

CENTRAL NEW JERSEY MARKET OUTLOOK

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JOB SITUATION

Central New Jersey, which encompasses Mercer County, entered 2017 on sound footing. Payroll employment grew faster than the national average in the second half of 2016 as the region's core economic drivers steadily gained strength (Chart 1). The region's finance industry has been challenged by Dodd-Frank rules that limit depository institutions' ability to engage in proprietary trading. Nevertheless, banking and related back-office operations continued to expand. Also, an improving commercial real estate market boosted hiring by real estate and leasing firms. What is also encouraging is that state government employment managed to rise, despite New Jersey's persistent budget woes. This is important because the state government is the largest employer in the area, accounting for about 19 percent of total employment. Education and healthcare, anchored by Princeton University, have been instrumental to the region's economic expansion. Professional services, many of which are well-paying high-tech jobs, are adding to the economy as well. The regional unemployment rate fluctuated between 4.5 and 4.7 percent between June 2016 and December 2016. Payroll jobs are now up by nearly 10 percent from their 2008 peak. Nationally, employment is up a little more than 5 percent from its pre-recession peak.

INCOME

Regional income growth is forecast to pick up in 2017 as the jobless rate declines and employment in higher-wage industries such as finance and professional services increase. On the downside, the 23 cent per gallon increase in the state's gasoline tax in November 2016 will soften real disposable income by lifting inflation pressures. Although some of this increase was offset by tax cuts elsewhere, this was the first increase in the tax since 1988 and takes New Jersey from having one of the lowest gasoline taxes in the country to one of the highest. From a longer-term perspective, income growth in Central New Jersey usually keeps pace with the U.S. average. However, the median household income is 34 percent higher

Chart 1
Job Growth, (% change year ago) & Unemployment Rate, (% , SA)

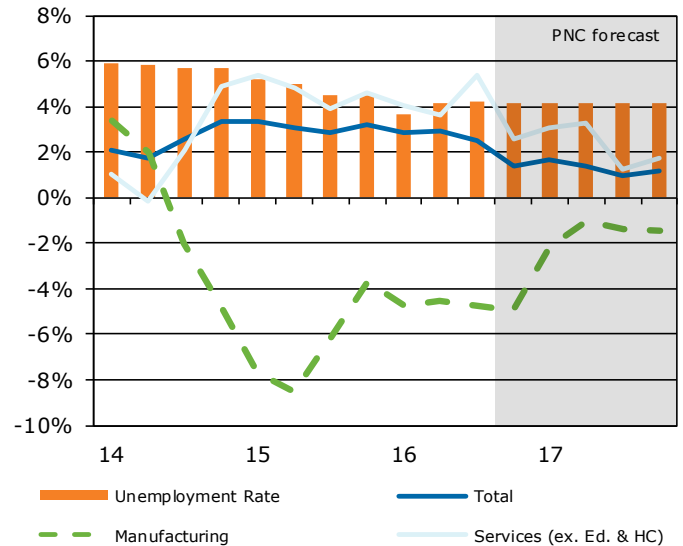


Chart sources: Bureau of Labor Statistics; The PNC Financial Services Group

Chart 2
Median Household Income (Ths. \$, SA)

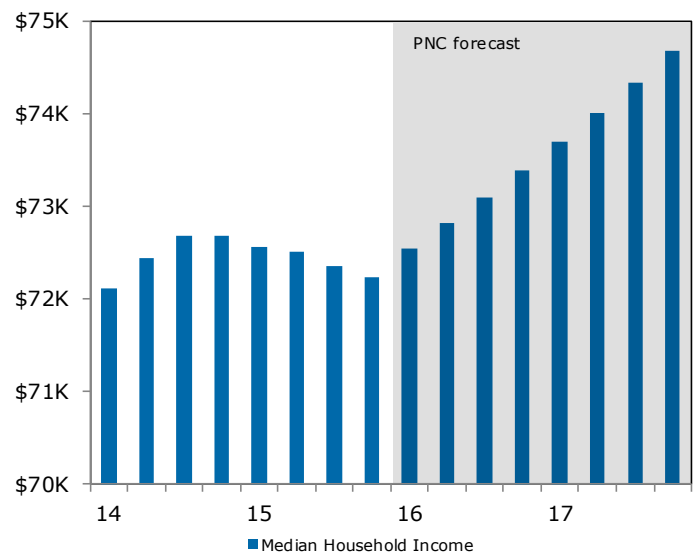


Chart sources: Bureau of Census; Moody's Analytics; The PNC Financial Services Group



than the nation's because of the large presence of well-paying financial services such as insurance carriers and brokerage firms (Chart 2). High-tech industries such as computer systems design also have an outside presence in the region and pay very well. Locally, high-tech industries account for about 7 percent of total employment whereas they account for less than 5 percent of total employment nationwide. Princeton University provides an additional boost to local income. Although the cost of living in the area is higher than average, per capita income is high enough to more than make up for it. This is a plus for local retail and housing industries.

HOUSING

Steady improvement in the labor market will lift home sales in Central New Jersey over the next several quarters. High per capita income, easier access to credit and household formations are additional supports to housing demand. However, home price increases will be slower than the U.S. average because of a significant burden of foreclosed properties (Chart 3). The foreclosure inventory, when adjusted for the number of households is four times as high as the U.S.'s. Given that the state's judicial process is among the most lengthy in the country, price increases and construction could prove weaker than forecast if the backlog of distress properties are slow to clear.

DEMOGRAPHICS

Central New Jersey's underlying demographic trends are better than one finds in many other Mid-Atlantic markets. Aside from ties to New York City, aided by good rail connections, Central New Jersey is a favored destination of international migrants. The local labor force participation rate is about four percentage points higher than the national average owing to the greater-than-average share of the local population that is between ages 40 and 54. Labor force quality is also very high, partly because of Princeton University's presence. Locally, 38 percent of adults over age 25 have at least a bachelor's degree compared with 31 percent in the U.S. We expect net-migration into Central New Jersey to improve in the years ahead and for the population to grow at a steady rate (Chart 4). However, given that the region is a densely populated and mature market, population growth will likely trail the U.S. average.

Chart 3
Home Sales (Ths., SAAR)
& Price Growth, (% change year ago)

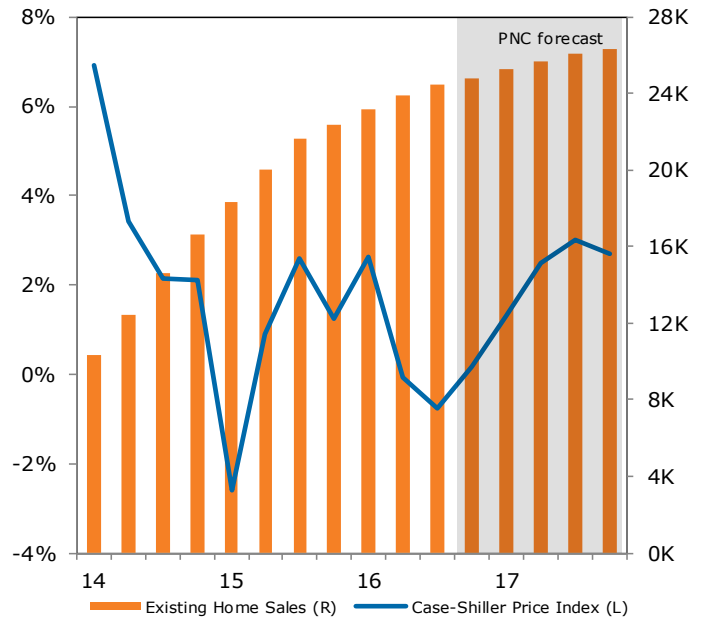


Chart sources: National Association of Realtors; Fiserv, Inc.; The PNC Financial Services Group

Chart 4
Demographic Growth, (% change year ago)
& Net Migration, (Ths., SA)

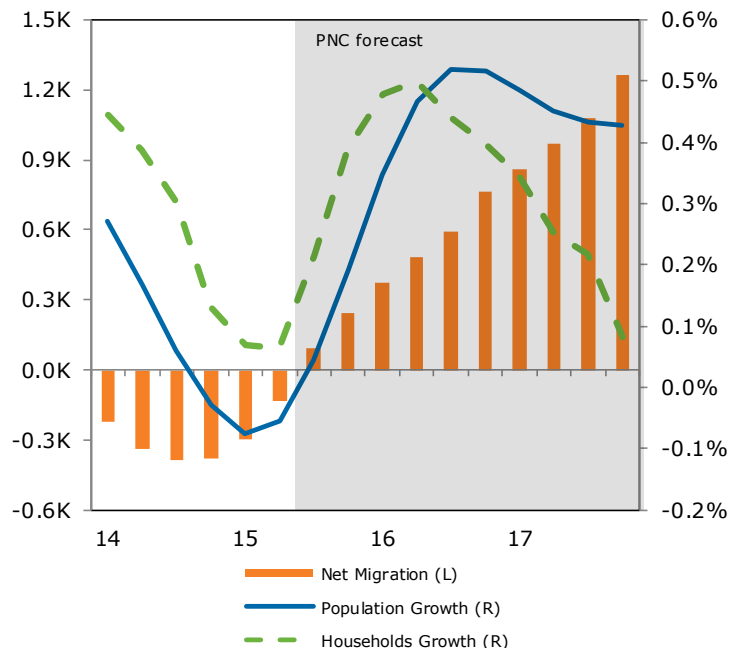


Chart sources: Bureau of Census; Bureau of Economic Analysis; Moody's Analytics; The PNC Financial Services Group

OUTLOOK SUMMARY

The rate of job growth in Central New Jersey will moderate in 2017 but the regional economy will still be on a positive trajectory. The U.S. economy is set to gain momentum and business taxes are likely to come down, both of which bode well for corporate profits. This will translate into more jobs in the region's large professional services sector. The Federal Reserve is picking up the pace of its rate hikes and financial regulations could be relaxed and these would boost the local finance industry. Education and healthcare will continue to be reliable growth drivers as they usually are. Despite the overall positive outlook, a number of downside risks to the outlook remain. First, a large inventory of deeply discounted foreclosures could subdue house price increases and construction more so than expected over the next couple of years. Also, the market area is struggling to deal with a downsizing pharmaceuticals industry. Finally, the State of New Jersey's persistent budget problems could reverse the positive effects of what is usually a stabilizing presence for this economy's labor market. Although Governor Christie's fiscal 2018 budget calls for increased spending, the risk remains that cuts will be needed down the road if revenues come in below projections.

Central New Jersey is an affluent economy, with a strong, diverse array of employers and ties to New York City's well-paying financial industries. Business costs are reasonable by Mid-Atlantic standards while the labor force is highly educated and these will help boost the area's long-term growth potential. Moreover, the presence of fine educational institutions, Princeton University in particular, brings not only well-qualified residents, but also the important commercialization of its academic research that in good times fuels entrepreneurship and job creation in IT and biotech. Overall, Central New Jersey is just emerging from a particularly difficult period, but its unique positive attributes will help it rebound in the years ahead.

FORECAST TABLE

| | U.S. | | | Central NJ | | |
|---|------|-------|-------|------------|-------|-------|
| | 2015 | 2016E | 2017F | 2015 | 2016E | 2017F |
| Employment Growth, (% change) | 2.1 | 1.7 | 1.5 | 3.1 | 2.4 | 1.3 |
| Unemployment Rate, (%) | 5.3 | 4.9 | 4.5 | 4.8 | 4.1 | 4.2 |
| Median Household Income, (Ths. \$) | 55.8 | 57.1 | 58.2 | 72.4 | 73.0 | 74.2 |
| House Prices**, (% change) | 4.6 | 5.0 | 3.7 | 0.5 | 0.5 | 2.4 |
| Single-Family Permits* (% change) | 10.2 | 8.5 | 4.4 | 18.8 | 71.6 | 1.8 |
| Multifamily Permits* (% change) | 11.5 | -2.5 | 2.1 | 374.4 | 49.4 | -53.7 |

*E = Full year estimates, F = PNC forecast, *U.S. starts*

| | U.S. | | Central NJ | |
|---|------------|------------|------------|------------|
| | 2007-2012† | 2012-2017† | 2007-2012† | 2012-2017† |
| Employment Growth, (% change) | -0.6 | 1.8 | 0.2 | 2.2 |
| Unemployment Rate, (%) | 7.7 | 6.0 | 6.9 | 5.7 |
| Median Household Income, (Ths. \$) | 50.8 | 54.7 | 72.5 | 72.7 |
| House Prices**, (% change) | -4.8 | 5.9 | -3.6 | 2.4 |
| Single-Family Permits* (% change) | -12.3 | 8.5 | -25.1 | 35.2 |
| Multifamily Permits* (% change) | -4.2 | 9.8 | 7.4 | 4.9 |

*E = Full year estimates, F = PNC forecast, *U.S. starts, †per annum*

LONG-RUN EMPLOYMENT TRENDS

Chart 5
Total Employment, (% change year ago)

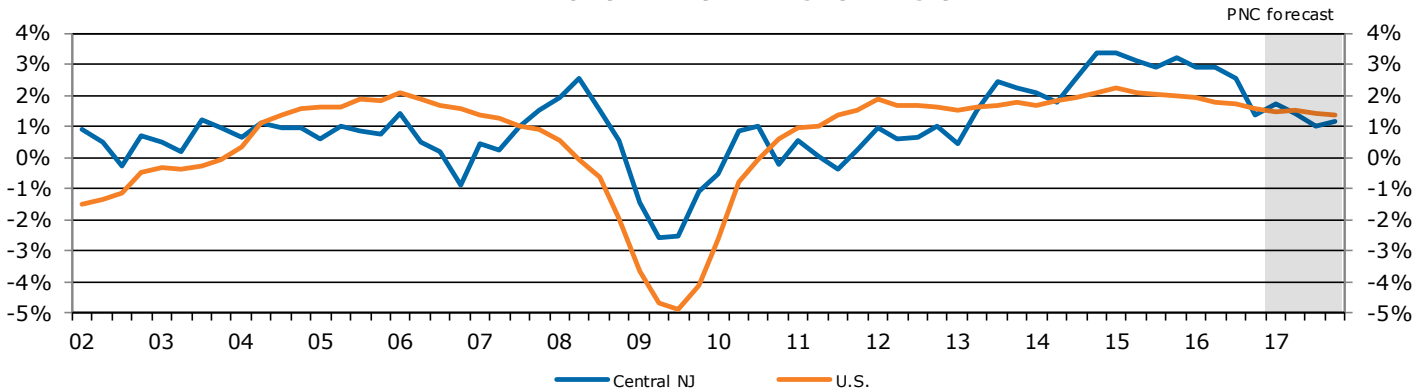


Chart sources: Bureau of Labor Statistics; The PNC Financial Services Group

LONG-RUN DEMOGRAPHIC TRENDS

Chart 6
Population, (% change year ago)

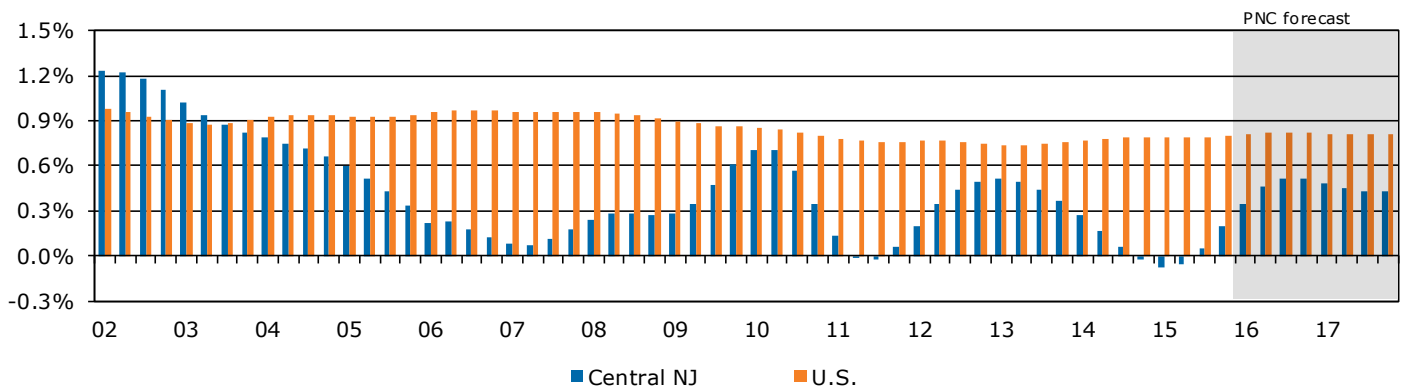


Chart sources: Bureau of Census; Moody's Analytics; The PNC Financial Services Group

LONG-RUN HOUSE-PRICE TRENDS

Chart 7
Case-Shiller House Price Index, (% change year ago)

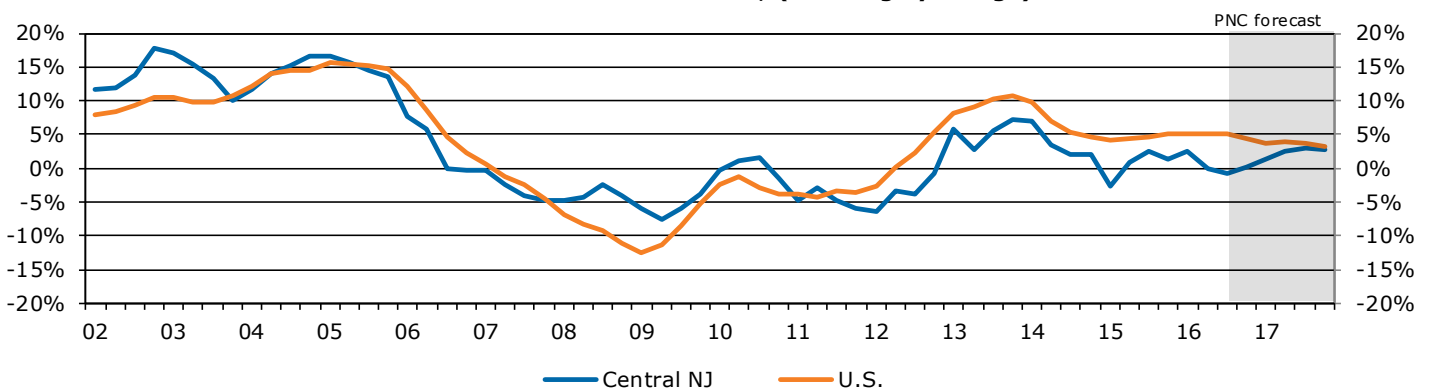


Chart source: National Association of Realtors; Fiserv, Inc.; The PNC Financial Services Group

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