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Inter-Departmental Memo

To: Hon. Judy Jacobs, Chairperson
Members of the Budget Review Committee

From:  Eric C. Naughton, Director
Legislative Budget Review

Date: August 13, 2008

Re: Second Quarter 2008 Regional Economic Forecast

Attached is a copy of the Office of Legislative Budget Review's Second Quarter 2008 Regional Economic Forecast. This report is intended to assist the Legislature in making policy decisions and in assessing budgetary forecasts. The data presented are the most current as of the date of circulation and are the most geographically relevant.

cc: Hon. Howard Weitzman, County Comptroller
Martha Wong, Acting Director, OMB
Eric Eichenlaub, Majority Counsel
Christopher Ostuni, Minority Counsel
Evan Cohen, Executive Director, NIFA
Dan McCloy, Special Assistant Minority
Tom Stokes, Deputy County Executive
Charo Ezdrin, Director of Legislative Affairs
Chumi Diamond, Clerk of the Legislature
Edgar Campbell, Chief of Staff
Roseann D'Alleva, Majority Finance

AN ECONOMIC OUTLOOK OF NASSAU COUNTY SECOND QUARTER 2008

NASSAU COUNTY OFFICE OF LEGISLATIVE BUDGET REVIEW

The County's Economic outlook remains bleak as the impact of the downturn in the housing market continues into the second half of 2008. With the highest inflation in 17 years, the Federal Reserve is juggling its policies to safeguard against inflation, yet keep recessionary forces in check.¹ Further, due to growing health care and export sectors, real GDP has not shown signs of decline, while at the same time, important monthly indicators - such as job creation and housing show weakness.

This report focuses on Nassau County's economic position as it relates to some significant economic indicators that have been impacted by, and impact our national and regional economies as we enter into the second half of 2008: 1) housing indicators, 2) employment, 3) retail sales and 4) gross domestic product. Forecasts were obtained from Moody's Economy.com, a leading independent provider of economic, financial, and industry research.

Overview:

The US economy and Nassau County will be faced with a range of problems in the upcoming months and as we enter into 2009 as a result of 1) the deep recession in the real estate market, 2) the seeming breakdown of self-regulation in the banking system, 3) the impact on investment, sales and property tax revenues, 5) falling payroll

employment, 6) soaring fuel and food prices, 7) plunging consumer confidence, and 8) tighter lending standards imposed by banks in the face of billions of dollars lost from bad mortgage loans. Despite various remedies proposed by the federal government to remedy the housing crisis, including averting foreclosure, and extending resources to Fannie Mae and Freddie Mac, economists are not optimistic that the economy will turn around anytime soon. According to Allen Sinai, chief economist at Decision Economics, "there's no pickup, there's no recovery from where we are six months ahead."²

Some economists maintain that the "wealth effect" once felt by consumers as a result of their real estate holdings has now changed into a "poverty effect". The increase in consumer spending that accompanies an increase or perceived increase in wealth that people feel as their home prices go up in value is now a poverty effect as their home values decline. It is estimated that each 5% decline in home values erases \$1.0 trillion of Americans' net worth. The Federal Reserve Board estimates that for every \$100 change in home values, consumer spending changes by \$3.75 and many economists think the ratio is higher--\$7.00 per \$100. If they're right, a 5% property value decline would cut consumer spending by as much as \$70 billion per year.³

¹ The Fed held to the 2% rate after seven consecutive reductions in a campaign that has brought rates down by 3.25 percentage points since mid-September when the Fed began its expansionary approach

² Moscrip, L. (2008). Economic outlook retreats in monthly survey: conference Board report shows decline in leading indicators in June. *CNNMoney.com* (July 21, 2008)

³ The Financial Crisis in the United States. *Policy Today*. (May 9, 2008)

Overall, economists are still evenly divided as to whether the U.S. is in a recession. A survey of 54 economists at corporations, universities and trade associations shows 51% of economists believe we are now in recession, compared to 67% in April.⁴

The question for the nation in general and Nassau County in particular, is whether the economy will rebound from the fallout of the sub-prime mortgage and credit markets, or if the threat of further weakening remains.

Residential Housing Market

The latest home data for June 2008 confirm a declining real estate market at both the sub national and national levels from a monthly and annual perspective. On a national level, the National Association of Realtors reported the slowest sales pace in housing since the first quarter of 1998. The downward slide in sales depressed prices, too. The median price for a home sold in June dropped to \$215,100, down by 6.1 percent from a year ago. That was the fifth largest year-over-year price drop on record. Inventories of homes on the market rose by 0.2 percent to 4.49 million units, which means it would take 11.1 months to exhaust the current backlog at the June sales pace, the second highest level in the past 24 years. The glut of unsold homes is being made worse by a rising wave of foreclosures.⁵

Another potential threat is rising mortgage rates with Freddie Mac's nationwide survey showing that 30-year mortgages jumped to 6.63 percent this week, the highest level in nearly a year, reflecting financial market turbulence. Even though the recently approved housing bill has some positive elements, it will be difficult to

remedy the financial upheaval in the short term, if mortgage rates keep rising.

For Nassau County, from an annual perspective, average closed sale prices decreased roughly 2.3% and median closed sale prices decreased 6.8%. Residential inventory levels were up roughly 4.7%, from 10,574 units in 2007 to 11,067 units available in June 2008. On a month to month basis, residential inventory levels were up in June by 2.4% from 10,808 units available in May 2008. While the number of closed residential transactions through June 2008 has increased from 2,862 in May to 3,670 in June, or 28.23%, on an annual basis closed residential transactions have decreased from 4,835 units, showing a 24.1% year to year decrease.

Closed median home prices for Nassau County were reported at \$499,000 in June 2008, or 9.11% less than the \$549,000 reported last year. Suffolk County reported a closed median home price in June 2008 of \$399,000, which represents a 9.3% decrease from a year prior, when the closed median price was \$439,900. Closed median home prices for Nassau County were reported at \$499,000 in June 2008, or 9.11% less than the \$549,000 reported last year.

Growth projections illustrate decreases in Nassau and Suffolk counties, and nationally for mortgage originations and home prices. The only forecasted increase is 4.3% in refinancings on a national level. See attached Exhibit on Local Area Unemployment Statistics, LI Region, June 2008, for a reporting of unemployment data by Long Island region.

⁴ Waggoner, J. and Hansen, B. (2008). Survey: Fewer economists believe recession likely. *USA Today*. (July 29, 2008)

⁵ Crutsinger, M. The slump persists: Home sales tumble across US. *The Associated Press*. (July 24, 2008)

Annual 2008 Growth Projections			
	Mortgage Originations		Median Home
	Purchase	Refinance	Sale Price
Nassau County	-12.8%	-13.1%	-7.4%
Suffolk County	-13.3%	-12.8%	-7.0%
United States	-13.1%	4.3%	-11.5%

Source: Moody's Economy.com

Of particular interest, some economists believe that tighter credit will upset the ability of homeowners to borrow against the value of their homes for consumption. The market for Home Equity Lines of Credit (HELOCs) has really come to a standstill since HELOC's fall behind first mortgages in the line of creditors. That is, when a foreclosed house sells, the sale proceeds are first used to pay off first mortgages. The holder of the HELOC receives any left over funds. Since foreclosed properties tend to sell at discounted prices, very often the HELOC is not paid in full or is completely written off. As a result of such a high risk premium, banks have stopped offering HELOC's. Residents who have been utilizing their home equity to finance major purchases will make fewer purchases and homeowners will no longer have as great an opportunity to borrow against the value in their homes to make purchases. As a result, the County will collect less sales tax and mortgage related revenues. To date, mortgage tax collections across Nassau County have decreased by 41.2%, or \$15.0 million in the first half of 2008, compared to the same period in 2007.

The Conference Board Employment Trends Indexes for the regions suggest conditions are months away from turning around. A national turnaround is even further away — perhaps next spring.⁶

⁶ <http://www.conference-board.org/economics/outlook.cfm> (July 28, 2008)

Employment

The Labor Department reported that for the week ending July 19, 2008, the number of new applications filed for unemployment benefits rose by a seasonally adjusted 34,000 to 406,000 for the week ending July 19. The last time claims were higher was after the devastation of the Gulf Coast hurricanes in mid-September 2005, when they spiked to 425,000.⁷ The unemployment rate remained the same in June for the nation, at 5.5%, after zooming in May by the most in two decades. The unemployment rate is expected to climb to 6% or higher by early next year.⁸

According to Moody's, the forecasted average unemployment rate for the remaining two quarters of 2008 is 4.34% for Nassau County, and slightly higher, at 4.61% when forecasted to the end of next year. The number of unemployed residents is projected to grow by 24.9% to the end of the year, and slightly higher, to 28.3% when forecasted to 2009. The number of already employed residents is expected to decrease by 7.3% to the end of the year, and marginally lower, to 7.0% in 2009.

Suffolk is expected to see an increase in its unemployed residents by 25.6% and to record an average unemployment rate of roughly 4.57% for the remainder of 2008.

Forecast of Year End 2008 and 2009 Unemployment Rate			
	Nassau	Suffolk	United States
2008	4.34%	4.57%	5.38%
2009	4.61%	4.85%	5.74%

Source: Moody's Economy

⁷ Unemployment claims jump past 400K: Labor department says number of newly laid off workers rose by 34,000 last week. *CNNMoney.com*. July 24, 2008

⁸ *Ibid.*

Gross Domestic Product

The gross domestic product, the broadest measure of the nation's economic activity, grew at an annual rate of 1.9% in the second quarter of 2008. Even though that is up from a 0.9% growth rate in the first quarter, the reading was weaker than expected. Economists polled by Thomson Financial/IFR and Briefing.com had expected growth of 2.4% and 2.3% respectively, in the broad measure of the economy's health. .

Several economists, including Federal Reserve Chairman Ben Bernanke, have expressed worries that with the stimulus checks already cashed, spending and economic activity could slow even further.

Robert Brusca of FAO Economics described the first three months GDP data as even weaker than the 1.9% growth rate would suggest, saying that if it weren't for changes in imports and exports GDP would have declined in the quarter. According to Brusca, "the consumer adds only 1.1 percentage point to overall growth, and this is with a rebate check in hand. GDP was net negative on the domestic front. As we look to the second half of the year foreign growth is fading so U.S. exports are sure to slow. Also the rebate checks no longer are a factor. Meanwhile the housing sector is still a negative."⁹

Likewise, Mark Vitner, senior economist for Wachovia, said the report indicates growth is just narrowly above what would be seen in a recession and that domestic demand is at the weakest level seen since the 1991-92 recession.¹⁰

Regionally, Moody's is forecasting Nassau real GDP to rise an additional 0.95% through the rest

of 2008. In 2009, Moody's is expecting Nassau County real GDP to expand 2.43%. Suffolk is forecast to experience similar economic growth for the rest of 2008, and stronger growth in 2009.

Forecast of Year End 2008 and 2009 Gross Domestic Product Growth Rate			
	<u>United States</u>	<u>Nassau</u>	<u>Suffolk</u>
2008	1.56%	0.95%	0.90%
2009	4.55%	2.43%	3.20%

Source: Moody's Economy

Particularly, decreased housing wealth and employment losses contribute to Nassau's sluggish economic growth since both are forecast to decrease through the remainder of 2008.

The sluggish economic growth rates may be seen as contributing to the slow growth rates recorded in Nassau's sales tax collections. YTD sales tax is \$540.8 million, which represents growth of 1.9% over 2007.

Retail sales have historically represented 63.0% of Nassau County sales tax collections. Since individuals require income to make purchases, as personal income grows so should County sales tax collections.

According to the forecast, all areas surveyed will record, positive growth through the end of 2008 in retail sales and personal income. The nation is forecast to experience stronger real GDP, personal income and retail sales growth than that seen throughout the region.

The general consensus among economists is that 2.5-3.5% per year growth in real GDP is the range of best overall benefit; enough to provide for corporate profit and jobs growth yet moderate enough to not incite undue inflationary concerns.¹¹ If the economy is just coming out of recession, it is considered normal for the GDP

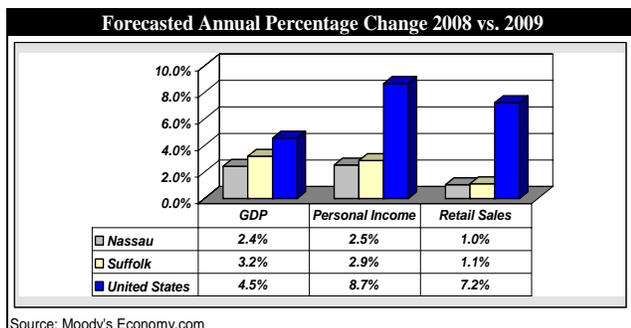
⁹ Isidore, C. Economy Grows, but warnings sound. *CNNMoney.com* (July 31, 2008)

¹⁰ Ibid.

¹¹ U.S. Department of Commerce. Bureau of Economic Analysis. <http://www.bea.gov/>

figure to jump into the 6-8% range briefly, but investors will look for the long-term rate to stay near the 3% level.

Finally, one area that the County will need to keep an eye on is County Clerk collections related to mortgage transactions, which are anticipated to decline as a result of the housing market and mortgage industry downturns. As we reported in our previous economic report, forecasted declines will have an immediate and direct impact on Nassau County Clerk fee revenues which are closely aligned with mortgage refinancing and the number of closed transactions. OLBR is currently forecasting 2008 County Clerk fee revenue to come in at \$9.9 million, nearly \$4.0 million less than budgeted for 2008.



Although Nassau is expected to experience a 2.5% increase in personal income, retail sales will grow 1.0%.

Conclusion

In the second quarter of 2008, regional and national spending on food, clothing and other items increased as a result of government stimulus checks. In addition, fortified by the government's rebate checks consumers boosted their borrowing in June at the fastest pace in seven months. However, as companies cut jobs, a growing number of analysts believe consumers will decrease spending later this year as the bracing impact of the tax rebates fades, dealing a blow to the economy.¹² Consumers have been forced to charge more of their purchases on credit cards as banks have tightened lending standards on other types of loans.

Prepared by:
Dr. Helisse Levine
Office of Legislative Budget Review

¹² Consumer debt jumps by \$14 billion. CNNMoney.com (August 7, 2008)

LOCAL AREA UNEMPLOYMENT STATISTICS - LONG ISLAND REGION				
June-08				
AREA	Civilian Labor Force	Number Employed	Unemployed Number	Unemployed Rate
Nassau-Suffolk	1,530,817	1,458,378	72,439	4.7%
Nassau County	719,143	685,302	33,841	4.7%
Freeport Village	23,388	22,144	1,244	5.3%
Glen Cove City	13,797	13,132	665	4.8%
Hempstead Town	403,712	384,003	19,709	4.9%
Hempstead Village	26,564	24,976	1,588	6.0%
Long Beach City	20,406	19,455	951	4.7%
North Hempstead Town	119,218	113,923	5,295	4.4%
Oyster Bay Town	162,004	154,789	7,215	4.5%
Rockville Centre Village	13,484	12,905	579	4.3%
Valley Stream Village	19,676	18,710	966	4.9%
Suffolk County	811,674	773,076	38,598	4.8%
Babylon Town	116,295	110,221	6,074	5.2%
Brookhaven Town	265,993	253,400	12,593	4.7%
Huntington Town	109,342	104,530	4,812	4.4%
Islip Town	182,345	173,063	9,282	5.1%
Lindenhurst Village	15,479	14,757	722	4.7%
Riverhead Town	17,544	16,799	745	4.2%
Smithtown Town	64,428	61,681	2,747	4.3%
Southampton Town	31,486	30,119	1,367	4.3%
May-08				
AREA	Civilian Labor Force	Number Employed	Unemployed Number	Unemployed Rate
Nassau-Suffolk	1,493,419	1,425,404	68,015	4.6%
Nassau County	701,293	669,808	31,485	4.5%
Freeport Village	22,849	21,643	1,206	5.3%
Glen Cove City	13,458	12,835	623	4.6%
Hempstead Town	393,755	375,321	18,434	4.7%
Hempstead Village	25,896	24,411	1,485	5.7%
Long Beach City	19,924	19,015	909	4.6%
North Hempstead Town	116,073	111,347	4,726	4.1%
Oyster Bay Town	158,074	151,289	6,785	4.3%
Rockville Centre Village	13,158	12,613	545	4.1%
Valley Stream Village	19,181	18,287	894	4.7%
Suffolk County	792,126	755,596	36,530	4.6%
Babylon Town	113,553	107,729	5,824	5.1%
Brookhaven Town	259,240	247,671	11,569	4.5%
Huntington Town	106,745	102,167	4,578	4.3%
Islip Town	178,013	169,150	8,863	5.0%
Lindenhurst Village	15,122	14,424	698	4.6%
Riverhead Town	17,159	16,419	740	4.3%
Smithtown Town	62,890	60,286	2,604	4.1%
Southampton Town	30,758	29,438	1,320	4.3%

June-07	Civilian	Number	Unemployed	
AREA	Labor Force	Employed	Number	Rate
Nassau-Suffolk	1,513,261	1,458,119	55,142	3.6%
Nassau County	711,150	685,181	25,969	3.7%
Freeport Village	23,063	22,140	923	4.0%
Glen Cove City	13,755	13,130	625	4.5%
Hempstead Town	399,032	383,935	15,097	3.8%
Hempstead Village	26,296	24,971	1,325	5.0%
Long Beach City	20,179	19,451	728	3.6%
North Hempstead Town	117,910	113,903	4,007	3.4%
Oyster Bay Town	160,259	154,762	5,497	3.4%
Rockville Centre Village	13,318	12,903	415	3.1%
Valley Stream Village	19,447	18,706	741	3.8%
Suffolk County	802,111	772,938	29,173	3.6%
Babylon Town	114,792	110,202	4,590	4.0%
Brookhaven Town	263,041	253,355	9,686	3.7%
Huntington Town	108,138	104,512	3,626	3.4%
Islip Town	179,799	173,032	6,767	3.8%
Lindenhurst Village	15,339	14,755	584	3.8%
Riverhead Town	17,383	16,796	587	3.4%
Smithtown Town	63,787	61,670	2,117	3.3%
Southampton Town	31,130	30,114	1,016	3.3%

Source: workforcenewyork.org