The Sun Peaking Thru?

Suffering Only Small Job Losses But No Recession

The Connecticut Economic Outlook: August 2008

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This CCEA Outlook forecasts a deteriorating state employment over the next 30 months, primarily because of the continuing sharp decline in construction. Even so, the net loss of 9,500 jobs over this period argues that Connecticut will suffer mild job losses, especially compared to both previous contractions and compared to most other states.

At the same time, the total output in the Connecticut economy will continue to grow—so Connecticut will not experience a recession. And by the end of the forecast period in 2010, this Outlook anticipates growth in the Connecticut economy to accelerate. This reasonably good outcome—a soft landing in employment losses while output continues very modest growth--is not inevitable. The weakened dollar has clearly helped Connecticut manufacturing, but a strengthening dollar or strong inflation could reverse this pattern.

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Sector Growth Diverges

Declining Construction Midst Improved Manufacturing Performance

Declines in private residential building permits normally predict future declines in construction. Understandably with the debacle in sub-prime mortgages and the ailing housing market, the number of Connecticut housing permits over the first six months for each of the last two years have fallen 22.4%. During the same intervals, the decline in their total values has not been as precipitous – 21.9% and 13.2% respectively. But the situation may be getting dramatically worse: the average value of CT housing permits from May to June of 2008 collapsed, falling from $204,000 to $132,000. This reveals a massive shift away from higher-end houses toward low-cost multiple units. More pain in residential construction is probably on its way.

Overall, because of major non-residential construction and a backlog of repair projects over the first half of 2007 and 2008, the construction sector of the state's Real Gross Domestic Product (RGDP) did not at first contract as sharply as housing permits, falling only 10.1% in the first half of 2007. But in 2008, the contraction in the sector sharply accelerated, to 19.9%. The unavoidable associated job losses in construction have only just begun: during the first half of 2007 CT construction employment actually grew 1.8 percent, and has shown only a 1% contraction thus far in 2008. Given the underlying level of activity, this sector is looking at significant job losses over the next two years.

But there is good news as well. The latest federal statistics on Connecticut's manufacturing sector, covering 2007, revealed that it did better than CCEA's had estimated. During the first half of 2007, both production of durables and non-durables experienced growth, of 6.6% and 3.1% respectively. This CCEA Outlook anticipates durable manufacturing will continue growing at a healthy 4.5%, while non-durable manufacturing will decline 4.4%, giving back slightly more than it had gained. The Outlook also sees Finance Insurance and Real Estate (FIRE) and Trade Transport and Utilities (TTU) continuing to grow, despite the sharp drop in FIRE's CT RGDP growth to a miniscule 0.3%, reflecting the poor performance at troubled financial intermediaries.

The federal Bureau of Economic Analysis's (BEA) advanced estimates of GDP, which CCEA uses in developing its Connecticut Economic Outlook, attributes improved 2008 second quarter national performance to strengthening exports, falling imports, increased personal consumption, sustained non-residential construction, and government spending. The shifting pattern of foreign trade clearly flows from the falling value of the dollar and domestic demand from the infusion of dollars that the Economic Stimulus Act provided. The impacts from both continue to percolate throughout the economy.

While the BEA's revisions to national accounts were generally downward, BEA gave Connecticut a significant boost for the fourth quarter of 2006 with an increase in RGDP of $625 million. BEA's revisions means CCEA in turn revised its estimates for Connecticut's performance in 2007, raising CT RGDP estimates from $181,155 billion to $183,460 billion in CT 2007Q4 and $185,330 billion for 2008Q2 (in constant dollars).

Slow Growth in Output

Chart 1 shows the current CCEA Outlook for Connecticut's economy over the next 30 months. CCEA develops its projection of total Connecticut output (Ct RGDP) from the known output through 2007, estimated output projected from available personal income data through to 2008Q1, and extrapolated income for one quarter into 2008; we then use statistical techniques (BVAR) to forecast output for ten quarters (30 months) to 2010Q2. As Chart 1 shows, this Outlook sees Connecticut enjoying improved performance compared to the picture in the last Outlook, a result of the federal BEA revisions and the strengthened export performance in manufacturing. Despite the short-term dip in CT nondurable manufacturing in 2008Q2, this Outlook sees both manufacturing segments resuming modest growth for the rest of the period. Connecticut's reasonably good performance depends critically on avoiding a surge in U.S. inflation and continuing modest growth in the National economy. Current predictions see the national economy growing over the next four quarters at 1.8% and over the subsequent 12 months at 2.0%, roughly similar to 2008Q2.

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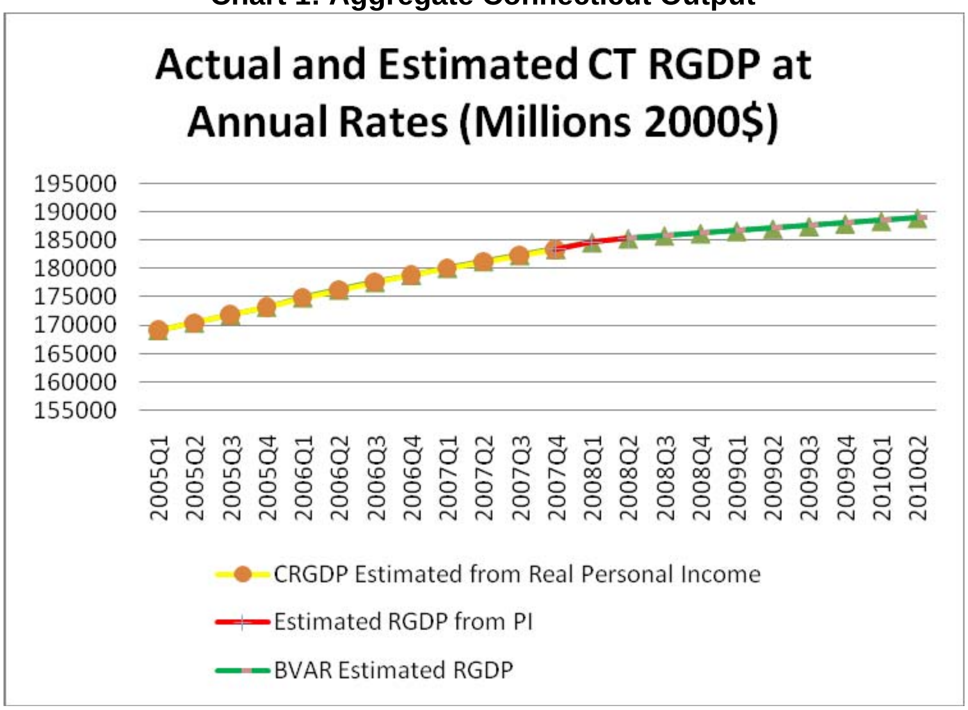
Chart 1: Aggregate Connecticut Output

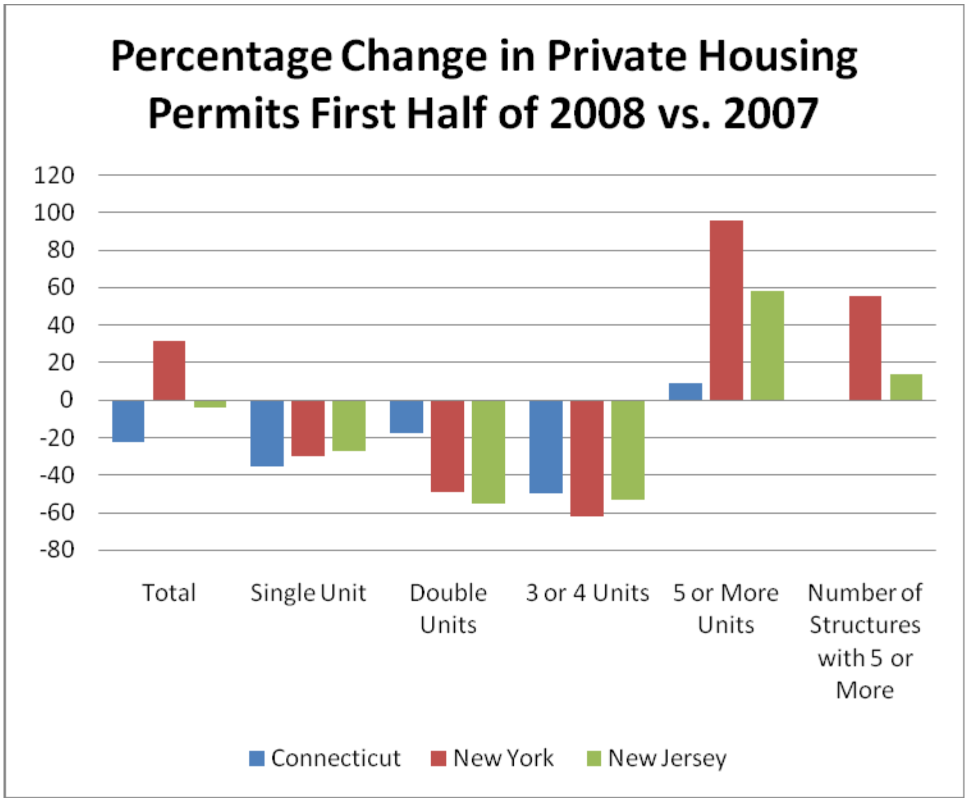


Construction is the main drag on CT RGDP; CCEA expects construction activity to decline nearly sixty percent, from $3.1 billion in 2008Q2 to $1.2 billion in early 2010 despite annual residential permits flattening out in the 1,500 to 1,600 range. There are clearly some significant pending nonresidential projects (e.g., in Preston, Bridgeport, and Fairfield) that could improve this situation, delivering improvements to this Outlook in both construction and office employment as new facilities come on-line.

Housing permits in Connecticut and throughout the Tri-State region continue to perform below historic norms for all types of housing except those containing five or more units.

The previous Outlook indicated that during 2007 Connecticut had fared relatively well within the Tri-State in permits issued for units in multiple unit buildings. That differential has narrowed, with the rest of the Tri-State catching up. Chart 2 illustrates the percentage change in permits for private housing issued in the first half or 2008 compared to the same period in 2007. The percentage cutbacks among single unit permits were most severe in CT, whereas Connecticut's percentage of cutbacks among doubles and 3 to 4 unit facilities were the smallest among the three.

Chart 2:

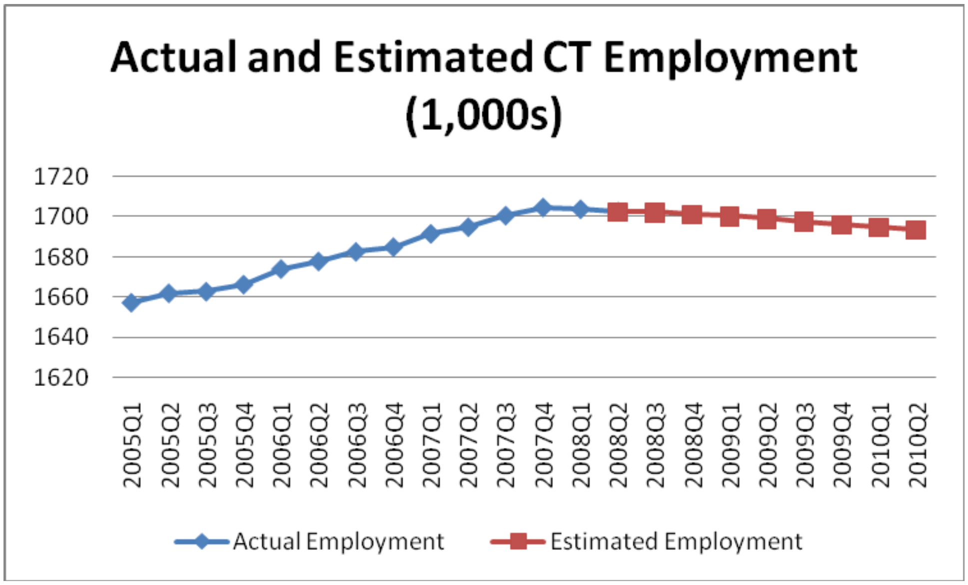


Employment and Output

With stronger than expected real manufacturing earnings compared to the May 2008 Outlook, this CCEA Outlook sees a milder contraction in CT employment. The result, over the two years, is a private sector loss of only 8,800 jobs, with another loss of 1,700 in government. This compares favorably to the anticipated loss of 24,000 jobs in the previous Outlook.

Chart 3 below illustrates the employment situation. Expected employment in 2010Q2 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, a matter of deep concern for the long-term competitiveness of the state.

Chart 3:



As illustrated in Chart 4, which shows the outlook for CT RGDP growth by sector, the construction industry will take the brunt of the cutbacks, with minor government belt tightening and lower traffic at casinos. Generally the private sector grows, particularly in both durable and non-durable manufacturing, from the ongoing stimulus in exports and opportunities for import substitution.

Chart 4:

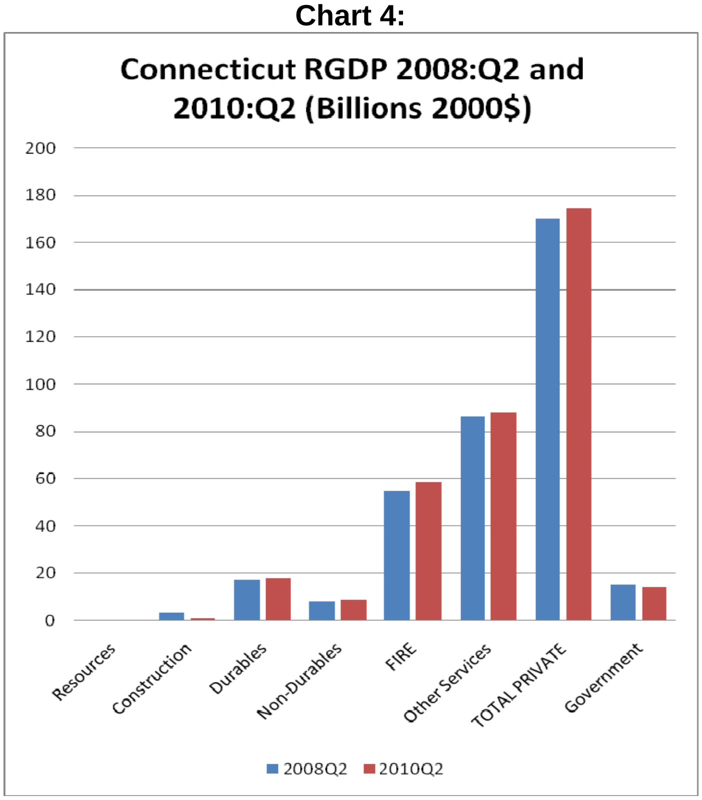
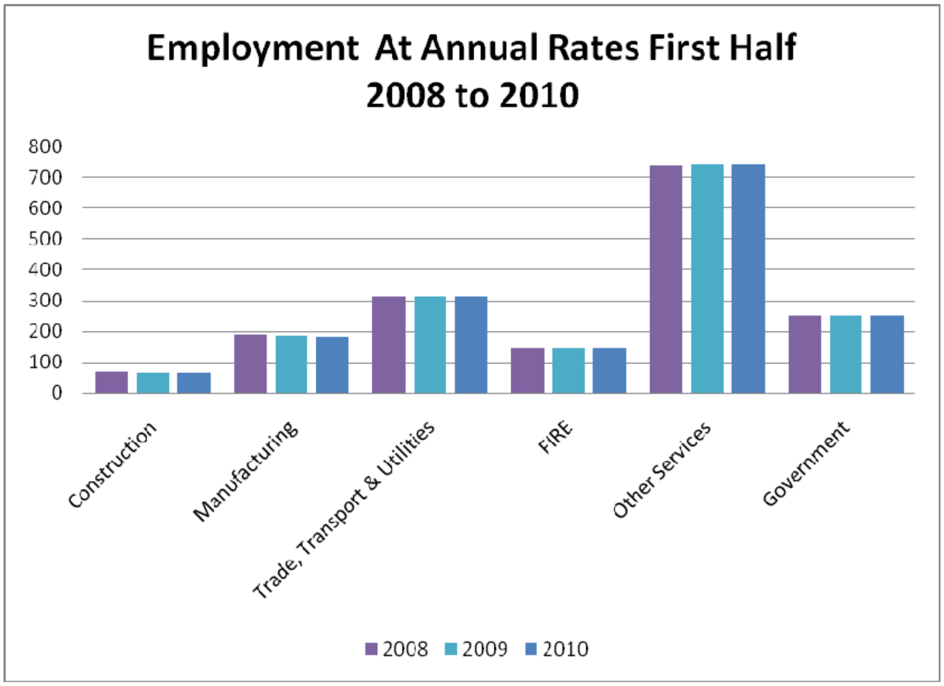


Chart 5 shows the sectoral employment picture. Employment decline in Construction from loss of building activity (-4,300); Manufacturing, despite its growing value of output, driven by productivity growth, sees reduced employment (-8,600); Government, reacting to shrinking tax revenues, sheds jobs (-1,700), while Other Services (+3,800) and TTU (+1,800) lessen overall loses.

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 less than one percent 2008 and 2009 before flattening out in 2010.

Outlook Vulnerabilities

Like any other Outlook, this one is vulnerable to economic shocks. The recovery of manufacturing is dependent on the devaluation of the dollar remaining effective. The emergence of significant inflation would put those gains at risk. Alternatively, initiatives in public policy to improve infrastructure or to invest in alternative energy supplies may modify the construction outlook. Completion and occupation of the new Royal Bank of Scotland facilities in Stamford may by itself improve the employment in FIRE significantly. Moreover, development of other transit-orient developments may both retain residents here to work and attract reverse traffic out both have the potential to accelerate growth and employment in services and CT’s tax base over and above this base forecast.

On current trends, Connecticut will experience its mildest economic adjustment in more than two generations. Despite that encouraging picture, Connecticut faces a very difficult long-term challenge: its competitive position is clearly declining. Connecticut's economy has failed to create net new jobs or generate net new businesses for twenty years. Moreover, it is seeing the loss of higher wage jobs, the growth of lower wage jobs, deterioration in the quality of its workforce, and a continuing loss of young adults. Coming out of the current economic malaise, Connecticut must look to how it will address these very troubling long-term trends.

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