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EMERGING FROM THE RECESSION: WHAT CAN THE LONG ISLAND EXPECT?

The nation is beginning to emerge from the deepest and longest recession since World War II. Preliminary figures indicate that the U.S. Gross Domestic Product grew at a 2.8 percent annual rate in the third quarter of this year after declining for four consecutive calendar quarters. This signals that technically at least, the recession is over. Without government support, however, the economy would not have grown significantly in the third quarter. Although Wall Street is doing somewhat better, Main Street has yet to benefit from the improved economy.

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The National Economy

Today, the U.S. economy stands at a crossroads. The housing market is at or near a bottom. Manufacturing and consumer spending have begun to recover from their respective bottoms. Much of this occurred because the federal government has held short-term interest rates near zero for more than a year and has pumped $1 trillion into the financial system through loans and securities purchases. The government now accounts for 26 percent of economic activity in this country, the highest level since World War II.

Preliminary figures show that GDP grew at a 2.8 percent annual rate in the third quarter. Virtually all of this growth was attributable to government support programs or inventory rebuilding by businesses. One percentage point came from increased car sales, the result of the government-financed "cash-for-clunkers" program. Home building increased by more than 23 percent in the third quarter as builders rushed homes to completion to allow first-time homebuyers to qualify for an $8,000 government tax credit. Inventory rebuilding contributed a full percentage point to third-quarter economic growth.

There is considerable uncertainty about how the economy will fare once federal government support fades. Most sectors of the economy remain weak and there may not be enough private-sector demand to support a sustained economic recovery. Job losses are continuing. The nation lost another 190,000 jobs in October and the U.S. unemployment rate rose to 10.2 percent. This represents the highest level of unemployment since April 1983. Almost 16 million persons were unemployed in October and 36 percent of them were jobless for 27 weeks or longer. When underemployed workers, discouraged workers and those employed part-time involuntarily are included, the actual unemployment rate is currently 17.5 percent.

Employment losses have been slowing. They averaged 188,000 per month for the past three months as compared with 357,000 monthly in the prior three months. However, unemployment is likely to remain high for several years after the job market bottoms out because recessions caused by disturbances in the financial sector are generally followed by long periods of joblessness. The U.S. currently faces a gap of almost 10 million jobs. This includes the 7.2 million jobs lost since the recession began and the 1.5 million jobs that normally occur annually to absorb new labor force entrants. To return to pre-recession job levels in two years would require more than 500,000 new jobs per month, a rate of job creation not seen since 1950-51. Moreover, recent productivity gains may thwart future hiring. Nonfarm businesses experienced productivity gains of 9.5 percent in the third quarter and 6.9 percent in the second quarter of this year. These gains are directly attributable to recent layoffs. Because businesses have learned to produce more with fewer workers, they will be slow to hire during the recovery period. Economists don't expect unemployment to fall below 6 percent until 2013 and it could take until 2014 or 2015 for the unemployment rate to decline to a more normal 5 percent.

The worsening job market has hurt consumer confidence. The Conference Board's consumer confidence index declined in October, indicating that shoppers expect a worsening business climate, fewer jobs and lower salaries. Declining consumer confidence does not necessarily equate to declines in consumer spending. In fact, same store sales were up by 1.8 percent in October

Trends in Payroll Employment on Long Island, October 2008-09

Industry	Payroll Jobs, October 2009	Net Change, October 2008-09
Manufacturing	76,200	-5,200
Construction	65,200	-10,200
Wholesale Trade	68,500	-4,500
Retail Trade	154,900	-5,300
Transportation, Utilities	35,900	-2,500
Information	24,900	-1,600
Financial Activities	72,400	-1,900
Professional/Business Services	160,000	-6,200
Educational & Health Services	224,200	4,400
Leisure & Hospitality	98,800	-2,100
Other Services	53,800	100
Government	202,400	-4,300
Total Employment	**1,237,200**	**-39,300**

Source: New York State Labor Department

when compared with year-ago levels. Retailers are slightly more optimistic about future sales and are not slashing inventories as much as in the recent past. The National Retail Federation, a trade group, expects holiday sales to be down by about 1 percent from last year, when there was a 3.4 percent decline in holiday spending. Absent job growth and wage increases, consumer spending is unlikely to rebound significantly. Household net worth is currently 19 percent below its peak in the third quarter of 2007. Household debt currently equals 95 percent of disposable personal income, up from 65 percent of DPI in 1999. Moreover, much of today's household debt consists of real estate debt, which is harder to reduce than credit card debt.

It is unclear that the business sector can carry the recovery alone, without help from consumers and the federal government. Business spending remains weak because credit is still expensive and a glut of retail and office space is discouraging new investment. American multinationals are spending more, primarily for their facilities abroad. Companies that have cut their workforce to the bone are investing in technology, software and other equipment that boosts productivity. Business investment in renewable energy has increased due to federal subsidies authorized by the recent stimulus package. However, businesses are likely to spend cautiously until they see a sustained economic recovery. More businesses are failing today than at any time in recent memory. Through October 15, almost 4,600 U.S. companies filed for Chapter 11 protection, a 12 percent increase over last year. Companies backed by private equity funds are particularly vulnerable. Many were acquired at the top of the market in leveraged buyouts. Their purchase price reflected expectations of continued growth, expectations that are unlikely to be met in the immediate future.

The residential housing market, where the crisis began, has recovered somewhat due almost exclusively to strong government support. Residential real estate prices have fallen to 2003 levels but have begun to increase. Pending home sales are up and the volume of signed contracts for existing homes has increased for eight straight months. Spending for residential construction rose by almost 4 percent in September, the biggest jump in housing activity since July 2003. However, the federal government currently finances 9 out of 10 new home mortgages and guarantees most of the new mortgages being issued. This puts U.S. taxpayers at risk if buyers default. The foreclosure crisis is now hitting those with good credit, some of whom purchased relatively expensive homes. Some 30 percent of June foreclosures involved homes in the top third of local housing values and 58 percent of foreclosure starts in the second quarter involved prime mortgage loans. In some cases, interest-only mortgages were used to buy high-end homes. Buyers couldn't refinance these mortgages when they came due because the drop in home values left them "underwater" in the sense that their mortgages were larger than the market value of their homes. Foreclosure volumes are not expected to level off until 2010.

Defaults on commercial real estate loans have also begun to increase.

Percent Change in Sales Tax Revenues Accruing to Nassau and Suffolk Counties*

2009	Nassau	Suffolk	Nassau-Suffolk
First Quarter	**-9.5**	**-9.3**	**-9.4**
January	-4.6	-3.4	-4.0
February	-10.7	-12.2	-11.4
March	-12.9	-12.1	-12.5
Second Quarter	**-9.5**	**-10.4**	**-10.0**
April	-10.5	-8.6	-9.4
May	-11.2	-11.9	-11.6
June	-7.4	-10.5	-9.0
Third Quarter	**-5.1**	**-9.1**	**-7.3**
July	-11.8	-13.6	-12.8
August	-8.9	-9.1	-9.0
September	3.3	-5.5	-1.6

*Reflects percent change from previous year.

Source: New York State Department of Taxation & Finance

Commercial properties have been hard hit by the recession. More than 10 percent of retail space at U.S. open-air shopping centers was vacant in the third quarter, up from 8.4 percent a year ago. At enclosed malls, the vacancy rate rose two percentage points to 8.6 percent. Retailers have announced 8,300 store closings so far this year, including more than 1,500 large anchor stores. Asking rents for retail space are down by almost 4 percent and are not expected to return to 2008 levels until 2016. Office rents are also falling at the fastest pace in more than a decade. Nationwide, third quarter office rents were 8.5 percent below year-ago levels, the steepest year-to-year decline since 1995. Companies returned more than 64 million square feet of office space to the market in the first three quarters of this year. The current office vacancy rate, 16.5 percent, is at a five-year high. Some analysts believe that office vacancies may not peak until 2011.

The banking industry has not yet recovered from last year's financial shock. It is still burdened by credit card and consumer loan losses. Losses on commercial real estate loans are also becoming a problem, particularly for small and medium-sized banks with the greatest exposure to such loans. Banks currently hold more than half the $3.4 trillion in outstanding commercial real estate debt. Yet, banks with heavy exposure to such loans set aside only 38 cents in reserves during the second quarter for every $1 in bad loans. At the beginning of 2007, there was $1.58 in reserves for every $1 in bad loans. In the aggregate, commercial real estate losses for banks could be as high as $300 billion. Federal Reserve data show that bank lending to households and nonfinancial businesses actually fell sharply in the third quarter of this year. Consumer and business loan losses could constrain future bank lending. As a result, businesses that rely on bank loans instead of raising capital in the bond market, notably small businesses, will continue to experience credit tightness.

The Median Price of Newly Sold Nassau-Suffolk Homes

2009	Nassau	% Change*	Suffolk	% Change*
January	$385,000	-12.5	$317,300	-15.1
February	400,000	-12.8	309,500	-13.9
March	405,500	-8.9	319,800	-12.4
April	380,000	-15.0	315,000	-14.9
May	396,000	-9.7	334,500	-7.1
June	415,000	-8.2	330,000	-13.8
July	415,000	-9.5	350,000	-10.0
August	420,000	-12.0	350,000	-5.4
September	405,000	-9.2	338,000	-6.1

*From previous year. Source: Multiple Listing Service of Long Island

As the foregoing analysis suggests, the U.S. economy is in a technical recovery but there are still significant risks ahead. The federal government will provide much less support for the economy next year and another massive stimulus program is unlikely because of the growing federal budget deficit. The national debt, which equaled 30 percent of GDP in the early 1980s, currently stands at 50 percent of GDP. This year, 40 percent of individual income taxes will go toward interest payments on the national debt.

With inflation muted, the Federal Reserve will continue to keep short-term interest rates close to zero for the foreseeable future to aid the recovery. The government will also help those most severely hurt by the recession. It has already extended unemployment benefits for the long-term unemployed. It will also continue to provide some support for the housing market. The first-time homebuyer credit has been extended through June and expanded to include current homeowners who purchase a new home. A new "deed for lease" program will help borrowers who don't qualify for loan modifications but who face foreclosure. They will be able to transfer their property to Fannie Mae in exchange for a lease lasting up to a year. This program is designed to keep them in their homes and avoid more foreclosures until the economy recovers.

It is unclear that this level of federal support will be sufficient to keep the recovery going. Unemployment is expected to remain above 10% next year, which will dampen consumer spending. Business spending could also be muted. As a result, GDP growth is expected to slip back to 1.7 percent in the current quarter and to remain sluggish during the first half of next year. Low interest rates and the risks associated with the growing federal debt have caused the dollar to decline by almost 16 percent against a market basket of foreign currencies since last March. The falling dollar will stimulate exports, but will raise the cost of imports, thereby creating inflation. Recently, the price of a barrel of crude oil surpassed $80 because crude is bought and sold in dollars. This explains why oil prices are rising despite ample supplies. Although the Federal Reserve is loath to repeat the error of 1937, when it raised interest rates too early and prolonged the Great Depression, it may not be able to keep interest rates at today's lows for much longer. If the falling dollar causes inflation and discourages foreign investment in U.S. sovereign debt, interest rates will begin to rise by next spring, even if unemployment remains high. These circumstances suggest a sluggish economic recovery next year.

The Long Island Economy

Nassau and Suffolk Counties lost more than 39,000 jobs in the twelve months ending in October. With the exception of educational and health services, virtually all Nassau-Suffolk industries lost jobs in the past year.

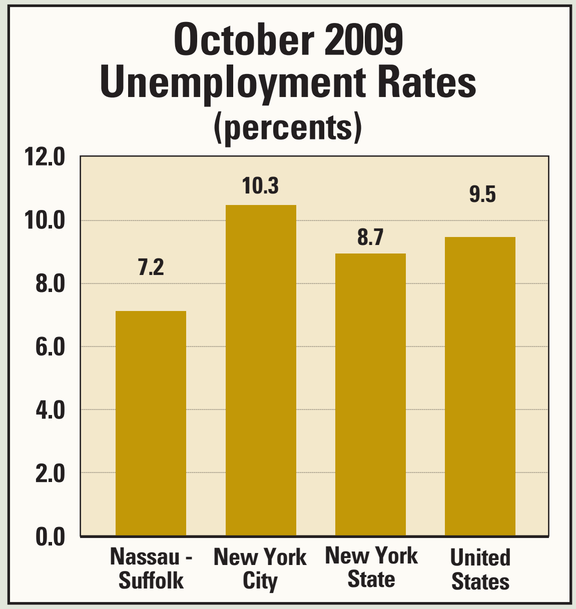
Hardest hit were construction, - 10,200 jobs, retail trade, -5,300 jobs, and professional and business services, -6,200 jobs. There was a loss of 4,300 government jobs during this period.

Nassau-Suffolk's October unemployment rate, 7.2 percent, remains well below that of New York State, 8.7 percent, and neighboring New York City, 10.3 percent. Nevertheless, the loss of jobs in high-paying industries such as business and professional services could skew Long Island's job base toward lower-paying industry sectors, a bad outcome for a high-cost area like Long Island.

The "cash-for-clunkers" program boosted September retail sales and this was reflected in somewhat better sales tax revenues, particularly in Nassau County. Nevertheless, third quarter sales tax revenues were 5 percent below year-ago levels in Nassau and 9 percent below year-ago levels in Suffolk.

Nassau-Suffolk home prices are still declining but the inventory of unsold homes has fallen during the past year. The September median price of newly sold homes was down by 9 percent in Nassau and by 6 percent in Suffolk when compared with last September.

An estimated 9,500 Nassau homes and 12,800 Suffolk homes were available for sale in September. This represents a 9.5-month inventory in Nassau and an 11.5-month inventory in Suffolk at the current sales pace.



The Economic Outlook.

Job losses on Long Island are likely to persist well into next year. Long Island could lose between 35,000 to 50,000 payroll jobs before the job market bottoms out. Price-cutting by retailers could boost holiday spending somewhat, particularly since inflation has been muted. However, even if holiday sales firm up, both Nassau and Suffolk Counties could experience sales tax declines of between 7 percent and 8 percent this year, putting them in a fiscal bind.

Declining sales and income tax revenues and reduced state aid payments are likely to force a reduction in government payrolls. Therefore, any improvement in the private-sector job market is likely to be offset by declining public-sector employment, including school district employment. Further job losses could exacerbate Long Island's foreclosure problem. More homeowners with good credit histories could default on their mortgages when they lose their jobs. These circumstances suggest that the Long Island economy will be relatively flat next year and that a sustained economic recovery may not occur until 2011.