The Economic Outlook for the United States and Southern New Jersey

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I would like to thank Dean Leontiades for inviting me to be part of the panel this morning addressing the economic health of South Jersey. Since the last Business Outlook discussion in October, the groundwork for a rebound has begun to emerge --- both nationally and regionally. Today, I would like to first share with you my economic outlook for the nation, and then discuss our prospects for economic growth in and around South Jersey.

The national economy is in the midst of recession

March 2001 marked the official start of our 10th post-war recession. Yet it is a recession that will forever be associated with the September 11th attacks. The post-9/11 economic impact became readily apparent in real GDP figures: third quarter 2001 real GDP growth is now estimated at -1.3% and fourth quarter growth is forecasted to be negative as well. This, the first recession since 1990-91, officially brings to a close the longest period of post-war economic expansion in American history.

The consensus view is that recovery will begin in the first half of 2002

Economic recovery is widely anticipated to begin in the first or second quarter of 2002 according to the median forecast from our Bank's *Survey of Professional Forecasters.* While I concur that recovery is pending, I believe it will occur around mid-2002, a few months later than the median forecast predicts. In fact, most professional economists are moving toward this view given the obstacles that have turned up along the road to recovery.

Reason for confidence: Substantial monetary and fiscal stimulus are in the pipeline

The economy is now valiantly trying to find its footing. It is being helped in large part by the biggest fiscal stimulus and lowest interest rates we have had for a very long time.

Fiscal policy, as captured by the projected federal budget, has changed dramatically in this cycle. The government's stimulus package --- expected to equal over $200b, or roughly 2% of GDP --- should have a significant positive impact on the economy.

On the monetary policy front, as a direct result of aggressive Federal Reserve action, interest rates have reached levels not seen for over forty years. Since January 2001, short-term rates dropped 475 basis points. Our rapid-fire rate cuts have gone a long way toward strengthening consumer spending, which should keep the current downturn mild and brief.

As a result of these fiscal and monetary activities, the economic landscape is beginning to resemble pre-attack days in one important way: It is beginning to give mixed economic signals. This is a good sign, and an indication that the economy may be preparing to resume growth.

The pattern of recovery will be typical, but its pace will be a slower than usual

For this recovery to progress, certain conditions must be met: decumulation of excess inventories, retention of consumer confidence, increased business investment spending and a stable world economy. These criteria involve risks that may complicate recovery.

First, the build up of excessive **inventories** has been a key part of both the manufacturing recession and tech contraction. Now, businesses' liquidation of excess inventories -- a crucial first step to recovery -- is well along. We do not yet feel the effects on new orders, but this is paving the way for increased production and a revival of the hard hit manufacturing sector.

What are the risks to recovery here? First, the decumulation of inventories may take longer than planned. Despite substantial inventory adjustment, slow sales have kept the inventory-to-sales ratio too high for sufficient decumulation to occur. Second, inventory restocking is predicated on expected sales growth, and I sense a rather cautious business sector. Accordingly, firms may replace their depleted inventories more slowly than usual. Then there is the auto sector. Most expect the high year-end sales figures were the result of pulling sales forward from 2002. It is unlikely inventory restocking here will occur anytime soon.

But, **consumer spending** should remain strong into the spring. The consumer has proven surprisingly resilient. Retail sales, while down since 9/11, have been better than expected. The durability of the housing market is further testament to consumers' willingness to spend through the weak economy.

However, there are concerns here as well: Consumers must be employed to spend. Softness in the labor markets could put pressure on consumer spending and affect confidence going forward. If sharp job losses persist, consumers may retrench, making the recovery slow and potentially more painful. That said, we should remember that unemployment is a lagging indicator. It is likely that unemployment numbers will still be on the rise as the economy begins its rebound. But as long as consumers keep the faith, the recession should be mild and short-lived.

Healthy growth in business investment spending is also needed for a sustained expansion. As you know, the sharp decline in **business investment spending** was the number one contributor to this recession. Historically, when overall economic growth accelerates, it is usually led by consumer spending, and then amplified by business investment. Therefore, I do not anticipate a recovery in business investment spending until the second half of 2002, but it must at least stabilize and not be a drag on economic growth.

Here overcapacity in the technology sector remains a concern. The sudden collapse in business investment spending was, in large measure, the bust following the late 1990s boom in the tech and telecom sectors. These sectors are still plagued by overcapacity. For example, analysts estimate capital spending in the telecom industry will fall $58 billion in 2002 from its peak of $98 billion in 2000. However, a bottom to this process appears ahead.

Finally, the rest of the world

It is important to remember that the U.S. economy does not operate in a vacuum. We are well aware that the prognosis for growth in the U.S. is related to recovery elsewhere. At this moment, with one or two exceptions, the world economy seems well poised for growth in the coming year. Foreign economies, as far as Asia and near as Central America, will add to the recovery picture for the U.S. economy in 2002.

But risks are present here as well. Japan must end its current recession, and Argentina must contain its instability. Finally, but most importantly, growth in the Eurozone must begin to accelerate. Anything less will slow U.S. recovery.

Recovery by mid-year is likely, but not yet certain

As with any forecast, uncertainty remains. Of course, a key uncertainty here is progress in the war on terrorism - a risk on which it is impossible to put a probability. The world has changed, and although consumers and businesses have adapted surprising well to the new realities, there is still much left to discover. Unforeseen developments in the war on terrorism could delay a recovery, just as the speed of the war has buoyed the world economy and hastened the recovery.

The South Jersey Regional Economy

How will South Jersey's economy fare in the months ahead? Let me say I expect South Jersey to be a full participant in the nation's recovery.

The past few economic downturns have hit the Delaware Valley region harder than the nation as a whole. Typically, we slide into recession sooner, decline more sharply, and recover later than the rest of the country. But this time appears to be different. Thus far in this downturn, we are running on an even keel with the national economy, and employment declines here occurred simultaneously with the national decline.

This closer alignment of our region's economic performance with the nation's is a result of our evolution from a manufacturing based to a more service based economy. This partially explains why the unemployment rate for the Philadelphia Metro area, including South Jersey, is 4.6% compared to the national rate of 5.8%.

Health care, pharmaceuticals, and the broad technology industry are large and growing components of New Jersey's service economy. The importance of the health care industry is unmistakable. In South Jersey alone, 10 of the top 50 largest employers are health care organizations. In fact, Virtua Health, Our Lady of Lourdes Health Services and Cooper Health System make the top five.

In a state that has been referred to as "the cure corridor" and "the nation's medicine chest," the pharmaceutical industry is the fastest growing sector of the state's economy. Fifteen of the 20 largest pharmaceutical firms in the world are New Jersey-based, giving the state a strong leadership position. This critical mass gives New Jersey a huge advantage. Access to the state's highly educated pool of scientists is the top reason drug companies give for moving to the Garden State. New Jersey has more scientists, per capita, than any other state in the country.

This knowledge pool has made biotech another bright spot in the Garden State economy. New Jersey now has 110 biotech companies, ranking it fourth in the nation. Employment in the state's biotech sector jumped 25% last year, reflecting a $3.9 billion impact on the state's economy.

In the telecommunications sector, such giants as Bell Labs and RCA Labs put New Jersey on the map. While this sector is currently weathering some difficulty, its long-term prospects remain strong. As such, the current and future growth in the state's telecom sector has been attributable to smaller telecom firms, primarily in internet and wireless applications.

The challenge that lies ahead is to continue this evolution, and develop greater concentration in the general technology sector. A recent study by the U.S. Commerce Department suggests the state is making ample progress. Of 50 states, New Jersey ranked first in the percentage of businesses categorized as high-tech. Moreover, New Jersey followed only Massachusetts in percentage births of new high-tech businesses. And, the state has a number one ranking in net high-tech formations, a key measure of the ability to create and sustain new high-tech businesses.

This evolution to a knowledge-driven economy serves New Jersey well. But, as a region, we must continue to build and diversify our computer and tech-intensive industries. Over the next decade, the fastest growing occupations in the U.S. are expected to be in computer technology and its application areas of data processing and data management. Participating in that trend will mean more growth, more jobs and a higher quality of life in New Jersey.

In a strategy to lure high-tech companies to the state, the New Jersey Commission on Science and Technology was recently allocated $10 million to spend on technology incubators. Two of these incubators are up and running right here in South Jersey, one in Camden and the other in Mount Laurel. With visions of a new image as a high-tech hub, New Jersey seems committed to getting high-tech entrepreneurs out of the lab and into the economy.

This is not to say that the region is without strong representation in the technology arena, as I am sure Mike Camardo will attest. After all, South Jersey's largest employer is Lockheed Martin.

Conclusion

To summarize, I see 2002 as a turnaround year. Thanks to the progress we have made in recent years, South Jersey should recover along with the nation. We will see clear signs of renewed growth by mid-year, and a healthy pace of sustained growth by year-end. Our challenge is to manage the current period of economic weakness with an eye to the future. There is no question that business owners and employees will still face some anxious months. But ultimately economic conditions over the next couple of years will be determined by fundamentals, and those fundamentals are positive: tame inflation, low interest rates, and robust productivity growth borne of continuing technological innovation. Thus we move ahead with the confidence that our economy, like our nation, is enormously resilient.