CONNECTICUT ECONOMIC OUTLOOK
Third Quarter 2013 to Fourth Quarter 2017

Highlights of the Connecticut Forecast – 2013:Q3 to 2017:Q4[1]

- NEEP anticipates that the pace of the Connecticut recovery 2014-2017 will be steady, but less robust, than that of either the U.S. or as projected by the Moody's Connecticut baseline.

- The federal fiscal shutdown and sequester, along with higher federal payroll state and federal income taxes, should limit the state's annual job gain to 14,400 positions in 2013, similar to the 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 positions. Through August 2013, Connecticut had regained 62,200 jobs, or 51.3% of those lost. By comparison, the U.S. economy had recovered 78.2% of the 8.6 mil recession jobs that it lost.

- From 8/12 to 8/13 Connecticut job gains totaled 15,400, with increases in trade (4,000), professional services (4,000), leisure/hospitality (6,800), construction (3,700), and ed/health (6,100). Conversely, job losses appeared in construction (-1,300), manufacturing (-3,000), financial activities (-3,000), and government including Indian Casinos (-2,400).

- NEEP expects slow job growth in Connecticut financial activities, retail, construction, government, and healthcare. Manufacturing and information should show few if any net job gains, while casino employment will face growing competition from gaming in surrounding states.

- Job increases of 18,700 and 24,900 are expected in 2014 and 2015 as the U.S. recovery and a rising housing market drive growth. Thereafter, jobs should rise steadily, reaching 1.736 million in 2017:Q4, with all of recession job losses being recovered by 2016:Q2.

- The Connecticut 8/13 unemployment rate was 8.1%, and above the 7.3 % U.S. rate. NEEP projects an unemployment rate of 7.9 % for 2013 with 7.5% in 2014, and falling to 6.4% in 2017. The Connecticut economy was late into and will be slow to recover from the national "Great Recession".

- Slower U.S. and Connecticut growth in 2013-2014 may limit gains in state revenues, while weaker residential and commercial property values should limit spending and service increases 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

[1] The NEEP Connecticut forecast data does not incorporate specific 2013:Q4 adverse state growth consequences resulting from October's 16-day federal fiscal shutdown. However, the qualitative aspects of the growth problem are identified in later sections of this narrative.

management firms should potentially reduce Connecticut income and sales tax revenue gains.

- Total nominal and per capita personal incomes peaked at $201.95 billion ($56,959) in 2008, but fell to $188.42 billion ($52,900) in 2009. Nominal income rebounded to $212.47 billion ($59,177) in 2012. Further gains to $219.61 billion ($61,097) are projected for 2013, and $231.77 billion ($64,435) in 2014. By 2017 the totals should reach $272.51 billion ($75,256) which should help to support a rise in both 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. Short sales and foreclosures are expected to continue through 2014, although at declining levels. This will slow the pace of the Connecticut housing recovery.

- Existing Connecticut single family median home prices peaked at $320,800 in 2007, but fell annually to a low of $239,600 in 2012. Sale prices are expected to average $260,700 for 2013 and $270,000 in 2014. Slow but steady price gains are expected, with an average sale price of $293,700 in 2017. 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 4,669 for 2012, with 5,496 units expected in 2013, and 6,810 in 2014. The diminished supply of new homes could lift permits gradually to peak at 8,529 in 2016, but falling to 8,035 in 2017 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 32,400 in 2011. Existing home sales totaled 36,000 units in 2012, and should rise a bit to 40,000 in 2013. Steady gains, aided by economic expansion and pent-up demand are likely in 2014 (44,400) and beyond, with a peak of 47,400 units in 2016.

- ***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 cuts and the fiscal shutdown may limit Connecticut job and income gains. High quality, high paying jobs have been lost in finance, business services, and construction. Financial and health related firms still appear to be retrenching, along with possible job cuts at defense firms.***

- ***An eventual rebound is expected in the financial, insurance, construction, and professional services sectors in 2015-2017. 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.***

The Connecticut History and Outlook 2013 - 2017

Overall, the NEEP Connecticut 11/13 forecast for 2014-2017 is on balance equal to or slightly less optimistic than it was in 5/13. The sole exception is the job estimate for 2013, which is much stronger here than in the 5/13 outlook, due to delays in defense cuts and sequestration effects. The latter year differences reflect national RGDP and Personal Income revisions, along with a general slowing of the U.S. recovery resulting from the federal fiscal restraints. Annual projections for manufacturing jobs, the labor force, new home permits, and real gross state product 2013-2017 are a bit below those for NEEP 5/13. Total employment and existing home sale prices for 11/13 are above 5/13, but almost all are below the Moody's Analytics (MA) 9/13 baseline. Connecticut labor force numbers were even more negative in 2012 after the March 2013 data re-benchmarking. Both NEEP 11/13 and MA 9/13 have the Connecticut labor force numbers rising through 2017. This projected reversal bears watching, as it will potentially impact the forecast for the unemployment rate, along with employment, output and income estimates. Manufacturing employment is relatively the same in all three outlooks. Defense cuts do not appear to be as sharp as projected in NEEP 5/13, but gains from both domestic foreign demands may be less intense that previously expected.

The NEEP 11/13 annual unemployment rate projections for 2013-2017 are higher than both the NEEP 5/13 and MA 9/13 estimates, mostly because of the higher annual labor force projections. The Connecticut housing industry mostly turned upward in 2013 from its 2012 bottom, with median sale price gains being constrained by late cycle sales of foreclosed homes. All three forecasts listed above anticipate a similarly moderate Connecticut housing recovery with rising new permits, existing sales and median sale prices for 2013-2015. However, new home permits may decline somewhat in 2016-2017 as rising interest rates, and higher home prices restrain buyer purchasing power. Bank loans, especially for first time buyers and builders, are still hard to secure and will also limit the price gains. Lastly, a moderation in the sales of distressed existing property should be reinforced by inventory constraints that will raise the sale price of existing homes from the 2012 low of $239,800 to $293,700 in 2017. Overall, while sales and prices are rising moderately, it will still be difficult for new home builders to develop competing property in an environment of high land prices and higher construction costs. While NEEP 11/13 expects the number of new permits to show gains from 2013-2017, the forecast peak of 8,529 units in 2015 is still only 75% of last cyclical high in new permits in 2005.

The strength of the Connecticut recovery is potentially constrained by national and global events along with state specific conditions including:

A pre-recession history of employment and income growth that had been heavily dependent upon wage and bonus gains in the still weakened financial services sector;

State and local budgets that are still under server stress resulting from a slow recovery in tax revenues combined with rising social service demands;

Rising taxes at the federal level including the 2% re-imposition of the federal payroll tax and the increased tax rate on Connecticut high income earners;
The expressed reluctance of the state's largest private employer, United Technologies, to expand in a state that it sees as severely cost uncompetitive;

The potential loss of defense jobs at Sikorsky Aircraft and Pratt & Whitney as national defense cuts mirror the downsizing of the wars in Iraq and Afghanistan;

The budgetary continuation of the federal fiscal sequester which holds potentially significant negative effects for Connecticut;

The potential for decline in government contract work for the state's third largest private manufacturing employer, Electric Boat;

A housing recovery that is constrained on the construction side by the high cost of available land and permitting delays, and on the existing sale and price side by the anticipated supply of foreclosed/distressed properties and continued tight bank mortgage lending standards;

A state business climate that is perceived to be anti-commerce, especially by small firms;

A high cost for energy including gasoline, electricity, and home heating oil that is draining consumer purchasing;

Continued job and revenue weakness at the two Indian casinos which are being faced with increased gaming competition in Massachusetts, Rhode Island, and New York.

The Connecticut Forecast - Employment

The annual non-ag employment number, which is published monthly by the Connecticut Department of Labor,[2] 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 14,100 positions in 2012. With 1,654,000 jobs as of 8/13, the Connecticut job total is up 15,400 positions from 8/12, and matches the amount first reached in Nov-Dec 1987.[3] This implies **no net job growth for Connecticut** over the 26 year period.

The NEEP Short Term Outlook: 2013-2015. NEEP anticipates that Connecticut will add 14,100 jobs in **2013**, led by gains in education and health (+4,900), leisure/hospitality (+5,700), construction (+3,400), trade (+1,600), and professional services (+3,800). Job cuts are expected in government (including Indian casinos) (-1,000), financial activities (-1,800), manufacturing (-2,900), and other services (-200). However, the health care component of this leading employment Super Sector is under considerable cost containment pressure from reduced reimbursement rates 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 The Affordable Care Act 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 moderating sequester effects in **2014**, Connecticut could add 18,700 new positions, with most major Connecticut NAICS sectors

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[2] http://www.ctdol.state.ct.us/

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

experiencing job gains The leading job creating sectors would be education/health services (+5,500), professional/business services (+5,000), financial activities (+1,600), leisure and hospitality (+2,000), and trade (+2,000). Even previously hard hit government (+1,700) and construction (+1,100) should register job increases. Only manufacturing (-700) could register job weakness depending upon how federal defense spending and European export markets move.

In 2015, Connecticut is projected to register its largest annual employment gain for the forecast period, up by +24,900 positions. Large NAICS gainers should include education & health services (+3,600), financial activities (2,600), professional & business services (+3,600), government (+5,000), leisure & hospitality (+2,800), construction (+3,200), trade (+1,800), Other Services (+1.0k). Manufacturing jobs could rise by (+600) positions, reversing almost all of the losses experienced in the previous year.

As these job gains materialize, the Connecticut unemployment rate could fall from an average of 8.3% in 2012, to 7.9% in 2013, 7.5% in 2014, and 7.1% in 2015. However, the annual unemployment rate will be influenced by changes in the size of the Connecticut labor force. The Connecticut labor force has declined by -61,000 participants from its annual peak of 1,913 million in 2010 to 1,852 million as of August 2013. NEEP projects a slight rise by 14,000 in 2014, and a further gain of 40,000 in 2015. A combination of worker retirements, increased college enrollments, and discouraged works help to explain the labor force declines.[4] However, a rise in labor force participation might be expected as college students graduate and a larger number of job opportunities attracts new workers and reentrants. Therefore, a larger workforce would tend to hold down the expected gains in the unemployment rate.

As of August 2013, Connecticut employment accounted for 1.205 % of total U.S. non-ag jobs. This was down from 1.223% in August 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 2003-2007 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 (2016-2017). 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 2.1%, and 1.2% in each of the final two years. In comparison, while the absolute Connecticut employment changes are expected to be respectable at +19,100 and +15,200 jobs, they average gains of just 1.2 %, and 0.9% 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 +29,000 of the +35,100 total two-year job gain. Super Sector job advances should be led by education & health services with +10,500, professional & business services +6,900, financial services +3,500, and leisure/hospitality at +3,000. The goods-producing sectors should

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

add +1,400 jobs including construction (+1,800), with manufacturing down by (-500). With budget recoveries at both the state and local levels, government employment, including casinos, should add +4,800 positions rounding out the job gains. By 2016:Q2, Connecticut employment is projected to reach and exceed the previous job peak of 1,713,470 positions achieved in March 2008. The state should end with 1,735,600 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 8/13 it stood at 7.3%, but by 2017 the U.S. unemployment rate is projected to average a more tolerable 5.4 %. In Connecticut the unemployment rate peaked at 9.4% in 2010:Q4 up from 4.3% in 2006:Q2. For 2013 it is expected to average 7.9%, but should fall slowly to average 6.4% in 2017. As with the 2013-2015 outlook, the unemployment rate for 2016-2017 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 23,000 persons from 2015-2017, peaking at 1.928 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 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 5,496 units, up by 827 units or 17.7% from the revised 169 town 2012 total of 4,669 units. Throughout the year, monthly state government (DECD) permit totals are only available for 128 towns. Through July 2013, this data showed 2,307 new permits issued, up by 10.3% from the July 2012 total.[5] NEEP projects further gains to 6,810 units in 2014, with the total peaking at 8,529 units in 2015. The latter year is the one with the strongest percentage gain at 25.2%, 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 71.8% 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. Condemnations and destruction from hurricane Sandy may lead to a slight rise in demolitions in 2013.

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 28,200, up by 25.2%. 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 2013-2014. However, the volume of originations is projected to fall by 13.5% to 24,200 in 2013, and 17,900 in 2014 as the number of distressed sales and refinancing decline.

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

The **median sale price of an existing Connecticut home** fell by -7.0% to $239,600 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 $260,700 and 40,000 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 47,400 units in 2015 with median prices at $281,300

<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, with permit numbers stabilizing in the 8,000 to 8,500 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 2014-2016, then the number of **new permits** should decline slowly but steadily from 8,529 units in 2015 to 8,035 units in 2017. This ending number is still some 3,800 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.

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 $293,700 in 2017, rising from $281,300 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 15.8k in 2016 rising to 16,100 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 5.82 per hundred loans in 2016, and rising to 6.3 in 2017. Finally, as the housing industry recovers with both rising prices and higher mortgage interest rates, the FHFA **Affordability Index** should rise moderately from 413.8 in 2015 to 445.8 in 2017.

Conference Theme: Metro Boston: Its Role in the Network of New England Economic Activity

The Greater Boston economy would appear to play dual, and somewhat opposing, roles as both **stimulus and competitor/stressor** in its interaction with the Connecticut economy. Some of these conflicting roles are listed below and discussed in greater length later in the NEEP Outlook.

Benefits as a Connecticut growth stimulus include:

> Location of firms, including professional services and distribution, in Connecticut who are looking to serve both customers in both the Greater Boston and NYC metro areas.

Development of firms with a similar or complimentary skill set to those in the Greater Boston-NYC markets including, high tech manufacturing, finance, Web/Internet.

Provision of access to world class medical and higher education services on site in Boston to Connecticut residents.

Connecticut local geographic spinoffs from the clustering effect of Greater Boston medical and higher education facilities.

Competitor/Stressor links between Greater Boston and Connecticut economies including:

Retention of Connecticut college grads educated in or attracted to Greater Boston.

Competitor for existing Connecticut jobs or startup firms.

Contributor to commercial Connecticut Interstate highway congestion.

Southwestern Connecticut counties more closely linked to Greater NYC for jobs, housing, cultural events, second homes, tourism and entertainment events.

Weak data evidence of cyclical economic linkage of Greater Boston and Connecticut.

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