Skirting a Recession: How thin the Ice?

The Connecticut Economic Outlook: May 2008

Peter E Gunther, Senior Research Fellow
Connecticut Center of Economic Analysis
University of Connecticut

This CCEA Outlook sees a deteriorating state economy, with construction contracting nearly one third. Growth in output elsewhere barely offsets this collapse, resulting in a loss of 24,000 jobs in Connecticut over the two-year forecast period. Such a dire outcome is probable--but not inevitable. How thin is the ice?

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Overview: *Skirting a Recession?*

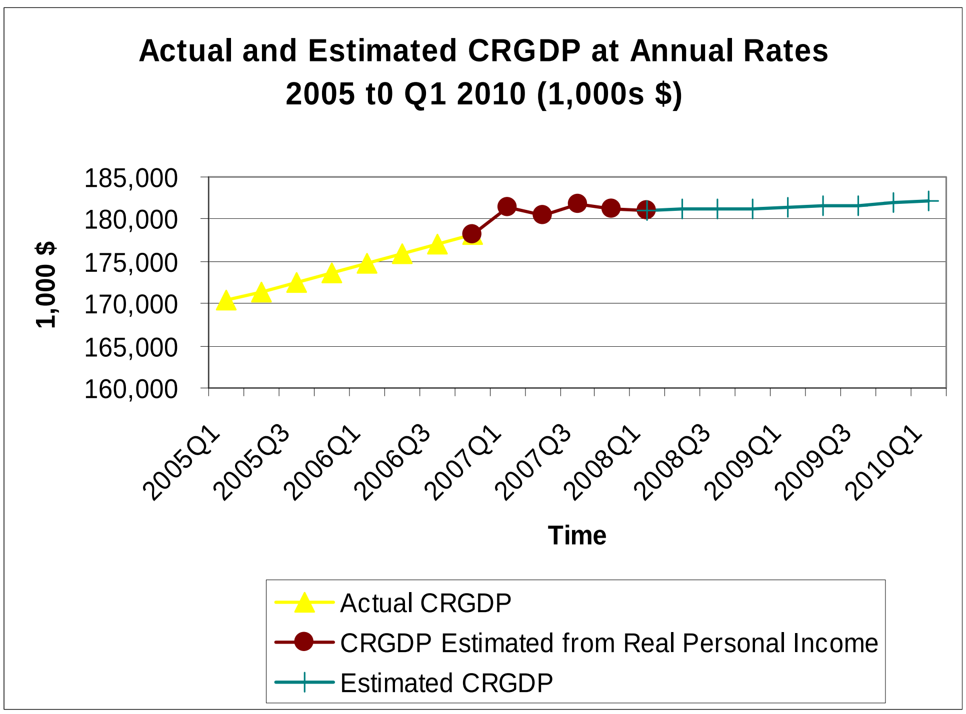
Anemic Growth in Output; Flat or Falling Employment

Current expectations see Connecticut economic growth decelerating at least through the last quarter of 2008, then accelerating slowly through 2009 and into 2010. National economic growth of only 1.5% this year followed by 0.9% next year will obliterate CT Real Gross Domestic Product (CRGDP) growth in 2008 and hold it to a measly 0.2% in 2009. Such slow growth will thwart demand for labor; this Outlook thus forecasts a loss of 24,000 Connecticut jobs from the beginning of 2008 through the first quarter of 2010.

Slow Growth in Output

CCEA developed its projection of total Connecticut output (CRGDP) shown in Chart 1 from the known output through 2006, the available personal income data through 2007, and extrapolated income for one quarter into 2008; we then use statistical techniques (BVAR) to forecast output to 2010. Chart 1 reminds us of the $4 billion dollars in bonuses paid out to CT residents in the first part of 2007—but it had no lasting effect. Indeed, the second quarter of 2007 saw a decline in income, and little change through the balance of the year. The turmoil in financial markets points to the continued flatness in the first quarter of 2008.

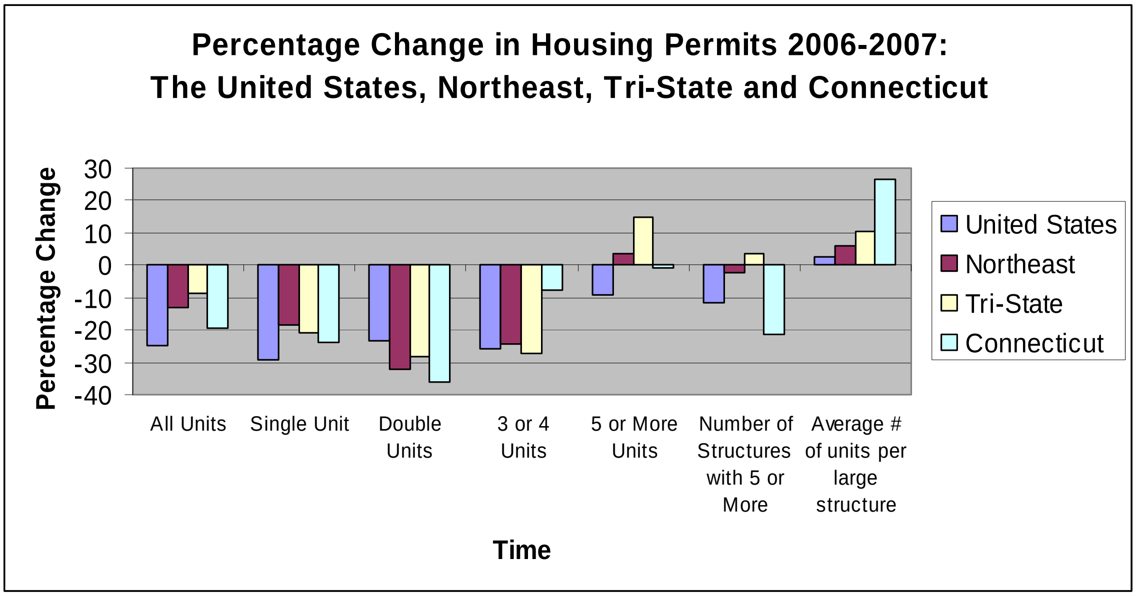
Chart 1: Aggregate Connecticut Output



No surprise—construction is the main drag on CRGDP; CCEA expects construction activity to decline from $3.6 billion in 2008-Q1 to $2.5 billion in 2010-Q1.

Housing permits in Connecticut and throughout the Tri-State region continue to wallow well below historic norms. Chart 2 illustrates the percentage change in permits for private housing issued in 2007 compared to 2006. Among all units the percentage declines in Connecticut were greater than in either the Northeast or the Tri-State region, but less than for the nation. Those relative percentage changes also held for both single dwellings units and in buildings containing five or more units. While Connecticut had the largest percentage decline in buildings with five or more units it also had the largest increase in the average number of units within those buildings. Among the four jurisdictions, Connecticut experienced the largest percentage decline in permits for double units and the smallest for 3-4 units. But these declines—Connecticut -11.2%, Northeast -10.3%, and the Tri-State – 6.5%--were nowhere near the scale of national fall of -23.8%,.

Chart 2:



The high end of Connecticut's housing market has sustained construction above the levels that unit permits would suggest. Connecticut led among the four jurisdictions in increased value of the average permit at 10%, compared to elsewhere in the Tri-State where it barely grew, seeing increases of only 1.6% to 3.3%.

This Outlook anticipates a further decline in the number of Connecticut permits issued of 12.8% 2007-2008, with a miniscule rise in 2008-2009 of 0.7%. We should expect that the hangover from the sub-prime mortgage debacle will be prolonged and severe for Connecticut's construction industry, with white goods sales, dependent on new housing completions, suffering as well.

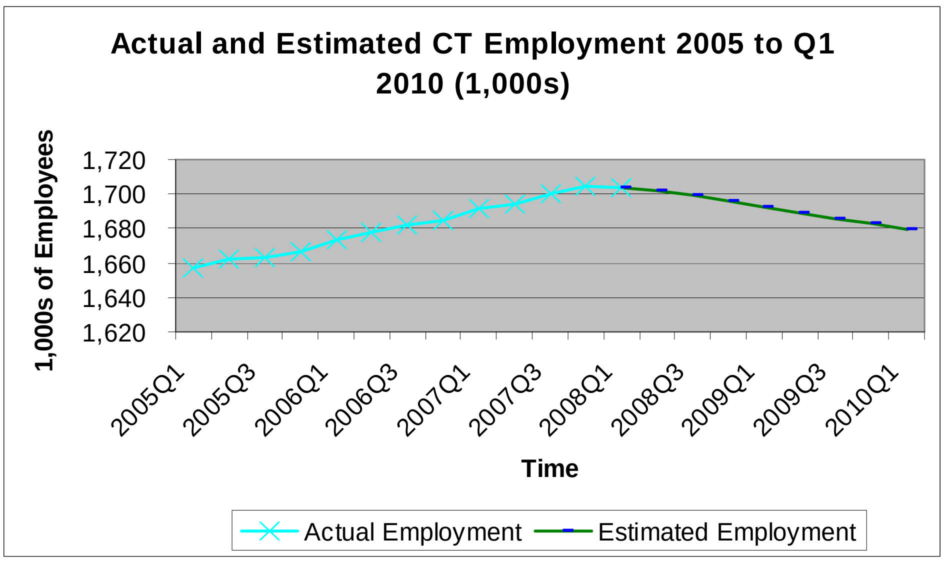
Devaluation of the U.S. dollar makes the outlook for other key sectors somewhat more robust. The historic slide in Connecticut manufacturing output has been flattening and has begun to reverse itself, particularly among durable manufacturers. The dollar's decline has also been favorable to expanded outputs in Services, and Finance, Insurance and Real Estate. On the other hand, state and local governments face both revenue declines and cost pressures from fuel and other energy related expenditures; some Connecticut municipalities have already announced layoffs, hiring freezes, and other measures to reduce spending. Clearly government—even as demand for its services swell—will contribute to the economic malaise.

Employment and Output

With lower housing permits, slight declines in real manufacturing earnings, contraction in government, and slower income growth, this CCEA Outlook sees a sharper downturn in CT employment at the outset of 2008 than the previous Outlook. This will result, over the two years, in a loss of 24,000 jobs, from total employment of 1,704,000 in 2008Q1 to 1,680,000 in 2010Q1. A previous Outlook had foreseen a rise to 1,713,000 by the end of 2009, so that lagged effects from the current turmoil may cut 33,000 jobs from that potential level of employment.

Chart 3 below shows the employment trend line and Chart 4 the outlook for employment growth by sector. Nevertheless, expected employment in Q1 2010 remains well above that of three years ago, though a longer perspective reminds us that Connecticut will at that point have added no new jobs compared to the level twenty years ago. This pattern should elicit very deep concern for the long-term competitiveness of the state.

Chart 3:



Employment in the construction industry will take the brunt of the cutbacks in employment, with minor impacts elsewhere where productivity gains facilitate some labor savings.

The government sector is complex. Employment expansions at the Foxwoods and Mohegan Sun casinos will come online as part of the government sector and therefore offset some expected losses at state and municipal levels.

Chart 4:

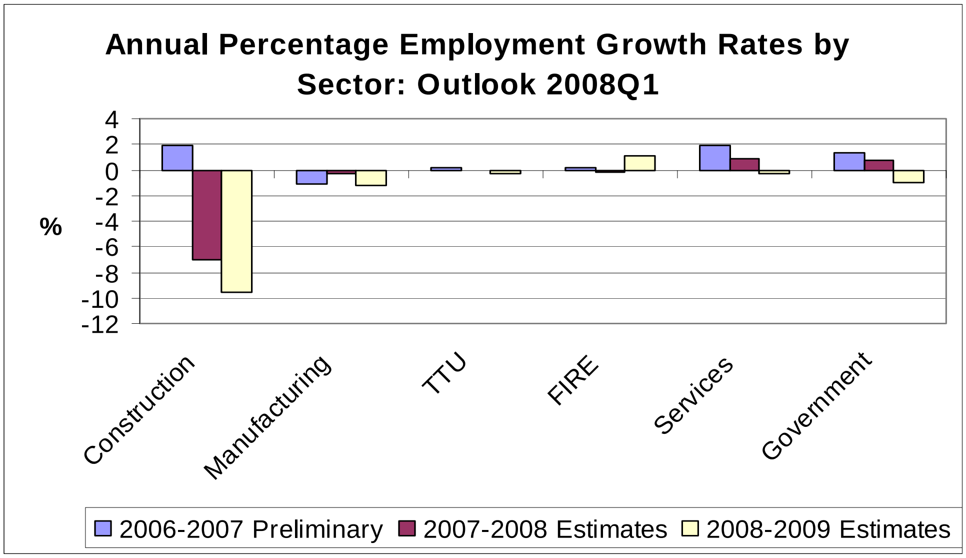
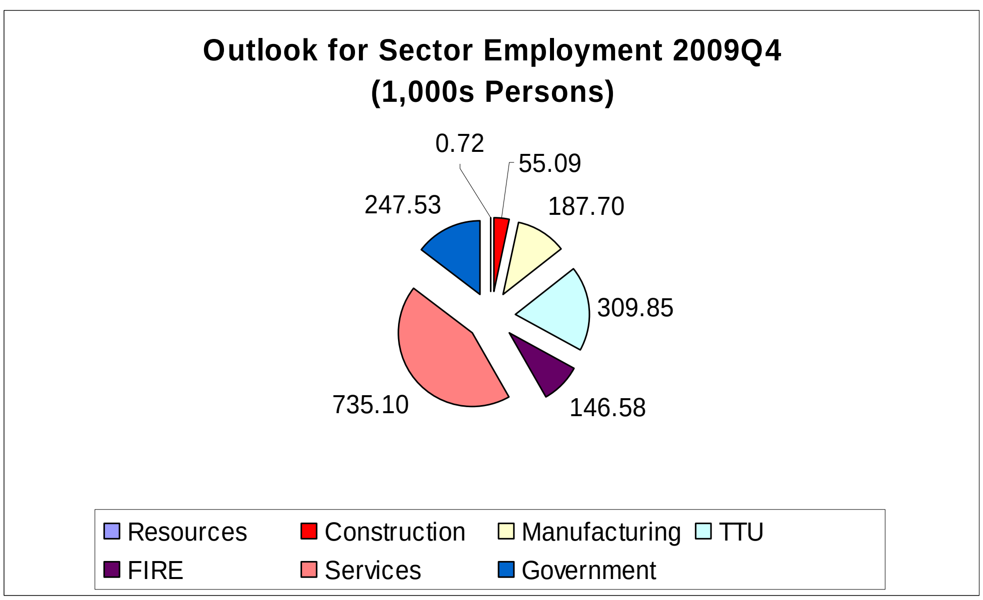


Chart 5 shows sectoral employment by the end of 2009. In contrast with the previous Outlook, there is considerably less employment in Construction (-11,200), Transportation, Trade and Utilities (TTU) (-5,000), and other Services (-4,900) that are only partially offset by more employment in Manufacturing (5,800) and marginal changes in Government, and Finance, Insurance and Real Estate (FIRE).

Chart 5:



Consistent with employment demand too small to absorb new entrants to the labor force and a loss of overtime for current workers, this Outlook sees real manufacturing earnings (RME) continuing to fall by one percent annually in 2008 and 2009. This process has already begun. Preliminary data for 2008Q1 perpetuate the decline that began in late 2007.

Is it Inevitability?

Like any other Outlook, these project outcomes are not inevitable. With the decline situated mainly in construction, offsetting projects may emerge. Potential candidates include alternative energy investment initiatives—an idea that grows more compelling with each rise in the pump price of gasoline. It may be tempting for governments to undertake such initiative alone or through incentives for prototypes. Yet, the previous Outlook examined constraints that are impinging on state government expenditures. Fortunately, there are other avenues to attract private investment and frugal but environmentally friendly consumption patterns on the scale that can encourage construction and accelerate the switch to new energy sources.

Such initiatives include, but are not limited to, the rapid establishment of:

1. Tradable CO2 equivalent credits as incentives to invest in curtailing greenhouse gases;
2. Peak rates for generation of peak electricity with ready grid access for non-utility quality suppliers;
3. Peak rates for consumption of electricity in order to shift demands off-peak and to encourage broadly-based conservation;
4. Accelerated R&D on alternative energy generation from non-fossil fuel sources and energy saving technologies – light bulbs, improved engines and appliances, lighter vehicles, better photovoltaics and various biotechnologies; and
5. Once lithium ion batteries are safe, accelerate the adoption of hybrid and plug-in vehicles.

All the above encourage private as well as some government investment and construction, but those prices, rates, and incentives need to be clear, concise, and, above all else, put in place quickly and efficiently. The currently high international price for fuels clarifies the need to accelerate the shift to alternative fuels. The above mechanisms, presented in detail at the University of Connecticut's recent Sustainable Energy Symposium, are among those most likely to succeed.

For additional comments or clarifications, please contact:
Peter Gunther at 1-888-999-6535 (toll free),
or
Fred Carstensen at (860) 305-8299.