CONNECTICUT ECONOMIC OUTLOOK
First Quarter 2013 to Fourth Quarter 2017

Highlights of the Connecticut Forecast – 2013:Q1 to 2017:Q4

- NEEP anticipates that the pace of the Connecticut recovery will be slower and less robust than that of the U.S., and a bit below the pace projected in the Moody's baseline.

- The federal fiscal sequester, higher payroll state and federal income taxes, along with weaker European demand for Connecticut goods should limit the state's annual job gain to 5,500 positions in 2013, down from a 14,100 job gain in 2012.

- Connecticut employment peaked at 1.713 million jobs in March 2008, and hit bottom in February 2010 at 1.592 million, with a loss of 121,000 jobs. Through February 2013, Connecticut had regained 48,600 positions, or 40.1% of the lost jobs. By comparison, the U.S. economy had recovered 66.1% of the 8.6 million recession jobs that it lost.

- From 2/12 to 2/13 Connecticut job gains totaled 2,000 with gains in trade (2,200), professional services (2,800), leisure/hospitality (4,300) and education/health (800). Conversely, job losses appeared in construction (-1,300), manufacturing (-2,600), financial activities (-2,200), and government including Indian Casinos (-1,600).

- NEEP expects 2013 individual job cuts in government, along with Connecticut defense, financial, casinos, and health insurance firms. Hospital/medical mergers along with uncertainties over Obamacare may slow near-term gains in health care positions.

- Job increases of 13,600 and 29,700 are expected in 2014 and 2015 as a rising housing market drives growth. Thereafter, jobs should rise steadily, reaching 1.733 million in 17:Q4, with all of recession job losses being recovered by 2016:Q3.

- The Connecticut 2/13 unemployment rate was 8.0%, and above the 7.7 % U.S. rate. The 3/13 annual re-benchmarking of the Connecticut jobs data boosted state employment by 8,600 positions in 2012, and another 6,500 positions were added in 2011 for a total job gain of 14,300 for that year. NEEP data supports a forecasted unemployment rate of 7.6% for 2013 with 6.5% in 2014, and falling to 5.7% in 2017. The Connecticut economy was late into and will be slow to recover from the "Great Recession".

- Connecticut has a projected current services budget gap of $415 million for FY13 and a projected gap of $1.2 billion for FY14 and $1.8 billion for FY15. The methods for closing these gaps have yet to be decided. However, slower U.S. and Connecticut growth in 2013 may limit gains in state revenues, while falling/weaker residential and commercial property values should cause spending and service cuts in local budgets for at least another fiscal year.

- The restructuring/downsizing of the U.S. financial services industry including Wall St, Connecticut insurance, commercial and investment banking, along with money management firms should potentially reduce Connecticut income and sales tax revenue gains.

- Total real and per capita real personal incomes peaked at $186.76 billion ($52,946) in 2007, but fell to $172.87 billion ($48,533) in 2009. Real incomes rebounded partly to

$182.78 billion ($50,802) in 2012. Further gains to $184.44 billion ($51,248) are projected for 2013, and $191.88 billion ($53,157) in 2014. By 2017 the totals should reach $216.22 billion ($59,379) which should help to support a rise in consumer spending and state tax revenues.

- Despite an absence of overbuilding, excessive reckless lending, and a later arrival of the housing recession, the decline in Connecticut housing industry has been severe. Additional short sales and foreclosures are expected to continue through 2013, which will slow the pace of the Connecticut housing recovery.

- Existing Connecticut single family median home prices peaked at $320,800 in 2008, but fell annually to $239,800 in 2012. Sale prices are expected to average $252,800 for 2013 and $260,600 in 2014. Slow but steady price gains are expected, with an average sale price of $291,800 in 2017. An aging population and 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 5,481 for 2012, with 5,820 units expected in 2013, and 6,546 in 2014. The diminished supply of new homes could lift permits gradually to peak at 8,696 in 2017.

- Sales of existing homes peaked in 2005:Q1 at 61,300 and fell to a low annual total of 32,400 in 2011. Existing home sales totaled 36,000 units in 2012, but should rise a bit to 40,500 in 2013. Steady gains, aided by economic expansion and pent-up demand are likely in 2014 (45,200) and beyond, with a peak of 49,900 units in 2017.

- ***The modest recovery is expected to continue for the Connecticut economy in 2013-2014, but issues surrounding federal payroll and income tax hikes along with sequestration may limit Connecticut job and income gains. High quality, high paying jobs were lost in finance, business services, and construction. And banking firms still appear to be retrenching, along with possible job cuts in defense. An eventual rebound is expected in the banking, insurance, construction, and professional services sectors in 2014-2015 and beyond. But the health of the U.S. economy along with the number, timing, and nature of these new Connecticut jobs will significantly affect the pace of the State's recovery.***

Current Conditions in the Connecticut Economy as of March 2013

Connecticut DOL data through March 2013 indicated that the Connecticut economy has struggled to rise from the depths of the Great Recession. The state lost 121,000 jobs from the March 2008 peak of 1,713,000 positions to the cyclical low of 1,592,000 jobs in February 2010. Subsequently, the state made slow but steady **job progress** through March 2013 regaining 51,200 positions or 42.2% of the total jobs lost. The Connecticut private sector actually added more jobs, regaining 59,200 positions, or 51.9% of the 114,000 private jobs it lost. However, net job cuts of -8,000 in state and local employment, including Indian casinos, accounted for the difference. The 42.2% Connecticut job recovery was less than two-thirds of the 66.4% of lost jobs recovered at the national level.

The Connecticut **unemployment rate** registered 8% in 3/13, with the number of unemployed persons dropping by -5,500 from 3/12. The Connecticut rate was down from 8.1% in 3/12, and well below its cyclical peak of 9.4% recorded each month from August 2010 through December 2010. However, the 3/13 Connecticut rate was above the U.S. 3/13 rate of 7.6%. The Connecticut improvement was aided by a year over decline in the state's **Labor Force** of -33,300 persons. The decline reflects baby boomer retirements, discouraged worker dropouts, and persons returning to school. A similar phenomenon had been observed, but to a lesser extent, at the national level. However, the U.S. labor force decline was magnified in the March 2013 data where the national number fell by -496,000 persons.

Connecticut DOL 3/13 **Super Sector data** showed a 12 month job gain of 1,000 positions, led by leisure & hospitality (4,800), education & health services (3,700), and construction (1,700). However, major job declines were registered in manufacturing (-2,700), financial activities (-2,300) and government (-2,500). Two of the state's **Labor Market Areas**, Danbury (1,200) and Hartford (3,600), showed seasonally adjusted job gains. However, Bridgeport-Stamford (-3,200), New Haven (-700) and Norwich-New London (-1,500) recorded job losses. **Average Weekly Initial Claims** for unemployment insurance totaled 4,398, down by 515 claims from 3/12, and down by -375 from 2/13. The average **workweek in manufacturing** totaled 41.0 hours up by 0.5 hours from 3/12. Lastly, **Average Weekly Earnings** in 3/13 were down considerably for both all private (-$25.27) and manufacturing ($-95.15) employment relative 3/12. This resulted from Average Weekly Hours being down in all Private and up only slightly in manufacturing employment, and Average Hourly Earnings being down in manufacturing and in all private employment. The March 2013 Connecticut DOL employment report partially reversed the sharp decline in 2/13 employment data due to abnormally strong 2/12 comparative data, and winter storm disruptions in 2/13.

The Connecticut Forecast - Employment

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 3/13 employment re-benchmarking showed Connecticut jobs grew by 13,100 positions in 2012. With 1,640,400 jobs as of 2/13, the Connecticut job total is up just 2,400 positions from 2/12, and matches the amount first reached in June 1998.[1] This implies no net job growth for Connecticut over the 15-year period.

<u>The Near Term Outlook 2013-2015</u>. The NEEP 5/13 forecast looks for the combination of state specific effects from the federal fiscal sequester and an overall slowing in the mid-2013 U.S. growth rate to limit the gain in Connecticut employment to 5,500 positions, for an annual total of 1,644,700 jobs. This is significantly less than the 14,100 positions that were added in 2012 and the 17,300 that were added in 2011. For 2013, NAICS job gains are expected in professional & business services (1,400), leisure & hospitality (3,100), trade (2,200), along with education & health services (3,700). NAICS sectors that are projected to experience job losses include government (-2,300), construction (-1,000), and financial activities (-2,000).

<u>The NEEP Short Term Outlook: 2013-14.</u> NEEP anticipates that Connecticut will add 5,500 jobs in **2013**, led by gains in education and health (+3,700), leisure/hospitality (+3,100), trade (+2,200), other services (1,200), and professional services (+1,400). Job cuts are expected in government (including Indian casinos) (-2,300), financial activities (-2,000), manufacturing (-600), and construction (-1,000). However, the health care component of this leading employment Super Sector is under considerable cost containment pressure from reduced reimbursement rates

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

and non-paying patients. This has led to several efficiency and cost-containment driven statewide hospital mergers and private practice consolidations. In 2014, additional cash payments from Obamacare should help to offset some of the reductions in reimbursement rates. However, on balance, health services it may not be able to fully deliver the projected job gains despite the rise in the number of Connecticut Senior Citizens and the inclusion of some 33,000 Connecticut residents previously not covered by health insurance.

Assuming a pickup in the national recovery and modest sequester effects in **2014**, Connecticut could add 13,600 new positions, with all major Connecticut NAICS sectors experiencing job gains The leading job creating sectors would be education/health services (+4,000), professional/business services (+2,100), financial activities (+1,600), and trade (+1,600). Even government (+800), construction (+1,000), and manufacturing (+1,200) could register job increases, with the latter gains being a function of a projected recovery in European export markets.

As these job gains materialize, the Connecticut unemployment rate could fall from an average of 8.3% in 2012, to 7.6% in 2013, and 6.5% in 2014. However, the rate change may be influenced by changes in the size of the Connecticut labor force. The Connecticut rate has declined, along with the national rate, by -33,000 participants from 2010 to 2012. NEEP projects a further decline of 17,000 in 2013 but a gain of 19,000 in 2014. A combination of worker retirements, increased college enrollments, and discouraged works help to explain the labor force declines.[2] And a rise in labor force participation might be expected as college students graduate and a larger number of job opportunities attracts new and reentrants. A larger workforce would tend to hold down the expected gains in the unemployment rate.

As of March 2013, Connecticut employment accounted for 1.215% of total U.S. non-ag jobs. This was down from 1.232% in March 2012, and down from 1.26% as recently as 2001. Therefore, it is apparent that Connecticut has lagged in employment gains relative to the rest of the nation. Given the severity of the national recession in Connecticut, a prolonged downturn in the Connecticut economy followed by a repeat of the earlier jobless recoveries could leave Connecticut further behind in terms of relative job growth. Reinforcing this cautionary note is the observation that an important part of Connecticut job growth in 2003-07 took take place in Financial Activities, Business and Professional Services, Construction, and Education and Health Services. Many of these positions were good paying and environmentally friendly, boosting both state incomes and related jobs, as well as enhancing the attractiveness of Connecticut as a place to live and work. However, the financial activities, business services, and health care super-sectors are being squeezed in Connecticut. Therefore, the quality, along with the quantity, of near-term job growth becomes an important issue.

The NEEP Intermediate Term Forecast (2015-2017). NEEP anticipates a steady employment recovery that will be driven by, but be slower than, the national job expansion. The MA baseline forecast projects that U.S. employment should grow by an average of 4.4%, 3.6%, and 2.9% in each of the final three years. In comparison, while the absolute Connecticut employment changes are expected to be respectable at 29,700, 25,400, and 16,300 jobs, they average gains of just 1.8%, 1.5 %, and 1.0% per year. Private service producing sectors are expected to account for 48,700 of the total job gain. Super Sector job advances should be led by education & health services with 32,100, professional & business services at 14,000, financial services at 6,200, and leisure/hospitality at 7,700. The goods producing sectors should add 10,800 jobs including construction (+8,700) and manufacturing (+2,000). With budget recoveries at both the state and

[2] *The Wall Street Journal* "Real Culprit Behind Smaller Workforce: Age", April 29, 2013, p.A2.

local levels, government employment, including casinos, should add 11,900 positions rounding out the job gains. Connecticut employment is projected to reach and exceed the previous job peak of 1,713,470 positions achieved in March 2008, in 2016:Q3, ending with 1,733,012 positions in 2017: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 3/13 it stood at 7.6%, but by 2017 the U.S. unemployment rate is projected to average a more tolerable 5.4 %. In Connecticut the UE rate peaked at 9.4% in 2010:Q4 up from 4.3% in 2006:Q2. For 2013 it is expected to average 7.6%, but should fall slowly to average 5.7% in 2017. Five Connecticut super-sectors are expected to surpass their 2008 pre-recession highs by 2017 including education & health services (+41,000), leisure & hospitality services (+17,300), professional/business services (+13,900), other services (+2,800) and manufacturing (+400). The remaining five should still trail their 2008 annual average including construction (-5,700), information (-5,400), financial activities (-4,300), government including Indian casino jobs (-3,300), and trade (-6,100).

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

The NEEP short-run housing outlook 2013-2015. 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 2013, the expectation is that new permits will show a relatively modest rise to 5,820 units, up by 6.2% from the 2012 original baseline total of 5,481 units. Subsequently, the early May arrival of final 2012 data for all 169 towns showed permits at 4,669 units, or 800 below the assumed 2012 base. Further gains are projected to 6,546 units in 2014 and 7,689 units in 2015. The latter year is the one with the strongest percentage gain at 17.5%, as the relatively slower pace of the overall state recovery will imply that Connecticut is expected to be late to the housing recovery as well. This 2015 total is still only 65% of the previous peak, and implies a short supply of housing in general as Connecticut home demolitions run 900-1,000 units per year. Condemnations and destruction from hurricane Sandy may lead to a slight rise in demolitions in late 2012 and 2013.

While both single and multifamily numbers have declined, the fall has been less steep for 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.

Connecticut permit data collected by the Connecticut Department of Economic and Community Development (DECD) for 128 out of 169 municipalities through March 2013 showed a total of 781 new permits issued.[3] This total is only four units above the total for the same period in 2012. However, there was unusually mild weather during the first quarter of 2012, while the weather was extremely cold and snowy in 2013. Therefore the matching monthly permit totals to date

[3] www.ct.gov/.../census_128_towns_monthly_permits_jan_2013.xls

may lend support for the NEEP projection of a modest rise in permits for 2013. However, there is still a heavy volume of distressed and foreclosed sales of existing homes at bargain level prices. This makes it difficult to find buyers and banks willing to put up the funds to finance the construction of more expensive new homes.

Given the prevalence of distressed sales in 2012 along with low mortgage rates, the number of **mortgage originations** for home purchases and refinancing rose to 27,400, up by 28.6%. NEEP anticipates that in the near term, the Connecticut housing market will show historically low mortgage interest rates, still relatively low home prices, more willingness to lend by banks, and eager builders in 2013. However, the volume of originations is projected to fall by 19.8% to 22k in 2013 as the number of distressed sales and refinancing decline. The **median sale price of an existing Connecticut home** fell by -7.0% to $239,800 in 2012, helping unit sales to rise by 11% to 36,000 units. Both home prices and the number of **sales of existing homes** are projected to rise in 2013 to $252,800 and 40,100 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 2017 is at or below the annual percentage gain in Connecticut nominal personal income. This points to the potential for even greater increases in home prices to 2017. As the Connecticut existing market recovers the **Affordability Index** will show only modest annual increases allowing existing sales to reach 47,700 units in 2015 with median prices at $272,300

On balance, historically low mortgage rates and Connecticut home prices well below historic highs should help to bolster existing sales through the end of 2013. Furthermore, the authors of the Prudential report anticipate that pent-up demand for housing will help to drive a recovery in the existing home sale market in 2013 and 2014.

<u>The NEEP Intermediate Term Outlook 2016-2017</u>. NEEP anticipates that the housing market will re-establish a more normal balance between housing supply and demand. For 2016-2017 NEEP expects the Connecticut housing market to continue to recover slowly despite the anticipated rise in mortgage interest rates. Connecticut was late and sluggish to both the job and the housing recoveries. If Connecticut job growth finally kicks in as NEEP projects in 2015-2016, then the number of **new permits** should grow slowly but steadily from 7,687 units in 2015 to 8,696 units in 2017. This ending number is still some 3,200 units below the 2005 peak, and 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 restrain the recovery in Connecticut home building.

Existing sales should average 49,000 units annually with fewer distressed sales. This should allow **median existing home sale prices** to increase further to average $291,800 in 2017, rising from $272,300 in 2015. Again, from 2015-2017 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 16,800 in 2015 rising to 21,100 in 2017. 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 less than five per hundred loans in 2015, and rising to 5.4 in 2017. Finally, as the housing industry recovers with both rising prices and mortgage interest rates, the FHFA **Affordability Index** should rise moderately from 398.9 in 2015 to 429.2 in 2017.

Conference Theme: The Pending U.S. Manufacturing Recovery: Is The Connecticut Manufacturing Sector Ready?

Manufacturing has an extremely important place in Connecticut's current employment picture. The state's global competitiveness may well be enhanced by lower domestic energy costs, supply chain concerns over distance and reliability, higher wages and working condition problems in China and elsewhere, and concerns about protecting intellectual property rights. However, there are major obstacles and potential issues on both the supply and demand sides of the Connecticut manufacturing picture that may dull the extent of any state response to a national manufacturing structural expansion. Issues on the **supply side** include:

- The condition of the state's transportation and utility infrastructure;
- State's 44th place ranking in CNBC 2012 Business Competitiveness Index;
- State's 40th place ranking in Tax Foundation's Business Tax Climate Index;
- Limited Connecticut link to lower cost and higher production from reduced energy costs;
- Relatively higher unit labor costs in manufacturing;
- Concerns that U.S. manufacturing recovery is cyclical not structural;
- A shortage of key labor skills.

Issues on the **demand side** include:

- Federal fiscal sequester effects on Connecticut defense manufacturing;
- Economic weakness in major European export markets;
- End of war zone activity with reduced need for Connecticut defense equipment;
- Potential relocation/redirection of Connecticut commercial firearms manufacturing.

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