Connecticut Economic Outlook

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State Gross Product Breaks $200 Billion; Employment Continues Slooooow Recovery

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By the end of 2005, Connecticut's economic output was surging past $195 Billion. Based on underlying growth that the University of Connecticut Center for Economic Analysis has tracked for 2006 the CCEA Outlook see the state achieving by the end of the year record output of more than $200 billion in current dollars.[1] In 2008, current output is expected to exceed $215 billion.

Of more importance to many is that the CCEA Outlook sees real growth continuing through 2008, at modestly lowered rates, falling from 3.5% in 2006 to 2.8% in 2007 and 2.6% in 2008. This pattern follows the much-hoped-for "soft landing" as the country works its way out from under the "twin deficits" of trade and federal deficits.

Following the national pattern, the CCEA Outlook sees growth in employment lagging growth in output as increasing productivity continues to undermine the need to hire significantly more employees. Even so, the CCEA Outlook anticipates Connecticut employment continuing modest growth, falling from the 0.8% rate of 2005 to 0.6% in 2006, 0.5% in 2007, and 0.4% in 2008. This means that towards the end of 2008 Connecticut would finally approach its historically high level of total employment. But it will have taken the state nearly eight years to recover to its previous high, and that barely matched employment levels of twenty years ago! The picture that the CCEA Outlook provides emphasizes the continuing challenge to Connecticut of creating sufficient jobs for its own citizens.

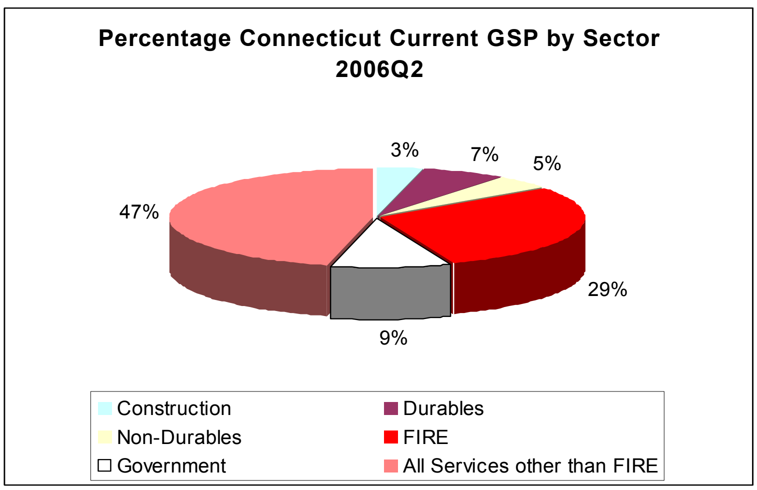
[1] The US Bureau of Economic Research rebased regional output, which reduced Connecticut's official output for 2004 by 1.8%, to 182.5 billion. But strong growth quickly covered this adjustment.

The CCEA Outlook to the end of 2008, must be seen within the context of potential downside risks and possible upside stimulants. Expanding hostilities in the Middle East, disruptions in other significant petroleum producing regions, unusual drawdown of national gas reserves this summer, and the disruption to the national food supply resulting from the unprecedented heat wave in the San Joaquin Valley could undermine economic performance in the next thirty months. But continuing devaluation of the US dollar could pay handsome dividends for American exports. In addition, sustaining the historically low interest rates American households and firms now enjoy and the possibility of federal deficit low than had been expected would be positive developments. The next three months should help to clarify where the Connecticut economy will be headed in the years ahead.

Charts:

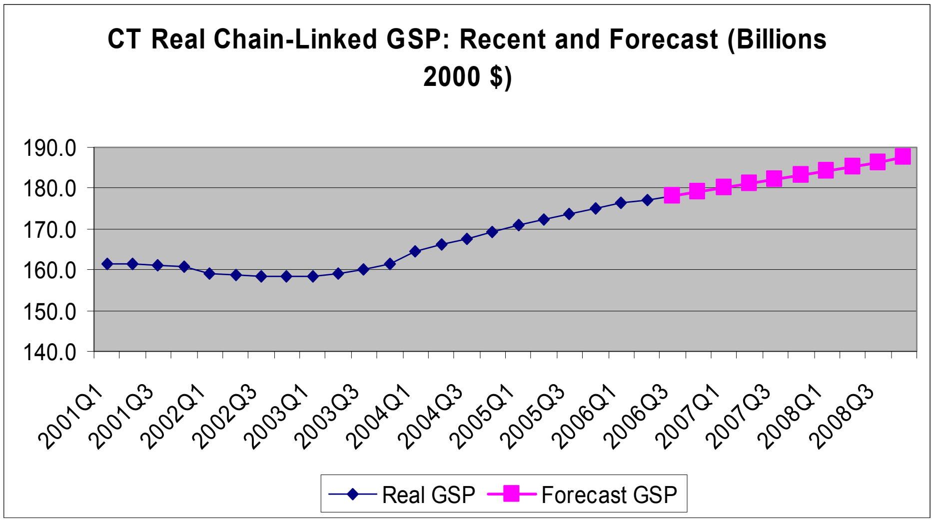
The sector breakout of CT GSP appearing in Chart 1 indicates dominance by various services, Finance, Insurance and Real Estate (FIRE) being the principle one. Durable manufacturing is twice as important as non-durable manufacturing.

Chart 1:



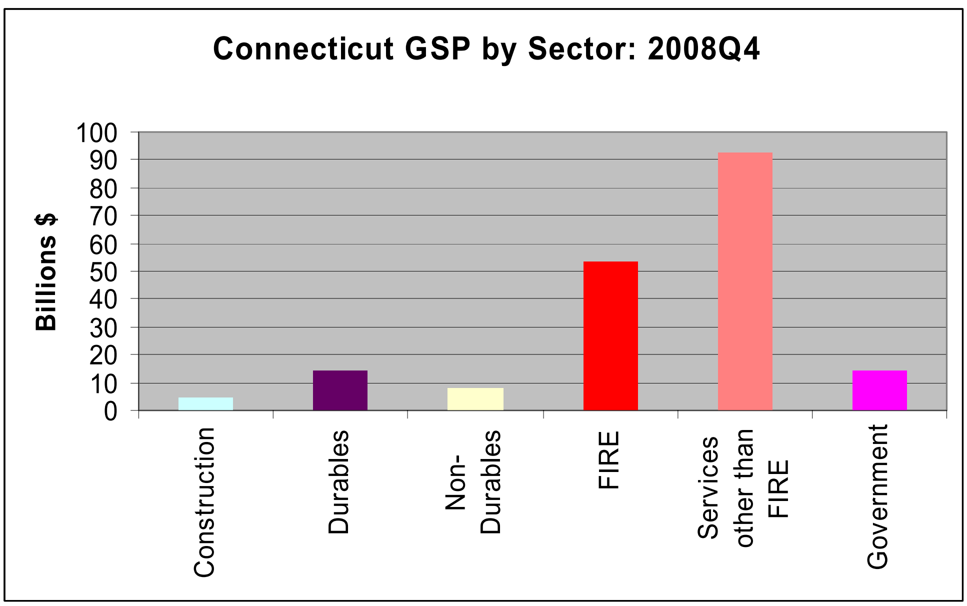
CT real chain-linked GSP is expected to grow at 2.7% this year followed by 2.2% next year and 2.4% in 2008. While these rates are below the 3.4% achieved in 2005, they are far from the doldrums of 2003 when there was no growth. As noted in Chart 2, this outlook attains real GSP of $187.5 billion by 2008Q4. At 95% level of confidence GSP at that point will be between $176.6 and $199.2 billion.

Chart 2:



Aside from the minor resources sector, components of other private sector GSP were also estimated. Keeping government and resources constant, expected seasonally adjusted sector shares in 2008Q4 are shown in Chart 3.

Chart 3:



This result indicates somewhat larger roles for services other than FIRE, FIRE itself, and slight recovery in durable manufacturing as well as smaller roles for government and non-durable manufacturing. In order of current importance, "Other Services" includes health, retail trade, wholesale trade, transportation and public utilities, and private educational services. Expansion of most of these components is consistent with an aging and reasonably affluent population.

Chart 4 traces Connecticut seasonally adjusted employment during since 20001. Notably, the outlook envisages returning employment to levels exceeding those at the outset.

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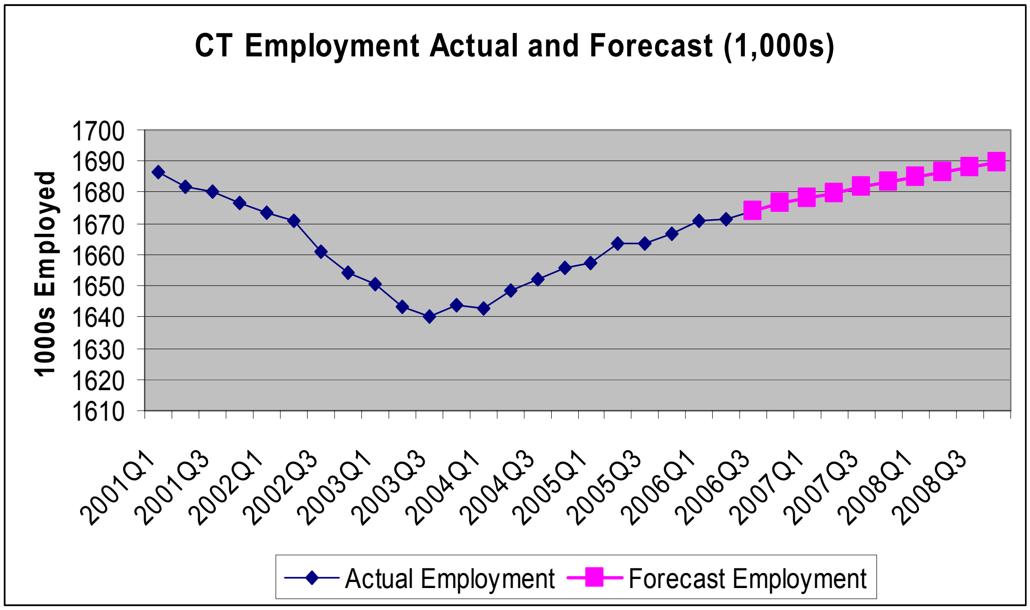
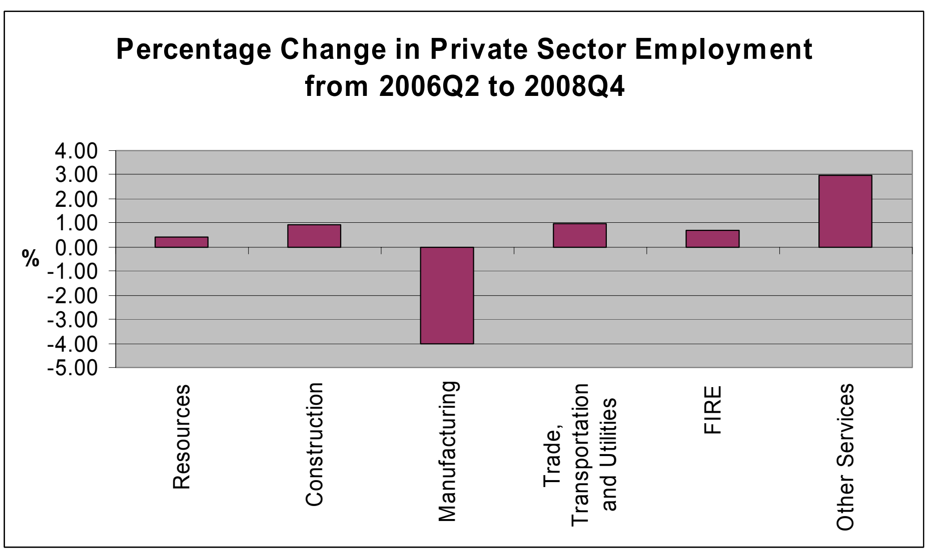


Slowing GSP growth mollifies annual employment growth rates from the 0.8% achieved in 2005 to 0.6% this year, to 0.5% in 2007 and 0.4% in 2008. While CT's leading indicator of employment was up in the first quarter, results for the first two months of the second quarter were down and commensurate with slower growth[2]. Expected private sector employment growth from 2006Q2 to 2008Q4 differs among the CT's as shown in Chart 5.

Chart 5:



[2] Francis W. Ahking and Stan McMillen, **Connecticut Continues to Grow In Spite of High Interest Rate and Energy Costs, CCEA 2006.**

Explanatory notes:

Current Dollar CT GSP

The ground beneath the feet of observers of the CT economy has shifted with the Bureau of Economic Research's (BEA) revamped GSP database back to 1963. The upshot is that their new current dollar CT GSP number for 2004 is $182.5 billion, or 1.8% below their previous estimate of $185.8 billion. Rapid 2005 current dollar GSP growth to $194.5 billion has more than offset the difference. Adjustments to real GSP are even larger.

For readers and modelers adjustments of this magnitude are akin to tremors. The basis for thinking about the economy changes and economic relationships need to be fine-tuned. As with frequent earthquake victims, readers may also experience a sense of *déjà vu* since lower 2004 GSP means that 2005 growth has covered what was thought to have been achieved. BEA's June 2006 current dollar estimate of CT GSP at annual rates is $199 billion. Underlying growth clearly indicates that the current dollar CT GSP will surpass $200 billion this year.

Real GSP

In contrast, BEA revisions to real chain-linked GSP - adjusted to eliminate inflationary impacts and changers in consumer tastes - have had greater relative impact than on current dollar GSP. BEA's new real CT GSP number for 2004 is $166.7 billion, or 2.7% below their previous estimate of $171.5 billion. Solid real growth in 2005 to $173.1 billion has more than made up the difference. These downward adjustments to real GSP without parallel modifications to employment imply that CT productivity gains since 1963 have been marginally lower than thought heretofore. The 2005 real GSP sector shares were similar to those measured in current dollars but with government loosing a percentage gained by durable manufacturing where inflation has been marginal.

Expected GSP Growth

The CCEA has estimated expected real GSP out to 2008. Real GSP growth is tied to growth in national Real Gross Domestic Product (RGDP), housing permits, Real Manufacturing Earnings, and CT employment.

Based largely on the strong first quarter in 2006, seasonally adjusted annual RGDP growth is expected to reach 3.5% this year followed by more modest growth of 2.8% and 2.6% in each of the next two years. Such a view is consistent with a soft landing in the slowdown of the U.S. economy.

Seasonally adjusted housing permits fell sharply from a peak of 3,297 in 2004Q3 to 2,517 2006Q2. The forecast anticipates a slight recovery in this quarter to 2,566 followed by a much milder decline than in recent years to 2,475 in 2008Q4. Declining numbers of permits over the last year should not obscure the rise in the value of permits issued. The average value in permits issued 2006Q2 was $199,520 compared to $176,806 for 2005Q2 – a 12.8% rise. Rather than suggesting growth in the size or quality of residences permitted, the underlying reason for higher permit values is found largely in rising energy and material costs of construction. Based on producers' price indexes, The Associated General Contractors of America have noted rising input costs such as #2 diesel fuel (33%), concrete products (11.2%), plastic construction products (19.2%) and gypsum (23.3%) during the year ending June 2006. Consistent with the last two years of only minor fluctuations, the outlook for real manufacturing earnings remains flat.

Against this backdrop, CT real chain-linked GSP is expected to grow at 2.7% this year followed by 2.2% next year and 2.4% in 2008. While these rates are below the 3.4% achieved in 2005, they are far from the doldrums of 2003 when there was no growth. As noted in Chart 2, this outlook attains real GSP of $187.5 billion by 2008Q4. At 95% level of confidence GSP at that point will be between $176.6 and $199.2 billion.

Employment

Recent trends in seasonally adjusted employment have been expansionary, particularly in public utilities, FIRE, and other services. Commensurate with the lower number of housing permits, construction employment was down by 2,088 in 2006Q2 relative to a year before. Employment declines in manufacturing of 2,264 more than matched those in construction. These reductions were more than offset by gains in trade and public utilities 735, FIRE 1,627, other services 7,558 and government 2,461.

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Peter Gunther, Senior Research Fellow, at the University of Connecticut Center for Economic analysis, is the author of the CCEA Outlook. The Outlook provides a ten quarter projection of state output and employment. CCEA releases the Outlook every quarter. Please see attached pages for charts and notes that illuminate this Outlook.