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It's Later in the Economic Cycle Than It Used To Be

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Preface

This paper, “It’s Later in the Economic Cycle Than It Used To Be,” is part of the NJLM Educational Foundation’s ongoing “Friends of Local Government” Policy Paper series.

Despite being in the midst of the longest economic expansion in the history of the United States, municipal officials struggle with a persistent sense of uncertainty, with worrying mixed signals that challenge conventional expectations. This paper glances in the economic rear view mirror, starting five recessions ago, to examine the potential municipal finance future. The article is contributed by James W. Hughes, University Professor and Distinguished Professor of Urban Planning, Dean Emeritus of the Edward J. Bloustein School of Planning and Public Policy, Rutgers, The State University of New Jersey.

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About the Author

James Hughes is a University Professor and Distinguished Professor of Urban Planning and Dean Emeritus of the Edward J. Bloustein School of Planning and Public Policy (EJBPPP) at Rutgers, The State University. Dr. Hughes is a nationally-recognized expert on demographics, housing, and regional economics and served as Dean of EJBPPP from 1995 through 2017. A prolific researcher and scholar, he is author or co-author of 34 books and monographs and more than 150 articles. Among his books are *New Jersey’s Postsuburban Economy*, published by the Rutgers University Press, and *The Atlantic City Gamble*, published by the Harvard University Press. He was also a contributing editor to the magazine *American Demographics* for 14 years. He has provided extensive budgetary and economic testimony before many New Jersey State Legislative committees, and has given numerous policy briefings in Washington, D.C. and Trenton on demographics, housing, and the economy. He has served on the Governor’s Commission on Jobs, Growth, and Economic Development, the Governor’s World Class Economy Task Force, and the Governor’s Property Tax Commission.

Among his awards are the 2014 Distinguished Service Award of the New Jersey State League of Municipalities, the Rutgers School of Engineering 2014 Medal of Excellence, the Warren Hill Award of the New Jersey Bankers Association, the Rutgers Richard P. McCormick Award for Excellence in Alumni Leadership, the Distinguished Service Award of the New Jersey Chapter of the American Planning Association, and the Rutgers Presidential Award for Distinguished Public Service. Dean Hughes has been both a Woodrow Wilson and Ford Foundation Fellow.

Introduction

The summer of 2019 should have been a time for economic celebration. According to historic records of the National Bureau of Economic Research, which date back to 1854, this past July marked the longest economic expansion in history of the United States–121 months in length. It started a full decade ago–June 2009–and is now proceeding through its 11th year. Champagne corks should have been popping in recognition of this remarkable achievement, a comeback whose duration could not have been imagined when we were mired in the dark days of the Great 2007-2009 Recession. But the celebration has been muted, to say the least. Nonetheless, congratulations to all municipal officials are still in order–you have just lived through a historic record-breaking expansion. In the future, you will be able to regale your grandchildren with tales of a remarkable experience.

Surrounding this extraordinary economic event, however, is a sense of persistent uncertainty. Conflicting signals abounded in the first half of 2019. On the positive side, job markets still appeared to be resilient, with the nation's employment growth for the first six months of 2019 still growing far faster than the growth in the labor force, as it has done for more than nine-straight years. The resulting unemployment rate has tumbled to strikingly low levels–consistently below 4%–rates, which in the past raised the specter of imminent inflation and rising interest rates. But inflation was still nowhere in sight and interest rates have failed to increase, challenging conventional economic expectations (as well as raising serious question as to the adequacy of the unemployment rate metric as a decoder of labor market conditions.) Upbeat consumer spending remained a deep reservoir of economic strength–"shop till you drop" still lives in America. And the stock market surged, rising by almost 20% during the first half of the year.

On the negative side, gloom increasingly made its presence felt. A global economic slowdown became increasingly apparent as 2019 progressed. Bond markets have been flummoxed and worried as the interest rates on long-term debt instruments slipped below the rates on short-term debt instruments. Economists have labeled this condition an inverted yield curve, which is often a harbinger of an oncoming recession. Little resolution of the United States-China trade relations appears likely, with trade tensions increasingly looking like a continued feature of a new economic landscape. Concurrently, lower manufacturing activity, sinking business confidence indices, and a slowdown in business investment have added further fuel to the fires of mid-2019 uncertainty. A key question at this point in our mature business cycle is whether an economic slowdown and subsequent recession is now on the national horizon. This possibility has translated into expectations that the Federal Reserve will embark on a trajectory of lower interest rates to ensure continued economic expansion, a marked reversal of its 2018 stance of raising interest rates in order to get ahead of the inflation curve. A global easing cycle–a lowering of interest rates by central banks worldwide–also gained momentum as the second half of 2019 progressed.

States and municipalities are enveloped in this broader national and global uncertainty. In retrospect, the United States economy has undoubtedly been riding high to this point, keeping the most ominous local fiscal concerns at bay.

While the United States still has a long way to go to match Australia–the "wonder down under" hasn't had a recession since 1991, 28 years ago–concern is growing about whether the nation's expansion can continue to ride high given its record length. But the reality is that expansions rarely die of old age or longevity, i.e., they rarely die in their beds. Often, their demise is caused by the bursting of an overseen economic bubble, or by direct actions of the Federal Reserve confronting an overheated economy that is beset by accelerating inflation. In the latter case, it has been argued that the Federal Reserve usually murders an expansion by sharply increasing interest rates. In fact, over 50 years ago, then chair of the Federal Reserve, William McChesney Martin, asserted that the job of the central bank was to take away the punch bowl when the economic party was really warming up. Perhaps that was what was happening in 2018, when the Fed raised interest rates four times, but certainly not in 2019. Given the likely accommodative stance of the Federal Reserve going forward, a key question revolves around the conditions that would yield a severe national economic setback and recession–and significant municipal fiscal pain. A glance in the economic rear view mirror, starting five recessions ago, may prove useful.

The Historical Recession Record

The 1973-75 and 1981-82 recessions were the product of two unprecedented oil shocks which led to massive increases in energy prices and inflation. The nation and New Jersey suffered severe economic consequences from these events. But oil and natural gas production in the United States has surged during the past decade, changing the world energy order. Thus, external oil shocks pose much less of a threat to the nation's economic well-being going forward.

So, let's look in more detail at the following three economic setbacks that enveloped the Garden State, starting with the 38-month-long 1989 to 1992 recession. It was the worst economic downturn in New Jersey since the Great Depression. The state's recession stood in marked contrast to a national setback (1990-1991) which was much more modest in both its length and severity. This differential was the result of the bursting of a severe real estate bubble in New Jersey. A unique bicoastal real estate boom characterized the 1982-1990 national expansion, with New Jersey one of its major epicenters. The great suburban office building boom that swept the state swelled the property tax bases of many of its constituent municipalities. By 1989, 80% of all of the commercial rental office space ever built in the history of New Jersey had gone up in the preceding nine years. One legacy of the overbuilt 1980s suburban office inventory is the current glut of aging obsolete space, the root of today's suburban office problem.

Overheated residential markets also bolstered many municipal fiscal positions. Between 1980 and 1988, home prices nationally increased by 45%. In New Jersey, they increased by 145%. Those were heady times for property assessors and appraisers. The following phrases captured the spirit of the decade: "People who owned their own homes during the boom seemingly made more money going to sleep at night than they did going to work during the day," "New Jersey's newest demographic was the three-income (earner) family, comprising two spouses and the house," and "Real estate and real property ownership replaced sex as the everyday fantasy of most New Jerseyans." But it all came crashing down in 1989 when the real estate bubble burst. The aftereffects are still with us.

The state and nation emerged from the recession gradually as the 1990s advanced. New Jersey was bolstered by what we now call America's "Great Transmillennial Economic Expansion," which started in March 1991 and ended in March 2001. Until it was eclipsed by the current upcycle, it was the longest expansion in the nation's history–120 months in length or a full 10 years. It was an expansion of robust economic growth, producing a decade of general prosperity for New Jersey.

However, the second half of this expansion was actually fueled by a high-technology, dot-com bubble, which ultimately caused its demise. A key metric of the excesses that emerged was the NASDAQ Composite Index. Driven by speculative, internet-based dot-com stocks, the index went from 1,000 in 1996 to over 5000 in 2000–a quintupling in just 4 years. New Jersey was one of the epicenters of the high-technology bubble due to the vast scale of its telecommunications sector. In fact, so robust its presence in the I-78 office corridor that the latter assumed the moniker of “telecommunications corridor.”

Unfortunately, you are rarely cognizant that you are in a bubble economy until its bursts. In 2000, dot-com became dot-bomb, leading to a stock-market meltdown. The NASDAQ Composite Index fell by 78%, and the stock market’s losses totaled $5 trillion. This quickly led to the March 2001 to November 2001 national recession, which lasted just eight months because of extraordinary actions of the Federal Reserve, extraordinary actions which ultimately fueled a subsequent bubble.

Economic recovery ensued in November 2001, as the nation again entered the expansionary stage of the business cycle. The 2001-2007 economic expansion lasted 73 months and came to an end in December 2007. As is clear today, this expansion was also propelled by a bubble–an unprecedented national and global housing fantasy linked to an unprecedented credit bubble. America’s homeownership rate soared from its historic 64% rate to over 69%, breaking all historic records. But inevitably the bubble would burst. That’s what happened in December 2007 when the great housing and credit meltdown began in earnest. The world was soon staring into the economic abyss as the Great Recession unfolded.

An old adage suggests that economic wild parties are often followed by prolonged economic hangovers. And, America and New Jersey had a very prolonged hangover. State and municipal financial systems fell into grave straits. The Great 2007-2009 Recession–the nation’s worst downturn since the Great Depression–lasted 18 months, starting in December 2007 and ending in June 2009. The nation lost an astonishing 9 million jobs during the official recession and its aftermath, while New Jersey lost more than one quarter of a million. Obviously, after-party economies are not very pretty.

So, the three most recent historical business-cycle setbacks were spawned by bursting economic bubbles. What may be equally important for today’s outlook is that the expansions preceding these recessions were thus bolstered by unforeseen and unsustainable excesses, i.e., the economic advances that took place during the expansions were not firmly based on sustainable foundations, but were also dependent on untenable short-term excesses. That was particularly the case during the runup to the Great Recession.

Current Upcycle

As noted earlier, in June 2009–just over 10 years ago–economic contraction was technically supplanted by recovery. Compared to past national upcycles, growth has not been especially buoyant during the current expansion, at least when gauged by economic output (GDP). But that may be partially a consequence of the lingering aftereffects of the worst financial crisis since the Great Depression of the 1930s, or perhaps due to the absence of economic excesses (bubbles) stimulating stronger output growth. Nonetheless, by June 2019, the nation has added 21.6 million jobs to its total employment ranks since the recessionary trough while New Jersey has added approximately 375,000 jobs. At the same time that the state’s gain is far in excess of its recessionary employment losses (approximately 256,000 jobs), it actually represents just a modest advance during the entire expansion period.

Two metrics benchmark this reality. At the start of the expansion, New Jersey accounted for approximately 2.9% of the employment base of the United States. That would represent the share of national employment growth that New Jersey would have to capture in order to match the national pace of growth. However, New Jersey's share of post-recession national employment growth through mid-2019 was only 1.7% (375,000 out of 21.6 million). So, the state has not been able to maintain growth parity with the nation.

The same conclusion is evidenced by differential employment growth rates. From the end of the Great Recession through mid-2019, total employment in the United States increased by 16.6%. In New Jersey, total employment increased by only 9.8%. This lag is not solely a Garden State phenomenon. It is characteristic of the broader Northeast and Midwest regional environment. Compared to our immediate neighbors (competitors), New Jersey has been growing faster than Connecticut and Pennsylvania, but trails New York State. However, extracting rapidly growing New York City from New York State yields a growth rate that is similar to that of New Jersey. Nonetheless, this overall trailing growth position leaves New Jersey and its state neighbors vulnerable to a national economic slowdown, and highly vulnerable to a full-fledged national recession. What could instigate the next economic downturn in the United States?

Downturn-Spawning Events

Absent an international incident/conflict of major proportions–and remaining cognizant of the fact that bubbles are recognizable mainly in hindsight–there are no obvious recession-causing excesses on the economic radar screens. The nation's growth has been slower than past expansions but that has partially been due to fundamental structural changes in the economy. Shifts from construction and manufacturing, the more cyclical sectors of the economy, toward the less volatile service sectors have resulted in more stable, but less-rapid, growth. At the same time, in contrast to the preceding three expansions, it is possible that there are no unsustainable excesses "juicing-up" growth. This raises the possibility of an upcycle lasting much longer than historical norms. The average postwar expansion in the United States is just slightly under five years, which is less than one-half of the length of the current expansion.

As *The Economist* magazine recently pointed out, the familiar triggers for a recession are still absent, suggesting that "moderately good times can roll on for years yet."[1] But, as the economy has changed, so too have the possible expansion-ending causal factors, according to *The Economist.* For example, increasingly important globally interconnected firms with their complex interdependent multi-nation supply chains stand at heightened risk as trade and tariff tensions expand. A sharp escalation here could be recession inducing. Another potential trigger may stem from an entire economy that may have become addicted to cheap money. Given the sharp increase in private debt the past half-decade, rising interest rates could cause widespread stress for firms and households, to say nothing of a stock market now perched at record levels. Other concerns loom, such as the quandary raised by potential public policy excesses. Frustrations with slow growth, lagging (until recently) wage levels, and sluggish gains in living standards have the potential of producing wild public policies from both sides of the political

[1] *The Economist*, Volume 432, Number 9151, July 13th-19th 2019.

aisle that could have unanticipated negative economic effects. The bottom line is that while the traditional factors that spawned recessions are in remission, new ones are emerging to fill the void. In other words, the next recession will eventually arrive on time, but its causal factors still remain under wraps.

Looking Forward

Based on the first six months of 2019, it appears that New Jersey is on track to gain 51,000 total jobs for the year. It should be acknowledged that monthly job figures have been quite volatile at times and are eventually subject to revision at year's end. Thus, this preliminary estimate may be low or high when the totals are ultimately finalized (March 2020). Nonetheless, this preliminary estimate, 51,000 jobs, exceeds the 39,400 job increase of 2018 and the 48,600 job gain of 2017.

So, it's plausible to suggest that the New Jersey economic position is more than treading water. It is also plausible to suggest that its actual employment growth is being inhibited by labor shortages, i.e., employers have open available positions but the labor supply is insufficient to fill them. The state's record-low 3.5% unemployment rate this past June may be indicative of this quandary.

New statewide public policy initiatives may improve the state's overall performance in the long term, but in the meantime New Jersey's municipalities will continue to face a relatively constrained fiscal future similar to that of the immediate past. As long as the nation's good times continue to roll, the state and its municipal jurisdictions can avoid excessive fiscal stress and severe problems. But, as that famous New Jersey economist, Yogi Berra, has allegedly observed: "it's later in the economic cycle than it used to be." Just how late remains open to question.