

William C Dudley: Regional economy and manufacturing update

Remarks by Mr William C Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the Quarterly Regional Economic Press Briefing, New York City, 22 July 2010.

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Good morning and welcome to the New York Fed's July 2010 Regional Economic Press Briefing. I value this opportunity to talk with the journalists covering our region – and through you, to the people in our District. My goal this morning is to share how I see regional economic conditions, with particular focus on the manufacturing sector in the Second Federal Reserve District. My colleagues will follow me and provide more detail on the patterns that I'll describe. As always, what I have to say reflects my own views and not necessarily those of the Federal Open Market Committee or the Federal Reserve System.

I. National economic conditions

To provide some context, I'll begin with a few words about national economic conditions. U.S. economic activity has expanded for four consecutive quarters, but at rates that can only be described as modest when compared with early stages of past recoveries. The June payroll numbers tell the story of this sluggish recovery in employment. The economy gained only 83,000 private-sector jobs, following a downwardly revised gain of only 33,000 in May. Growth in the third quarter may turn out to be a bit less than we saw in the first half of the year, though we think there is only a slight risk of a double dip. The road to recovery is turning out to be a bit bumpy as relatively weak consumer spending and the ongoing problems in financial markets are keeping growth far less robust than we would like.

To date, the manufacturing sector has been a key source of growth during the recovery. After an unusually steep decline from late 2007 to mid-2009, manufacturing output has grown rapidly over the past year, although the level of manufacturing output remains well below the previous peak. A major force behind the growth of manufacturing output has been an unusually pronounced inventory cycle. Production has expanded as firms across a variety of industries have been rebuilding their stocks to bring them into a better balance with sales. Another driver of manufacturing output over the past several quarters has been a pronounced rebound of our exports of manufactured goods. Economic activity abroad has been recovering from its weak levels in 2009, and that global recovery has helped fuel demand for our products, particularly capital goods.

The importance of manufacturing in the recovery makes it a timely topic for our regional economic briefing, namely, trends in the manufacturing sector here in the Second District.

II. Regional economic conditions (update since the April regional press briefing)

Turning to our region, we can see a nascent recovery in most areas, with a holding pattern in other parts. This mixed pattern of growth is not surprising in the aftermath of a recession, and particularly a deep one with a financial crisis, as well. On the positive side, I can report that economic activity has picked up in many parts of the region.

To measure activity we use a set of indexes of economic activity – called Coincident Economic Indicators – that we produce here at the New York Fed for New York State, New York City and New Jersey, plus a similar index produced in Puerto Rico. These indexes provide a timely, monthly gauge of economic activity. They show that in New York State and New York City, activity has expanded at a relatively brisk pace since the beginning of the year. In Puerto Rico, where the recession began three years before the mainland downturn,

the economy also appears to be picking up in recent months. In contrast, economic conditions in New Jersey remain essentially flat. Although activity there is no longer declining, New Jersey has yet to establish a sustained recovery.

But, what about jobs – which are the key for people to truly feel the recovery in their lives? I am pleased to note that private-sector job growth has turned up moderately across much of the region in the past few months, just as it has in the nation. Growth in private-sector jobs signals that some firms need to hire workers to meet their production needs. This is a good sign and necessary for a sustainable recovery. The number of private-sector jobs has increased in and around New York City, in Northern New Jersey and in some parts of upstate New York. The June job market report for New York and New Jersey showed the recovery is likely to be a bit bumpy. Private-sector employment fell in both in New York State and New York City, though despite June's dip, employment in New York City remains above its low point in December 2009. In contrast, New Jersey's private-sector jobs picture improved in June, though a weak public sector there continues to weigh down overall job growth.

Despite the improvements we have seen, unemployment in the region remains painfully high. In June, New York City's and New Jersey's rates were very close to the national jobless rate of 9.5 percent. The rate for New York State, which has been improving since the first quarter, is noticeably lower at 8.2 percent. Puerto Rico, which has had much higher unemployment than the mainland for the past several decades, had a jobless rate of 16.3 percent in June, with little evidence of recovery so far.

III. Regional manufacturing sector

Background

The manufacturing sector is important to our region because it provides a substantial number of high-wage jobs and, in some parts of the region, is a key driver of business cycles and longer-term trends. To understand manufacturing in our region, it is important to note that different parts of the region specialize in different products. For example, New York City's largest manufacturing industry is apparel; motor-vehicle parts is a large industry in western New York, as are computers and electronics in Syracuse, Binghamton and the Hudson Valley. The pharmaceuticals industry is dominant in Northern New Jersey and Puerto Rico.

Over the past several decades, manufacturing wages have risen, while the number of workers it employs has fallen. These long-term trends stem from fundamental structural changes in trade, technology and consumption patterns. Some manufacturing has moved to other parts of the United States or overseas. The advent of information technology and computerization has also profoundly altered many manufacturing processes. And, the mix of products demanded by consumers has evolved over time. All of these factors have combined to reduce the number of factory jobs across the nation, with the New York/New Jersey region hit particularly hard. What is less well known is that despite this **employment** decline, manufacturing **output** has actually continued to grow moderately in much of the New York/New Jersey region. This means that the sector has experienced substantial gains in productivity. These productivity gains – the result of innovation and adaptation – have been accompanied by rising average wages in manufacturing. Like the rest of the country, our job losses have been heavily concentrated in lower-skill positions, resulting in a leaner and more skilled manufacturing industry.

The manufacturing sector and its structural job-wage dynamics are particularly important in upstate New York. Upstate (especially in its rural areas) manufacturing workers tend to earn higher wages than the average in their region, and the sector employs a larger share of the workforce there than it does nationally.

Outlook

How will the current recovery in manufacturing employment play out? Nationally, the growth in manufacturing output over the past year has occurred in a variety of industries, including autos, machinery, and computers and other electronic equipment. This growth reflects a combination of the restocking of inventories, domestic demand growth (particularly in investment goods), and higher exports. The concentration of these industries in parts of our region meant that those areas were poised to take advantage of this growth. The region has seen some increase in factory jobs in recent months, which undoubtedly reflects the expansion of production that has occurred nationally in these industries.

A number of indicators suggest that the inventory cycle may be largely complete – that is, the recent restocking has brought inventories into a better balance with sales. If so, we will lose restocking as an impetus for growth. Despite this, we expect manufacturing output to continue to expand because of improving domestic demand and foreign demand for U.S. manufactured exports. Yet, if this recovery follows the typical pattern for past recoveries, the prospect for growth in factory jobs will likely be weaker here than the rest of the nation.

Longer term, the sector's prospects are likely to be governed by a continuation of the trends I mentioned before in international trade, technology and consumption patterns. This means that output and wages will likely continue to rise, both nationally and regionally. However, the sector is unlikely to be a major source of job growth. Beyond the national trends that work against an expansion of factory jobs, the New York-New Jersey region faces ongoing competitive pressures as a location for manufacturing production. That competition comes from other regions of the country, as well as from abroad. One key to meeting these competitive challenges will be for the region to ensure that it develops and attracts a highly skilled workforce that can meet the needs of innovative and rapidly changing firms.

IV. The Empire State Manufacturing Survey

In order to monitor conditions in the region, the New York Fed conducts a monthly survey of manufacturing firms in New York State, our *Empire State Manufacturing Survey*. Let me tell you a little about the survey and then review recent patterns.

The survey is sent to a pool of about 200 manufacturing executives in a wide variety of industries across the state. About 100 responses are usually received. For the survey's main index – which is called the General Business Conditions Index – respondents report the change from the previous month in overall conditions in their firm. To explain their answers, we also ask them to assess components of activity such as orders, shipments, inventories and employment. Respondents are also asked for their views on the likely direction of these indicators over the next six months. In addition, each month we ask supplementary questions on a topic of current interest. To share the information as quickly and broadly as possible, we post results on our public website on the 15th of each month or the next business day. In doing this survey, we join the four other Federal Reserve Banks that use a survey to monitor conditions in their manufacturing sectors.

This morning I want to highlight the results of our July survey, which we released last Thursday. Our main index began to signal an upturn in the manufacturing sector in New York State last summer and, despite a brief dip last December, has given a consistently positive signal for a year now. Our July survey showed that conditions continue to improve, but at a slower pace than in previous months. In this month's supplementary questions, we asked respondents about the importance of trade with various parts of the world to manufacturing activity in New York State. In general, respondents indicated that exports account for a growing share of their revenues. Their firms are devoting more resources to marketing abroad – particularly in Asia – and expect their export sales to be higher in the next 12 months than in the past 12 months.

In sum, the region is showing signs of a moderate recovery, and the manufacturing sector is playing a key role in that recovery in parts of the region.

Thank you for your kind attention. I will now ask Jaison Abel to provide more details on current regional economic conditions.