CONNECTICUT ECONOMIC OUTLOOK

Highlights of the Connecticut Forecast – 2014:Q2 through 2018:Q4

- The gradual but below U.S. pace of the Connecticut job recovery (just 64.7% as of 7/14) is expected to continue through 2018:Q4, with all lost jobs to be regained by 2016:Q2

- NEEP anticipates that Connecticut employment 2013:Q4-2018:Q4 will add 80,000 jobs, or 28,000 positions below the Moody's Connecticut baseline.

- NEEP expects slower than historical job recoveries in Connecticut financial activities, retail, construction, government, and healthcare. Manufacturing and information should show few if any net job gains, while casino jobs should fall as firms face growing competition from gaming additions in surrounding states.

- From July 2013 to July 2014 Connecticut job gains totaled 9,400, with increases in trade (4,900), professional services (1,800), leisure/hospitality (4,800), construction (2,700), and education/health (5,200). Conversely, job losses appeared in manufacturing (-600), information (-900), financial activities (-1,200), and government including Indian Casinos (-8,100).

- Job increases of 14,100, 25,100, and 23,300, are expected in 2014, 2015 and 2016 as the U.S. recovery, employee wage gains, and a rising housing market drive growth. Thereafter, job gains should slow, reaching a forecast peak of 1.742 million in 2018:Q2.

- The Connecticut July 2014 unemployment rate was 6.6%, down from 7.9% in July 2013, but still above the 6.2 % U.S. rate. NEEP projects an unemployment rate of 6.8% for all of 2014, with 6.4% in 2015, and falling to 5.7% in 2018. A healthy annual gain averaging 1% in the Connecticut labor force should keep the unemployment rate from falling faster and farther.

- Weak gains in residential and commercial property values should limit spending, job, and service increases in local budgets for at least another fiscal year.

- Also, the restructuring of the U.S. financial services industry including Wall St, Connecticut insurance, commercial and investment banking, along with money management firms should potentially limit Connecticut income and sales tax revenue gains for 2014-2016, and contribute to a projected $1.2 billion state budget deficit for fiscal 2016.

- Total nominal and per capita personal incomes peaked at $198.98 billion ($56,121) in 2008, but fell to $191.31 billion ($53,712) in 2009. Nominal income rebounded to $218.29 billion ($60,703) in 2013. Further gains to $226.65 billion ($62,991) are projected for 2014, and $241.44 billion ($66,956) in 2015. By 2018 the totals should reach $281.42 billion ($77,457) which should help to support a rise in both consumer spending and state tax revenues.

- Existing Connecticut single family median home prices peaked at $320,800 in 2007, but fell annually to a low of $251,100 in 2012. Sale prices are expected to average $258,600 for 2014, and $272,700 in 2015. Slow but steady price gains are expected, with an average sale price of $293,100 in 2018. A slow growing and aging population, along with rising sales from departing retirees, should keep prices from rising further and faster.

- New home permits (saar) peaked at 12,269 in 2005:Q3 and reached bottom at 3,173 for all of 2011. New permits rebounded to 5,424 for 2013, with 6,033 units expected in 2014, and 7,734 in 2015. The diminished supply of new homes could lift permits to a peak of 9,028 in 2016, but falling thereafter to 8,269 in 2018, in response to rising mortgage rates.

- Sales of existing homes peaked in 2005:Q1 at 61,300 and fell to a low annual total of 32,300 in 2011. Existing home sales totaled 38,100 units in 2013, but may just hold steady at 38,300 in 2014. Aided by pent-up demand, gains in existing sales are likely in 2015 (45,600), with a peak of 47,700 units in 2016.

- ***The modest Connecticut recovery is projected to continue for the forecast period 2014-2018. But internal changes in financial service and construction jobs, Connecticut demographics, issues surrounding Connecticut business competitiveness, and gains in income, biased in favor of high income earners, should constrain the pace of the state's advance. Therefore the actual Connecticut economic trajectory will depend heavily on the existence, strength, and timing of the U.S economic expansion.***

The Connecticut Forecast - Employment

The "Great Recession" cut 119,100 jobs from Connecticut payrolls, both private (-112,000) and public (-7,900) including Indian casino losses. Through July 2014, the Connecticut economy has regained 76,400 positions or 64.1% of the lost jobs. The private sector has regained 86,100 jobs or 76.9% of those it lost. However, the governmental super sector has continued to lose jobs having dropped another -8,100 positions since July 2013, mostly at the local level whose total includes an additional number of undisclosed cuts at the two state casinos. A rough estimate would place casino job losses in the 7,000 range for the entire recession, down from approximately 20,000 at their combined peak. Connecticut added 15,000 jobs in 2013, down just slightly from the 15,500 positions added in 2012. The annual non-ag employment number fell by 18,500 jobs in 2010, after falling by 72,700 positions in 2009. With the recovery under way, the Connecticut job total advanced by 17,300 positions to average 1,625,100 jobs in 2011, and the March 2013 employment re-benchmarking showed Connecticut jobs grew by 14,100 positions in 2012. With 1,670,300 jobs as of July 2014, the Connecticut job total matches the amount first reached in August 1988.[1] This implies **no net job growth for Connecticut** over the 26 year period.

<u>The Near Term Outlook 2014-2016</u>. The NEEP October 2014 forecast looks for Connecticut employment gains of 14,100 in 2014 relative to 2013. This advance is down slightly from the 18,000 position gain as projected in the NEEP November 2013 forecast. Most of the discrepancy comes from the winter weather related, and "still on the books", reported loss of 10,900 positions in January 2014 relative to December 2013. **While the March 2015 federal employment re-benchmarking may soften the job loss number, it continues to drag down the total gain for 2014, as well as the NEEP forecast for 2014 as well as the future pace of the Connecticut recovery.**

[1] http://www1.ctdol.state.ct.us/lmi/ctnonfarmemployment.asp

For 2014, NAICS job gains are expected in professional & business services (2,400), which includes possible Affordable Care Act related part time job gains, leisure & hospitality (4,600), trade (3,900), construction (2,100) including Hurricane Sandy repairs, along with education & health services (4,600). NAICS sectors that are projected to experience job losses include government (-2,800), information (-300), and financial activities (-1,100). Jobs in domestic and international banking, money management, and insurance, are still being negatively affected by the aftermath of the Great Recession. Conversely, the "well to do" appear to be "doing very well" as indicated by the rise of 18,500 positions in leisure & hospitality sector since the low of 33,600 in 2010. Also, a very informal restaurant seat availability index ☺, has reached what appears to be an historically low value, especially in Fairfield County.

The Connecticut Labor Market Paradox

Another Connecticut growth headwind involves what might be stated as the Connecticut Labor Market Paradox: Connecticut is seen as having a **surplus of workers** juxtaposed with a **shortage of worker skills**. As the U.S. recovery gains momentum in 2014-2016 and manufacturing sees new life resulting from a rise in domestic private and military demand, the local spinoff of this rebound should lead Connecticut firms to look for additional skilled and semi-skilled employees. The quality as well as volume of these workers are becoming increasingly tight as the state economy and educational system no longer produces a steady supply of blue collar and professional level technical workers. The lack of skilled labor is making it more difficult for manufacturing and other high tech firms to be competitive from, as well as remain and expand in Connecticut. Conversely, the level of foreign demand for Connecticut manufactured goods is becoming more suspect in the short run, as European national customers as well as China continue to face declining growth in their economies.

Adding to the problem is the graying of the Connecticut blue collar workforce, where large numbers of the remaining skilled workers are reaching retirement age. Conversely, many of the new jobs that are being filled in Leisure, Health Care, Retail Trade, and Business Support Services are lower paying, lower skill positions. These jobs will contribute little in the way of multiplier effects for additional employment and income growth, or tax revenue to help with balancing the state's budget.

The NEEP Intermediate Term Forecast (2017-2018). NEEP anticipates a steady Connecticut employment recovery that will be driven by, but slower than, the national job expansion. The MA baseline forecast projects that U.S. employment should grow by an average of 1.3%, and 0.5% in each of the final two years. In comparison, while the absolute Connecticut employment changes are expected to be positive at +18,400 and +5,100 jobs, they average gains of just 1.1 %, and 0.3% per year. The slow down at both the Connecticut and U.S. levels is expected to be driven by higher interest rates. In Connecticut, private service producing sectors are expected to account for +17,000 of the +23,500 total two-year job gain. Super Sector job advances should be led by education & health services with +8,100, professional & business services +8,400, financial services +1,100, and leisure/hospitality at +2,900. The goods producing sectors should lose -1,400 jobs including construction (+1,100), with manufacturing down by (-2,300). With budget recoveries at both the state and local levels, government employment, including casinos, should add +1,900 positions rounding out the job gains. By 2016:Q2, Connecticut employment is projected to reach and exceed the previous job peak of 1,713,000 positions achieved in March 2008. The state should end with 1,741,000 positions in 2018:Q4.

Looking at the unemployment rate, the U.S. figure peaked at 9.9% in 2009:Q4, up from 4.4% in 2006:Q4. As of July 2013 it stood at 6.1%, but by 2017 the U.S. unemployment rate is projected to average a more tolerable 5.1 %. In Connecticut the unemployment rate peaked at 9.4% in 2010:Q4 up from 4.3% in 2006:Q2. For 2014 it is expected to average 6.8%, but should fall slowly to average 5.7% in 2018. As with the 2014-2016 outlook, the unemployment rate for 2017-2018 will reflect not only the growth in jobs but also any expansion the in Connecticut labor force. NEEP expects the Connecticut labor force to grow by 13,000 persons from 2016-2018, peaking at 1.947 million in the final year. If this modest expansion fails to materialize, then the annual unemployment rate will be correspondingly lower.

The Connecticut Forecast – Housing, Real Estate, and Home Finance Data

The NEEP short-run housing outlook 2014-2016. The state's annual cyclical peak for **housing permits** totaled 11,885 in 2005. The issuance of new Connecticut permits hit their recession low in 2011, numbering 3,173. This was down by -8,712 units, to a figure of just 27 % of their earlier peak total. The new permit numbers for 2011 represented an unprecedentedly low absolute total. From 1989-1993 during Connecticut's "Great Recession" the number of Connecticut permits fell by 4,492 or -37.5% from 11,969 to an annual low 7,477 units in 1991. The recent past recession from 2005 to 2011 showed a decline of -73%. These latter numbers represent depression level figures for the Connecticut housing industry and have had a devastating effect on home builders and construction employment.

For 2014, the expectation is that new permits will show a relatively modest rise to 6,033 units, up by 609 units or 17.7% from the revised 169 town 2013 total of 5,424 units. Throughout the year, monthly state government (DECD) permit totals are only available for 128 towns. Through June 2014, this data showed 2,490 new permits issued, up by a substantial 32.0% from the June 2013 total.[2] However, all of the permit gains have been in multi-family units, with single family permits being down by -1.2% or -14 units from June 2013. It is doubtful that the smaller non-monthly reporting towns will show such a bias in favor of multi-family permits when all of the Connecticut housing data will be released in May 2015.

NEEP projects further gains to 7,734 units in 2015 up by 28.2%, with the total peaking at 9,028 units in 2016. The latter year peak reflects the slower pace of the overall state recovery, such that Connecticut is expected to be late to the housing recovery as well. This 2016 total is still only 76% of the previous peak, and implies a short supply of new housing in general as Connecticut home demolitions run 900-1,000 units per year.

While both single and multifamily numbers fell to 2011, the fall and subsequent rebound has favored multifamily units as builders have erected new rental units to house the growing number of displaced former home owners. About the best that can be said is that the decline in new permits has taken some of the pressure off of the supply side of the housing market, thereby helping to keep housing prices from falling even further. However, there are still some distressed and foreclosed sales of existing homes at bargain level prices.

NEEP anticipates that through mid-2015, the Connecticut housing market will show historically low mortgage interest rates, still relatively low home prices, and more willingness to lend to first time home buyers by banks. However, the volume of originations is projected to fall by 22% to 16,700 in 2014, and rising to 18,300 in 2015 as the number of distressed sales and refinancing decline.

[2] http://www.ct.gov/ecd/cwp/view.asp?a=1106&q=250640

The **median sale price of an existing Connecticut home** fell by -2.6% to a cyclical low of $251,100 in 2012, helping unit sales to rise by 9.6% to 35,400 units. Both home prices and the number of **sales of existing homes** are projected to rise in 2014 to $258,600 and 38,300 respectively. The price gain will be helped by a limited amount of inventory as sellers wait for still higher prices. The ability for nominal home prices to rise annually is eventually constrained by annual gains in nominal income. Except for 2013, the projected annual percentage gain in home prices to 2018 is at or below the annual percentage gain in Connecticut nominal personal income. This points to the potential for greater increases in home prices to 2018 than is currently forecast. As the Connecticut existing market recovers the **Affordability Index** will show only modest annual increases, thereby allowing existing sales to reach it forecast peak 47,700 units in 2016 with median prices at $282,100.

Berkshire Hathaway Home Services (BHHS) is an extremely trustworthy source for housing sale and price data. The firm relies on local MLS information to track Connecticut single family and condo sales for the state, its eight counties, and most of the individual 169 towns.[3] Their latest report covering activity in 2014:Q2 showed many indicators moving in the direction of a stronger housing market relative to 2014:Q1 and some being unchanged or slightly lower relative to 2013:Q2. **Single family home sales** at 7,420 units were down by 5.8% from 2013:Q2, but up by 57.5% from 2014:Q1 which was adversely affected by severe winter weather. Sales in the two largest markets of Fairfield and Hartford counties were down -8.4% and -2.2% respectively. The **median sale price** statewide was down by 1.1% to $262,000. Clearly, Connecticut local housing markets reflected the slowing in price gains registered by the S&P/Case-Shiller 20 market index, which rose by 1.1% in April 2014 relative to March and 10.8% from April 2013.[4] For Connecticut, the number of **days on market** was down for both 2014:Q2 single family and condo sales in all eight counties. Also, for sale inventory rose by 5.7% from the previous quarter, yielding 7.3 mounts of supply for single family homes and 5.7 months for condos. Lastly, sales in the ultra-luxury segment of the Connecticut housing market, priced at $5 million+, were very strong with 22 sales, up by 57% from 2013:Q2. Again the "well to do" appear to be doing "very well".

On balance, historically low mortgage rates and Connecticut home prices well below historic highs should help to bolster existing sales through the end of 2016. Furthermore, the authors of the BHHS report anticipated that pent-up demand for housing will help to drive a recovery in the existing home sale market in 2014 and 2015.

The NEEP Intermediate Term Outlook 2017-2018. NEEP anticipates that the housing market will re-establish a more normal balance between housing supply and demand, with permit numbers stabilizing in the 8,200-8,700 unit per average as mortgage rates begin to rise. Connecticut was late and sluggish to both the job and the housing recoveries. If Connecticut job growth finally kicks in as NEEP projects in 2015-2017, then the number of **new permits** should decline slowly but steadily from a peak of 9,028 units in 2015 to 8,269 units in 2018. This ending number is still some 3,600 units below the 2005 peak, but reasonable in a state with a severely depressed level of home building in 2008-2011. However, an aging population, net outmigration, land limitations, and rising mortgage rates later in the forecast should account for the restrained the recovery in Connecticut home building.

3 http://www.bhhsneproperties.com/documents/market-report/2014Q2.pdf

4 https://www.spice-indices.com/idpfiles/spice-assets/resources/public/documents/97929_cshomeprice-release-0624.pdf.

Existing sales should average 46,000 units annually with fewer distressed sales. This should allow **median existing home sale prices** to increase further to average $293,100 in 2018, rising from $282,100 in 2016. Again, from 2016-2018 the annual rise in home prices are projected to be at or below the annual gains in nominal income. Both the pace of existing sales and median sale prices will take a long time to return to the peaks of 58,100 sales in 2005, and median prices of $320,700 recorded in 2007. Slow state economic and population growth combined with a rising senior citizen cohort and potentially strong net outmigration should place more inventory on the market helping to account for the modest annual price increases. **Total originations** should reach a low of 16,000 in 2017 rising to 18,900 in 2018. This latter number is still well below the pre-recession peak of 43,700 in 2005. The **mortgage delinquency rate** is projected to fall further to 4.66 per hundred loans in 2016-2018. Finally, as the housing industry recovers with both rising prices and higher mortgage interest rates, the **FHFA Affordability Index** should rise moderately from 414.9 in 2016 to 435.2 in 2018, implying decreased affordability over time.

The Connecticut Forecast – Income, Population, and Migration

Nominal personal income fell by -3.9% in 2009, with a gain of 3.4% in 2010 and 4.7% in 2011. For 2006 and 2007, nominal personal income rose by 9.0% and 7.1% respectively. The rise and fall of taxable nominal personal income helps to explain the why Connecticut had such problems in balancing the state budgets in 2008-2011. NEEP anticipates that with the modest national recovery and steady state job growth, Connecticut nominal personal income should rise by 3.8% and 6.5% in 2014 and 2015, with a gain of 6.5% being possible in 2015. Still healthy income increases of 6.3% and 5.4% are expected in 2016-2017, with a low of 4.0% in 2018. Job growth will lead to higher personal incomes along with higher tax collections which should help state government to achieve its goal of a balanced budget.

Advances in annual **real personal** are expected to be less as inflationary effects are subtracted out of the nominal numbers. Very slow real growth of 0.7% was recorded in 2013. Higher gains of 2.2% and 3.8% are projected for 2014-2015. However, in 2016, real growth should decline slightly to 3.6%, with subsequent declines to 2.6% and 1.7%. This decline in real income growth should occur as the national economic expansion is projected to be slowed by higher interest rates and lesser Connecticut job gains.

A closer comparison of a**verage** and **median nominal household income** figures clearly shows that all Connecticut residents are not sharing equally in the state's recovery. For every year of the forecast, the percentage change in average income exceeds that of nominal median income, often by 0.5%-1% or more. In 2013, Average Household Nominal Income was 2.29 times the amount of Median Household Nominal Income. By 2018, the gap between Average and Median income is projected to grow to 2.38 times. Both the divergence and the growth in the divergence of these two statistics holds important implications for Connecticut consumer spending. Average household income is being influenced by the extremely high incomes received by the wealthiest of Connecticut households. Spending patterns here focus to a greater extent on luxury goods, higher priced real estate, and services. Conversely, median household income better reflects the economic condition and purchasing power of the typical Connecticut household. Recently, Federal Reserve data has showed that this growing gap between median and average incomes, along with wealth is a serious national problem.[5] Only strong job growth, targeted at households with lower skill and

[5] Binyamin Applebaum, "Least Affluent Families' Incomes Are Declining, Fed Survey Shows", The New York Times, September 5, 2014, p.B2.

educational levels, is likely to narrow the widening gap. Such job expansion is not reflected in the Connecticut employment forecast to 2018.

NEEP **population** projections appear to reflect a story of potentially limited Connecticut growth and job opportunities, in the face of higher living costs. The state's population is expected to grow by just 37,000 persons from 2013 to 2018, or approximately 7,400 persons (0.2%) per year. This is substantially below the projected U.S. (1.0%) average annual increase. The below average Connecticut population gains reflect the state's below average annual rate of job creation, the outmigration of some retired seniors, and it's higher living costs as evidenced by housing, taxes and energy prices.

Two slightly more positive statistics help to cushion the problems surrounding the population and income figures. First, the negative Connecticut **net outmigration** numbers for existing adults and children helps to explain the slow growth in Connecticut population. Net outmigration totaled -400 persons in 2013. That number is projected to rise slightly to average -1,400 persons per year for 2014, with a decline to -800 persons in 2015. For 2016-2017 the annual net migration number should show a small gain to 500 persons or less per year in response to a stronger Connecticut economy. However, the number again turns slightly negative in 2018 as higher interest rates are expected to restrain the pace of Connecticut job growth. For all six New England states, there is an annual net in migration averaging 1.9% per year from 2013-2018, which is well ahead of the 0.0% annual gain expected in Connecticut.

A closer look at the available **age cohort data** shows that the Connecticut age cohort for 65 years of age and up is expected to be the fastest growing cohort in CT, and yet it grows more slowly than it does at the national level. This may seem odd given that Connecticut residents have the sixth oldest median age among U.S. states. Also, for the 20-24 and 25-44 cohorts, the Connecticut annual percentage change numbers are generally more negative or at least less positive than are U.S. figures. These cohort data trends seem to imply that individuals of retirement age tend to depart from Connecticut more readily than elsewhere, and that it is more difficult to attract and/or hold young workers in the most productive age brackets. With older/wealthier Connecticut residents departing and younger/more productive residents growing more slowly, there is potentially a less favorable growth potential for Connecticut income and spending patterns.

However, the departure of retirees may be slowed as minimal gains in home prices make it less attractive or financially feasible for current home owners to sell and depart. Also these net Connecticut cohort flows are consistent with a slow growing, employment challenged, and fiscally burdened state. And they hold implications for the ability of the Connecticut housing market to rebound quickly during the 2014-2018 forecast period.

Second, the recession based decline in employment and the longer term slow growth pattern in the Connecticut economy has retarded the rate of growth in **household formation**. Doubling up, the return of college grads to live with parents, and the slowing marriage rate all worked to squeeze the rate of household formation. In 2013, Connecticut had 1,385,900 household units of all sizes. This number is projected to rise by 43,300 units to a peak of average 1,429,200 units in 2018. However, the average annual Connecticut household expansion pace of 0.6% is below both the U.S. pace of 1.1% and that of New England at 0.9% per year. The slower Connecticut household growth should provide less of a stimulus locally for the building of additional owner occupied dwellings and rental units.

Conference Theme: Key Economic Challenges Facing Connecticut

Any list of key, non-survey generated, economic challenges facing a particular state most likely will contain some degree of subjectivity and selection bias. In particular, the focus on economics will most assuredly understate the number and size of any social, racial, and political challenges. With that qualifier in mind, a ready list of key economic challenges would certainly include:

- The fact that Connecticut faces an estimated state budget deficit of approximately $1.28 billion starting in fiscal 2016. Approximately one-half of the shortfall will result from previously negotiated, mandatory pay increases for state workers. The fall 2014 governor's race should focus having each candidate informing the electorate in detail as to how he would deal specifically with the shortfall.

- Two recent competitiveness surveys by CNBC and Thumbtack.com have rated Connecticut as one of the lowest ranking states in terms of economic competitiveness and friendliness towards small business. While such surveys have their own limitations, the persistent low ranking for Connecticut raises a very large red flag that helps to explain the states paltry level of post-recession job recovery.

- Connecticut faces some serious demographic challenges. It has an extremely low rate of annual population growth, a long history of net outmigration, a very low level of household formation, and a 65+ population that is the fastest growing age cohort in the state. In combination, these demographic issues hold considerable consequences for future labor and housing markets, entrepreneurship, the educational system, and health care.

- Infrastructure, including rail and highways, are in serious need of repair. Accidents and equipment breakdowns are common on the Metro North's New Haven rail line that takes more than 125,000 commuters to and from work in lower Fairfield County and New York on a daily basis (sometimes). Highway infrastructure is just as bad with Connecticut roads and bridges recently being rated as among the worst in the nation.

- Lastly, a recent Federal Reserve Bank of Boston study, using Connecticut data as a proxy for conditions in the New England region, found that poverty was a serious problem not just in the central cities but in the suburbs as well. Family units totaling 181,000, had incomes less than $40,000 per year in Connecticut. Of those, 81,000 were located in the suburbs. The same report also contained a list of the most important challenges facing low income families, with the lack of job opportunities being first on the list.

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