose 10.1 percent and 2.3 percent, respectively, while sales taxes rose 10.1 percent. In the second quarter, state revenue grew 3.2 percent, the tenth consecutive quarter of growth. In the third quarter of 2012, state tax revenues increased 2.7 percent. State income, sales, and corporate tax revenues have increased more slowly from the recent recession than prior ones. See Lucy Dadayan, "Tax Revenues Continue to Grow in Early 2012," State Revenue Report, The Nelson Rockefeller Institute of Government, University of Albany, August 2012, no. 88, http://www.rockinst.org/pdf/government_finance/state_revenue_report/2012-08-02-SRR_88.pdf; Lucy Dadayan and Donald J. Boyd, "Sales Tax Revenues Show Slowest Growth in the Last Two Years," State Revenue Report, The Nelson Rockefeller Institute of Government, University of Albany, October 2012, no. 89, http://www.rockinst.org/pdf/government_finance/state_revenue_report/2012-10-25-SRR_89_v2.pdf; and Lucy Dadayan and Donald J. Boyd, "State Tax Revenues Continue Slow Rebound," State Revenue Report, February 2013, no. 90, http://www.rockinst.org/pdf/government_finance/state_revenue_report/SSR-90.pdf.

to higher demands for unemployment insurance benefits, public assistance benefits, Medicaid, housing assistance, and other social services, putting more pressure on governments' coffers. Other challenges including rising healthcare and pension costs, and reduced support from the federal government will magnify the already lean budgets of state and local governments.

Therefore, the decline in state and local government spending is likely to persist into 2013 as problems linger from the recession. State and local government spending has not fallen for more than three consecutive years since the end of World War II. Then, spending decreased for five straight years from 1940 to 1944 (see Figure 24). Although tax collection is anticipated to improve further, spending cuts will hamper state and local government spending. As a result, state and local government spending declined an estimated 1.3 percent in 2012 and is forecast to fall again by 0.4 percent in 2013. In 2014, state and local government spending is forecast to remain flat as tax collections increase from stronger economic growth and align with outlays that had been reined in the prior years.

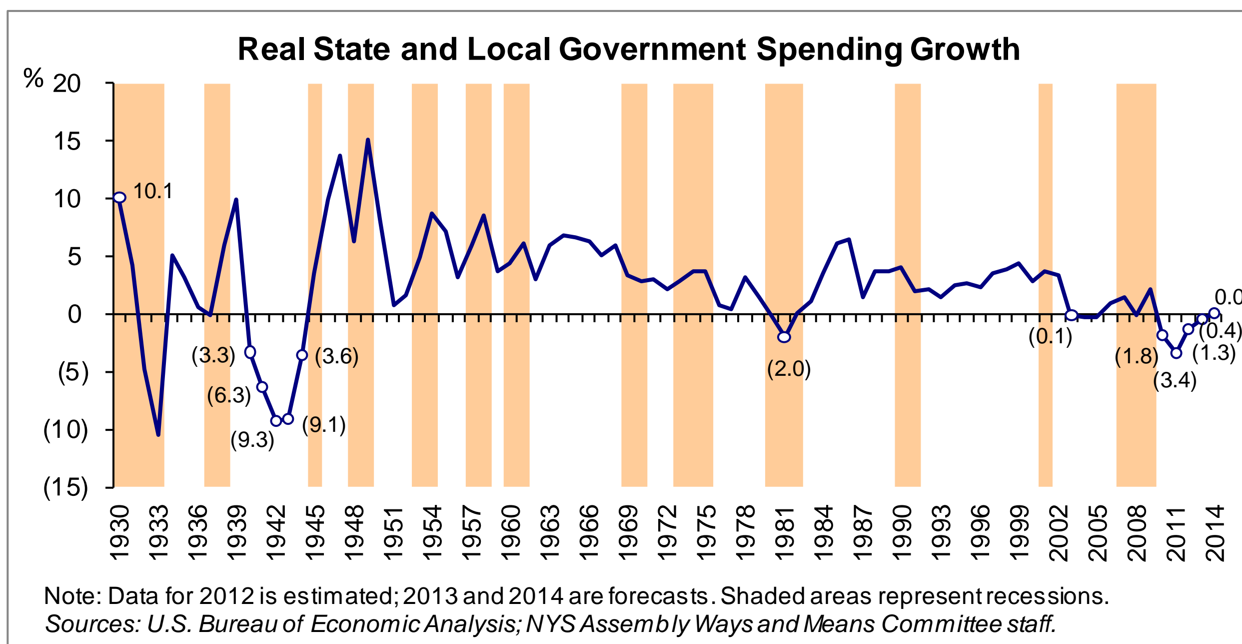


Figure 24

Exports and Imports

After growing for six years in a row following the 2001 economic downturn, U.S. trade declined sharply in 2009 as the world slipped into recession. Since then, U.S. trade has continued to recover due mainly to the weak U.S. dollar and global economic recovery. Exports increased 11.1 percent in 2010, followed by another increase of 6.7 percent in 2011. Similarly, imports rose 12.5 percent in 2010 and 4.8 percent in 2011.

The European debt crisis continues to weigh on global growth and world trade. Several European countries were in recession in 2012; as a result, U.S. trade was slow. Exports are estimated to have grown by 3.4 percent in 2012, while imports are estimated to have grown only 2.4 percent. The outlook of global recovery remains somewhat gloomy, due to the European debt issue. However, the world economy is anticipated to grow faster in 2013 and 2014, while the U.S. dollar is expected to remain weak. As world GDP is anticipated to grow faster than the U.S. throughout the forecast period, driven by growth in developing countries, exports are expected to continue to grow faster than imports in 2013 and 2014. Exports are forecast to grow by 2.8 percent in 2013, before growing further by 5.3 percent in 2014. Imports are expected to increase by 2.0 percent in 2013 and 5.0 percent in 2014 (see Figure 25).

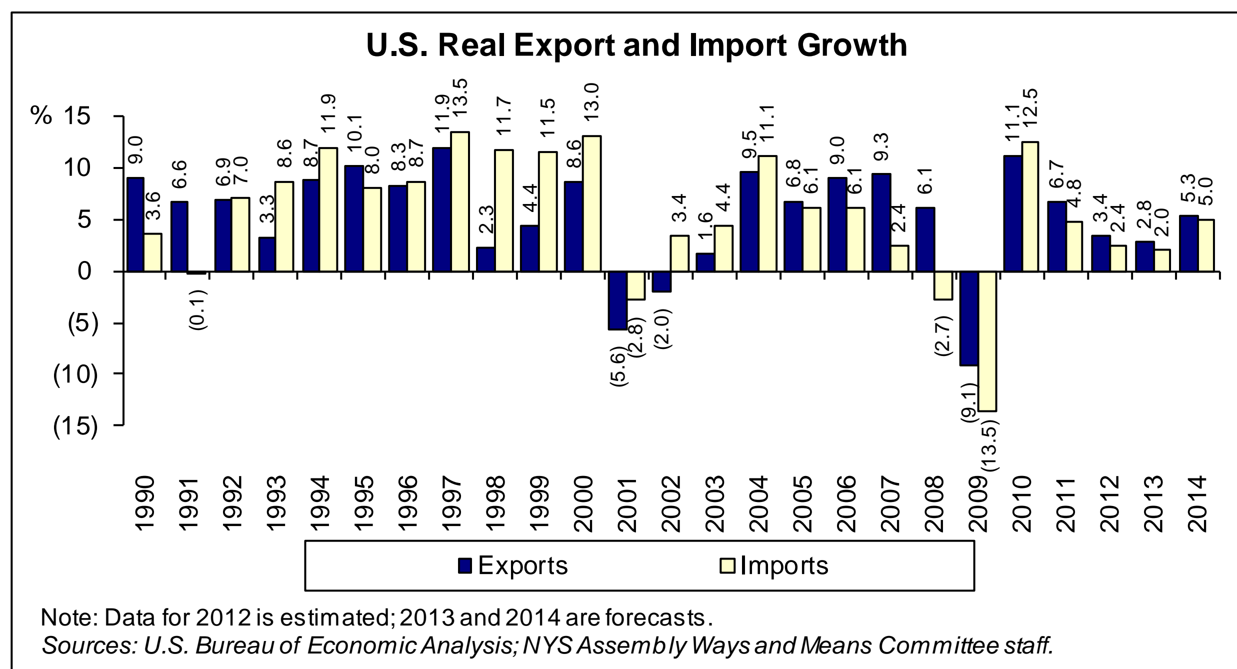


Figure 25

After six years of depreciation, the U.S. dollar gained sharply in 2009 as investors moved money towards the safe-haven currency amid world recession. Although debt problems in European countries emerged in early 2010 and continued to linger through 2011, downward pressure from increasing worries over mounting U.S. debt and the concern about the pace of U.S. recovery caused the dollar to depreciate in 2010 and 2011. The dollar depreciated 4.7 percent in 2010 before depreciating further by 5.2 percent in 2011. The situation in Europe continued to deteriorate in early 2012, and as the eurozone has been in recession in 2012, investors have shifted their investments to dollar-denominated assets. As a result, the dollar appreciated 2.1 percent in 2012. The debt crisis has deviated recently as the European Central Bank (ECB) started to intervene in the secondary market to purchase bonds, which has boosted investors' confidence. As a result, government bond yields in highly indebted countries (i.e., Spain, Italy, Greece, and Portugal) have recently dropped sharply. The Organisation for Economic Co-operation and Development (OECD) composite leading indicators for those countries has also improved in recent months. Though the fiscal situation remains a concern, as the European debt problem subsides the dollar's value is expected to remain low throughout the forecast period. The dollar's value is expected to depreciate 0.9 percent in 2013, and then gain 1.0 percent in 2014 (see Figure 26).

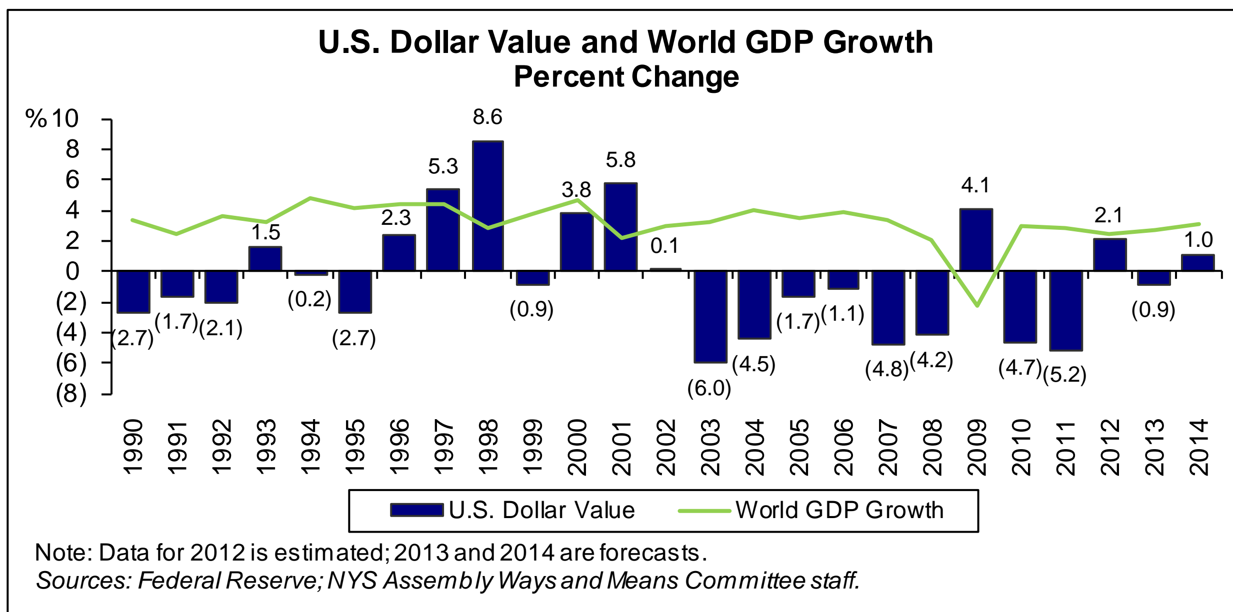


Figure 26

Details of U.S. Trade and the International Economy

Since 1995, industrial supplies and high value-added capital goods such as aircrafts and computers have been the major categories of goods exported by the U.S. In 2012, industrial supplies and capital goods accounted for 67 percent of total exports (see Figure 27). The U.S. had a trade surplus of $62.6 billion in capital goods and industrial supplies (excluding petroleum) in 2012 compared to $71 billion in 2011, while overall trade was in deficit. The U.S. has recorded trade surpluses in these investment goods and production inputs for twelve out of the past seventeen years since 1995, while overall trade has been in deficit every year. Trade of these goods and supplies appears to be relatively less sensitive to the changes in the value of the U.S. dollar.

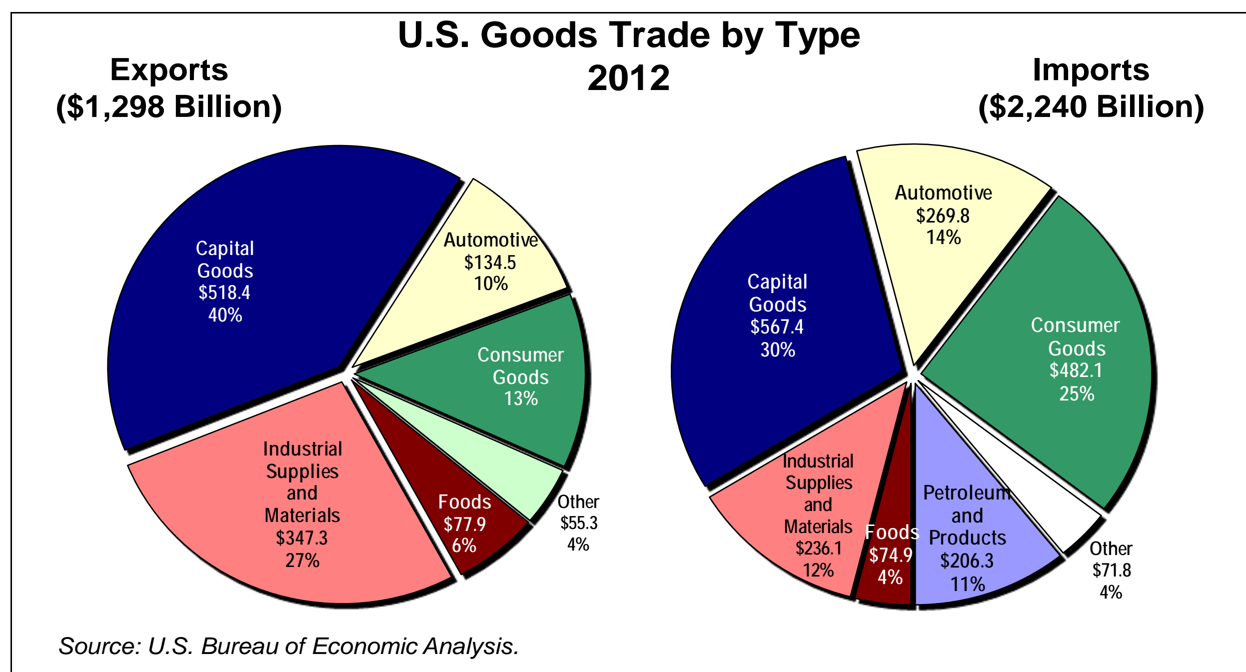


Figure 27

Countries around the globe experienced stronger growth in 2010 and 2011 than in 2009 when the world went into recession.[15] Most countries continued to grow in 2012, with the exception of several European countries that are still in recession. Almost three years after the European debt crisis emerged, problems remain unresolved and continue to be a major risk for global growth. Faced with high debt as well as problems with local real estate and financial markets, many European countries were in recession in 2012. As a result, the eurozone economy slipped back into recession in 2012, after growing 1.9 percent in 2010 and 1.5 percent in 2011.

[15] International Monetary Fund, World Economic Outlook Database, October 2012, http://www.imf.org/external/pubs/ft/weo/2012/02/weodata/index.aspx.

Although the rest of the world has fared better than Europe, the European debt problems have added uncertainty to the world economic environment, which has adversely impacted business confidence. This debt problem has also put a drag on other economies through trade and financial burden.[16] As a result, many countries across the globe experienced slower growth in 2012 than in 2011.

After growing at 4.4 percent in 2010, the strongest growth since 1990, Japan went into recession in 2011, due mainly to the earthquake and tsunami that caused many factories to shut down for more than a month. The Japanese economy declined 0.7 percent in 2011. Rebuilding activities boosted economic growth in Japan to 1.8 percent in 2012. Growth is forecast to continue to rise in 2013, although at a slower pace than in 2012. The Canadian economy, the largest trade partner of the United States (see Figure 28), has been growing after a recession in 2009. It is expected to grow by 1.9 percent in 2013 and 2.5 percent in 2014.[17]

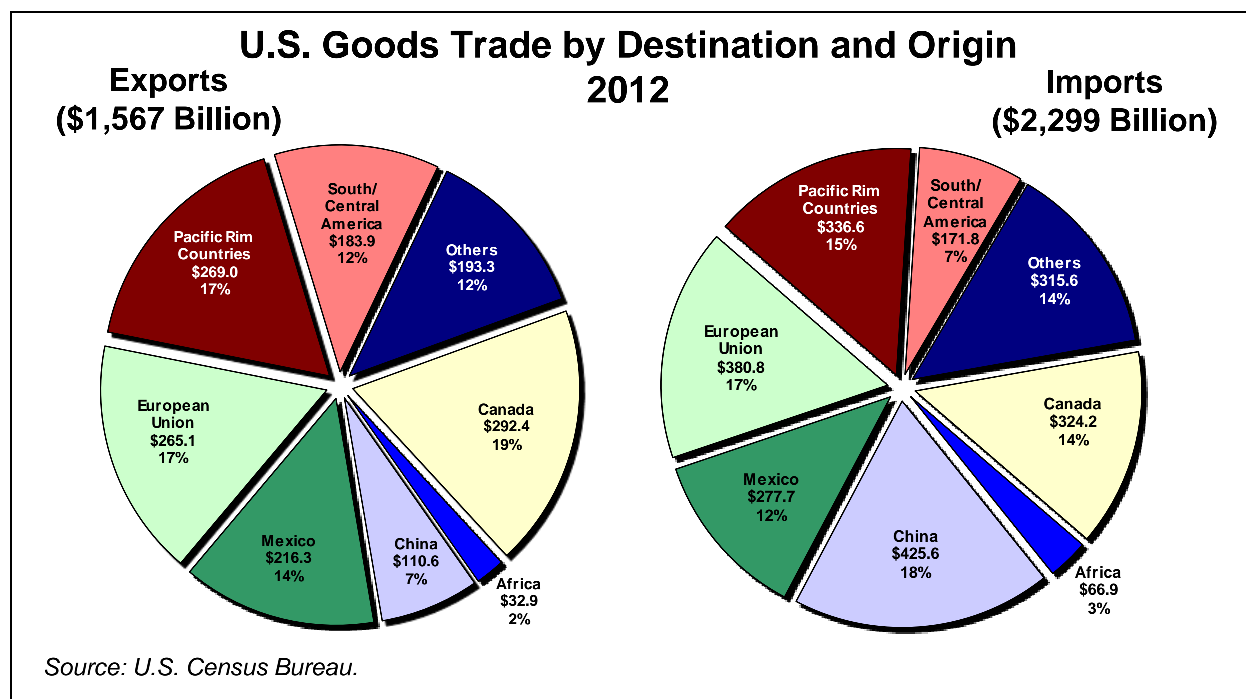


Figure 28

[16] One of the main countries that contributed resources to the bailout funds is Germany.

[17] All growth rates for other countries cited in this section are from Blue Chip International Consensus Forecasts, *Blue Chip Economic Indicators*, vol. 38, no. 2, February 10, 2013.

Developing economies have also been affected by the European debt crisis through trade. China, the largest U.S. trading partner in Asia and the largest developing economy, grew 9.3 percent in 2011 and is estimated to have grown 7.7 percent in 2012, the slowest growth in more than ten years due to lower exports and issues in the real estate market. It is forecast that China's economy will grow at 8.1 percent in 2013 and again in 2014. Many countries in South America also experienced slower growth in 2012. The Brazilian economy, the largest economy in South America, grew 2.7 percent in 2011 before slowing to 1.5 percent in 2012. Developing countries are expected to continue to lead global growth in 2013. However, the European debt crisis remains a risk to the global recovery. The debt crisis in Europe could continue to linger and have an impact on other countries as well as the global financial system through exports and banks' exposure to those countries debt.

Employment

The slow employment recovery remains a critical issue for the national economy. Of the 8.7 million jobs that were lost during the recession, only 5.5 million have been regained (see Figure 29). This makes the current recovery different from past recoveries because employment has been far slower to return. It must also be noted that the job loss during the recent recession was considerably more than the jobs lost in earlier recessions.

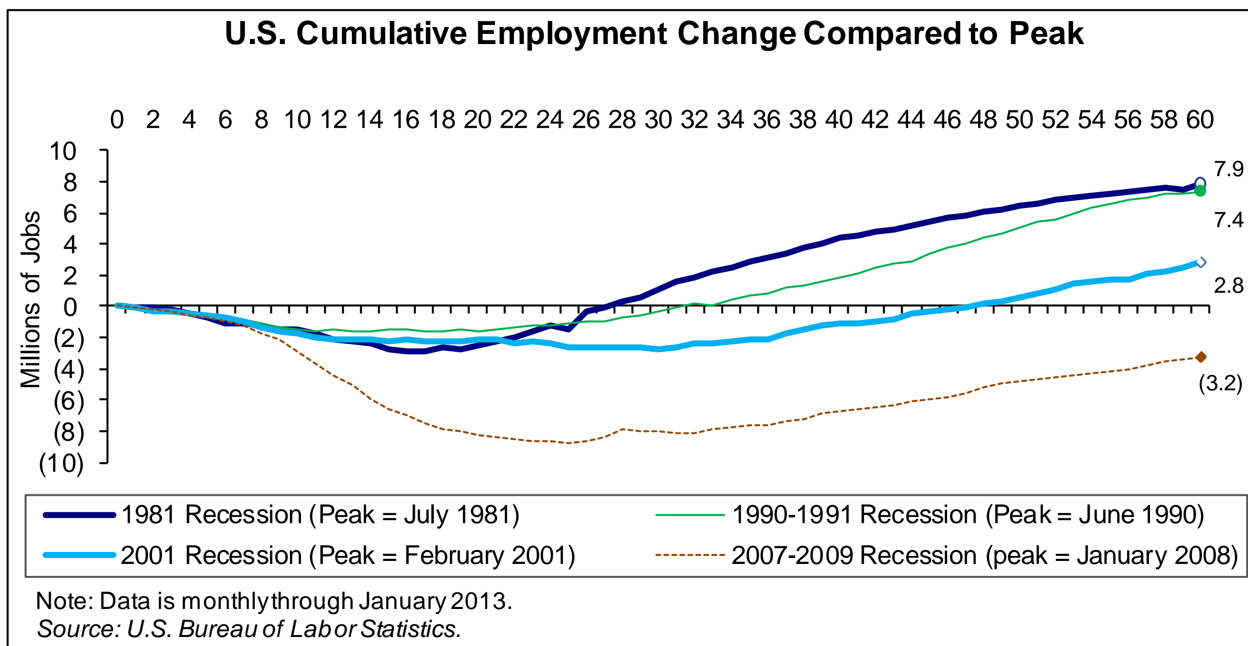


Figure 29

Total national payroll employment declined sharply by 4.4 percent in 2009, and then dropped by 0.7 percent in 2010. Employment grew 1.2 percent in 2011 (see Figure 30). In 2012, payroll employment continued to grow by 1.7 percent, still indicative of the slow pace of the economic recovery and the hesitancy businesses continued to display in hiring.

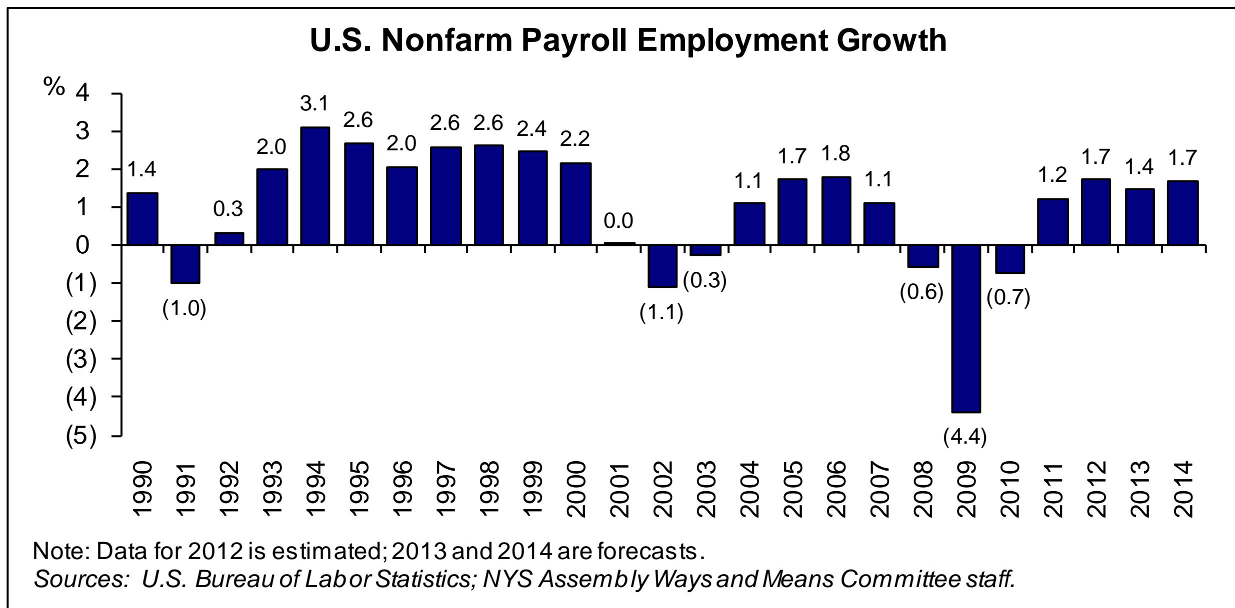


Figure 30

The education and health sector did not lose employment during the recession; however, almost all other major sectors did and few sectors have recovered enough employment to surpass their pre-recession level (see Table 2). The leisure and hospitality sector has recovered, as has natural resources and mining. The professional and business services sector has recently surpassed its pre-recession employment level, driven by gains in temporary help services. The strength of temporary help services may be at the expense of jobs in other sectors, indicating that employers continue to be uncertain enough about hiring permanent employees.

Although manufacturing employment has not surpassed its pre-recession peak, employment in the sector grew in 2011, the first annual growth since 1997. Strength in transportation equipment manufacturing has helped to contribute to a slight recovery in manufacturing jobs. In addition, several other factors have contributed to the increase in manufacturing jobs. As the economy has changed over time, especially in response to the recent recession, reasons that had previously made the U.S. unattractive as a place to cite a manufacturing plant have become less of an obstacle. Some companies have started to move manufacturing jobs out of China, in response to rising labor costs in that country. Freight

costs, the availability of a skilled workforce, and currency values also must be taken into consideration. Manufacturing employment is expected to continue to improve throughout the forecasting period; however, as employers continue to increase efficiencies and productivity increases, the job gains are expected to be modest.[18]

Table 2

U.S. Employment by Sector (Percent Change)

	Actual 2010	Actual 2011	Estimate 2012	Forecast 2013	Forecast 2014
Total	**(0.7)**	**1.2**	**1.7**	**1.4**	**1.7**
Construction	(8.3)	0.3	2.0	3.1	5.7
Manufacturing[1]	(2.5)	2.3	2.0	1.0	1.5
Retail Trade	(0.5)	1.6	1.4	1.4	0.8
Transp. & Utilities[2]	(1.1)	2.3	2.4	2.2	1.9
Wholesale Trade	(2.4)	1.7	2.4	1.7	1.8
Information	(3.4)	(1.2)	0.2	(0.1)	(0.8)
Finance & Insurance	(1.4)	0.1	1.1	0.8	0.6
Real Estate, Rental, & Leasing	(3.0)	(0.4)	1.2	1.5	3.0
Professional Services	(0.9)	3.0	2.9	2.8	3.2
Mgmt. of Companies	0.3	3.3	3.9	1.6	2.6
Education and Health[3]	1.8	1.8	2.2	2.0	2.0
Leisure & Hospitality	(0.2)	2.4	3.0	2.2	2.3
Other Services[4]	1.4	2.7	2.9	2.0	2.1
Government	(0.3)	(1.8)	(0.8)	(0.4)	0.1
Federal	5.2	(3.9)	(1.5)	(1.6)	(1.1)
State and Local	(1.1)	(1.4)	(0.7)	(0.3)	0.2

[1] Including Mining and Logging.
[2] Transportation, Warehousing, and Utilities.
[3] Includes private employment. Public education and health employment is included in the government sector.
[4] Including Administrative, Support, and Waste Management Services.

Sources: U.S. Bureau of Labor Statistics, Current Employment Statistics (CES); NYS Assembly Ways and Means Committee staff.

Due to ongoing cuts in defense and nondefense spending, the decline in government sector employment is expected to persist until 2014. Also, it is not likely state and local

[18] See The Economist, "Coming Home (A growing number of American companies are moving their manufacturing back to the United States.)," *Economist*, January 19, 2013, http://www.economist.com/news/special-report/21569570-growing-number-american-companies-are-moving-their-manufacturing-back-united; The Economist, "Welcome home (The outsourcing of jobs to faraway places is on the wane. But this will not solve the West's employment woes.)," *Economist*, January 19, 2013, http://www.economist.com/news/leaders/21569739-outsourcing-jobs-faraway-places-wane-will-not-solve-wests; and James R. Hagerty, "U.S. Factories Buck Decline, (Sector Creating More Jobs Than It's Cutting; 'Shining Star')," *Wall Street Journal*, January 19, 2011, http://online.wsj.com/article/SB10001424052748704029704576088412618821224.html.

governments will see budgetary pressures ease sufficiently to increase employment after significantly reducing their workforce during and after the recession until at least 2014.

In addition to slow growth in employment, the composition of the growth among industries since the recession is also of concern. Job gains since the most recent employment trough have been concentrated more in low-wage industries (see Table 3). The administrative and waste services sector gained 666,897 jobs, accounting for 17.7 percent of all the jobs gained between the first quarter of 2010 and the first quarter of 2012. The accommodation and food services sector gained 615,722 jobs (16.4 percent of all jobs gained). These sectors accounted for over thirty percent of the total jobs created and can be considered low wage jobs, based on the fact that their average weekly pay is significantly lower than the overall average. This has implications for the personal income outlook.

Table 3

Sector Share of Employment Change and Average Weekly Wage

	Share of Total Employment Change 2010:Q1 to 2012:Q1 (%)	Average Weekly Wage 2011 ($)
Total Nonfarm	**100.0**	**924.0**
Administrative and Waste Services	17.7	651.0
Accommodation and Food Services	16.4	337.0
Health Care and Social Assistance	15.9	856.0
Manufacturing	11.2	1,139.0
Professional and Technical Services	10.6	1,535.0
Retail Trade	10.2	521.0
Natural Resources and Mining	5.9	1,033.0
Transportation and Warehousing	5.9	872.0
Wholesale Trade	4.8	1,272.0
Educational Services	4.6	840.0
Management of Companies and Enterprises	3.7	1,982.0
Other services except public administration	3.1	575.0
Construction	2.2	975.0
Arts, Entertainment, and Recreation	1.9	634.0
Finance and Insurance	0.9	1,698.0
Real Estate and Rental and Leasing	0.1	882.0
Information	(1.2)	1,506.0
Total Government	(14.4)	946.0

Note: Data is not seasonally adjusted.
Source: U.S. Bureau of Labor Statistics, QCEW.

The sluggish recovery in the labor market has contributed to the high rate of unemployment that persists (see Figure 31). The unemployment rate remains high compared to before the recession and the lack of available jobs that match the skills possessed by available workers has created frustration among those looking for work. Monthly flows in and out of the labor force are also affecting the unemployment rate. Discouraged workers leave the labor force, while others who see prospects improving re-enter.

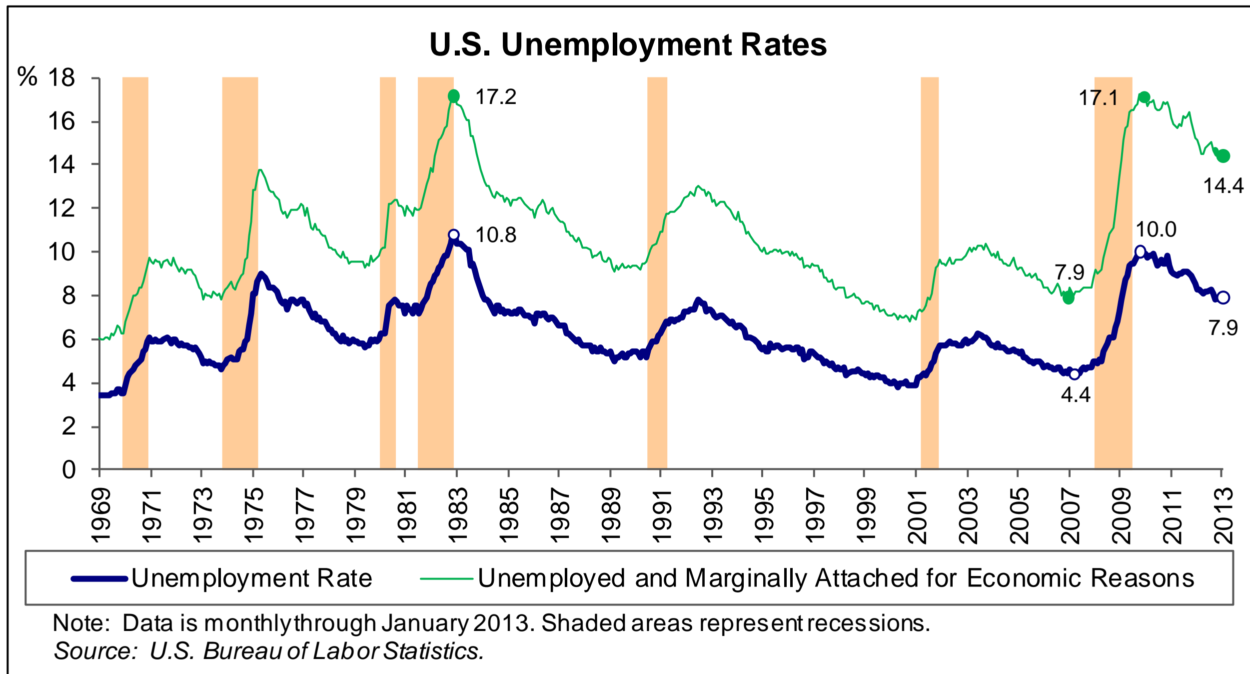


Figure 31

As of January 2013, 38.1 percent of the unemployed had been out of work for 27 weeks or longer and the average duration of unemployment was 35.3 weeks. Before the recent recession, the highest this figure had ever been since 1948 was 21.2 weeks, a level reached after the 1981 recession. In addition, the median number of weeks unemployed remains elevated (see Figure 32). Coupled with the longer duration of unemployment is that many unemployed people have exhausted their unemployment benefits, leaving them with limited income options.

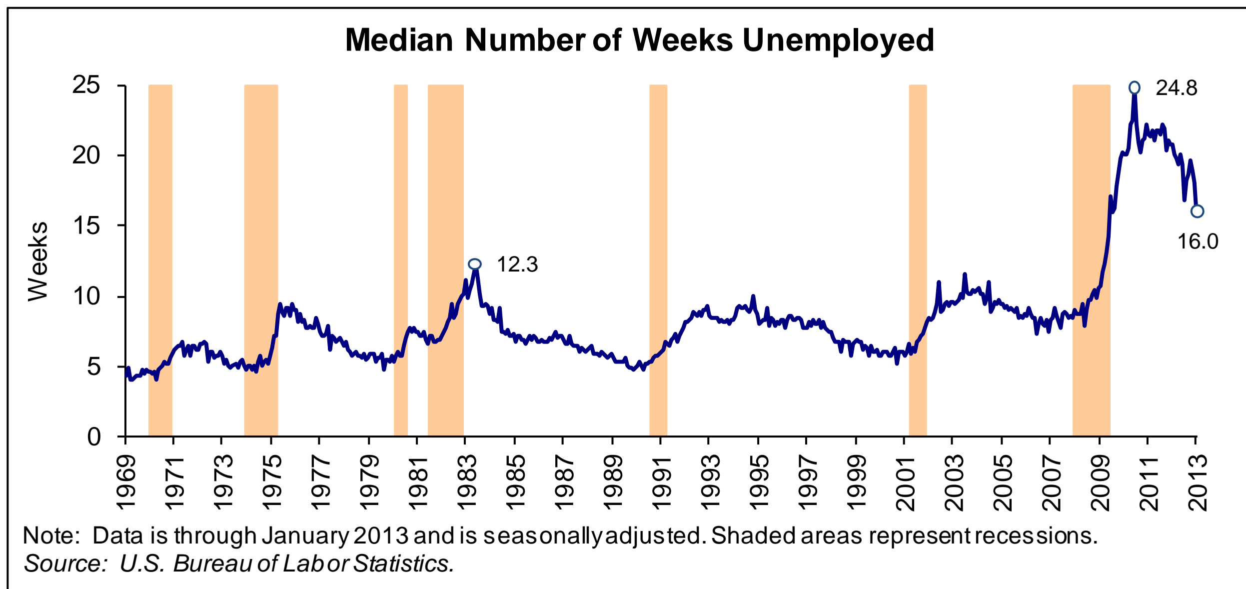


Figure 32

Various demographic groups have been impacted differently by the employment challenges presented by the recent recession. For example, younger people may find it hard to secure a job without having experience. Older workers may choose to stay in the workforce longer in order to try to rebuild retirement savings and wealth lost during the recession. The differences between demographic groups may be reflected in the unemployment and participation rates of various groups. For example, the unemployment rate for 16- to 24-year-olds is currently 16.3 percent, more than double the overall rate. In addition, young people are also leaving the labor force. The labor force participation rate for 16- to 24-year-olds was 55.3 percent in December 2012. This is down from 59.2 percent before the recession in December 2007, and down 10.6 percentage points from December 2000 (see Table 4). Prior to the recent recession, the participation rate for that age group had not fallen below 60 percent since 1971.[19]

[19] Data is from the U.S. Bureau of Labor Statistics.

Table 4

Labor Force Participation Rates					
	December 2000	December 2007	December 2010	December 2011	December 2012
Total	67.0	66.0	64.3	64.0	63.6
By Age					
16-24 years	65.9	59.2	54.7	55.2	55.3
25-34 years	84.5	83.1	81.7	81.5	81.9
35-44 years	84.8	83.9	82.8	82.6	82.5
45-54 years	82.3	82.2	81.0	80.6	79.7
55-64 years	59.3	64.1	64.5	64.2	65.4
65 years & older	12.9	16.2	17.5	18.2	18.5
By Gender					
Male	74.7	73.1	70.7	70.5	70.0
Female	59.9	59.4	58.3	57.8	57.7

Note: Data is seasonally adjusted.
Source: U.S. Bureau of Labor Statistics.

While labor force participation rates for workers younger than 55 years old fell during and after the recent recession, older workers have responded to their economic situation by reentering the workforce or delaying retirement plans. The labor force participation rate of those persons 65 years and older rose from 16.2 percent in December 2007 to 18.5 percent in December 2012. Along with the rise in participation, the unemployment rate for workers over 55 years old spiked to over 7 percent after the recent recession, and currently remains at 5.9 percent. Although this is a lower rate than that of other age groups, it is well above historical levels.

Personal Income

Personal income grew by 5.1 percent in 2011 after increasing 3.8 percent in 2010 due to modest growth in wages and salaries. However, growth is still below pre-crisis rates (see Figure 33). Part of the gain in personal income was due to the reduction in payroll tax where the employees' share of the Social Security tax went from 6.2 percent to 4.2 percent in 2011.[20] Proprietors' and dividend incomes contributed to growth, though at a slower rate than in 2010. Strong growth in rental income also boosted personal income. However, a drastic slowdown in transfer payment growth curtailed personal income growth as federal

[20] See, *The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010* (2010 Tax Relief Act); Public Law 111-312, 111th Congress, December 17, 2010.

extensions of unemployment insurance benefits expired for many unemployed workers. In addition, programs under the American Recovery and Reinvestment Act of 2009 (ARRA) such as Consolidated Omnibus Budget Reconciliation Act (COBRA) premium reduction benefits and tax credits wound down. Personal income would have increased 5.9 percent excluding transfer income in 2011.

In 2012, personal income grew only an estimated 3.5 percent. The slowdown in personal income growth was due to all components of personal income except for transfer income experiencing decelerated growth. Growth in transfer payments stemmed from increases in Medicare, Medicaid, Social Security, and veteran's benefits mitigating the decline in unemployment insurance and other fiscal stimulus benefits.

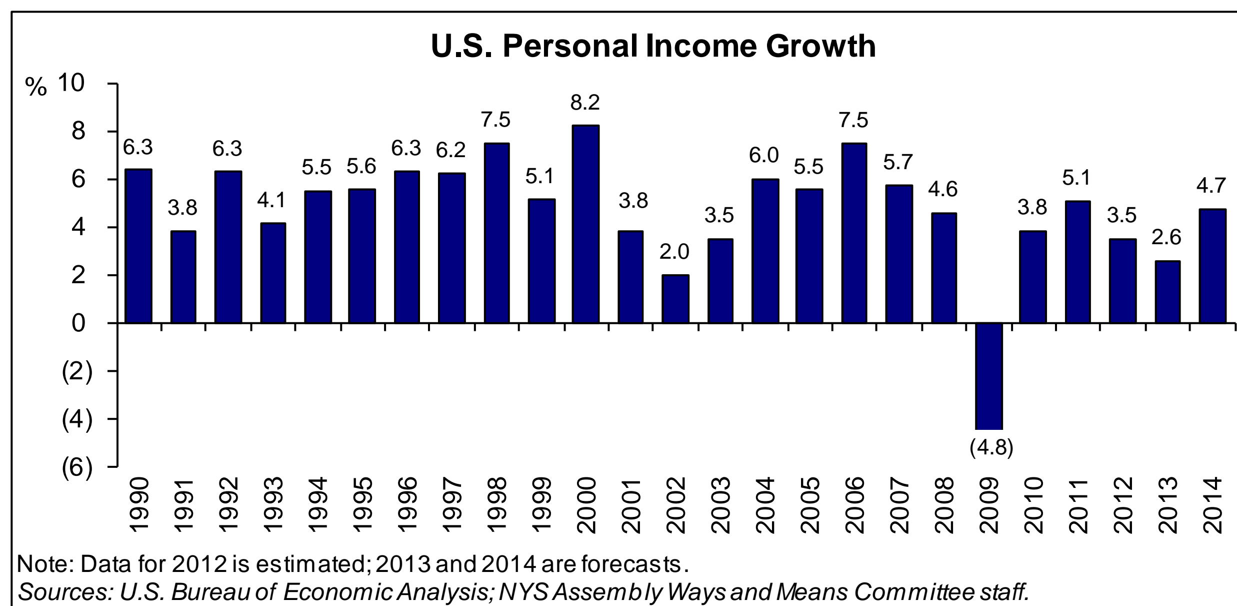


Figure 33

Personal income growth is forecast to slow to 2.6 percent in 2013 due in large part to the expiration of Social Security payroll tax cuts on January 1, 2013. This will cause employees' contribution to government social benefits programs to increase by approximately $127 billion, slowing personal income growth. In 2014, personal income is projected to grow by 4.7 percent as a more resilient economy encourages stronger employment and wage growth.

Wages and salaries, the largest component of personal income, grew an estimated 3.2 percent in 2012 after an increase of 4.0 percent in 2011 (see Figure 34). The weakness in

wage growth stems partly from low paying jobs being a major influence in the employment recovery and high paying jobs growing modestly. Of the jobs gained since nonfarm employment reached its trough in the first quarter of 2010, more than 60 percent were in lower paying jobs compared to higher paying jobs. The administrative and waste services sector and the accommodation and food services sector accounted for approximately 34 percent of the jobs gained, while the manufacturing sector and the professional and technical services sector comprised almost 22 percent (see Table 3 on page 35).[21]

The weak job recovery continues to stymie the acceleration in wages. As the slack in the labor market persists into 2013, wage and salary growth will continue below pre-recession rates. Wage and salary growth is forecast to increase to 3.5 percent in 2013. With an unusually large pool of unemployed workers from which to choose, employers have little pressure to increase wages. By 2014, a stronger economic outlook and better job market are forecast to push wages and salaries up by 4.8 percent.

Figure 34

As unemployment insurance benefits were exhausted and other government social benefits such as Medicare, Medicaid, and veteran's benefits decelerated in 2011, personal transfer income slowed to 1.5 percent from 6.7 percent in 2010. In 2012, transfer income

[21] Data is from the U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages. A low paying sector is defined as one that has an average weekly wage lower than the average weekly wage of total nonfarm.

grew an estimated 2.4 percent as the 3.6 percent cost of living adjustments to social security benefits were moderated by a falloff in other government social benefits. Personal transfer income growth is forecast to increase to 2.8 percent in 2013 as the exhaustion of extended federal unemployment insurance benefits by many unemployed workers is outweighed by accelerated spending on social security and government funded healthcare programs.[22] In 2014, transfer payments are forecast to increase 3.4 percent.

Dividend income grew a robust 16.3 percent in 2011 as profits rose from more business activities and firms restricted wage growth. Dividend income was bolstered in 2012 as many corporations doled out dividends in the fourth quarter of 2012 in anticipation of higher taxes on dividend income at the beginning of 2013. However, new regulations in the financial industry, U.S. banks' exposure to European countries' debt, other global uncertainties, a slowdown in productivity at nonfinancial companies, and weak economic growth will weigh on corporate profits tempering dividend income. Consequently, dividend income growth is estimated to slow to 11.9 percent in 2012 and forecast to be 2.5 percent in 2013. The slowdown in dividend income growth is also attributable to the shift in dividend payout from 2013 to 2012. In 2014, dividend income growth is forecast to grow only 5.3 percent as labor costs increase and profits slow.

Interest income fell 0.8 percent in 2011 after declining 7.0 percent a year earlier, and is estimated to have declined another 1.9 percent in 2012. The falloff in 2012 was the fourth consecutive yearly decline in interest income. Low interest rates are primarily responsible for the decrease in interest income. "Operation Twist," implemented by the Federal Reserve in 2011, helped suppress long-term interest rates and consequently interest income was affected. Interest income is projected to fall 1.6 percent in 2013.[23] With long-term interest rates expected to edge higher, interest income is forecast to increase 4.9 percent in 2014.

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[22] As of February 16, 2013, 5.6 million people were receiving unemployment benefits. This is 3.6 million less people than in February 2011. This number continues to fall as people exhaust their regular, state, extended, and emergency benefits. See U.S. Department of Labor, Office of Public Affairs, *News Release*, February 21, 2013, http://workforce security.doleta.gov/press/2013/022113.asp (accessed on February 23, 2013). To the extent that the falloff represents exhaustions and not people moving from unemployment benefits to a job, the downward trend is troublesome for personal income.

[23] The idea behind "Operation Twist" was that the Federal Reserve buys long-term bonds and sells short-term (up to three-year) Treasuries, driving down long-term interest rates; in this case, the Fed sold $400 billion in short-term Treasuries and bought an equal amount in long-term Treasuries, beginning in October 2011 and ending in June 2012. The short-term Treasury securities will have maturities of three years or less, while the long-term Treasury securities have maturities of six years or more. Investors holding long-term bonds will see their interest income dip. See Board of Governors of the Federal Reserve System, *Press Release*, September 21, 2011, http://www.federalreserve.gov/ newsevents/press/monetary/20110921a.htm.

Prices

Price increases have been relatively muted since the end of the recent recession. After falling in 2009 for the first time since 1955, prices grew 1.6 percent in 2010, and then grew 3.1 percent in 2011, driven by high energy prices. The increases in prices since then have been small, and continue to be mostly driven by energy prices, particularly gasoline prices.

Overall consumer prices increased 2.1 percent in 2012 (see Table 5). The lower inflation was mainly due to the fact that energy prices did not grow as fast in 2012 as in 2011. Energy prices have been a volatile component of the Consumer Price Index (CPI) and often are the major contributor to price increases. It is unclear if the trend will be sustained. Energy and food prices represent two areas of risk to the inflation outlook, and increases in either would have adverse effects on already struggling consumers.

Table 5

U.S. Consumer Price Index (CPI) by Category (Percent Change)

	2007	2008	2009	2010	2011	2012
All Items	**2.9**	**3.8**	**(0.3)**	**1.6**	**3.1**	**2.1**
Services	3.3	3.5	1.4	0.8	1.7	2.1
Food & Beverages	3.9	5.4	1.9	0.8	3.6	2.5
Energy	5.7	13.7	(18.1)	9.5	15.2	0.9
Housing	3.2	3.2	0.4	(0.4)	1.3	1.7
Apparel	(0.4)	(0.1)	1.0	(0.5)	2.2	3.4
Transportation	2.2	5.7	(8.1)	7.9	9.7	2.4
Medical Care	4.4	3.7	3.2	3.4	3.0	3.7
Recreation	0.5	1.6	0.9	(0.8)	0.0	1.2
Education and Communication	2.4	3.4	3.0	2.0	1.2	1.8
Other Goods and Services	3.6	3.6	6.7	3.4	1.6	1.9
All Items Less Food & Energy (Core)	2.3	2.3	1.7	1.0	1.7	2.1

Source: U.S. Bureau of Labor Statistics.

In 2013 and 2014 consumer prices are expected to grow, but at the tame pace of 1.8 percent and 2.0 percent respectively, as slow economic growth keeps pricing pressure in check (see Figure 35). In addition, relatively slow productivity growth and slow growth in unit labor costs will help keep price increases modest.

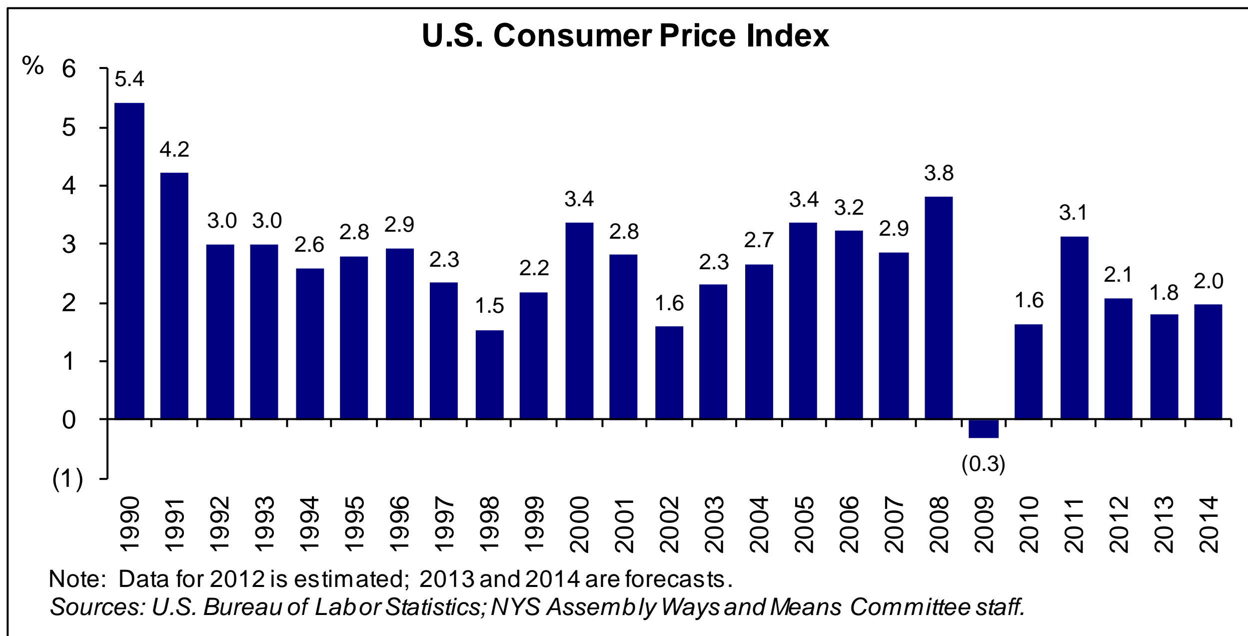

Figure 35

Energy Prices

Current economic conditions, not just in the United States, but also abroad, have kept oil demand in check, helping to ease upward pressure on prices that might result from faster growth in demand. However, even with the weak economy, energy prices have been volatile, sometimes increasing more than economic supply and demand fundamentals seem to support. Volatile energy prices have the potential to damage the economy, and add to the uncertainty that businesses and consumers feel. High energy prices fosters hesitancy in purchasing other goods, as a larger part of disposable income is taken up by energy-related costs, especially for many low and middle income households.

After a sharp increase in 2008, oil prices dropped sharply to levels more in line with the 2007 levels seen before the recent recession. Since reaching their most recent low in February 2009, oil prices have climbed steadily as the world economy started to recover. Prices reached over $110 per barrel (nominal) in early 2011.[24] Prices have since dropped, but

[24] This refers to monthly data on the U.S. Refiner Acquisition Cost of Oil (RAC), a volume weighted average price of imported oils. For the purposes of this report and the forecast contained within, the RAC is utilized due to the fact that it is generally thought to be less volatile than other spot prices. News stories referring to volatile spikes in crude oil prices on a daily or intra-day basis of several dollars or more are usually referring to WTI daily spot prices or futures prices of other various oil price measures.

remain close to $100 per barrel (see Figure 36). The continually elevated level of oil prices creates concerns that would detract from an already fragile economic recovery.

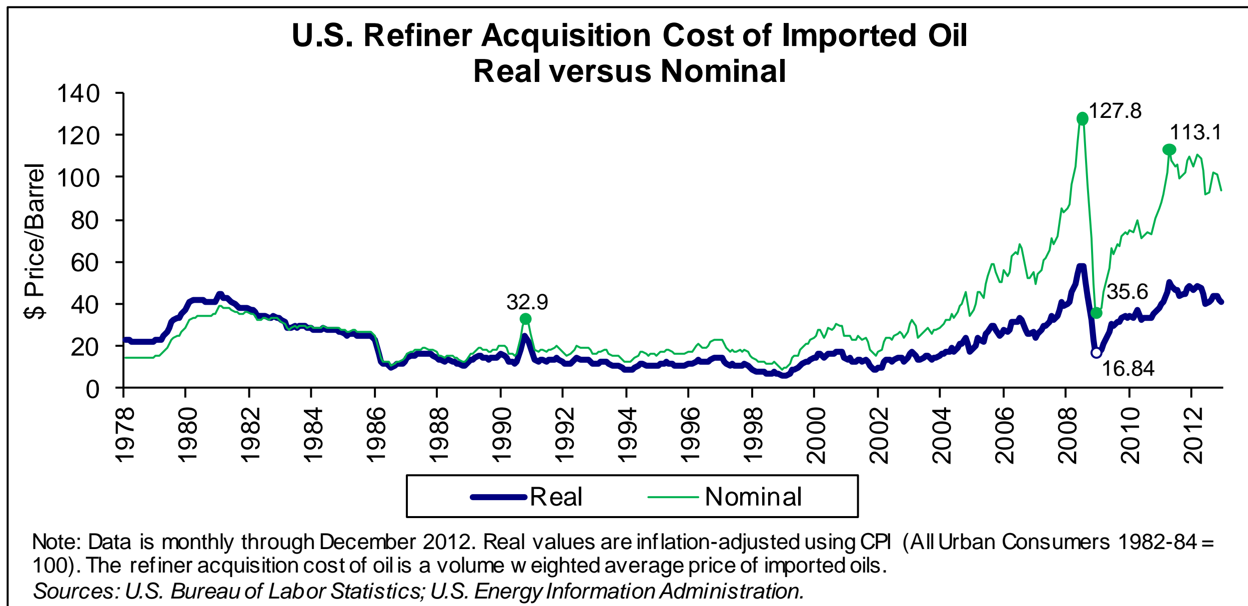

Figure 36

Although overall inflation has been relatively tame, consumers have been adversely affected during the recovery by the rise of prices in goods that they buy on a regular basis, especially since the rise in prices is coupled with stagnant wages. The rise in food and energy prices, particularly the rise in gasoline prices, presents an immediate challenge for consumers. Gasoline prices are currently averaging $3.69 nationally, almost $2 above mid-2008 prices, but below the high of $4.05 in July 2008 (see Figure 37).[25]

[25] According to the U.S. Energy Information Administration (EIA), $3.69 was the national average for regular gasoline for the week of February 18, 2013.

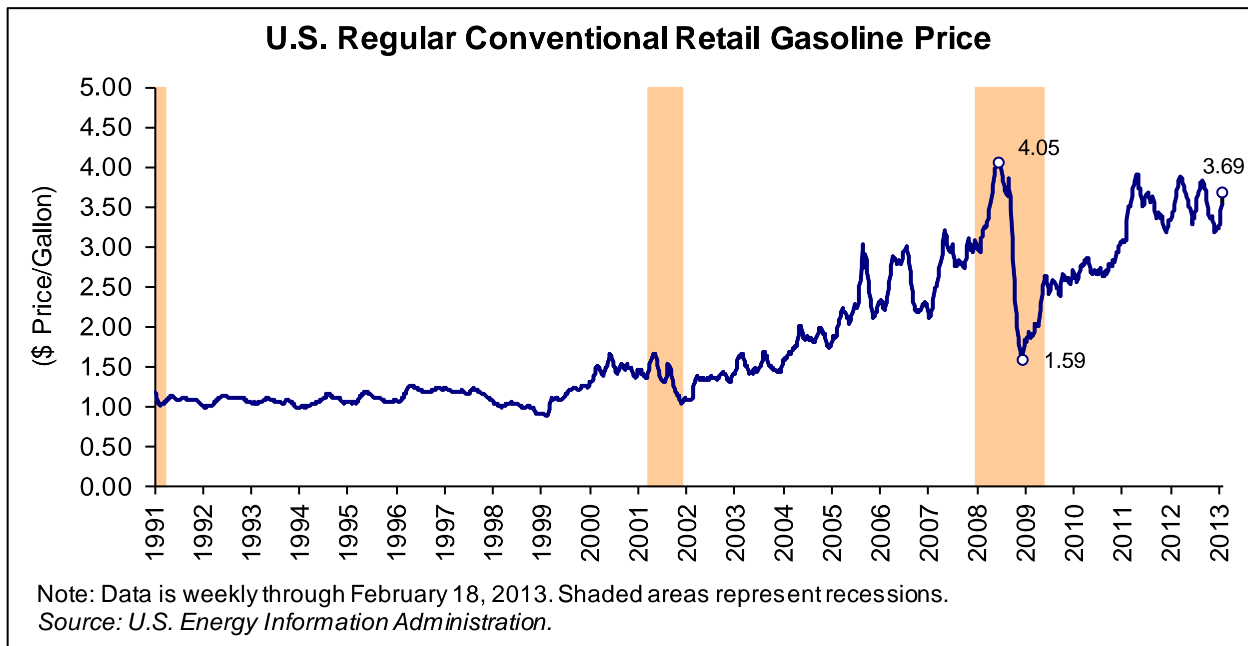

Figure 37

Corporate Profits

Corporate profits rose 7.3 percent to $1.8 trillion in 2011 after gaining 26.8 percent in 2010. Profits at both financial and nonfinancial firms were negatively affected by weak economic growth and heightened global uncertainty in 2011. These factors combined with new financial regulations, which forced changes in business models and activities, turned profits at financial firms negative. Profits at non-financial firms and at U.S. firms abroad slowed from the 2010 growth rate, but remained positive in 2011 due to continued productivity growth and strong demand in emerging economies. Corporate profits growth is estimated to have decelerated to 5.1 percent in 2012 as revenues at financial firms weakened, the global economy slowed, and labor costs rose. Corporate profits growth will decelerate in 2013 and 2014, growing just 4.6 percent and 3.4 percent, respectively.

Though the rate of growth has slowed, U.S. corporations remain highly profitable, with total profits approximately 20 percent above the 2006 pre-recession peak (see Figure 38). Labor costs remain fairly low, supporting continued gains at nonfinancial firms. In 2013, final domestic sales will likely be pulled downward due to the expiration of the payroll tax cuts on December 31, 2012, and the addition of any fiscal austerity. Wages are expected to remain depressed, but labor costs will rise in the forecast period as businesses are forced to increase payroll through new hires in order to improve output. As such, profit growth at nonfinancial firms is forecast to slow to 3.5 percent in 2013, after growing an estimated

23.4 percent in 2012. As labor costs rise, profit growth at these corporations will remain weak at just 2.8 percent in 2014.

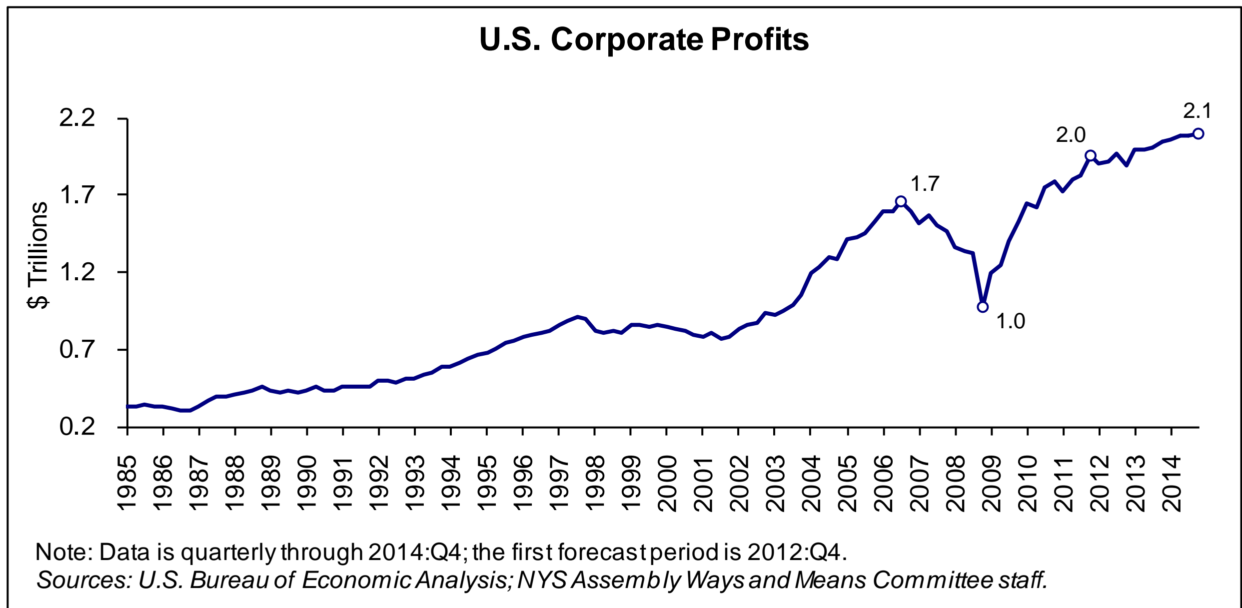

Figure 38

Profits at financial firms struggled in the first half of 2012 as high volatility in the global markets made it difficult for banks to generate revenues from slowed stock and bond trading. As was also seen in 2011, financial corporations continue to struggle with new regulatory constraints on fees, and companies remain reluctant to issue debt. Despite weakness in certain components, profits at financial firms remained resilient in 2012, growing an estimated 12.1 percent as mortgage loans improved along with trading in the second half of the year. In the forecast period, regulatory constraints and uncertainty over eurozone debt issues are expected to continue to weigh on revenues, creating lackluster growth in profits at financial firms (see Figure 39).

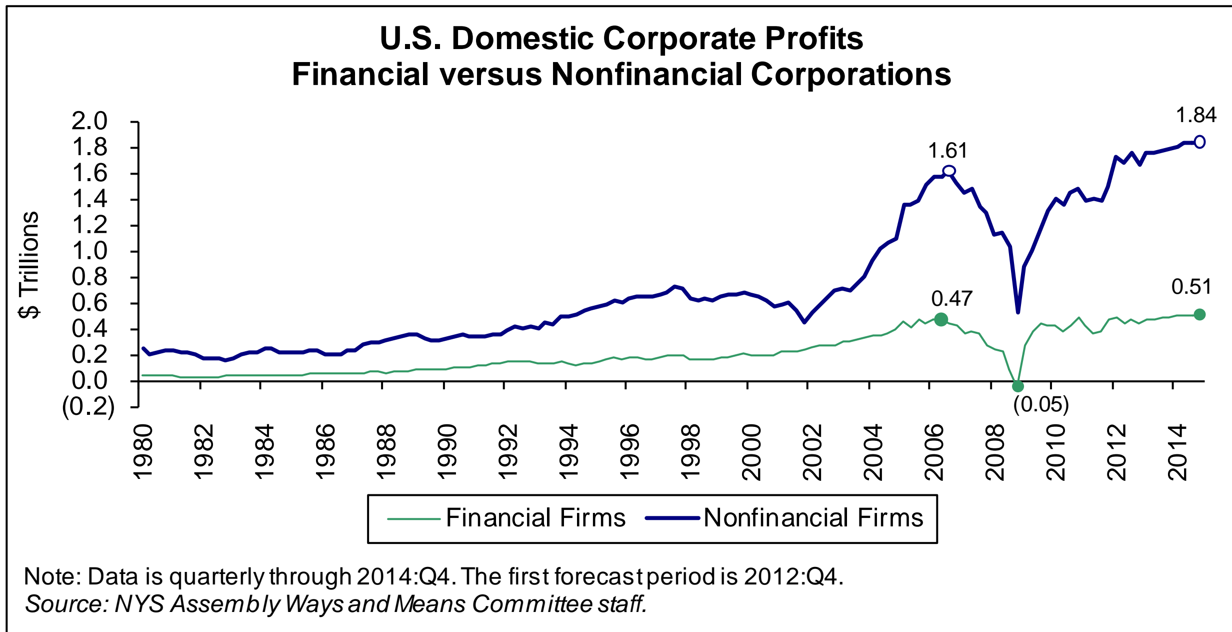

Figure 39

Over the past three years, the share of corporate profits in national income has risen significantly, as corporate profits have strengthened and wage pressures have remained weak. This share rose to 14.4 percent in the fourth quarter of 2011, after dropping to 7.9 percent during the recent recession. The share of corporate profits in national income is forecast to remain elevated throughout the forecast period (see Figure 40).

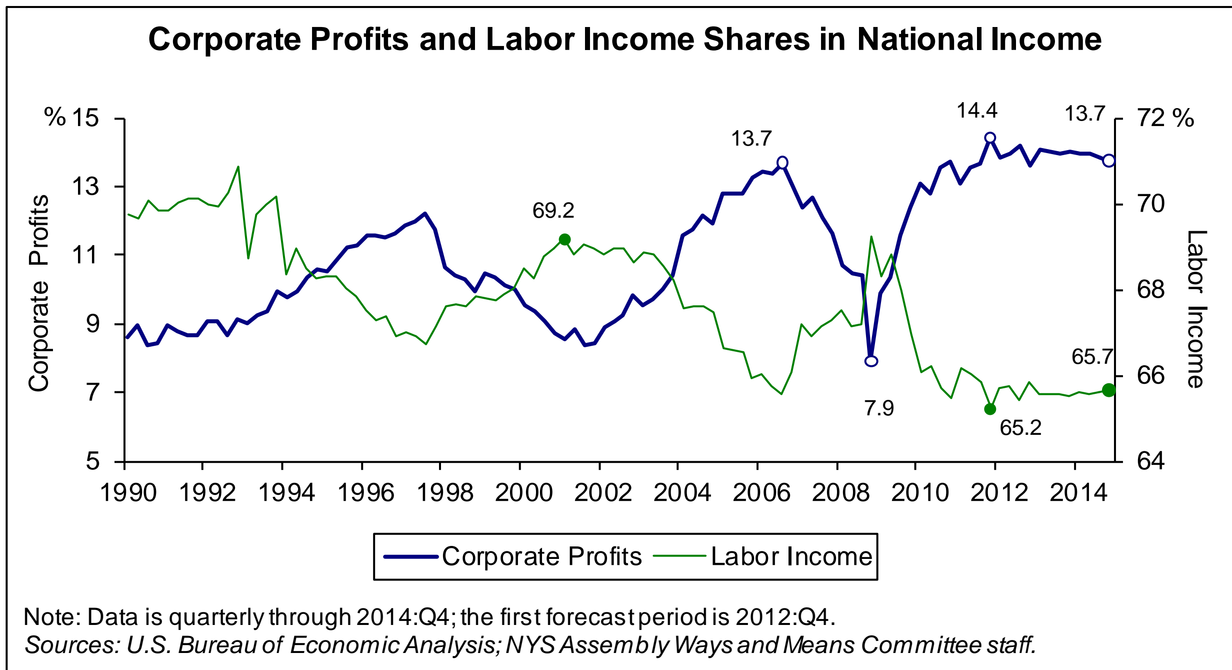

Figure 40

Stock Market

The stock market plunged to its recent trough as the U.S. economy went deeper into recession in 2009. Both the Standard & Poor's 500 Composite Stock Price Index (S&P 500) and the Dow Jones Industrial Average (DJIA) dropped by more than 50 percent from their peaks in October 2007 to their trough in March 2009. The market then grew rapidly and by the end of 2009 the S&P 500 had gained almost 50 percent. Since then, the stock market has gone through several corrections and has been growing at a slower pace.

Despite the setbacks as a result of global events that raised uncertainty (such as the European debt crisis, unrest in the Middle East and North Africa, and a natural disaster in Japan), the market continued to gain steadily in 2011 and 2012. While most other sectors remain depressed, stock market indices have almost reached their previous peaks (see Figure 41).

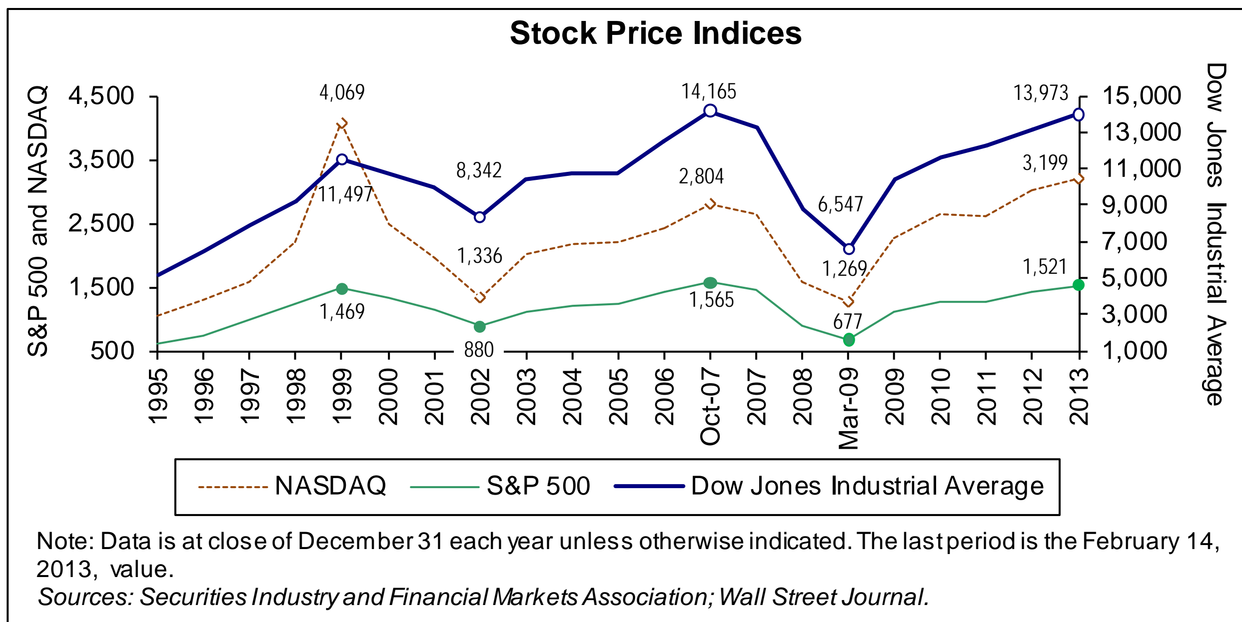

Figure 41

On a quarterly average basis, the S&P 500 reached a peak of 1,496.4 in the second quarter of 2007. As the U.S. went into recession, the S&P 500 dropped 45.9 percent from the second quarter of 2007 to 809.3 in the first quarter of 2009. The market then quickly gained almost 40 percent from the first quarter of 2009 to the first quarter of 2010, and has continued to improve through the recent quarter (see Figure 42).

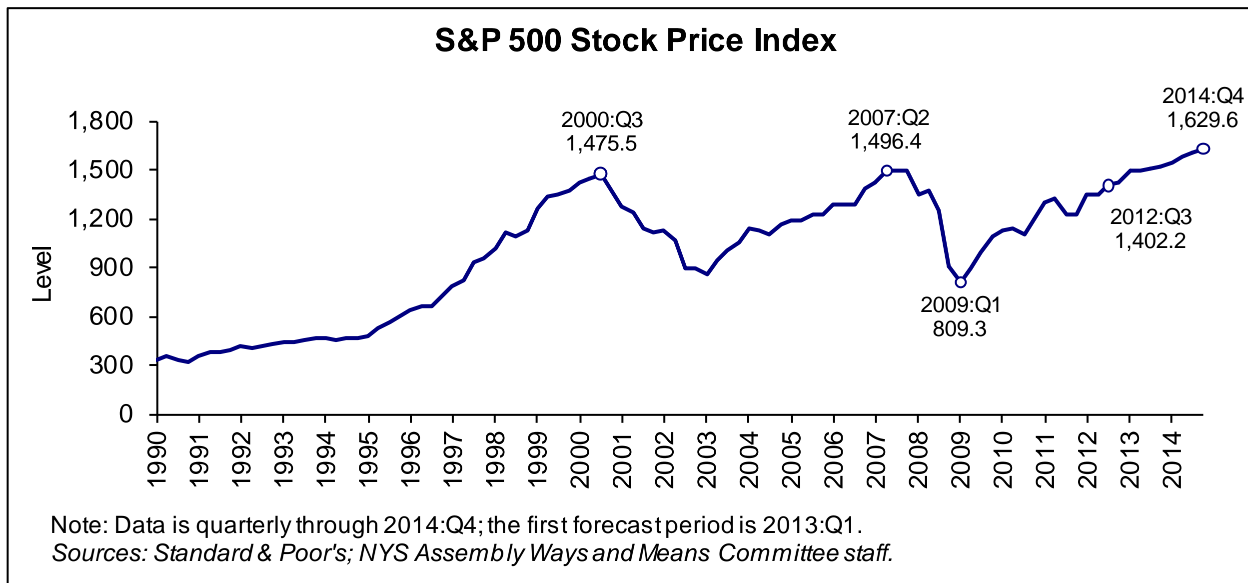

Figure 42

While stock prices have gained moderately during the recovery, corporate profits have gained strongly and have already surpassed their pre-recession level. As a result, S&P 500 price to earnings ratio (P/E ratio) has come down to below what it was during the majority of the time between 1991 and 2010, signaling that equity is a good investment. However, the market is facing several headwinds and high uncertainty remains in the market due to the European debt crisis, which continues to linger; slow U.S. and global growth; and uncertainty related to U.S. fiscal policy. Thus, despite high corporate profits and an attractive P/E ratio, the stock market outlook remains modest as investors will likely continue to be cautious and adjust their portfolio accordingly.

The stock market is expected to continue to improve throughout the forecast period. The S&P 500 averaged 1,379.6 points in 2012, a growth of 8.7 percent from 2011. The index is forecast to grow further by 9.0 percent in 2013 and another 5.7 percent in 2014.

Interest Rates

The Federal Reserve has held the federal funds rate at 0.0 to 0.25 percent since December 16, 2008, the lowest level on record. As a result, the federal funds rate, which averaged 0.2 percent in 2010, averaged 0.1 percent in 2011 and 2012.

Given the slow U.S. economic recovery, stagnant labor market, low inflationary outlook, and other risks concentrated on the downside, the Federal Reserve announced that

they would link future rate changes to the threshold levels of unemployment and inflation.[26] The Fed anticipates that this threshold will lead to a low level federal fund rate through mid-2015. Thus, the current forecast assumes that the Fed will maintain the rate within the current target range through early 2015 (see Figure 43). The federal funds rate is forecast to average 0.2 percent in 2013 and 2014. Similarly, the three-month Treasury bill yield is forecast to average 0.1 percent in 2013 and 2014.

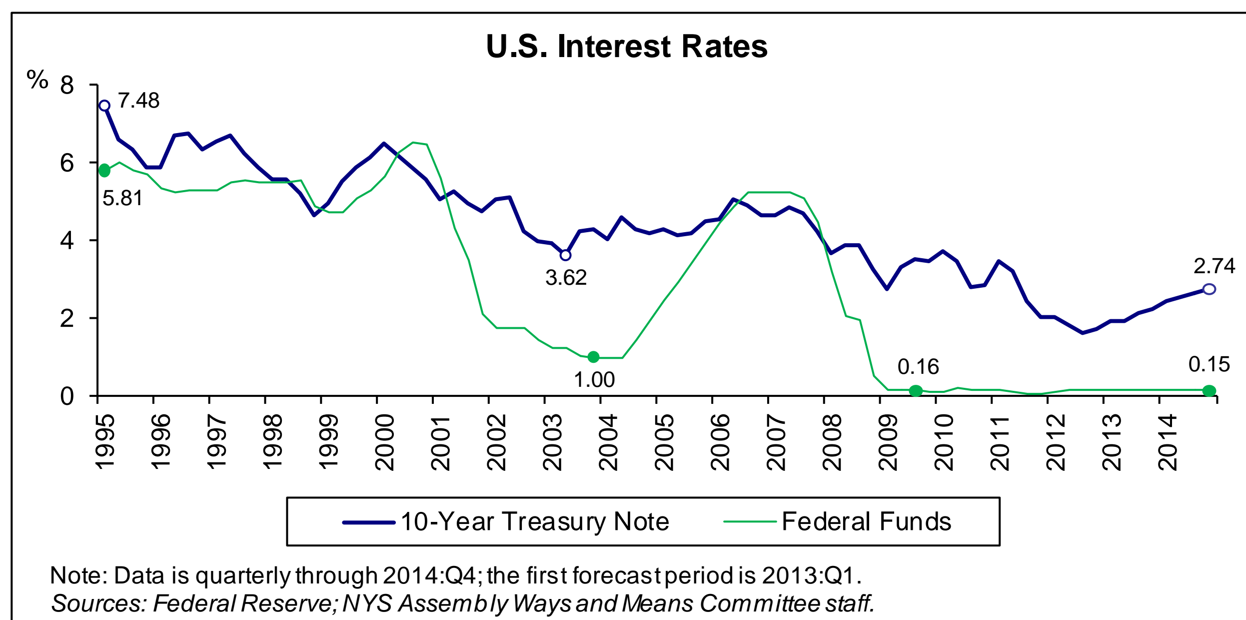

Figure 43

Other than the federal funds rate, the Fed has implemented various monetary policies during the recent recession and also during the recovery to help support economic activities.[27] Despite all their efforts, economic activities remained weak. As a result, on September 13, 2012, the Federal Reserve announced that it would take further action in order to support a stronger economic recovery, sustain low mortgage rates, and ensure that inflation will remain in the target range, by purchasing additional agency mortgage-backed securities at a pace of $40 billion per month (without a specific cutoff date) while maintaining other current policies (QE3).

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[26] The Federal Reserve will hold the rate unchanged until the unemployment rate falls to 6.5 percent or inflation is forecast to reach 2.5 percent. See Board of Governors of the Federal Reserve System and the Federal Open Market Committee, minutes of the Committee meeting held on December 11-12, 2012, release date January 3, 2013.

[27] Among those policies are the first quantitative easing (QE1), the second quantitative easing (QE2), and Operation Twist. Under QE1, the Federal Reserve increased liquidity in the market by purchasing toxic assets such as mortgage-backed securities; while under QE2, the Fed increased liquidity in the market by purchasing $600 billion in long-term Treasuries. With Operation Twist, the Federal Reserve keeps long-term rates low by selling Treasury securities with remaining maturities of three years or less and buying an equal amount of Treasury securities with remaining maturities of six to thirty years.

The global recession and the debt crisis in Europe that emerged in late 2009 through early 2010 caused investors to shift their investments to Treasury securities, which put downward pressure on bond yields. The purchase of U.S. Treasury bonds by foreign investors significantly increased from $325 billion in 2008 to over $700 billion in 2010. Although net purchases of U.S. Treasury bonds by foreign investors declined in 2011 and in the first half of 2012, they remain elevated. Additional domestic demand for long-term U.S. Treasuries under the QE2 and Operation Twist programs also put downward pressure on Treasury yields. As a result, the Treasury security yields have remained low in 2011 and 2012.

As the global economy is expected to recover at a stronger pace, investors are likely to shift their investment away from bonds to seek higher returns. Whereas extra demand for bonds, a result of quantitative easing policies, dissipates, bond yields are likely to rise throughout the forecast period. The 10-year Treasury rate averaged 1.8 percent in 2012, and is forecast to increase to 2.0 percent in 2013 and 2.6 percent in 2014.

United States Forecast Comparison

The NYS Assembly Ways and Means Committee staff's forecast for overall national economic growth in 2013 is 1.9 percent (see Table 6). The staff's forecast is 0.1 percentage point above the Division of the Budget. The staff's forecast is 0.2 percentage point below Moody's Economy.com, and 0.1 percentage point below Macroeconomic Advisers. The staff's forecast is equal to IHS Global Insight and the Blue Chip Consensus.

Table 6

U.S. Real GDP Forecast Comparison
(Percent Change)

	Actual 2011	Forecast 2012	Forecast 2013	Forecast 2014
Ways and Means	1.8	2.2	1.9	2.8
Division of the Budget	1.8	2.2	1.8	3.1
Blue Chip Consensus	1.8	2.2	1.9	2.8
Moody's Economy.com	1.8	2.2	2.1	4.0
Macroeconomic Advisers	1.8	2.2	2.0	3.1
IHS Global Insight	1.8	2.2	1.9	2.8

Sources: NYS Assembly Ways and Means Committee staff; NYS Division of Budget, FY 2014 Executive Budget Financial Plan, February 2013; Blue Chip Economic Indicators, February 2013; Moody's Economy.com, February 2013; Macroeconomic Advisers LLC, February 2013; IHS Global Insight, February 2013.

The Assembly Ways and Means Committee staff's forecast for overall national economic growth in 2014 is 2.8 percent. The staff's forecast is lower than the Division of the Budget by 0.3 percentage point, Moody's Economy.com by 1.2 percentage points, and Macroeconomic Advisers by 0.3 percentage point. The staff's forecast is equal to IHS Global Insight and the Blue Chip Consensus.

NEW YORK STATE FORECAST

The economy in New York State was dramatically affected by the recent recession and is still facing uncertainty as it recovers, especially in the financial sector. New York's economy did not decline as badly as some other states during the recent recession for reasons such as a milder downturn in the State's housing market. However, wages in the State were hit disproportionately due to the high concentration of higher paying jobs in the financial sector, which was severely impacted by the recession. Employment returned to pre-recession levels towards the end of 2012, total wages reached their previous peak in 2010 (see Figure 44). New York was one of only five states in the nation that had regained all of the private sector jobs lost during the recession as of September 2012.[28]

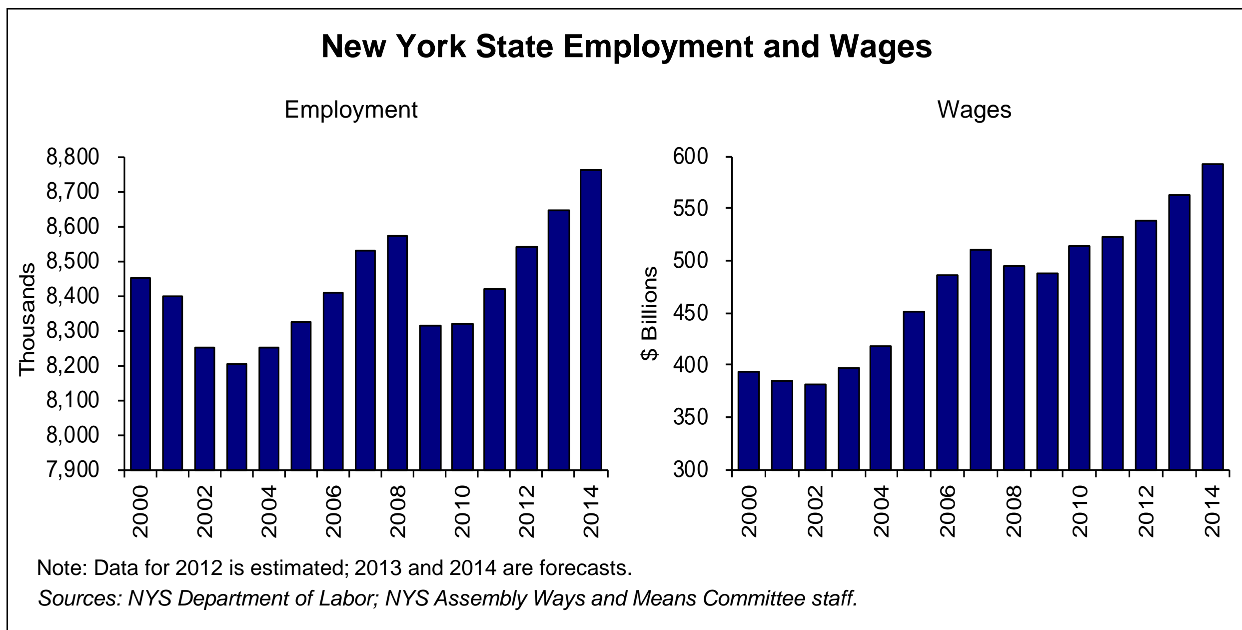

Figure 44

As with the nation's economy, the State's economic outlook is one of modest growth throughout the forecast period. Unlike early in the recovery, however, some components of the State economy will grow slower than the nation as states that were harder hit during the recession regain momentum and start to recover at a faster rate. Employment in the State is expected to grow at a moderate pace, returning to growth levels below the nation after outperforming the nation in the early stages of recovery. Both components of wages

[28] NYS Department of Labor, *Press Release*, "NYS Adds 2,900 Private Sector Jobs in September – Job Count Reaches an All-time High," October 18, 2012, (Albany, NY) http://www.labor.ny.gov/pressreleases/2012/october-18-2012.shtm.

(variable and base) are expected to grow. One of the more prominent differences between the State and national forecasts is the outlook for personal income and the performance of wages. Although the expiration of payroll tax cuts and the Bush-era tax cuts has consequences for personal income at both the State and national level, much of the wage outlook for the State remains dependent upon the performance of the financial sector.[29] Significant risks exist in terms of financial sector wage growth, but it also offers the prospect of faster wage growth in the State compared to the nation when Wall Street outperforms other sectors.

The NYS Assembly Ways and Means Committee staff estimates that in 2012 nonfarm payroll employment in the State increased 1.4 percent, wages grew by an estimated 2.2 percent, and personal income grew by an estimated 2.9 percent. In 2013 and 2014, employment will continue to recover, growing at an annual average rate of 1.2 percent and 1.3 percent, respectively (see Table 7). As discussed further in the Variable Compensation section on page 66, variable compensation is expected to grow throughout the forecast period, but growth will be moderated going forward by the uncertainty and lower profitability anticipated in the finance industry.[30]

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[29] Nationally, the finance and insurance sector accounted for 4.4 percent of employment and 8.3 percent of wages in 2012. In the State these percentages were 5.8 percent and 18.0 percent, respectively.

[30] Variable compensation figures are based on NYS Assembly Ways and Means Committee staff estimates. Variable compensation consists primarily of cash bonuses and exercised stock options. There is no known series of data for state or national variable compensation. The Committee staff estimates variable compensation based on seasonal variations in wage patterns. These seasonal patterns are analyzed at the NAICS three-digit level. The growth in this variation over time is also accounted for in the estimate. Since this estimate is based on seasonal variation, it may generally underestimate bonuses and commissions that come at frequent intervals throughout the year. It also may generally underestimate stock options to the extent that they are exercised throughout the year. On the other hand, in some cases non-variable pay may be included in variable compensation if there are regular seasonal patterns (e.g., if overtime regularly occurs in a certain quarter). Therefore, variable compensation contains high uncertainty—even in terms of the data history.

Table 7

New York State Economic Outlook (Percent Change)					
	Actual 2010	Actual 2011	Estimate 2012	Forecast 2013	Forecast 2014
Employment	0.1	1.2	1.4	1.2	1.3
Personal Income	5.6	4.4	2.9	3.3	5.5
Total Wages [calendar year basis]	4.3	3.7	2.2	4.2	4.8
Base Wages	1.9	4.2	3.2	3.7	4.4
Variable Compensation	26.6	0.6	(5.5)	8.8	8.4
Total Wages [fiscal year basis]	5.4	1.8	3.1	4.5	5.1
Base Wages	2.6	4.4	2.9	4.0	4.5
Variable Compensation	28.4	(15.5)	5.3	8.8	10.2
New York Area CPI	1.7	2.8	1.9	1.8	1.9

Note: Base wages and variable compensation are estimated by the NYS Assembly Ways and Means Committee staff and sum to total wages. New York area CPI is based on the New York-Northern NJ-Long Island, NY-NJ-CT-PA CPI-U series from the U.S. Bureau of Labor Statistics. For fiscal year variables, 2010 represents SFY 2010-11, etc.

Sources: U.S. Bureau of Economic Analysis; NYS Department of Labor, QCEW; U.S. Bureau of Labor Statistics; NYS Assembly Ways and Means Committee staff.

Going forward, the outlook for New York State, like the nation, remains one of a slow recovery. Although New York State wage and employment levels have returned to pre-recession peaks, growth rates still remain somewhat low. While variable wages grew by double digits in other recovery years, they are not forecast to grow at the high rates that were experienced in the past. Personal income is expected to grow 3.3 percent in 2013, below the historical growth rate average and well below the growth rates achieved after the 2001 recession.[31]

Employment

New York State employment performed better than that of the nation during the recent recession and the early stage of recovery, after lagging the nation almost every year from 1985 to 2006. The State entered the recent downturn one quarter after the nation. On a quarterly basis, New York State lost 3.7 percent of total payroll jobs from peak to trough compared to 6.2 percent for the nation. As the New York housing market fared better than that of the nation, the percentage of employment loss in the construction sector was much less than the national construction job loss. In contrast, during the 2001 recession, New York lost 3.4 percent of total nonfarm employment from peak to trough (quarterly

[31] Between 1990 and 2010, personal income in New York State grew an average of 4.3 percent per year.

numbers), compared to a 2.0 percent loss for the nation. Employment in the State also bottomed out sooner than the nation. New York State employment bottomed out in the fourth quarter of 2009, one quarter before the nation. The rate of employment recovery in the State has been comparable to that of the nation (see Figure 45). New York State employment grew 1.2 percent in 2011, the same rate as in the nation, and an estimated 1.4 percent in 2012 compared to 1.7 percent in the nation. As the State lost a substantially smaller percentage of jobs than the nation, total nonfarm payroll employment in the State has reached its previous peak, while national employment remains well below its previous peak. Importantly, the gains in employment for the State, like the nation, are mostly in lower paying jobs.

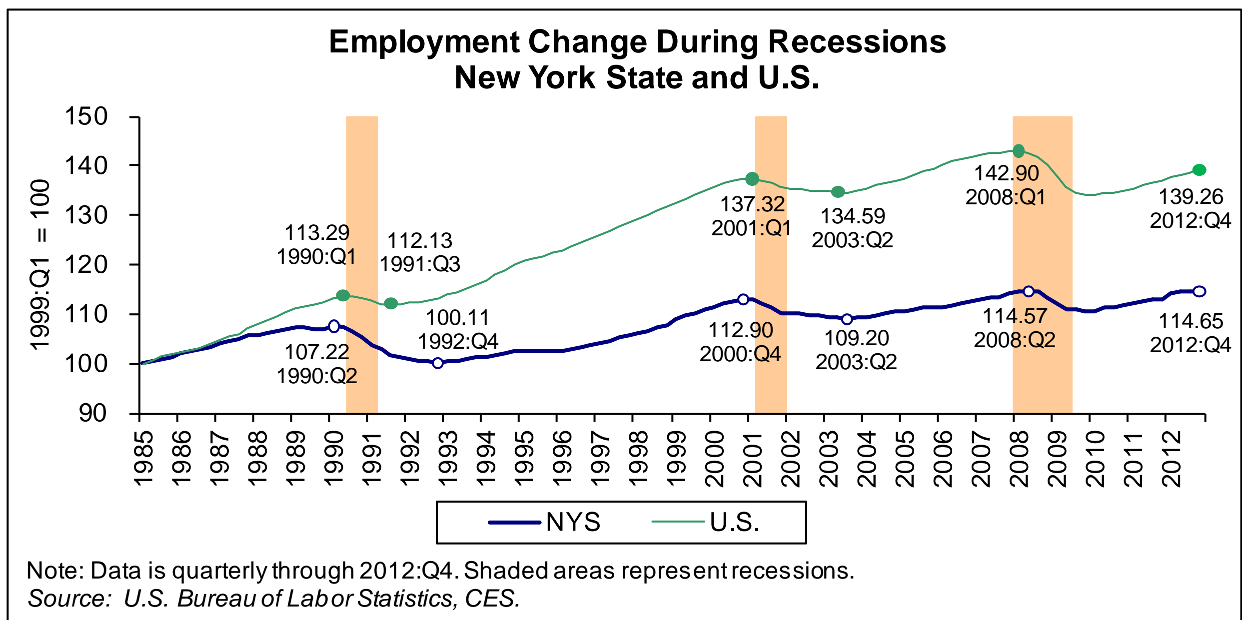

Figure 45

As the economy improves, employment in both New York State and the nation is forecast to continue to grow. Total nonfarm employment in the State is forecast to grow at 1.2 percent in 2013 before growing another 1.3 percent in 2014.

New York also performed better than most states, including other large states, during the recent recession. After ranking fortieth among fifty states and the District of Columbia in employment growth in 2006, New York State employment growth ranked twentieth in 2007, thirteenth in 2008, and improved to eighth in 2009, when the State's employment growth surpassed all other large states. This was due in part to a more stable construction sector in New York State. Although employment in several states that lost a significantly

higher percentage of jobs than New York has grown faster in recent years, New York still performs relatively well; State employment growth ranked fifteenth in 2012.

The recent recession has been milder in New York State than the two previous recessions in terms of employment. Although nonfarm employment loss was higher during the recent recession than during the 2001 recession, the employment recovery was much faster after the recent recession (see Figure 46). Fifty-six months after the employment peak, employment in the State had already surpassed its peak prior to the recession. On the contrary, employment in the State remained 4.8 percent below its previous peak 56 months after the 1990-91 recession hit, and 1.6 percent below its previous peak at the end of the same period following the 2001-02 recession.

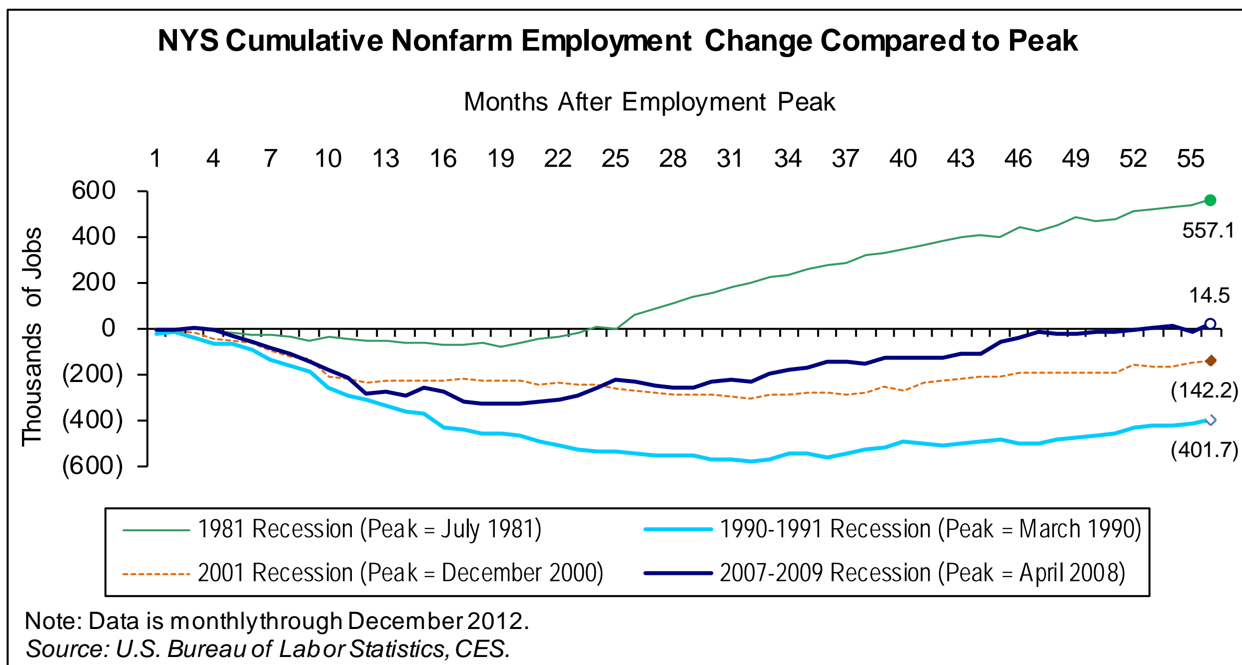

Figure 46

Sectoral Employment

Most sectors lost jobs during the recent recession, with the exception of the education and health sector. Education and health is the only sector that showed a gain in employment in 2009. The sector continued to grow in 2010 and 2011 (see Table 8). This sector's growth is expected to persist, as aging baby boomers will likely create more demand for healthcare services. The education and health sector is estimated to have grown 1.3 percent in 2012, and is forecast to grow 1.4 percent in 2013 and 1.5 percent in 2014.

The sector that lost the largest percentage of jobs during the recession was the manufacturing sector. From 2008 to 2010, the manufacturing sector lost approximately 76,850 jobs or 14.3 percent, which accounted for approximately 30 percent of total State nonfarm job loss. The sector started to rebound in 2011, gaining 0.2 percent of the jobs led by growth in durable goods manufacturing. Manufacturing employment is estimated to have grown 0.1 percent in 2012 and is forecast to grow 0.2 percent in 2013 and another 0.1 percent in 2014.

Continuing budget problems at all levels have put pressure on government employment. As a result, government employment declined four years in a row from 2009 to 2012. Employment in this sector fell 2.8 percent in 2011 and is estimated to have declined by another 1.4 percent in 2012. Government employment is expected to continue to decline in 2013 and 2014. As fiscal tightening persists, it is forecast that government employment will decline 0.7 percent in 2013, before declining further by 0.2 percent in 2014.

Two sectors that grew robustly coming out of the recent recession are the leisure and hospitality sector and the other services sector. Leisure and hospitality has been a main beneficiary of the weak dollar, which attracts more international tourists to the State. Total international visitors to New York City increased by 12.8 percent from 8.6 million in 2009 to 9.7 million in 2010 and 10.6 million in 2011.[32] As a result, leisure and hospitality employment grew 3.3 percent in 2010 and 4.3 percent in 2011, the strongest among all sectors. Leisure and hospitality employment is estimated to have grown 4.4 percent in 2012. As the value of the dollar is expected to remain low while the overall economy continues to improve, the sector is forecast to grow further by 3.3 percent in 2013 before growing further by 3.4 percent in 2014.

The other services sector, which includes temporary workers, also recovered quickly after the recession as employers selected to hire temporary rather than permanent workers due to numerous risks and uncertainties in the early stage of the recovery. Other services employment grew 1.3 percent in 2010 before growing further by 2.9 percent in 2011. As the economy continues on a more sustainable recovery path, firms are likely to start hiring for more permanent full-time positions. As a result, job growth in this sector slowed to an estimated 1.9 percent in 2012 and is forecast to continue to grow at a slower pace in 2013 and 2014.

[32] Nycgo.Com, "NYC, The Official Guide," NYC & Company, Inc., http://www.nycgo.com/articles/nyc-statistics-page, (accessed on January 16, 2013).

The professional services sector also rebounded strongly during the recovery as accounting and consulting firms started hiring in anticipation of a global recovery and new laws and regulations. The region that benefited the most from this hiring was New York City, where several big professional services firms are based; however, few other regions posted strong job gains in this sector. From December 2011 to December 2012, the State added 47,900 jobs in this sector,[33] of which 36,500 jobs were in the New York City region.[34] As these firms continue to hire, employment in this sector will likely continue to grow moderately throughout the forecast period (see Table 8).

Table 8

New York State Nonfarm Employment by Sector (Percent Change)

	Actual 2010	Actual 2011	Estimated 2012	Forecast 2013	Forecast 2014
Total	**0.1**	**1.2**	**1.4**	**1.2**	**1.3**
Leisure & Hospitality	3.3	4.3	4.4	3.3	3.4
Professional Services	(1.5)	3.7	3.8	3.3	3.4
Retail Trade	1.5	1.9	2.2	1.2	1.3
Other Services[1]	1.3	2.9	1.9	1.7	1.5
Construction	(5.4)	0.4	1.8	3.2	4.0
Information	(0.1)	1.3	1.8	(0.5)	(0.8)
Management of Companies	0.7	0.9	1.3	1.6	2.0
Education & Health[2]	2.0	1.5	1.3	1.4	1.5
Wholesale Trade	(1.3)	1.7	1.0	0.7	0.8
Real Estate, Rental, & Leasing	(1.3)	0.3	0.6	0.6	0.9
Manufacturing[4]	(3.9)	0.2	0.1	0.2	0.1
Transp. & Utilities[3]	(1.9)	0.9	0.1	0.5	0.8
Finance & Insurance	(1.8)	2.1	(0.1)	(0.2)	0.2
Government	(0.5)	(2.8)	(1.4)	(0.7)	(0.2)

Note: Industries are ranked by 2012 employment growth; rankings are based on two decimal places.

[1] Including Administrative, Support, and Waste Management Services.

[2] Includes private employment. Public education and health employment is included in the government sector.

[3] Transportation, Warehousing, and Utilities.

[4] Including Mining.

Sources: NYS Department of Labor, QCEW; NYS Assembly Ways and Means Committee staff.

[33] New York State Department of Labor, *Press Release*, "New York Adds 34,300 Jobs in December, Raising Number of Jobs Added to the State's Economy in 2012 to 123,200," http://www.labor.ny.gov/stats/pressreleases/pruistat.shtm (accessed on January 24, 2013).

[34] New York State Department of Labor, *Labor Statistics for the New York City Region*, http://www.labor.ny.gov/stats/nyc/index.shtm, (accessed on January 24, 2013).

New York State has seen significant change in its sectoral employment during the past several decades. While the size of many sectors remained relatively stable for decades, some sectors have been declining, and others have been growing. The most notable sectors are the education and health sector and the manufacturing sector. Education and health employment has been steadily increasing even during recessions. As this sector continued to grow while others contracted, its share of total nonfarm payroll employment in New York State has risen. The share of private education and health employment in total nonfarm State employment has almost doubled from 1980 to 2010. In 1980, education and health employment ranked fourth among all sectors in the State and accounted for less than 10 percent; this employment share jumped to 19.0 percent and ranked first in 2010. Both upstate and downstate shared equally in this gain as the employment share of education and health in downstate grew from 9.7 percent in 1980 (ranked fourth) to 19.7 percent in 2010 (ranked first). Similarly, this employment share in upstate grew from 10.0 percent in 1980 (ranked fourth) to 18.1 percent in 2010 (ranked second behind the government sector).

The manufacturing sector has also gone through a drastic change. Unlike the health and education sector, the manufacturing sector has been losing jobs for the past few decades. In 1980, the manufacturing sector accounted for 17.1 percent of total New York State employment, the second largest employment share in the State behind the government sector. In 2010, this sector dropped to eighth in rank, with employment share dropping to 5.5 percent. This was due to a structural shift in the economy and other economic factors. The manufacturing sector has become less vital to the downstate economy than to upstate, in terms of both the number of jobs and share of total employment. In 1980, manufacturing was the second largest sector in downstate, accounting for 14.0 percent of total employment. In 2010, the sector ranked tenth and accounted for less than 4.0 percent of total employment in downstate. Likewise, manufacturing was the largest sector in upstate in 1980, accounting for 24.6 percent of total employment; this share dropped to 10.2 percent in 2010 and ranked fourth.

As sectoral shares of total employment changed, contributions to total State wages also changed. For most sectors, their share of total wages changed in the same direction as their employment shares. For example, the education and health sector's share of total employment increased from 9.6 percent in 1980 to 19.0 percent in 2010, while the sector's share of wages rose from 7.9 percent to 14.2 percent. Conversely, manufacturing's share of employment declined from 17.1 percent in 1980 to 5.5 percent in 2010, while its wage share dropped from 19.2 percent to 5.5 percent. One sector that stood out was finance and insurance. While employment share of this sector fell from 6.8 percent in 1980 to

5.9 percent in 2010, its wage share rose from 8.6 percent to 18.8 percent. This is due to the sector's high wage growth over this period. Sectoral employment and wage shares have not changed much in recent years, except for the government sector, in which both employment and wage shares have declined by almost one percentage point from 2010 to 2011 as a result of job cuts.

Regional Employment

In 2011, the largest region by employment in the State was New York City, with employment of more than 3.6 million, accounting for over 40 percent of total State nonfarm employment. The smallest employment region was the North Country, which had 145,900 jobs. The two largest sectors in all regions were the education and health sector and the government sector, while in most regions the smallest sectors were the management of companies sector and the real estate, rental, and leasing sector.

During the recent recession, downstate and upstate employment were both hit hard. Downstate employment had a large decline in sectors such as construction, manufacturing, and finance and insurance. Similarly, upstate experienced large employment loss in construction, manufacturing, and other services sectors. From the second quarter of 2008 to the second quarter of 2009, downstate lost 3.3 percent of its employment or 194,600 jobs while upstate lost 3.0 percent or 80,900 jobs. The sectors that lost the most jobs in both upstate and downstate were manufacturing and other services; however, manufacturing accounted for a larger proportion of total upstate employment than that of downstate.[35]

Employment recovery in upstate has lagged that of downstate due to slower recovery in many large sectors. From the second quarter of 2009 to the second quarter of 2012, upstate gained 0.1 percent in nonfarm employment, while downstate gained 3.8 percent in nonfarm jobs. Downstate growth was driven by fast growth in the leisure and hospitality, other services, and retail trade sectors (see Table 9).

[35] In 2011, manufacturing employment made up 10.2 percent of upstate nonfarm employment, 3.4 percent of downstate nonfarm employment, and 5.5 percent of total State nonfarm employment.

Table 9

New York State Employment Change During Recession and Recovery (Percent Change)						
	Recession 2008:Q2-2009:Q2			Recovery 2009:Q2-2012:Q2		
	New York State	Downstate	Upstate	New York State	Downstate	Upstate
Total Nonfarm	**(3.2)**	**(3.3)**	**(3.0)**	**2.7**	**3.8**	**0.1**
Leisure & Hospitality	(1.6)	(1.7)	(1.2)	13.0	16.5	6.2
Professional Services	(4.4)	(5.2)	(2.3)	5.6	6.5	3.2
Other Services[1]	(5.8)	(5.5)	(6.6)	6.3	7.1	3.2
Information	(3.7)	(4.7)	(4.1)	2.9	5.2	(9.4)
Retail Trade	(4.2)	(4.6)	(3.6)	5.6	8.2	1.6
Education & Health	1.7	1.8	1.4	5.2	6.1	2.9
Wholesale Trade	(6.6)	(7.1)	(5.1)	1.1	0.9	0.7
Finance & Insurance	(7.3)	(8.2)	(3.6)	(0.5)	0.3	(1.2)
Management of Companies	(0.4)	(1.7)	1.8	1.9	2.2	0.1
Transportation & Utilities[2]	(4.8)	(4.3)	(6.4)	(0.9)	(0.7)	(1.5)
Construction	(10.0)	(10.8)	(7.6)	(4.3)	(7.4)	(0.5)
Real Estate, Rental, & Leasing	(4.1)	(3.7)	(5.6)	(0.4)	0.3	(2.1)
Manufacturing[3]	(11.2)	(11.0)	(11.4)	(4.0)	(5.9)	(2.5)
Government	0.2	0.1	0.3	(4.6)	(4.3)	(5.3)

Note: New York State total includes unclassified data.

[1] Including Administrative, Support, and Waste Management Services.

[2] Transportation, Warehousing, and Utilities.

[3] Including Mining.

Source: NYS Department of Labor, QCEW.

On an annual basis, the downstate regions hardest hit in the recent recession were the Mid-Hudson and Long Island regions, which respectively lost 3.6 percent and 3.4 percent of their nonfarm employment from 2008 to 2009 (see Table 10). However, all downstate regions have recovered faster than most upstate regions. From 2009 to 2011, downstate gained 2.1 percent in nonfarm jobs as a result of large employment gains in professional services and leisure and hospitality, with all regions gaining jobs. On the contrary, upstate continued to lose jobs during this period, with five of seven regions experiencing job loss. The North Country and Mohawk Valley regions lost the most jobs in terms of percentage from 2009 to 2011 due to a large employment decline in the government and manufacturing sectors.

Table 10

New York State Nonfarm Employment by Region 2008-2011								
	2008		2009			2011		
	Employment (Thousands)	Share of Total State Employment (%)	Employment (Thousands)	Share of Total State Employment (%)	Employment Change 2008-2009 (%)	Employment (Thousands)	Share of Total State Employment (%)	Employment Change 2009-2011 (%)
New York State	**8,573.7**	**100.0**	**8,312.0**	**100.0**	**(3.1)**	**8,420.0**	**100.0**	**1.3**
Downstate	**5,783.4**	**67.5**	**5,600.9**	**67.4**	**(3.2)**	**5,717.4**	**67.9**	**2.1**
New York City	3,672.6	42.8	3,563.6	42.9	(3.0)	3,662.9	43.5	2.8
Long Island	1,221.0	14.2	1,179.3	14.2	(3.4)	1,193.7	14.2	1.2
Mid-Hudson	889.8	10.4	858.0	10.3	(3.6)	860.8	10.2	0.3
Upstate	**2,652.7**	**30.9**	**2,577.5**	**31.0**	**(2.8)**	**2,569.6**	**30.5**	**(0.3)**
Finger Lakes	542.9	6.3	527.1	6.3	(2.9)	531.6	6.3	0.9
Western New York	629.1	7.3	610.9	7.4	(2.9)	612.8	7.3	0.3
Central New York	348.8	4.1	337.7	4.1	(3.2)	335.4	4.0	(0.7)
Southern Tier	298.1	3.5	288.0	3.5	(3.4)	285.7	3.4	(0.8)
Capital	507.6	5.9	495.6	6.0	(2.4)	491.1	5.8	(0.9)
North Country	152.0	1.8	148.2	1.8	(2.5)	145.9	1.7	(1.6)
Mohawk Valley	174.2	2.0	169.9	2.0	(2.5)	167.1	2.0	(1.6)

Note: New York State total includes unclassified data.
Source: NYS Department of Labor, QCEW.

Wages

The growth of wages in New York State remains a central issue in the State economic outlook and revenue forecasts. The State has typically been helped by strong growth in variable wages (bonuses) in the financial sector; however, this usual source of income declined during the recent recession leading to adverse effects on the State economy and revenues. Although wages grew in 2012, variable wages experienced a slight decline as a result of weakness in bonus payments in the first quarter. The strength of the outlook is somewhat unclear as financial firms continue to face an uncertain environment and base wages are constrained by firms' unwillingness to hire new staff, laying off workers, or not granting raises to existing staff. Total wages are forecast to grow 4.2 percent in 2013 and 4.8 percent in 2014.

Variable wage growth is not expected to reach the high levels attained in 2006 and 2007 when securities industry firms had huge profits and bestowed large bonuses on

employees (see Figure 47). Variable wage growth is expected to be 8.8 percent in 2013 and 8.4 percent in 2014, as firms continue to modify compensation packages compared to 2006 and 2007.

Base wages are expected to continue to recover in 2013 and 2014, reflecting an expectation of a slow, but continuing, recovery in employment. The relatively slow growth in base wages reflects many firm's continued caution about hiring workers. In addition, upward pressure on wages continues to be slight given the slack in the labor market, indicating that firms have been able to hold off on raising wages while still attracting new workers.

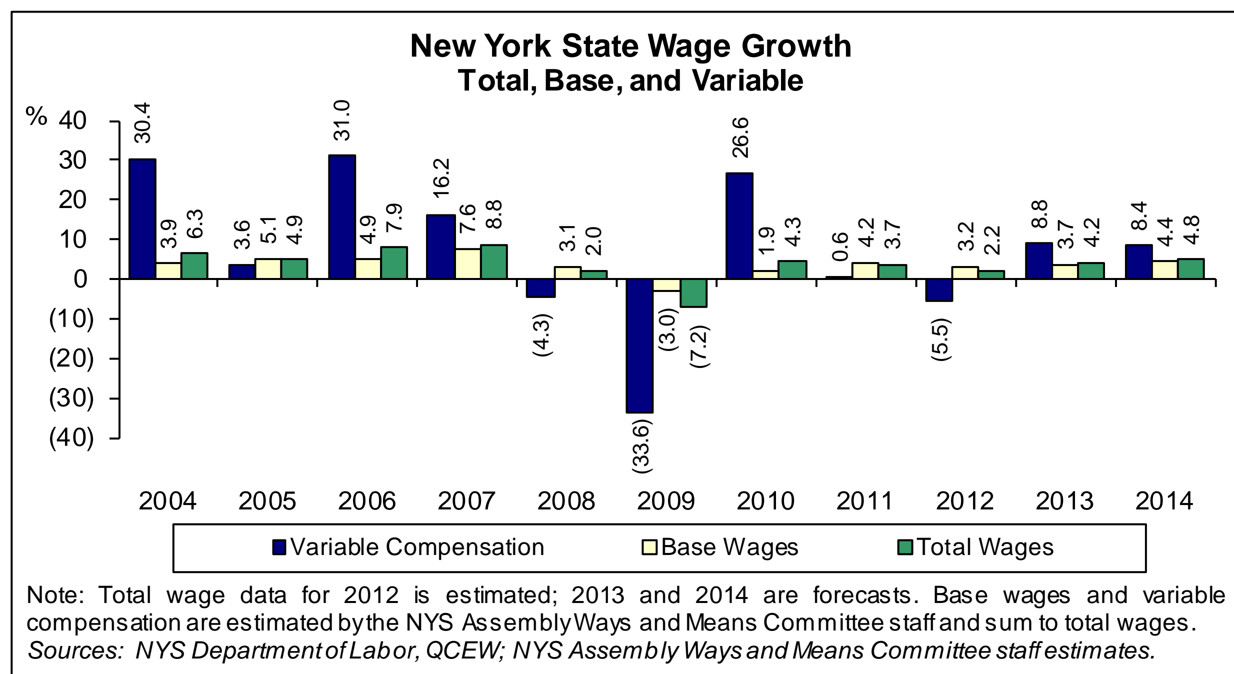

Figure 47

Historically, during recessions, wages have been more volatile in New York City compared to the State as a whole because of the City's employment concentration in the financial services sector. Although New York City has generally had higher wage growth on an annual basis than the State as a whole, it has also lost a greater percentage of its wages during downturns (see Figure 48). Although wages in both the State and the City have grown since the recent recession, wage growth has not reached the levels experienced in 2004-07. This is likely due to the fact that financial sector wages, particularly bonuses, have not grown as fast post-recession.

Figure 48

Some industries in New York State were more affected than others by the recent recession, in terms of average wage changes (see Table 11). While employment fell significantly, wages remained steady or grew. The average wage in many industries fell from 2007 to 2009; however, many of these average wages recovered between 2009 and 2011, and in some cases, the 2011 average wage had returned to or exceeded the 2007 level.

The construction industry average wage of $55,889 in 2007 increased each year to an average wage of $61,495 in 2011. The increase over this period was due to the rate of decline in employment exceeding the rate of decline in wages in 2009 and 2010, and the sector's rate of growth in wages being significantly greater than employment growth in 2011. The government sector average wage increased by over $5,000 between 2007 and 2011. While government sector employment in New York State has declined on an annual basis since 2007, wages in the sector continued growing until 2011.

The finance and insurance average wage fell more than $30,000 between 2007 and 2009. Wages fell at a much higher rate than employment in this sector, especially in 2009 when wages fell 22.1 percent, compared to a loss of 7.2 percent in employment. Although the sector has shown signs of recovery since 2009, the growth has not been sufficient to return the average wage to pre-crisis levels.

Table 11

New York State Average Wage by Industry
($)

Industry Title	2007	2008	2009	2010	2011
Total, All Industries	59,499	60,384	57,794	60,263	61,768
Total, All Private	61,455	62,195	58,881	61,523	63,057
Finance and Insurance	208,490	207,411	173,899	194,216	201,442
Mgmt. of Companies and Enterprises	141,100	133,198	119,804	140,145	142,705
Utilities	92,640	93,997	92,469	97,935	102,917
Information	86,365	88,239	87,970	90,896	95,978
Professional and Technical Services	84,813	88,231	87,136	90,886	94,054
Wholesale Trade	69,231	69,450	69,282	71,700	73,798
Mining	54,580	60,378	55,819	58,567	67,664
Construction	55,889	59,123	59,834	60,268	61,495
Manufacturing	56,007	57,239	57,144	59,439	60,059
Real Estate and Rental and Leasing	55,614	55,100	52,417	54,606	56,595
Government	49,774	51,422	52,594	54,198	55,252
Educational Services	43,619	45,320	46,772	47,299	48,733
Arts, Entertainment, and Recreation	44,514	45,226	44,246	45,173	45,775
Health Care and Social Assistance	41,409	42,945	44,104	44,653	45,282
Transportation and Warehousing	42,335	42,877	42,477	43,888	44,479
Administrative and Waste Services	39,470	40,664	40,546	42,529	41,931
Other Services	31,839	33,756	33,602	34,697	35,280
Retail Trade	29,199	29,518	29,202	29,582	30,260
Agr., Forestry, Fishing & Hunting	27,239	27,894	28,275	29,032	29,590
Accommodation and Food Services	21,094	21,678	21,369	22,191	22,815

Note: Average wage is total wages divided by total employment.
Source: NYS Department of Labor, QCEW.

Variable Compensation

Variable compensation is the most volatile component of New York wages and its outlook plays an important role in the forecasting of State wages. From 1990 to 2010, base wages growth rates fluctuated between negative 3.0 percent and positive 8.7 percent on an annual basis. In contrast, the growth of variable wages is more volatile and the magnitude of growth or loss can be enormous. As such, variable wage growth rates ranged between negative 33.3 percent and positive 67.6 percent. Therefore, even though the share of variable compensation in total wages is small compared to base wages, its impact on changes in total compensation cannot be ignored.

Variable compensation accounted for an estimated average of 12.3 percent of total State compensation from 2004 to 2008, increasing from around 5 percent in the 1970s. The

share reached a high of 14.7 percent in 2007. In 2009, however, this percentage fell to 9.9 percent as financial firms drastically cut back on bonus payouts in the face of billions of dollars in losses. In 2010 and 2011, variable compensation returned to about 12 percent of total compensation as financial firms' profits rebounded and the overall economy started to improve. However, given the challenges still faced in the financial sector, variable compensation's share of total compensation is expected to remain under 12 percent throughout the forecast period, well below the 2007 level.

Changes in variable compensation are difficult to predict, given the inherently uncertain nature of bonus payments coupled with the current economic climate in which firms face great uncertainty. While bonuses for current employees have the potential to increase should firms do well, layoffs may lead to a lower number of employees getting bonuses, meaning the overall total level of bonuses may not be as high.

Since the recent financial crisis, bonus season payments have become particularly difficult to forecast. Issues related to the division of bonuses between stock options and cash, deferral of stock option awards, the potential for changes in levels of base pay, as well as uncertainty surrounding regulations on pay add to the difficulty of forecasting variable compensation. In addition, the volatility of profits and revenues from one quarter to the next makes it difficult to assess how fundamentals may affect the levels of bonuses that will be paid.

On a State Fiscal Year (SFY) basis, the NYS Assembly Ways and Means Committee staff estimates that total variable wages is estimated to grow by 5.3 percent in SFY 2012-13 (see Figure 49). Securities industry variable compensation is estimated to grow by 7.2 percent as firms recover from the financial difficulties faced in SFY 2011-12, but are still faced with an uncertain revenue environment. In SFY 2013-14, as the economic environment improves and financial firms continue to be profitable, variable compensation (both overall and in the securities industry) should also improve.

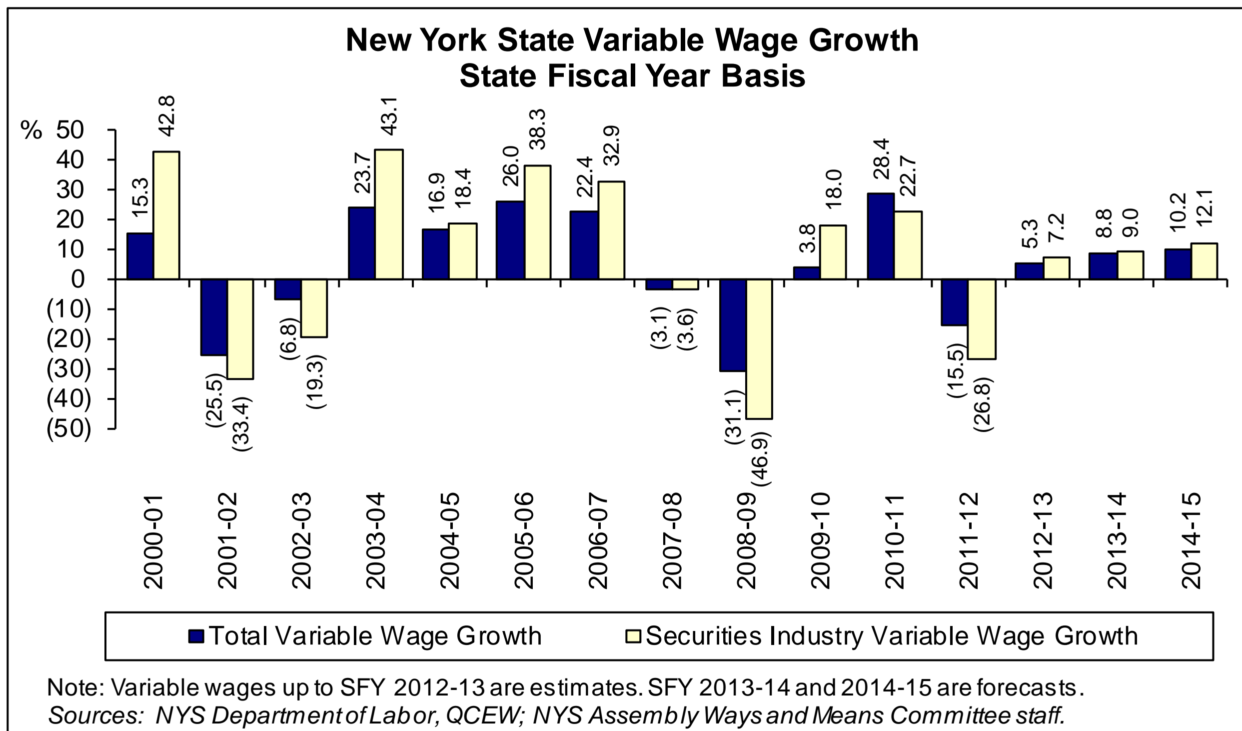

Figure 49

Finance and Insurance Sector

The finance and insurance sector is important to the overall health of the New York State economy, especially downstate as the sector's employment is heavily concentrated in New York City. While the sector accounted for less than 6 percent of total State nonfarm payroll employment in 2011, the industry comprised almost 20 percent of total State nonfarm payroll wages. As a result, the performance of the finance and insurance sector has a considerable impact on State tax revenues.

On a fiscal year basis, finance and insurance variable compensation in New York State fell sharply during the recession. As the national economy came out of recession in the second half of 2009, securities industry firms (one of the main drivers of finance and insurance wage fluctuations) started to pay higher bonuses. As a result, finance and insurance variable compensation rose by 14.1 percent to $28.4 billion in SFY 2009-10, before rising further to an estimated $35.5 billion in SFY 2010-11 as the overall economy continued to improve.

As activities in calendar year 2011 slowed, however, and revenues and profits of financial firms suffered in the second half of the year, wages in the first quarter of 2012 fell

compared to the first quarter of 2011. Over half of the drop can be attributed to the securities industry. As bonuses for performance in a calendar year are generally paid in the first quarter of the following year, the decrease in the first quarter of 2012 likely reflects a decline in bonus payments. Given this information, the Ways and Means Committee staff estimates that variable compensation in the finance and insurance industry fell 22.8 percent in SFY 2011-12. As revenues and profits appear to have stabilized, and the global economy continues to grow slowly, offering opportunities for profitable investments, finance and insurance variable compensation is expected to increase by 3.0 percent in SFY 2012-13 and 9.1 percent in SFY 2013-14. Nevertheless, even given the two years of increases, finance and insurance variable wages are projected to remain below the SFY 2007-08 record high of $46.2 billion throughout the forecast period.

While some facets of the financial sector are doing well, overall annual revenue and profit results have been mixed. Traditionally profitable revenue streams, such as mergers and acquisitions, remain constrained, mainly due to economic uncertainty. Fees for traditionally profitable activities were down for the first three quarters of 2012 compared to the first three quarters of 2011,[36] and only some investment firms reported an increased amount of compensation set aside.

In addition to the fallout on Wall Street, issues central to the financial crisis still continue to have an effect throughout the entire banking system. According to the Federal Deposit Insurance Corporation's (FDIC) failed bank list, only 52 banks failed between 2000 and 2008. Then, in the wake of the financial crisis, 140 banks failed in 2009, and an additional 157 failed in 2010, the highest since 1992. In 2011, the number of banks that failed declined to 92; in 2012, 51 banks closed.[37]

As of the third quarter of 2012 there were 694 problem banks, with total assets of $282 billion, compared to only 76 problem banks in the second quarter of 2007, prior to the recession. However, 694 is the smallest number of institutions that have been on the "problem" list since the third quarter of 2009. In addition, only 10.5 percent of FDIC

[36] Financial Times, Investment Banking Review," ft.com/leaguetables, *Financial Times*, n.d., http://markets.ft.com/investmentBanking/tablesAndTrends.asp (accessed on 2/21/13).

[37] Federal Deposit Insurance Corporation (FDIC), Failed Bank List, (last updated and accessed on January 16, 2013), www.fdic.gov/bank/individual/failed/banklist.html.

institutions reported negative net income in the third quarter, the lowest proportion since the second quarter of 2007.[38]

Within the finance and insurance sector, the securities industry was particularly hard hit by the recent recession and continues to be troubled by the problems in the financial system. Securities industry employment reached a record high of 871,200 jobs nationally in the second quarter of 2008, before falling 8.4 percent to its trough in the first quarter of 2010. As a result, securities employment in the State declined in 2009 and 2010, falling 9.7 percent and 1.9 percent, respectively. The industry currently employs just over 190,000 workers in the State, many of whom are located in New York City. Industry employment is estimated to have fallen 1.0 percent in 2012 as Wall Street firms continued to stream-line their operations in response to lower revenues and profits (see Figure 50). Securities industry employment in New York State is expected to remain almost flat throughout the forecast period as firms continue to use staffing level changes as a way to control costs.

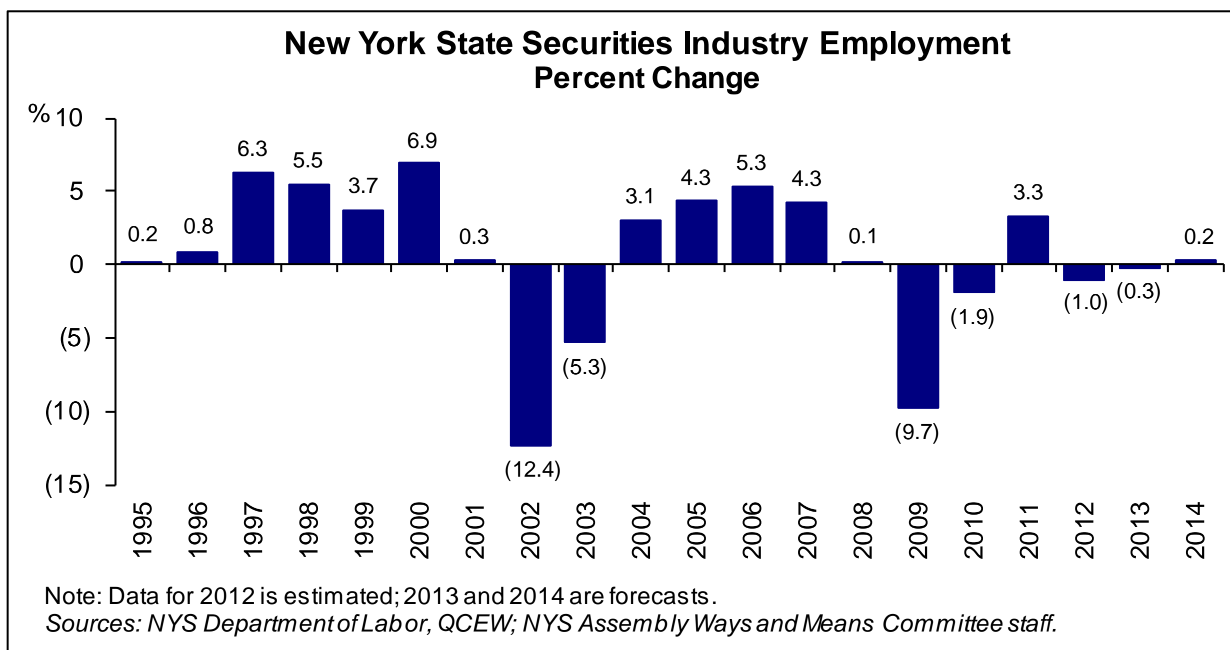

Figure 50

[38] Federal Deposit Insurance Corporation (FDIC), Quarterly Banking Profile, Third Quarter 2012, September 30, 2012.

Exports

Of all sectors in the State, the manufacturing sector has been the most significant contributor to State exports. Since 1999, the manufacturing sector has accounted for over 75 percent of State exports. In 2011, about 79 percent of total State exports, or $67 billion, were from goods produced in this sector. This share increased to 81.8 percent in 2012 (see Table 12).

Table 12

New York State Exports by Type
Share of Total Exports

	2006	2007	2008	2009	2010	2011	2012
Total ($ in Millions)	**$59,132**	**$71,116**	**$81,386**	**$58,743**	**$69,696**	**$84,888**	**$59,986**
Manufacturing	81.3%	80.6%	79.5%	76.9%	77.9%	79.1%	81.8%
Computer and Electronic Products	12.9%	10.7%	9.5%	10.8%	9.2%	8.2%	8.1%
Machinery (Except Electrical)	9.8%	9.5%	8.9%	8.6%	8.5%	7.9%	8.1%
Chemicals	8.2%	7.5%	6.2%	8.4%	8.4%	8.9%	7.9%
Transportation Equipments	9.4%	8.6%	8.9%	8.6%	7.6%	7.2%	7.0%
Primary Metal Manufacturing	6.9%	10.4%	11.7%	4.7%	7.1%	9.8%	12.4%
All Other Manufacturing	34.1%	33.8%	34.3%	35.8%	37.0%	37.1%	38.3%
Used or second hand merchandise	7.8%	7.8%	8.1%	9.2%	7.7%	6.9%	7.7%
Waste and Scrap	3.3%	4.2%	5.5%	5.1%	5.4%	5.4%	4.7%
Agriculture and Livestock Products	0.2%	0.2%	0.3%	0.8%	1.0%	1.7%	0.9%
Oil, Gas, Mineral, and Ores	0.7%	0.8%	0.7%	0.9%	1.0%	0.7%	1.0%
Other	6.8%	6.4%	5.9%	7.2%	7.0%	6.3%	4.0%

Note: Data for 2012 is for the first nine months.
Source: U.S. Department of Commerce.

As for the nation, Canada has long been the largest export destination for New York's goods, although the share has dropped in recent years. In 1999, Canada was the destination for almost 30 percent of total New York exports. This share has declined to less than 20 percent in 2011, as New York increased its trade to emerging economies like Hong Kong, China, and India. In 2012, New York exported over $10 billion of goods (about 17 percent of total exports) to Canada. Europe comprises a larger share of the export market for New York State than it does for the nation. New York State exported about $18 billion of goods, almost one-quarter of total State exports, to the European Union in 2012, compared to 17 percent of national exports (see Table 13). However, as exports accounted for a smaller proportion of the State's gross domestic product than that of the nation, the State has similar trade exposure to Europe at about 2 percent of gross State product in 2011.

Table 13

New York State Exports by Destination Share of Total Exports							
	2006	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Total ($ in Millions)	**$59,132**	**$71,116**	**$81,386**	**$58,743**	**$69,696**	**$84,888**	**$79,189**
Top 10 Destinations							
Canada	23.6%	21.1%	20.0%	21.4%	21.1%	19.2%	16.6%
Hong Kong	4.4%	4.8%	4.5%	5.0%	6.4%	9.5%	11.3%
Switzerland	7.1%	8.5%	6.8%	7.7%	6.8%	7.7%	8.3%
United Kingdom	6.2%	8.2%	9.7%	5.6%	6.1%	5.9%	8.0%
Israel	7.7%	6.8%	7.0%	6.3%	6.0%	6.0%	5.6%
China	3.7%	3.5%	3.5%	4.2%	4.8%	5.2%	5.4%
Mexico	3.8%	3.6%	3.8%	3.0%	3.5%	3.4%	3.4%
India	4.1%	3.0%	2.9%	3.0%	3.2%	3.1%	3.3%
Belgium	2.1%	2.4%	2.3%	2.6%	2.9%	3.2%	3.1%
Germany	4.1%	3.8%	3.8%	4.0%	4.0%	3.3%	2.9%
European Union*	24.9%	24.9%	24.3%	25.9%	24.2%	23.4%	22.9%

* The European Union covers 27 countries: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and U.K.
Source: U.S. Department of Commerce.

State Real Estate Market

After rising rapidly prior to the recent recession, overall home prices in both the State and the nation declined sharply during the housing correction. Home prices in the State rose 63.5 percent from the third quarter of 2001 to the third quarter of 2007, compared to 47.2 percent for the nation. Home price increases in New York State were driven largely by downstate housing prices, which inflated significantly during the housing boom before depreciating sharply during the housing downturn.

From the third quarter of 2007 to the third quarter of 2011, home prices in the State fell 10.6 percent, compared to 15.6 percent for the nation. The two metros that had the largest home price depreciation in New York State were the Nassau-Suffolk and New York City areas. Upstate home prices were less affected by the real estate cycle than downstate. Prices in Buffalo-Niagara Falls and Syracuse continued to appreciate during the housing downturn. Home prices in the State as a whole and the nation continued to decline through the third quarter of 2012, however, prices in the State have declined at a faster rate than that of the nation recently (see Table 14).

Table 14

Home Price Change by New York State Metropolitan Area 2001:Q3 to 2012:Q3 (Percent Change)			
	2001:Q3-2007:Q3	**2007:Q3-2011:Q3**	**2011:Q3-2012:Q3**
Buffalo-Niagara Falls	27.6	4.9	1.3
Rochester	20.1	(7.0)	0.3
Albany-Schenectady-Troy	70.3	(3.2)	0.0
Syracuse	37.2	0.8	(0.2)
New York-White Plains	76.0	(14.9)	(1.2)
Nassau-Suffolk	76.3	(16.3)	(1.3)
New York State	**63.5**	**(10.6)**	**(0.9)**
U.S.	**47.2**	**(15.6)**	**(0.0)**

Note: Data is not seasonally adjusted. The FHFA index presented herein may show different price changes from the S&P/Case-Shiller Index. This is because the two indices use different data. The FHFA index is based on homes with conforming loans, which have a loan limit of $417,000 for single-family homes. Therefore, the FHFA index does not reflect price changes for more expensive homes. The FHFA index also includes both sales and appraisal data.

Source: Federal Housing Finance Agency (FHFA).

The State's housing market has continued to have a lower foreclosure rate as well as a lower percentage of mortgage holders who owe more than their house is worth (negative equity) than the nation; however, foreclosure rates have recently increased sharply. In 2012, foreclosure starts in New York have increased by 31 percent from the previous year, compared to a decline of 3 percent for the nation.[39] New York had the fourth lowest percentage of mortgage holders in negative equity at 8.2 percent in the third quarter of 2012, compared to 22.0 percent nationwide. An estimated 157,020 of the State's mortgages were in negative equity, with another 49,218 mortgages in danger of entering negative equity.[40] Although negative equity in the State was lower than that of the nation, it has been on an upward trend during the past year, while declining in the nation. Thus, it is evident that the State's housing market remains strained.

As home prices have fallen faster than income, and mortgage interest rates have remained at record lows, housing affordability has improved. The National Association of Home Builders/Wells Fargo Housing Opportunity Index (HOI) indicates that housing

[39] RealtyTrac staff, "1.8 Million U.S. Properties with Foreclosure Filings in 2012" *RealtyTrac*, January 17, 2013; http://www.realtytrac.com/content/foreclosure-market-report/2012-year-end-foreclosure-market-report-7547.

[40] Corelogic, Corelogic's Negative Equity Data Updates, *Corelogic*, (as of January 17, 2013).

affordability jumped from 40.4 percent in the third quarter of 2006 to 74.1 percent in the third quarter of 2012.[41]

Regionally, housing in upstate New York has long been more affordable than that of downstate. While a few upstate metros were consistently ranked among the top fifty most affordable metros out of 225 metros nationwide, New York-White Plains-Wayne has been ranked as the least affordable large metro every quarter since the second quarter of 2008.[42] In the fourth quarter of 2012, only 29.6 percent of homes sold in New York-White Plains-Wayne are affordable to families earning the area median income, compared to over 90 percent in Syracuse. Nationally, 74.9 percent of all new and existing homes sold were affordable to families earning the national median income.[43]

Despite the improvement in housing affordability, a large disparity still exists in New York State. In 2011, downstate residents faced a much higher housing cost burden than those in upstate. The housing burden was highest in New York-Northern New Jersey-Long Island, where 42.9 percent of homeowners and 51.9 percent of renters paid more than 30 percent of their income on housing. The lowest burden was in Elmira, where only 18.1 percent of homeowners and 37.9 percent of renters paid more than 30 percent of their income on housing. In the State as a whole, 34.4 percent of all New York homeowners paid more than 30 percent of their income on housing in 2011, while about half of all renters paid more than 30 percent of their income on housing, compared to 29.6 percent and 49.3 percent for the nation, respectively (see Table 15).

[41] The Housing Opportunity Index is defined as the share of homes sold in the area that would have been affordable to a family earning the median income (i.e., the total monthly payment is less than 28 percent of the monthly median household income).

[42] Large metros defined as areas with population of 500,000 or more.

[43] National Association of Home Builders, NAHB/Wells Fargo Housing Opportunity Index (HOI), November 27, 2012.

Table 15

Housing Cost Burden by New York State Metropolitan Area					
	Owner		Renter		
	2011		2011		
	Owner-Occupied Housing Units Total	Percent with Housing Costs Over 30% of Household Income	Renter-Occupied Housing Units Total	Percent with Housing Costs Over 30% of Household Income	Housing Opportunity Index 2012:Q4
Metropolitan Statistical Area					
New York-Northern New Jersey-Long Island	3,472,909	42.9	3,317,034	51.9	29.6
Poughkeepsie-Newburgh-Middletown	158,795	40.1	74,111	52.0	84.5
Kingston	45,415	37.1	23,712	54.1	89.6
Glens Falls	37,177	27.8	14,982	56.6	77.3
Albany-Schenectady-Troy	228,119	25.6	117,543	46.3	87.8
Rochester	283,566	24.8	135,213	53.7	86.0
Syracuse	171,897	23.2	80,318	48.2	92.4
Utica-Rome	78,930	23.1	38,800	48.2	89.3
Buffalo-Niagara Falls	307,685	21.8	159,850	47.8	90.2
Binghamton	68,536	20.0	31,606	45.9	90.9
Ithaca	21,568	18.2	17,577	49.2	88.6
Elmira	23,431	18.1	12,213	37.9	NA
New York State	**3,851,687**	**34.4**	**3,336,251**	**51.3**	**NA**
United States	**74,264,435**	**29.6**	**40,727,290**	**49.3**	**74.9**

Note: The Housing Opportunity Index for New York-Northern New Jersey-Long Island was the Index for New York-White Plains-Wayne, NY-NJ.
Housing costs for homeowners include mortgage payment, real estate taxes, fire hazard and flood insurance, utilities, and fuels. The housing cost for renters is gross rent.
The Housing Opportunity Index is defined as the share of homes sold in the area that would have been affordable to a family earning the median income (i.e., the total monthly payment is less than 28 percent of the monthly median household income).
Sources: U.S. Census Bureau, 2011 American Community Survey 1-Year Estimates; National Association of Home Builders.

Commercial real estate activities in the State have recovered quite well after deteriorating in 2008 and 2009. In Manhattan, slow demand due to layoffs caused leasing activities to drop by almost 45 percent in the second quarter of 2009 compared to the same period in 2008, but activities have since increased sharply.[44] New leasing activities totaled 10.3 million square feet in the second quarter of 2011, the highest since the third quarter of

[44] Cushman & Wakefield, "Manhattan Office Report," *MarketBeat, Manhattan Office Report*, 2Q09 (Second Quarter 2009).

1999.[45] As a result, the overall vacancy rate in Manhattan dropped from 10.8 percent in the second quarter of 2010 to 9.4 percent in the second quarter of 2011. Leasing activities have slowed recently, with only 5.7 million square feet of new leases signed in the third quarter of 2012, and 6.4 million square feet in the fourth quarter of 2012. Overall, leasing activity fell 22.8 percent in 2012 from 2011. Despite the slower leasing activity level, renewal activity has been strong. Asking rents have continued to move steadily higher. The overall vacancy rate in Manhattan rose from 9.1 percent in the fourth quarter of 2011 to 9.4 percent in the fourth quarter of 2012, whereas direct asking rents rose from $57.68 per square foot per year in the fourth quarter of 2011 to $60.40 per square foot per year in the fourth quarter of 2012.[46]

Looking forward, the office market will likely continue to improve gradually as employment in the key office-using industries such as professional services are expected to recover slowly. In 2013, millions of square feet of class A office space will become available as two of the four World Trade Center buildings are scheduled to be finished. Despite several big pre-leases, this may have an impact on overall market vacancy rates as well as asking rents.

Capital Gains

Capital gains are only realized when the sale price of assets exceeds the purchase price of assets. The disparity between current year asset prices and prior years' asset prices has important implications for capital gains realizations in current and future years.[47] Thus, the performance of financial markets, especially the equity and real estate markets, is vital in determining the value of these assets at the time of their purchase or sale (see Figure 51). If an investor purchased stocks in 2004 and sold them in 2007, capital gains were most likely realized since, on average, equity prices were much higher in 2007 than 2004, based on the Standard & Poor's 500 Composite Stock Price Index (S&P 500). On the other hand, if investors made purchases in 2007 and sold in 2009, the probability is higher that they suffered losses because average equity prices were lower in 2009 than in 2007. Losses on assets sold reduce taxable capital gains.

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[45] Cushman & Wakefield, "Manhattan Office Report," *MarketBeat*, 2Q11 (Second Quarter 2011).

[46] Cushman & Wakefield, "Manhattan Office Report," *MarketBeat Office Snapshot*, Q4 2012 (Fourth Quarter 2012).

[47] Assets include corporate stocks; bonds; put and call options; futures contracts; real estate; mutual funds; partnerships, S corporations, and estate or trust interests; livestock; timber; depreciable business real and personal property; passthrough gains and losses; and capital gain distributions.

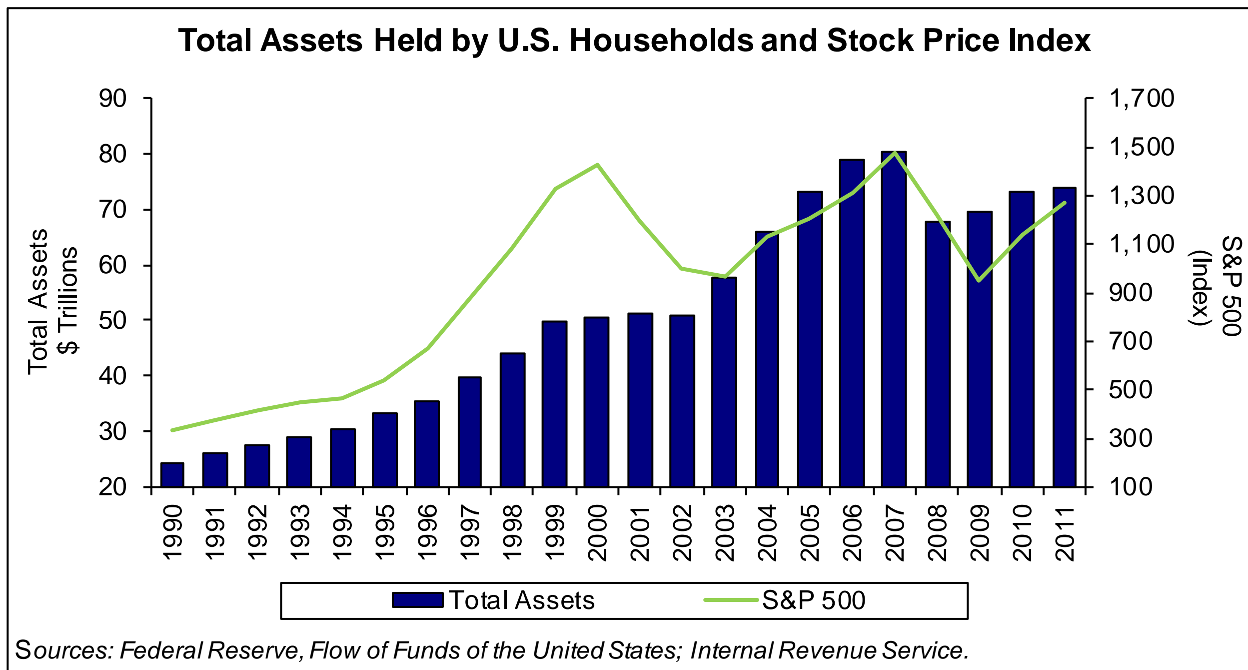


Figure 51

The contribution of the components of capital gains to total realized capital gains has been shifting in importance. Of all asset types in 2007, corporate stock accounted for 24.9 percent of total taxable capital gains at the national level, while passthrough gains represented the largest share of net gains of 40.1 percent. Real estate and capital gain distributions from the sale of mutual funds comprised 8.8 percent and 9.4 percent, respectively. In comparison, in 1999 corporate stock represented the largest share of taxable capital gains of 42.4 percent, passthrough gains accounted for 25.3 percent, real estate share was 10.0 percent, and capital gain distributions comprised 11.5 percent (see Figure 52).[48] Passthrough gains are capital gains associated with the sale of capital assets by a partnership, S corporation, estate or trusts, shareholder, or beneficiary level that are reported on individuals' income tax returns.[49]

[48] Internal Revenue Service, *Short-term and Long-term Capital Gains and Losses*, SOI Tax Stats for 1999 and 2007, Table 1a from each issue.

[49] Janette Wilson and Pearson Liddell, "Sales of Capital Assets Reported on Individual Tax Returns, 2007," *Statistics of Income Bulletin*, Winter 2010; http://www.irs.gov/pub/irs-soi/10winbulcapitalassets.pdf.

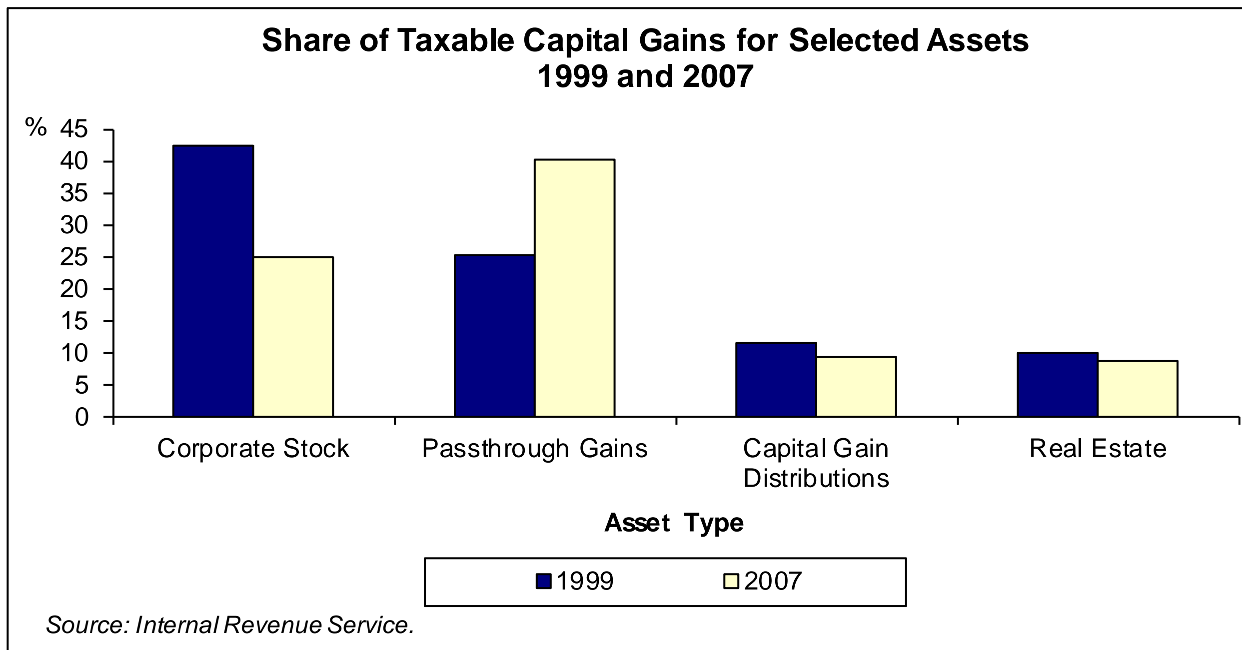
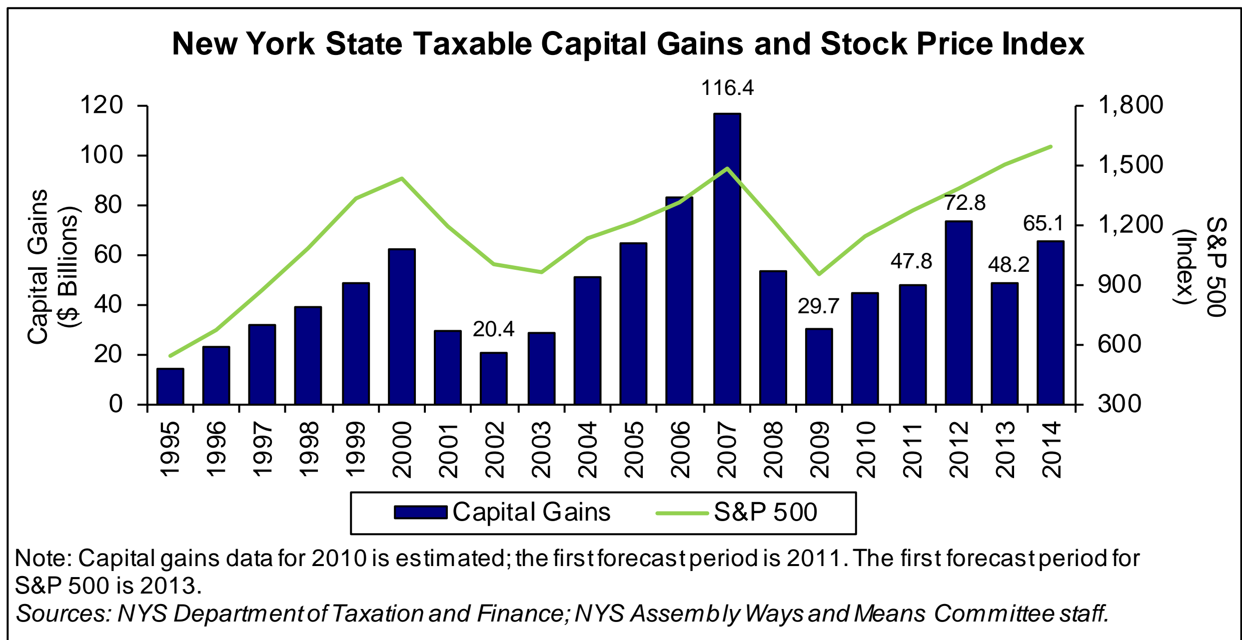


Figure 52

Despite improvements in the stock market beginning in mid-2009, taxable capital gains fell an additional 44.4 percent in 2009 to $29.7 billion after falling by $63.0 billion in 2008 as home prices continued to decline and investors faced stock prices that were lower than in prior years. Taxable capital gains rose by 50.5 percent to $44.7 billion in 2010 (see Figure 53). The increase in net gains was largely reflective of an increase in the financial markets since the housing market remained depressed. As weakness in the housing market persists, realizations through home sales are expected to comprise a smaller portion of capital gains than stock transaction gains.

Taxable capital gains increased 7.0 percent in 2011 to $47.8 billion as the performance of equity markets managed to improve further despite significant volatility in financial markets. Furthermore, investors who had bought lower priced stocks at the bottom of the market realized gains as stock prices inched up.



Note: Capital gains data for 2010 is estimated; the first forecast period is 2011. The first forecast period for S&P 500 is 2013.
Sources: NYS Department of Taxation and Finance; NYS Assembly Ways and Means Committee staff.

Figure 53

Capital gains are expected to grow to $72.8 billion or by 52.3 percent in 2012, partly attributed to gains being shifted from 2013 to 2012 as a result of an increase in capital gains taxes in 2013. Historical data suggests that investors are inclined to take gains when anticipating higher tax rates in the future. Consequently, capital gains are forecast to fall by 33.8 percent to $48.2 billion in 2013 because of the shift. With home prices expected to appreciate further and equity prices likely to accelerate, taxable capital gains is forecast to grow by 35.0 percent or to $65.1 billion in 2014.[50]

New York State Forecast Comparison

The NYS Assembly Ways and Means Committee staff's forecast for total nonfarm payroll employment growth in the State in 2013 is 1.2 percent (see Table 16). This forecast is equal to the Division of the Budget forecast. The staff's forecast for State wages in 2013 is 4.2 percent. This forecast is 0.9 percentage point above the Division of the Budget.

[50] A tax on unearned income of 3.8 percent as part of the healthcare package and the expiration of capital gains tax rates that had been extended in 2010 will result in an increase in tax rates on realized capital gains from 15 percent to approximately 24 percent. See *The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*, Public Law 111-312, 111th Congress, December 17, 2010; and *The Patient Protection and Affordable Care Act*, Public Law 111-148, 111th Congress, March 23, 2010.

The Assembly Ways and Means Committee staff's forecast for total nonfarm payroll employment growth in the State in 2014 is 1.3 percent. This forecast is 0.1 percentage point above the Division of the Budget. The staff's forecast for State wages in 2014 is 4.8 percent. This is 0.2 percentage points below the Division of the Budget.

Table 16

New York State Forecast Comparison (Percent Change)

	Actual 2011	Estimate 2012	Forecast 2013	Forecast 2014
Employment				
Ways and Means	1.2	1.4	1.2	1.3
Division of the Budget	1.2	1.4	1.2	1.2
Wages				
Ways and Means	3.7	2.2	4.2	4.8
Division of the Budget	3.7	3.1	3.3	5.0

Sources: NYS Assembly Ways and Means Committee staff; NYS Division of Budget, FY 2014 Executive Budget Financial Plan, February 2013.

RISKS TO THE FORECAST

Many of the risks to the economic outlook of the nation and New York State that were present during and at the end of the recent recession remain. Problems in the U.S. economy, particularly weaknesses in both the labor market and the housing market, remain. Furthermore, considerable uncertainty for both consumers and businesses from a variety of factors exists. The resolution of domestic fiscal issues including the sequestration and the debt ceiling situation add considerable uncertainty to the outlook. Automatic federal spending cuts, which are scheduled to take effect on March 1, 2013, would have a significant negative impact on the economy unless a bargain was negotiated to avoid them. The path of the European economy continues to weigh heavily on the economy and curtail optimism for the future. Persistent uncertainty holds downside risk for the outlook; however, if businesses and consumers could see a clear path to a better economic situation, there would be potential upside for consumer and business spending. In addition, if the housing recovery were to be derailed it could have detrimental effects on the outlook.

The growth rate of the world economy remains a concern, and other global issues such as unrest in the Middle East and volatility in oil prices add uncertainty to the outlook. If global economic growth should be slower than anticipated, the ability of the United States economy to grow would be negatively impacted. The European debt crisis and the overall health of the eurozone remain a risk to the global recovery, and any deterioration beyond what is assumed in this report may negatively affect the U.S. economy.

The current global and national economic climate presents particular challenges and risks to the New York State forecast. The European sovereign debt crisis and the associated European banking sector turmoil may roil financial markets again, having direct negative impacts on Wall Street. The Wall Street landscape has continued to change; hence, there is great ambiguity surrounding the State outlook. Wall Street and the financial markets play a central role in the State economy, and drastic cuts to or changes in the composition of Wall Street compensation (including bonuses) have critical implications for the economic health of the State. In addition, the extent to which regulations such as the Dodd-Frank Wall Street Reform Act and Basel III foster continued hesitation or inaction on the part of financial firms could infuse more uncertainty into the forecast.

APPENDIX A

U.S. Expansions since World War II (Based on NBER Business Cycle Dates)				
Trough to Peak	**Expansions in the first three years following the end of a recession**			
	GDP	Consumption	Investment	Employment
1961:Q1-1969:Q4	21.4% $602.6	22.4% $400.9	42.5% $112.7	6.8% 3,666.0
1970:Q4-1973:Q4	15.6% $665.0	14.6% $400.8	47.1% $215.1	9.3% 6,546.7
1975:Q1-1980:Q1	19.7% $944.2	18.1% $567.7	57.6% $283.2	9.3% 7,170.0
1980:Q3-1981:Q3	4.4% $253.3	2.3% $86.3	22.5% $147.2	1.2% 1,096.0
1982:Q4-1990:Q3	19.6% $1,150.8	13.6% $740.5	55.3% $343.2	10.2% 9,016.0
Average over All Previous Expansions	**16.2%** **$583.2**	**13.6%** **$340.4**	**36.8%** **$155.3**	**7.8%** **4,925.0**
1991:Q1-2001:Q1	**12.0%** **$953.3**	**12.4%** **$654.0**	**37.8%** **$337.5**	**2.9%** **3,169.3**
2001:Q4 - 2007:Q4	**10.6%** **$1,200.7**	**10.8%** **$859.8**	**25.8%** **$445.5**	**0.5%** **686.0**
2009:Q2 - 2012:Q4	**7.5%** **$946.6**	**7.5%** **$672.6**	**38.1%** **$531.0**	**3.2%** **4,545.3**

Note: GDP, consumption, and investment are in chained 2005 dollars. Employment is nonfarm total and in thousands. The percentages are the percent changes from the trough levels. The peak and trough dates are the dates picked by the NBER Business Cycle Dating Committee.

GDP has been expanding for 14 quarters. To compare growth in this expansion to previous expansions over the same period of time, GDP for all previous expansions is 14 quarters out from the trough, except in the cases of GDP expansions that lasted shorter than 14 quarters. The same was done for consumption (14 quarters expansion), investment (13 quarters expansion), and employment (11 quarters expansion).

Source: U.S. Bureau of Economic Analysis; NYS Assembly Ways and Means Committee staff.

APPENDIX B

NYS Employment and Wages in NAICS Sectors						
	Employment (Thousands)			Wages ($ in Billions)		
	Estimate 2012	Forecast 2013	Forecast 2014	Estimate 2012	Forecast 2013	Forecast 2014
Total	**8,540.0**	**8,642.5**	**8,758.5**	**532.3**	**554.9**	**581.6**
Education & Health	1,625.1	1,647.8	1,672.7	76.7	80.9	85.3
Government	1,374.1	1,364.4	1,361.0	77.3	78.4	79.7
Retail Trade	909.8	921.1	933.1	28.2	29.4	30.8
Other Services	768.1	780.9	792.8	30.7	31.9	33.4
Financial Activities	674.5	674.5	677.2	106.1	111.6	118.0
Leisure & Hospitality	797.3	823.4	851.4	22.1	23.1	24.4
Professional Services	593.7	613.0	634.0	57.2	60.6	64.6
Manufacturing	462.1	463.0	463.7	28.4	29.3	30.2
Construction	312.6	322.6	335.4	19.6	20.8	22.2
Wholesale Trade	333.5	335.9	338.5	25.4	26.2	27.4
Transport & Utilities	256.0	257.2	259.3	14.1	14.7	15.5
Information	259.1	257.8	255.9	25.6	26.2	27.2
Management of Companies	134.5	136.6	139.3	19.3	20.4	21.4

Note: Some NAICS sectors are grouped with others. For sector definitions, see Appendix H.

Sources: NYS Department of Labor, QCEW; NYS Assembly Ways and Means Committee staff.

NYS Employment and Wage Growth in NAICS Sectors
(Percent Change)

	Employment			Wages		
	Estimate 2012	Forecast 2013	Forecast 2014	Estimate 2012	Forecast 2013	Forecast 2014
Total	**1.4**	**1.2**	**1.3**	**2.2**	**4.2**	**4.8**
Information	1.8	(0.5)	(0.8)	4.8	2.6	3.6
Government	(1.4)	(0.7)	(0.2)	0.5	1.4	1.6
Manufacturing	0.1	0.2	0.1	2.6	2.8	3.3
Financial Activities	0.1	0.0	0.4	(3.7)	5.2	5.7
Wholesale Trade	1.0	0.7	0.8	4.3	3.3	4.6
Transport & Utilities	0.1	0.5	0.8	4.3	4.3	4.8
Retail Trade	2.2	1.2	1.3	4.7	4.2	4.7
Education & Health	1.3	1.4	1.5	4.1	5.3	5.5
Other Services	1.9	1.7	1.5	4.4	3.9	4.6
Management of Companies	1.3	1.6	2.0	1.9	5.4	5.3
Leisure & Hospitality	4.4	3.3	3.4	6.7	4.5	5.9
Professional Services	3.8	3.3	3.4	6.2	6.0	6.7
Construction	1.8	3.2	4.0	3.7	6.0	7.2

Note: Some NAICS sectors are grouped with others. For sector definitions, see Appendix H.

Sources: NYS Department of Labor, QCEW; NYS Assembly Ways and Means Committee staff.

APPENDIX D

New York State Economic Outlook State Fiscal Year		Actual 2011-12	Estimate 2012-13	Forecast 2013-14	Forecast 2014-15
Employment	***Percent Change***	1.3	1.3	1.2	1.4
	Level	8,453.6	8,564.5	8,670.0	8,788.5
Personal Income	***Percent Change***	2.9	3.4	3.9	5.7
	Level	981.4	1,015.0	1,054.4	1,114.3
Total Wages	***Percent Change***	1.8	3.1	4.5	5.1
	Level	522.2	538.5	562.7	591.5
Base Wages	***Percent Change***	4.4	2.9	4.0	4.5
	Level	465.4	478.7	497.6	519.8
Variable Compensation	***Percent Change***	(15.5)	5.3	8.8	10.2
	Level	56.8	59.8	65.1	71.8
CPI (1982-84=100)	***Percent Change***	3.0	1.7	1.9	1.9
	Level	249.3	253.6	258.3	263.2

Note: Employment level is in thousands; wage and personal income levels are in billions of dollars.
Sources: U.S. Bureau of Economic Analysis; NYS Department of Labor, QCEW; U.S. Bureau of Labor Statistics; NYS Assembly Ways and Means Committee staff.

APPENDIX E

U.S. Economic Outlook (Levels)				
	Actual	**Estimate**	**Forecast**	**Forecast**
	2011	**2012**	**2013**	**2014**
Real GDP*	13,299.2	13,593.8	13,857.3	14,247.8
Real Consumption*	9,428.8	9,605.3	9,785.2	10,032.3
Real Investment*	1,744.0	1,912.0	2,023.1	2,203.7
Real Exports*	1,776.9	1,837.0	1,887.8	1,988.3
Real Imports*	2,184.9	2,237.6	2,282.4	2,396.0
Real Government*	2,524.0	2,481.8	2,450.4	2,426.3
*Federal**	1,047.1	1,024.0	997.4	972.7
*State and Local**	1,482.0	1,462.5	1,456.9	1,457.6
Personal Income**	12,947.3	13,400.5	13,748.6	14,400.0
*Wages & Salaries***	6,661.3	6,874.9	7,114.2	7,456.5
Corporate Profits**	1,827.0	1,920.6	2,009.3	2,076.7
Productivity (1992=100)	110.2	111.6	112.8	114.4
Employment***	131.5	133.7	135.7	137.9
CPI-Urban (1982-84=100)	224.9	229.6	233.8	238.4
S&P 500 Stock Price (1941-43=10)	1,268.9	1,379.6	1,503.6	1,588.7
Treasury Bill Rate (3-month)****	0.1	0.1	0.1	0.1
Treasury Bond Rate (10-year)****	2.8	1.8	2.0	2.6

* In billions of chained 2005 dollars.
** In billions of dollars.
*** In millions.
**** Annual average rate.

Sources: U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics; Federal Reserve; Standard and Poor's; NYS Assembly Ways and Means Committee staff.

APPENDIX F

U.S. Economic Outlook (Percent Change)	Actual 2011	Estimate 2012	Forecast 2013	Forecast 2014
Real GDP	1.8	2.2	1.9	2.8
Real Consumption	2.5	1.9	1.9	2.5
Real Investment	5.2	9.6	5.8	8.9
Real Exports	6.7	3.4	2.8	5.3
Real Imports	4.8	2.4	2.0	5.0
Real Government	(3.1)	(1.7)	(1.3)	(1.0)
Federal	(2.8)	(2.2)	(2.6)	(2.5)
State and Local	(3.4)	(1.3)	(0.4)	0.0
Personal Income	5.1	3.5	2.6	4.7
Wages & Salaries	4.0	3.2	3.5	4.8
Corporate Profits	7.3	5.1	4.6	3.4
Productivity	0.7	1.3	1.1	1.5
Employment	1.2	1.7	1.4	1.7
CPI-Urban	3.1	2.1	1.8	2.0
S&P 500 Stock Price	11.4	8.7	9.0	5.7
Treasury Bill Rate (3-month)*	0.1	0.1	0.1	0.1
Treasury Note Rate (10-year)*	2.8	1.8	2.0	2.6

* Annual average rate.

Sources: U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics; Federal Reserve; Standard & Poor's; NYS Assembly Ways and Means Committee staff.

APPENDIX G

U.S. Economic Outlook State Fiscal Year (Percent Change)	Actual 2011-12	Estimate 2012-13	Forecast 2013-14	Forecast 2014-15
Real GDP	2.0	2.0	2.2	2.9
Real Consumption	2.2	1.8	2.1	2.6
Real Investment	7.6	7.1	6.9	9.4
Real Exports	5.5	2.9	3.5	5.4
Real Imports	3.3	1.8	3.0	5.2
Real Government	(3.1)	(1.4)	(1.3)	(0.9)
Federal	(3.3)	(2.1)	(2.6)	(2.5)
State and Local	(3.0)	(0.9)	(0.3)	0.2
Personal Income	4.2	3.4	3.1	4.9
Wages & Salaries	3.5	3.1	3.9	5.0
Corporate Profits	8.7	3.8	4.3	3.2
Productivity	0.8	1.4	1.1	1.5
Employment	1.4	1.6	1.5	1.8
CPI-Urban (1982-84=100)	3.3	1.8	1.9	2.0
S&P 500 Stock Price (1941-43=10)	8.1	10.6	7.2	6.5
Treasury Bill Rate (3-month)*	0.0	0.1	0.1	0.2
Treasury Note Rate (10-year)*	2.4	1.8	2.2	2.8

* Fiscal year average rate.
Sources: U.S. Bureau of Economic Analysis; U.S. Bureau of Labor Statistics; Federal Reserve; Standard & Poor's; NYS Assembly Ways and Means Committee staff.

APPENDIX H

The North American Industry Classification System (NAICS)

Code	NAICS Title
11	**Agriculture, Forestry, Fishing and Hunting**
111	Crop Production
112	Animal Production
113	Forestry and Logging
114	Fishing, Hunting and Trapping
115	Support Activities for Agriculture and Forestry
21	**Mining**
211	Oil and Gas Extraction
212	Mining (except Oil and Gas)
213	Support Activities for Mining
22	**Utilities**
221	Utilities
23	**Construction**
236	Construction of Buildings
237	Heavy and Civil Engineering Construction
238	Specialty Trade Contractors
31-33	**Manufacturing**
311	Food Manufacturing
312	Beverage and Tobacco Product Manufacturing
313	Textile Mills
314	Textile Product Mills
315	Apparel Manufacturing
316	Leather and Allied Product Manufacturing
321	Wood Product Manufacturing
322	Paper Manufacturing
323	Printing and Related Support Activities
324	Petroleum and Coal Products Manufacturing
325	Chemical Manufacturing
326	Plastics and Rubber Products Manufacturing
327	Nonmetallic Mineral Product Manufacturing
331	Primary Metal Manufacturing
332	Fabricated Metal Product Manufacturing
333	Machinery Manufacturing
334	Computer and Electronic Product Manufacturing
335	Electrical Equipment, Appliance, and Component Manufacturing
336	Transportation Equipment Manufacturing
337	Furniture and Related Product Manufacturing
339	Miscellaneous Manufacturing
42	**Wholesale Trade**
423	Merchant Wholesalers, Durable Goods
424	Merchant Wholesalers, Nondurable Goods
425	Wholesale Electronic Markets and Agents and Brokers

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The North American Industry Classification System (NAICS) -- *(continued)*

Code	NAICS Title
44-45	**Retail Trade**
441	Motor Vehicle and Parts Dealers
442	Furniture and Home Furnishings Stores
443	Electronics and Appliance Stores
444	Building Material and Garden Equipment and Supplies Dealers
445	Food and Beverage Stores
446	Health and Personal Care Stores
447	Gasoline Stations
448	Clothing and Clothing Accessories Stores
451	Sporting Goods, Hobby, Book, and Music Stores
452	General Merchandise Stores
453	Miscellaneous Store Retailers
454	Nonstore Retailers
48-49	**Transportation and Warehousing**
481	Air Transportation
482	Rail Transportation
483	Water Transportation
484	Truck Transportation
485	Transit and Ground Passenger Transportation
486	Pipeline Transportation
487	Scenic and Sightseeing Transportation
488	Support Activities for Transportation
491	Postal Service
492	Couriers and Messengers
493	Warehousing and Storage
51	**Information**
511	Publishing Industries (except Internet)
512	Motion Picture and Sound Recording Industries
515	Broadcasting (except Internet)
516	Internet Publishing and Broadcasting
517	Telecommunications
518	Internet Service Providers, Web Search Portals, and Data Processing Services
519	Other Information Services
52	**Finance and Insurance**
521	Monetary Authorities - Central Bank
522	Credit Intermediation and Related Activities
523	Securities, Commodity Contracts, and Other Financial Investments and Related Activities
524	Insurance Carriers and Related Activities
525	Funds, Trusts, and Other Financial Vehicles
53	**Real Estate and Rental and Leasing**
531	Real Estate
532	Rental and Leasing Services
533	Lessors of Nonfinancial Intangible Assets (except Copyrighted Works)

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The North American Industry Classification System (NAICS) -- *(continued)*	
Code	**NAICS Title**
54	**Professional, Scientific, and Technical Services**
541	Professional, Scientific, and Technical Services
55	**Management of Companies and Enterprises**
551	Management of Companies and Enterprises
56	**Administrative and Support and Waste Management and Remediation Services**
561	Administrative and Support Services
562	Waste Management and Remediation Services
61	**Educational Services**
611	Educational Services
62	**Health Care and Social Assistance**
621	Ambulatory Health Care Services
622	Hospitals
623	Nursing and Residential Care Facilities
624	Social Assistance
71	**Arts, Entertainment, and Recreation**
711	Performing Arts, Spectator Sports, and Related Industries
712	Museums, Historical Sites, and Similar Institutions
713	Amusement, Gambling, and Recreation Industries
72	**Accommodation and Food Services**
721	Accommodation
722	Food Services and Drinking Places
81	**Other Services - except Public Administration**
811	Repair and Maintenance
812	Personal and Laundry Services
813	Religious, Grantmaking, Civic, Professional, and Similar Organizations
814	Private Households
92	**Public Administration**
921	Executive, Legislative, and Other General Government Support
922	Justice, Public Order, and Safety Activities
923	Administration of Human Resource Programs
924	Administration of Environmental Quality Programs
925	Administration of Housing Programs, Urban Planning, and Community Development
926	Administration of Economic Programs
927	Space Research and Technology
928	National Security and International Affairs

Source: Executive Office of the President, Office of Management and Budget, North American Industry Classification System, United States, 2002.