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LIA Monthly Economic Report

A Research Report for Directors and Members of the Long Island Association, Inc.

July, 2018

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The U.S. economy remained strong overall. The revised first quarter GDP rose by 2 percent, in line with expectations. But second quarter GDP is expected to grow at a much higher rate—from 3 to 5 percent. The labor market continued its strong run as well. However, concerns over tariffs, inflation, and rising interest rates are stagnating the stock market.

On Long Island, the story was much the same. The labor market and business condition were very favorable and consumer spending was robust. Home sales prices increased substantially but sales and inventories declined.

The National Economy

The labor market continued to perform very well. There were 227,000 jobless claims during the week of June 23. This is near an historic low and points to a strong demand for labor. Household spending has improved as indicated by a large increase in May retail sales, which rose by 0.8 percent, well in excess of expectations.

The choppy real estate market showed some positive signs as well. Applications for home mortgages rose by 4 percent during the week of June 15, ending a 5-week string of declines. Housing starts grew at a robust pace of 5 percent in May but the outlook going forward is less favorable. Inflation is ticking upward with the May Consumer Price Index growing by 2.8 percent year-over-year. The supply of homes is somewhat low relative to demand. The supply of homes on the market in May is expected to clear in 5.2 months. A 6-month supply is considered to be a balance between supply and demand.

Consumer sentiment remains strong, despite concerns over rising prices and tariffs. The impact of tariffs on the U.S. and Long Island economies are discussed in more detail in the “Focus On” section of this report.

The Long Island Economy

Labor Market

Long Island’s private sector job count increased by 15,100 between April and May, slightly higher than the average gain of 13,700. The goods-producing sector of the economy had a strong May. The construction industry added 3,300 jobs in May compared to an average of 1,700, a high for the month.
Manufacturing also added 600 jobs, three times the monthly average.

Year-over-year jobs growth was greatest in:

- Trade, Transportation and Utilities (+5,300)
- Natural Resources, Mining and Construction (+4,400)
- Leisure and Hospitality (+3,200)

Long Island’s unemployment rate fell to 3.5 percent in May, its lowest level since May of 2007. However, this drop mostly reflects a decline in the labor force; that is, people exiting the labor market who are no longer counted among the unemployed.

In New York State, private sector hourly earnings rose by 3.2 percent year-over-year in May. The strongest gains were seen in:

- Information Services (+5.3%)
- Goods Producing Industries (+5.3%)
- Manufacturing (+5.0%)

Business Conditions

With small businesses comprising almost 90 percent of commercial establishments on Long Island, this is a key sector for economic growth. The National Federation of Independent Business' Small Business Optimism Index rose 3 points in May to 107.8, which was the second highest level in the 45-year history of the survey. Expectations for higher sales increased substantially, and there was widespread sentiment that conditions are favorable for expanding one's business.

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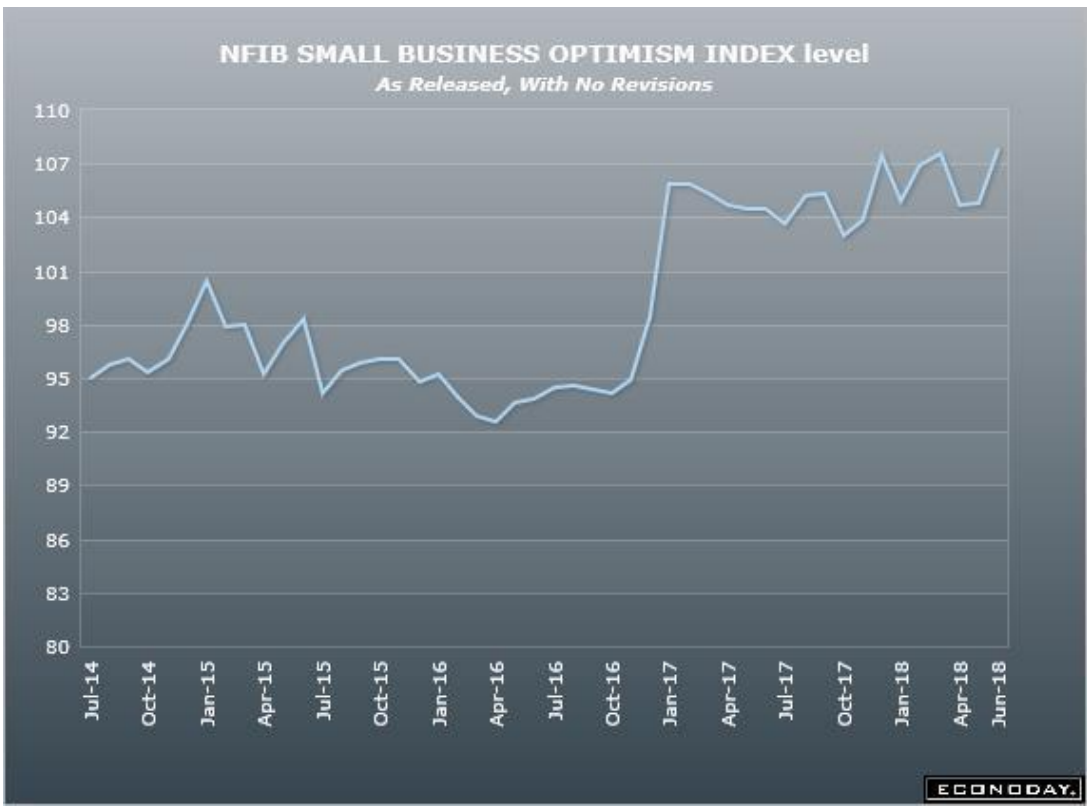
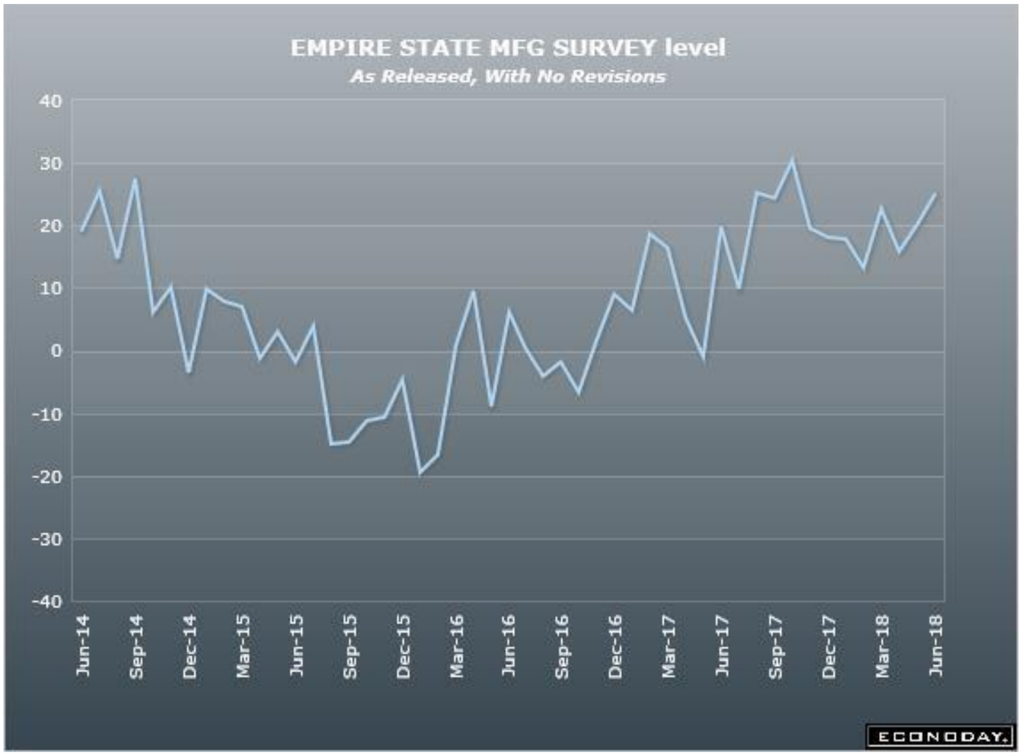


The manufacturing sector showed strong expansion. The Empire State Manufacturing Index rose substantially in June, well in excess of expectations. New and backlog orders accelerated, indicating continued growth in the coming months.



The region's service sector also showed rapid growth according to firms responding to the Federal Reserve Bank of New York's June 2018 Business Leaders Survey. The Survey's business activity index rose to its highest level in a decade. Indexes of employment and wages remained at high levels. And firms' six-month outlook for business conditions were optimistic.

Consumer Sector

Consumer spending as indicated by sales tax collections increased markedly in May. Year-over-year sales tax collections increased by 3.82 percent in Nassau County and by 7.23 percent in Suffolk. Given the increase in Internet sales over time, these year-over-year sales tax revenue comparisons may understate actual consumer spending because proportionately fewer purchases incur local sales taxes in later years. Adjusting for this change, estimated year-over- year spending may have risen by even more— 4.80 percent in Nassau County, and by 8.24 percent in Suffolk. Internet sales trends, and the methodology used to adjust for increasing Internet sales over time, are discussed in the "Focus On" section of the February, 2016 newsletter.

The Real Estate Market

Home prices rose strongly in May on Long Island. Prices increased by 10.4 percent year-over-year in Suffolk County, from $335,000 to $370,000. Home prices increased by 8.1 percent in Nassau County, from $480,000 to $519,000. But home sales declined, falling from 1,399 units sold to 1,345 in Suffolk County, a drop of 3.9 percent.
Home sales fell by 5.5 percent in Nassau County, from 1,017 to 961 units sold. May housing inventory also declined by 1.9 percent year-over-year.[1]

[1] These data include inventory for Nassau, Suffolk, and Queens Counties as separate data for Nassau and Suffolk are unavailable. However, Nassau and Suffolk Counties account for more than 75 percent of these inventories so the patterns described herein should be generally representative of inventory patterns in Nassau and Suffolk Counties.

Commercial Real Estate: Office Space

The Long Island office market is comprised of 43.3 million square feet in five geographic concentrations ranging in size from the 10.5 million square foot East Nassau submarket to the Southwest Nassau submarket, which amounts to 7.1 million square feet. In the ten-year period beginning with the second quarter of 2008, the Northwest Nassau submarket experienced the greatest introduction of new inventory- 283,000 square feet- amounting to 41.9% of all new competitive stock added to the market.

The median vacancy rate for office space was 9.7 percent, with a range of 0 percent to 59.5 percent.

Vacancy Rate Distribution— Office Space

Low	25%	Mean	Median	75%	High
0.0%	3.1%	13.6%	9.7%	19.1%	59.5%

As of May, 2018. Source: Reis Reports

Vacancy rates are much lower for newer office space built after 2009, indicating high demand for this space.

Vacancy Rates by Age of Facility—Office Space

Year Built	Vac. Rate
Before 1970	18.7%
1970-1979	15.9%
1980-1989	13.1%
1990-1999	14.5%
2000-2009	11.7%
After 2009	0.5%

As of May, 2018. Source: Reis Reports

The median asking rent for apartment space is $27.55 per square foot. But this varies widely, from a low of $16.20 to a high of $40.00.

Asking Rent Distribution— Office Space

Low	25%	Mean	Median	75%	High
$16.20	$23.50	$27.46	$27.55	$31.80	$40.00

As of May, 2018, Source: Reis Reports

Newer office space commands the highest price per square foot, reflecting the high demand for this space.

Asking Rents by Age of Facility—Office Space

Year Built	Vac. Rate
Before 1970	$27.21
1970-1979	$26.19
1980-1989	$28.36
1990-1999	$28.03
2000-2009	$27.08
After 2009	$31.33

As of May, 2018. Source: Reis Reports

Long Island's Economic Outlook

The Long Island economy appears to be quite strong. The labor market and business conditions are very favorable. Consumer spending is robust. However, tariffs pose a potential headwind for continued growth.

Focus On: Economic Outlook: Are Tariffs Ever a Good Idea?

Economic Outlook: Are Tariffs Ever a Good Idea?

Recent tariffs imposed by the U.S. on trading partners like Canada and China have raised concerns about a trade war as these countries and others retaliate with their own tariffs. This raises a number of questions. First, will this be beneficial to the United States? Second, what are the implications for the Long Island economy? And finally, one must ask if and when tariffs are ever a good idea.

As of now, the overall effects on the U.S. economy should be modest but it will have a far greater effect on some of its trading partners. For example, while Canada is the main source of imported steel to the U.S., the total amount exported was roughly $13.8 billion as of 2016. This is not a large number relative to the U.S. GDP but it accounts for half of Canada's steel production. And this is true for Mexico as well. Possibly, this is seen as giving the U.S. leverage in wresting more trade concessions from these countries.

But this is a risky strategy at best because another trading partner with a much larger economy than either Canada or Mexico - namely China - is in a position to fight back much more forcefully. This could escalate into a large scale and quite unpleasant trade war. According to the International Monetary Fund, the U.S. has the world's largest economy, estimated at $20.4 trillion as of 2018. But China is second at $14.1 trillion. A trade war between these two nations would be a fight between two economic heavyweights. In such a fight, even the "winner" would also lose because both economies would be damaged. Prices to consumers would rise significantly in both countries. And, with the consumer sector accounting for almost 70 percent of U.S. GDP, this would clearly be suboptimal.

Tariffs and the ominous possibility of a trade war would also be damaging to the Long Island economy. Exports from Long Island have been increasing steadily, rising to $9.8 billion as of 2015, a 53 percent increase since 2005. And both Canada and China are important sources for Long Island's exports. While the considerable diversity of Long Island's economy would act as a buffer, the net outcome would still be negative.

This leads to the last question: are tariffs *ever* a good idea? The short answer is that they are usually not. The threat of imposing tariffs may be a useful bargaining chip for negotiations but heavy-handed imposition of tariffs is likely to be far less effective. In chess, there is a saying that the "the threat is greater than the execution," meaning that if your opponent worries that you are about to make a strong move, then it could be more effective than the actual move itself. One might well say the same thing about tariffs.