The Recession is Here

The Connecticut Economic Outlook: November 2008

Peter E Gunther, Senior Research Fellow

Connecticut Center of Economic Analysis
University of Connecticut

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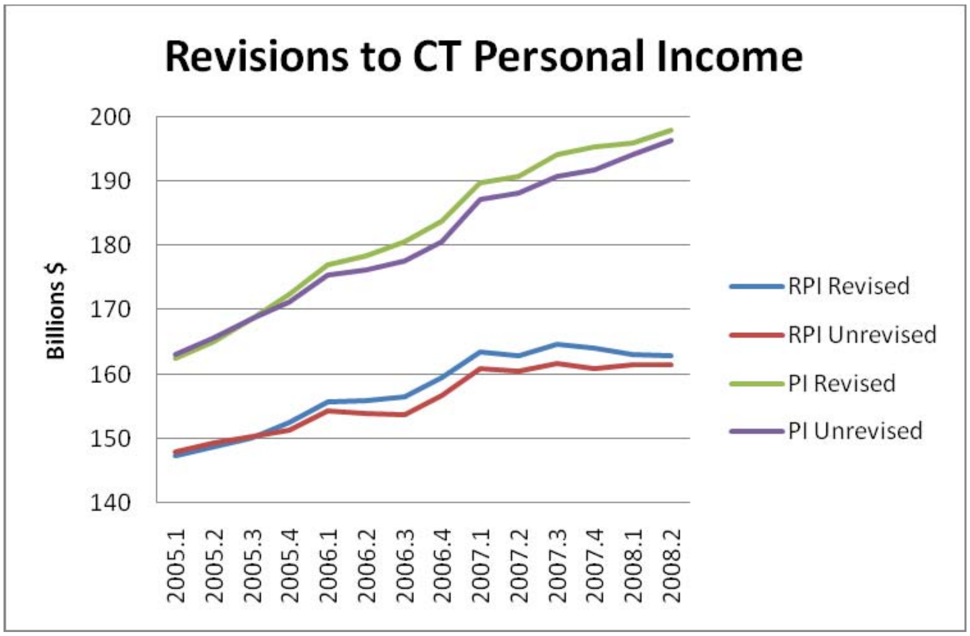
Connecticut's economy is in recession; the contraction began nearly a year ago, in third quarter 2007. But to date the pain has been remarkably little. Connecticut has seen only modest job loses through this period, and its unemployment rate, 6.1%, is below the national rate, 6.5%. Despite the gathering economic storm clouds, the CCEA Economic Outlook forecasts total job loses of only 40,000 and a modest decline in the state's economic output. Declining energy prices—the price of a barrel of oil has fallen nearly 60% since its peak—will mitigate the economic contraction, and President-elect Obama promises to enact a variety of economic stimuli soon after inauguration on January 20.

However the current economic malaise is unprecedented in its nature, the huge rescue packages crafted in the U.S., Europe, and Asian countries have yet to capture much traction, and resolution of the financial implosion credit derivatives is still, at best, months away. Thus we hope that the future performance of Connecticut's economy is able to meet this forecast—that in fact would be a very good, perhaps remarkable, outcome, with the state seeing less reduction than in any recession in the last thirty years.

Revising the Connecticut numbers

The U.S. Bureau of Economic Analysis (BEA) again revised Connecticut's real personal income (RPI) from 2005Q1 to2008Q3, resulting in a mixed message. BEA found Connecticut RPI was higher in the third quarter of 2007 than it had previously thought. But in raising that number, BEA then found that RPI declined more precipitously, showing no subsequent quarterly growth or even constant numbers. When measured in nominal (current) dollars, personal income (PI) has continued to grow, but not enough to offset price increases. Chart 1 shows the latest data for both PI and RPI.

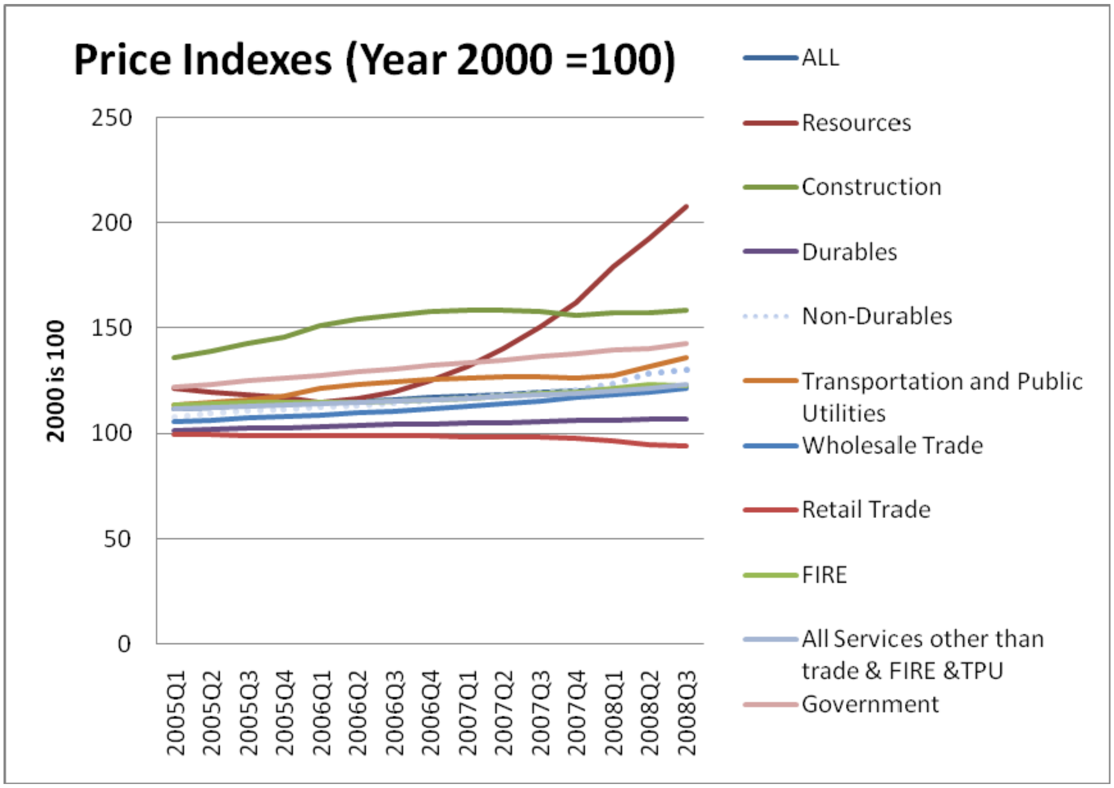
Chart 1:



The CCEA Economic Outlook relies on the performance of real personal income and its sector components to develop its estimate of the state's Gross Product (total output of goods and services). The upturn in the old BEA income series from 2007Q4 to 2008Q2 generated mild increases in estimated state output in 2008; the revisions, seeing steady income declines from 2007Q3 to the present, produced the opposite conclusion. In sum, Connecticut's economy has probably been contracting for the last four quarters, clearly qualifying as a statewide recession. Chart 3 below reveals this outcome.

Income measured in current dollars continues to rise, but rising prices have reduced its purchasing power. Chart 2 shows implicit price indexes for components of national Gross Domestic Product (RGDP). The rapid rise in the price index for resources based heavily on fossil energy is striking. More subtle are recent increases in price indexes for industries heavily dependent on fossil fuels, such as transportation and to a lesser extent both non-durables and Government.

Chart 2:



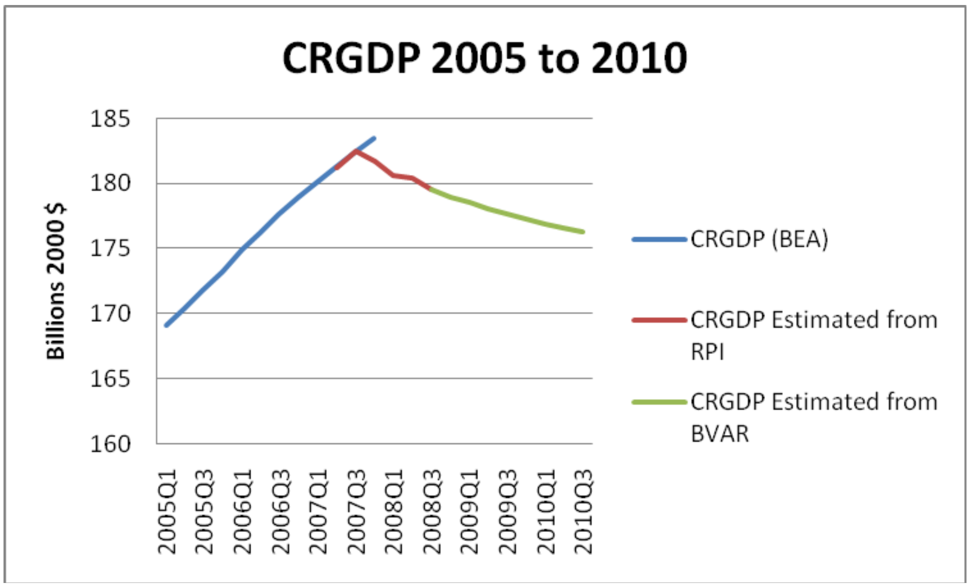
The good news is that during this quarter, 2008Q4, prices for fossil fuels appear to be falling by half or more, clearly sufficient to impact on implicit price indexes for resources and relatively heavy users of fossil fuels. Given OPEC's efforts to curtail production, there is debate over how long lower prices for fossil fuels will prevail. For this reason this CCEA Economic Outlook presents two scenarios. The initial outlook forecasts from the end of 2008Q3 based on business as usual, without accounting for falling energy prices. The second forecast modifies the first four quarter results from the initial outlook by assuming that the fossil fuel price declines to-date remain in place. It then contains an abbreviated one-year Fuel-Price Adjusted Outlook to 2010Q3. Considering only falling fuel prices for consumers, a $1.50 drop in the price of gasoline in CT saves the average driver $600 a year, or $1.8 billion among all CT vehicle owners. If spent on alternative goods and services, these windfall tax-free savings constitute a potential stimulus that would add 1.33% to Connecticut's real consumption annually.

Forecast I: Business as Usual

Taking no account of the price decline in fossil fuels, the Business as Usual Case (BUC) forecast proceeds from anemic national quarterly growth of 0.04% quarterly. This view is not far from the advanced estimates of a 0.3% cut for the latest quarter. Slow national growth hurts Connecticut, resulting in aggregate output falling at the rate of 0.22%/quarter over the next eight quarters; the state's real manufacturing earnings decline 0.25% a quarter, and CT employment erodes more rapidly at 0.30% a quarter.

Chart 3 shows these outcomes. The two estimates for 2007Q4 reflect the original BEA income figures and the revised data. The data in Chart 3 argue that the major contraction has already occurred, from 2007Q3 to 2008Q3, and that Connecticut will see slower contraction over time. Over the three years out to 2010Q3, the CT economy will shrink from real gross output of $182.4 billion to $176.3 billion, and employment will fall about 40,000, from 1,703 to 1,663 thousand. This will take state employment back to where it was three years ago, in 2005.

Chart 3:

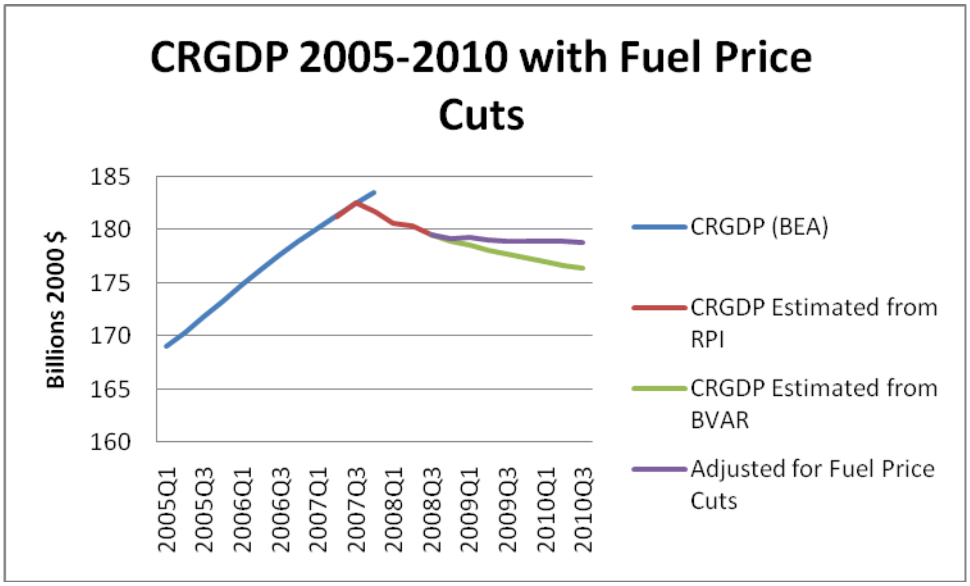


Forecast II: Fuel-Price Adjusted Outlook

The recent drop in fuel prices will generate a 1.33% increase in real consumption in the next quarter. CCEA projects the impact of lower fuel charges on CRGDP, employment, construction expenditures, and real wages. As expected, the Fuel-Price Adjusted CCEA Outlook is stronger than the business as usual one, but lower fuel prices are insufficient to return growth in the state's economy. Chart 4 shows the relative impacts on CRGDP. This Outlook avoids the worst of the decline, but aggregate output still falls $760 million over the next two years. Employment drops a mere 11,000, rather than 40,000 over the same period; the rate of decline in real manufacturing earnings is only three-quarters of what the business as usual case sees.

The dramatic decline in fuel prices also drives national output to improve by nearly $100 million by 2010Q1 over the business as usual case. Even so, national growth, if any, will be anemic, well below historical norms. This argues for the need for economic stimulus both nationally and state-wide. Such stimulus may take many forms, including accelerating the transition from fossil fueled vehicles to facilitating private investment in major projects.

Chart 4:



The CT construction industry has suffered remarkably little unemployment, given the precipitous decline of private housing permits from about 3,000 a quarter in 2004 to the record low in the latest quarter of 1,130. Even the more optimistic outlook has permits returning to only 1,256 in 2010Q3. Such a low level of private residential starts cannot sustain construction employment. This suggests the importance of facilitating non-residential investments, which are essential to maintaining employment close to current levels.

Conclusions

Current data argue that Connecticut entered a recession in 2007. Even so, to date its impact has been mild, with only a few thousand job loses. This CCEA Economic Outlook anticipates the recession will not be a deep one for the state, with aggregate output contracting only about $6 billion with a loss of 40,000 jobs out of about 1.7 million—much less than recessions over the last thirty years. Moreover, by taking account of the sharp drop in petroleum prices, the Outlook offers a second forecast in which those price reductions ameliorate the serious reversal of fortunes indicated in the business as usual forecast. Such cuts are however neither assured over the longer-term nor sufficient in the short-term to generate growth. The hope is that federal initiatives, perhaps supplemented at the state level, will short-circuit the recession and return the state and the nation of vigorous economic health.