New Jersey employers are deeply concerned about the near-term outlook for the state and national economies, and they anticipate a slowdown in economic activity at all levels, the New Jersey Business & Industry Association has found in its 2006 Business Outlook Survey.

For the state and national economies, a new pessimism has replaced last year’s relative optimism. This marks one of the most dramatic one year shifts from optimism to pessimism in 22 years of available survey data. Thirty-nine percent of survey respondents expect U.S. economic conditions to deteriorate in the first six months of 2006 and only 21 percent anticipate improvement, a reversal of last year’s outlook.

The near-term outlook for the state economy has deteriorated less dramatically, but this is only because employer’s optimism about the state economy was already more subdued. Expectations are similar, however, with 39 percent expecting conditions to worsen and only 18 percent anticipating improvement. A less pronounced shift to a more pessimistic view can be seen in respondents’ collective outlook for their own industries. (See Table 1)

In considering the prospects for their own business activity in 2006, respondents remain more upbeat than they do for the broader economy. More expect their sales, profits and employment to rise than expect them to fall in 2006. Still, they foresee less favorable conditions than did last year’s survey respondents.

A growing proportion of companies also believe their industries are recession bound, with 20 percent saying their industries are moving from expansion into recession. This is up from 8 percent who held a similar view a year ago.

The recent expansion has given companies appreciably more power than they had just a few years ago to raise prices. Fifty-four percent of survey respondents increased the prices of their primary products or services in 2005. This is the largest percentage reporting price markups since the question was first asked six years ago.

These are among the major findings of NJBIA’s annual Business Outlook Survey, now in its 47th year. The findings are based on responses of approximately 1,850 companies to the survey, which was conducted in September.

The timing of this year’s survey is significant as it was conducted just as Hurricanes Katrina and Rita were battering the Gulf Coast, dislocating local economies and sending oil and gas prices to record highs. This had an immediate and negative cost impact on businesses and consumers across the country.

Survey respondents also expressed a growing unhappiness with the administration of President George Bush, and they remain very unhappy with New Jersey’s business climate, which they view as much more costly and less business friendly than in other states.

But, it is the magnitude of the shift from relative optimism to relative pessimism in the space of a single year that remains the most dramatic, if not the most important, finding of the 2006 survey.
The Near Term Economic Outlook

This year’s survey participants have assumed a downbeat view of future economic conditions, a view at odds with the relative optimism expressed in the two preceding surveys. Also, a growing percentage of companies say they believe their industries are moving into a recession, a finding consistent with this changing view of the economy. The economic outlook is summarized in Table 1 along with other core survey data.

U.S. Economy. Only 21 percent of all respondents, the fewest since the 1999 survey, said they expect U.S. economic conditions to improve in the first six months of 2006. (See Chart 1) Nearly twice that many (39 percent) anticipate conditions will worsen. This is the reverse of last year’s outlook, when 42 percent foresaw an improving national economy, and only 16 percent expected a slowdown.

This is the single largest percentage-point shift from optimism to pessimism in the U.S. economic outlook in 22 years of available survey data.

NJ Economy. The near-term outlook for the state economy is nearly identical to the outlook for the national economy, the only difference being that the shift in sentiment is not as dramatic. This is because New Jersey employers in recent years have been more conservative in their outlook for the state economy and, thus, expectations were not as high to begin with.

Eighteen percent expect the state economy to show improvement in the first six months of the year, compared with 31 percent in last year’s survey. Meanwhile, 39 percent project a worsening of conditions, compared with 24 percent in the previous survey.

Own Industries. Looking at their own industries, companies anticipate a similar, though not as dramatic, change in conditions. Twenty-seven percent see conditions as improving, down from 41 percent a year ago, while 32 percent see things as getting worse, compared with 19 percent a year ago.

In a number of major industries that have driven growth in the current expansion, more companies are now negative in the outlook for those industries. The most negative responses were concentrated mainly in trade (both retail and wholesale) and construction. There was a closer balance between those expecting improvement and those foreseeing a worsening in manufacturing, services, transportation, as well as finance, insurance and real estate (these three industries are treated as a single category in the survey). Only the communications and regulated utilities industries remained upbeat, though far less upbeat than the year before. (See Table 2)
**Business Cycle.** When asked where they believe their industries are in the business cycle, respondents likewise were more pessimistic. A larger number see their industries as “moving from expansion to recession,” though not enough to warrant the conclusion that New Jersey employers as a group are in a recession or even in imminent danger of falling into recession.

The proportion of employers believing their industries to be in recession is 22 percent, a five-year low and the same as last year. However, the proportion saying their industries are moving from expansion to recession has jumped to 10 percent from 8 percent in 2001 and 6 percent the year before that. Thus, the overall proportion of respondents believing their industries are in recession or moving toward recession is now 42 percent, up from 31 percent last year, but still well off the 2001 recession high of 66 percent.

On the other side of the equation, the proportion of companies saying their industries are “moving from recession to recovery” or simply expanding has fallen to 58 percent from 69 percent the year before.

Despite the anticipated economic slowdown, more companies than not said they plan to expand employment in 2005, though the percentage expecting to hire more workers has fallen from a year ago. (See Table 1)

Twenty-four percent of companies said they plan to hire more workers in the year ahead and 10 percent said they expect to reduce the size of their workforce.

This outlook is somewhat less positive than it was a year ago when 27 percent anticipated employment growth and only 7 percent anticipated cutbacks.

Sixty-six percent of companies anticipate that employment will remain stable in the year ahead, a finding unchanged from the preceding four surveys.

Looking at the major industry groups, employment expectations declined almost across the board, although hiring expectations are still more positive than negative in every sector.

The retail, wholesale and construction sectors are least optimistic about their ability to add new hires in 2006, while the transportation and finance/insurance/real estate sectors are most optimistic. Taking up the broad middle ground are all other industries, including services, manufacturing and regulated communications and utilities.

Looking at their actual experience, a somewhat smaller percentage of companies hired more workers in 2005 than anticipated doing so in the preceding survey.

Twenty-one percent of this year’s survey respondents reported adding workers to their payrolls in 2005, less than the 27 percent who anticipated hiring more workers in the previous year’s survey.

Meanwhile, 15 percent said they trimmed their employment rolls in 2005, about twice as many as had anticipated the need to make cutbacks.
Sales, Profits and Purchases

Survey participants reported that sales and profits activity in 2005 was at the same moderately good levels as reported in 2004, with more companies enjoying sales increases than suffering declines. In their sales and profits outlook for the year ahead, however, they are notably less optimistic than they were last year, as illustrated in Chart 2. Nonetheless, optimists still outnumber pessimists on this important indicator.

While sales and profits activity has been moderately good over the past two years, it has been subdued when compared to the better years of the 1980s and 1990s expansions. Thus, sales and profits expectations appear to be slowing even before they have had a chance to reach the robust levels seen in the preceding upswings. Table 1 summarizes the outlook for sales, profits and purchases.

Sales. Forty-nine percent of companies reported sales increases in 2005, the same as the year before and up sharply from a 13-year low of 34 percent in 2003. At the same time, 28 percent of respondents said sales declined last year, also the same as the year before.

Looking ahead, 49 percent expect their sales to rise in 2006, down from 56 percent projecting sales increases last year. At the same time, 25 percent expect sales to slow in the year ahead, compared with 18 percent who anticipated slowing sales the year before. These expectations, while more positive than negative, remain well below the sales expectations seen at the height of the 1980s and 1990s expansions.

Profits. As go sales, so go profits. Forty-three percent enjoyed a rise in profits in 2005, and 33 percent experienced a decline. This was almost identical to the 2004 experience.

While this is vastly improved from the 2000-2002 recession years, when profit declines were more the norm, the net percentage seeing profit improvement in 2004 and 2005 is not even half of what it was in the better years of the 1980s and 1990s upswings.

Looking ahead to 2006, respondents collectively foresee a pullback in profit performance. Forty-three percent anticipate profit growth over the next year, down from 49 percent the year before. And 32 percent anticipate declining profits, compared with 26 percent the year before. Thus the net percentage of respondents anticipating profit growth next year is just 10 percent, down from 23 percent last year and 16 percent the year before that - and well below the levels seen in the two preceding economic expansions.

Purchases. As one would expect, companies that expect to sell less and make less will scale back their purchases of goods and services from other companies. Forty-two percent of companies expect to spend more on purchases in 2006, down from 46 percent the year before. And 23 percent expect to spend less in the year ahead, up from 18 percent anticipating scaled-back purchases in 2005.

“Sales and profits expectations appear to be slowing even before they have had a chance to reach the robust levels seen in the preceding upswings.”

Labor Availability

Although labor market conditions have been on the mend in New Jersey for more than two years (with unemployment sliding downwards from a high of 6.1 percent in July 2003 to 4.3 percent as of September), the state’s employers are experiencing only marginally greater difficulty in recruiting workers.

Sixty-three percent of this year’s respondents reported difficulty in finding the skilled labor they need, about the same as the last two years, but down from a recent high of 80 percent in the 2001 survey.

The percentage of respondents having difficulty finding qualified applicants was 50 percent for technical and professional positions, 42 percent for managerial occupations, 20 percent for clerical workers and 15 percent for unskilled labor. All of these levels are up only marginally from two years ago.

Quality of Entry-Level Workers

This year’s survey participants were asked additional questions to determine their views regarding the quality of entry-level workers and their educational backgrounds.

Respondents were most satisfied with the computer and technology skills of entry-level workers. More than half (53 percent) rated these skills as good or excellent, 36 percent rated them as fair and 11 percent said they were poor.

A substantial proportion also were pleased with the attitude and work ethic of new entrants, with 41 percent saying entry-level workers are good or excellent in this regard. About one third of companies gave good-to-excellent grades to the punctuality and verbal communications skills of these employees.

Employers were more evenly divided in their assessment of the math-science skills, critical thinking skills, and the self-motivation/initiative of entry-level workers. In these areas, about half gave a grade of “fair,” with the rest giving grades of good or poor in nearly equal measure.

Employers were less satisfied with the ability of entry-level workers to manage their time, giving grades that were somewhat more negative than positive. They were least happy with workers’ written communications abilities, giving a “poor” grade 30 percent of the time and a “good” grade only 20 percent of the time.
In rating workers by their educational backgrounds, most respondents were very pleased with the quality of workers graduating from colleges and universities (both private and public) and somewhat less satisfied with graduates of community and county colleges.

Seventy-one percent of private high school graduates received good-to-excellent ratings, with somewhat poorer grades going to graduates of private training institutes and vocational-technical schools. Public school graduates received the lowest grades. Only 33 percent of respondents said the quality of these workers was good-to-excellent, while 52 percent rated them fair and 15 percent gave them a failing grade.

**Expected Costs of Doing Business**

**Wage and Salary Rates.** Seventy-five percent of employers said they expect to give pay raises in 2006. One quarter of employers expects to give raises of 1-2 percent and another one-third, raises of 3-4 percent. Only 14 percent anticipate giving pay hikes of 5 percent or more. These projections are roughly in line with those from last year’s survey, which turned out to be on the conservative side. (See Table 3)

**Fringe Benefits.** Seventy-three percent of respondents say their fringe benefit outlays will increase in 2006, about the same as the three preceding surveys. Twenty-one percent said they expected no change and 6 percent anticipate a reduction. Of those projecting increases, 43 percent believe costs will rise by 1-5 percent, with the rest divided equally between those anticipating increases of 6-10 percent and those expecting cost hikes of 11 percent or more. Rising health insurance premiums undoubtedly are contributing to the high rate of benefit-cost increases.

**Advertising Budget.** Thirty-four percent of respondents expected to see their advertising budgets increase in 2006, 54 percent said they expected no change and only 12 percent projected a decline. The proportion anticipating higher outlays was down a bit from last year’s 36 percent but well above the 28 percent three years earlier when the state economy was in recession.

**Property Taxes.** As reported further on in this report, high and rising local property-tax rates remain a major concern of NJBIA members, exceeded in importance only by healthcare inflation. Seventy-nine percent of this year’s survey respondents expect larger property-tax bills in 2006, up fractionally from last year’s expectations. Of those anticipating higher rates, a growing majority foresees tax hikes well in excess of the general inflation rate. About two-thirds of those expecting an increase believe it will exceed 4 percent, with the rest of this group anticipating increases of 6 percent or more. Four years ago, only 13 percent thought their increases would reach the latter magnitude.

**Borrowing Costs.** The Federal Reserve has been nudging the federal funds rate upwards for more than a year. It comes as little surprise, then, that 68 percent of respondents believe borrowing costs will rise, while only 4 percent believe rates are headed downwards.

**Pricing and Productivity**

**Pricing Power.** Pricing power improved further in 2005 as the demand for goods and services continued to rebound from depressed recession levels. Fifty-four percent of survey respondents increased the prices of their primary products or services in 2005, up from 49 percent last year, 34 percent in 2003 and 30 percent in 2002. This was the largest percentage of companies reporting price markups since the question was first asked in the 2000 survey. The proportion reducing prices dropped from 17 percent two years ago to 7 percent in 2005.

**Productivity Investments.** Fifty-seven percent of respondents made investments to boost productivity during 2005, down from 60 percent a year ago and roughly in line with what they had reported, on average, during the preceding three years. Of those making productivity-improving investments, 72 percent upgraded their information technology, 50 percent engaged in workforce training and development, 48 percent invested in new production equipment or facilities, and 34 percent made outlays for production-process improvements.

**Capital Spending Plans for the Next 12 Months.** The proportion of respondents anticipating greater capital spending during the next 12 months edged slightly lower to 37 percent in this most recent survey after increasing during the two preceding years from 32 to 39 percent. This leveling off is consistent with their expectations of a more subdued pace of overall economic growth. Fifty percent of all respondents see capital outlays holding steady at last year’s levels and only 14 percent anticipate declines.

**New Jersey’s Business Climate**

When asked how they rate New
Jersey as a place to expand, this year’s survey respondents remained the most negative they have been at any time since the 1994 survey. Only 28 percent said New Jersey was a good or very good place to expand and another 21 percent said it was only average. The remaining 51 percent were about evenly split between those giving the state a thumbs down (28 percent responded “poor”) or rating it only fair (24 percent).

These assessments were essentially the same as last year’s. However, the “thumbs down” group accounted for only 9 percent of all respondents five years ago. At that time, half thought New Jersey was a good or very good place to expand.

NJBIA members also hold mostly negative views about the state government’s attitude towards business, its economic development efforts and its effectiveness in controlling the costs of doing business. Members were most unhappy with the performance of the state regarding taxes and fees, government spending and healthcare costs. The following percentages of respondents said New Jersey is worse than other states in:

- **Controlling healthcare costs:** 95 percent, compared with 93 percent last year and the same as in the 2003 and 2004 surveys. This matched the most unfavorable assessment since the 1991 survey.
- **Taxes and fees:** 94 percent, essentially unchanged since this question was first asked at the time of the 1999 survey.
- **Controlling government spending:** 92 percent, up fractionally from last year and the worst since the 1991 survey.
- **Controlling energy costs:** 84 percent, compared with 78 percent last year and the most negative response in 20 years of available data.
- **Cost of regulatory compliance:** 84 percent, compared with 77 percent five years earlier.

**Table 3**

<table>
<thead>
<tr>
<th>Pay Rate Change</th>
<th>% of Respondents</th>
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<tbody>
<tr>
<td>Decrease</td>
<td>3% 2% 2%</td>
</tr>
<tr>
<td>No Change</td>
<td>26% 26% 24%</td>
</tr>
<tr>
<td>Increase</td>
<td>72% 72% 75%</td>
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The following percentages of respondents said New Jersey is worse than other states in:

- **In the quality of its public schools:** 72 percent, little changed from 73 percent last year and otherwise the highest in 22 years of available data.
- **As a place to live:** 65 percent, up from 61 percent last year, but down from 74 percent five years ago.
- **Quality of its work force:** 64 percent, little changed since the question was first asked at the time of the 1999 survey.
- **Protecting the environment:** 61 percent, off from 64 percent last year and a near record high of 75 percent six years ago.

**Most Commonly Cited Problems**

The New Jersey business community has long struggled with the high and steeply rising costs of providing health care coverage to its employees. Its concern about this was once again evident in the responses of NJBIA members to this year’s Business Outlook Survey. When confronted by a list of 12 potential problem categories, 36 percent selected health insurance costs as their worst problem. This was the 17th consecutive year that health insurance costs topped the list.

Property taxes were identified as the worst problem by 19 percent of all respondents, followed by “the overall cost of doing business in New Jersey,” which 18 percent identified as their worst problem.

None of the remaining nine problem categories was labeled as “worst” by more than 5 percent of respondents. Much further down were, in order of importance: state taxes, frivolous lawsuits, state regulations, energy costs, workers’ compensation costs, wage/labor costs, availability of skilled workers, environmental compliance and unemployment compensation costs.

**Assessing Government Leaders**

This year’s survey once again solicited the views of NJBIA members regarding the performance of the Bush Administration and the state and national legislative bodies. Normally, there is also an assessment of the Governor. This was temporarily suspended because of last year’s resignation of Governor James E. McGreevey and the interim nature of Acting Governor Richard Codey’s tenure. What follows are the findings regarding the Bush Administration, Congress and the State Legislature.
Bush Administration. One of the more striking findings of this year’s survey is the markedly reduced popularity of the Bush Administration within the New Jersey business community. A year ago, 55 percent of survey respondents called the Administration’s performance good to excellent. Twenty-seven percent rated it as fair and only 19 percent thought it was poor. In marked contrast, only 36 percent of this year’s survey participants rated the Administration good to excellent while 34 percent assigned it a score of fair and a heftier 30 percent gave it a “poor.” At the peak of the president’s popularity three years ago, 65 percent rated his performance as good to excellent and only 9 percent rated it poor.

Congress. Survey respondents were even less kind this year to Congress, to which only 14 percent assigned a good-to-excellent rating, down from 21 percent last year and the fewest since the 1994 survey when the Democrats were in control. Thirty-five percent of this year’s respondents thought Congress was doing a poor job (compared with 22 percent in last year’s survey) and 52 percent, a fair job.

NJ Legislature. NJBIA members’ views regarding the State Legislature were little changed from a year earlier and comparable to ratings given to Congress. Fourteen percent of respondents rated the Legislature’s performance good to excellent in 2005, up from a low of 8 percent two years ago, while 45 percent rated it fair, and 41 percent, poor.

Conclusion

While NJBIA’s 2006 Business Outlook Survey does not show the economy to be either in recession or necessarily even in imminent danger of falling into one, it does reveal a striking shift from optimism to pessimism in the near-term economic outlook.

Over the last 22 years, there have been few shifts from positive to negative as dramatic as this one. Past shifts of comparable magnitude have sometimes foreshadowed a recession, sometimes not.

One thing is clear, however. This year’s survey respondents, who represent a broad cross-section of the New Jersey employer community, are anxious about the future. They expect the economy to hit a speed bump in the year ahead, with growth slowing.

While respondents are more pessimistic about the broader economy than about the prospects for their individual companies in the year ahead, this is not unusual. In past years, survey respondents have sometimes spotted trouble on a more distant economic horizon before realizing the full impact on their own operations.

Undoubtedly, the enormous damage caused by two destructive hurricanes played a role in raising fears about the economy, especially as it pushed energy prices to record highs. Coincidentally, the U.S. Conference Board reported that hurricane damage contributed to a decline in U.S. consumer confidence in October, which fell to its lowest level in two years.

It may also be that New Jersey employers are unusually cautious because the state economy has not been performing at a very high level. Survey data shows the net percentage of companies enjoying sales and profits growth over the last two years to be about half of what it was in the boom years of the 1980s and 1990s. Also, recent private-sector job growth in New Jersey has been unusually weak. As of September, 29 months into the current employment expansion, New Jersey’s private sector economy was limping through one of the weakest periods of job growth in more than half a century. In 2004, New Jersey was 41st in the nation in its rate of private-sector job creation.

The 2006 survey is flashing a warning signal that should not be ignored. For many New Jersey employers, the issue apparently is not if the economy will slow down, but by how much.