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Connecticut Economic Outlook

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CT Real Income Growth Outpaces the Nation

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For the third consecutive year Connecticut's real income growth rate is on pace to outdistance that of the nation. Based on preliminary data for the third quarter, CT 2006 Real Gross State Product (RGSP) is expected to grow at 5.1% compared to national RGDP growth of 3.4%. These results widen CT growth rate advantage. In 2004 and 2005 CT growth was 4.4% and 3.7% compared to national rates of 3.8% and 3.2%.

Factoring in productivity gains, CT 2006 employment gains will be modest at about 10,000 in 2006 as expected in the 2006Q4 forecast. With the softening of permits for private residences, construction employment fell from its 2006Q1 peak of 66,000 by 1,250 workers by Q3 and manufacturing continues to adjust. The strength of the CT labor market remains in services industries including professional services.

This outlook is somewhat bullish in that it extends the marginally better 2006 RGDP growth performance over the next two years at annual rates of 3.8%. Offsetting this potentially optimistic view, CT seasonally adjusted housing permits are expected to remain virtually flat in the narrow 2,141 to 2,110 range per quarter following a rapid descent of over 400 units a quarter in the last six months.

The factors driving housing demand, such as interest rates and consumer risk avoidance, given risk exposures to unknown energy prices, are largely outside the model. If the recent fall in energy prices were to be sustained or extended or the Federal Reserve were to lower interest rates, there is room for considerable upside from this sector. Alternatively, recent OPEC pronouncements and threats to Iran could exacerbate the energy uncertainties by eroding CT and national consumer confidence and real growth.

The resulting outlook for CT RGSP growth is for 3.9% over 2007 and 3.0% in 2008 with employment growth of 15,000 in 2007 and 12,000 in 2008. Over the two years, employment gains will be concentrated in the services sector (15,000), government (9,000), construction (4,000), due to a non-residential up-tick, and trade transport and utilities (2,000) offset by declines in manufacturing (-3,000). Should non-residential construction be further postponed, there would be some downward adjustments to this forecast.

Housing Affordability and Construction Employment

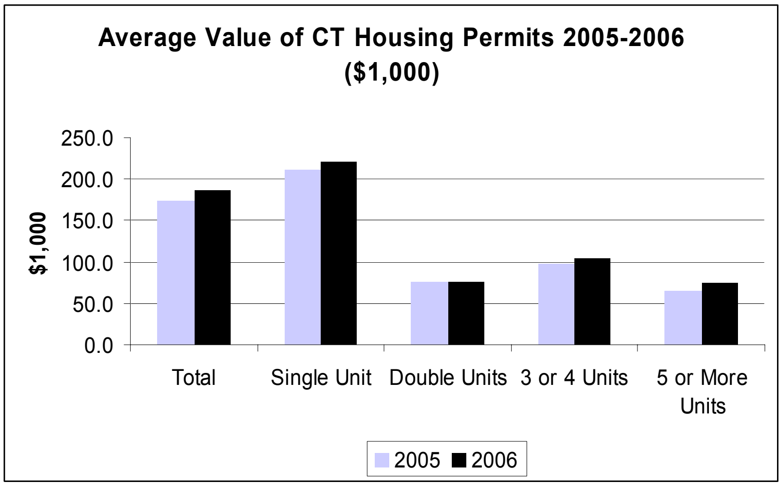
Recent press articles have emphasized the downturn in the national housing markets, especially in Florida, where cyclical markets related to secondary luxury homes exaggerate the price cycle's amplitude. Closer to home, others have expressed concern about affordability in Connecticut based on average home cost. Such claims warrant a more granular look at the recent CT permits data issued for single and multiple dwellings – specifically doubles, three or four unit complexes, and complexes containing five or more homes.

The average value of CT permits issued this year and last year, shown in Chart 1, illustrate that annual average permit values continue to rise for all recorded classes of homes except doubles, a possible plus for the contractors should markets sustain their expectations. Seasonally adjusted, both the national CPI for housing and the residential construction housing product price index continue to rise. The CPI for housing rose by 1.4 to 1.6% per quarter in 2006 and the housing product price index by 1.7% in the last quarter following a jump of 5.6% in the 2006Q2.

Important for first-time buyers, the average value of the permits for all types of CT multiple dwellings is less than half the average value of permits to construct single detached homes, thereby providing possible entry points into home ownership for young families and those with below average incomes.

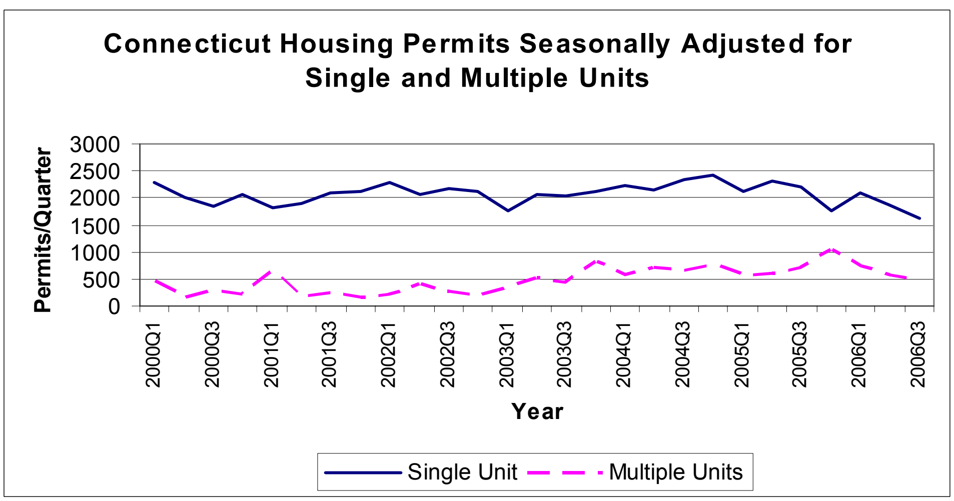
Historically families' fiscal capacity to buy single detached homes has been a combination of their annual income and wealth accumulated in the resale of smaller starter homes. Availability of starter homes is then important to established market dynamics as is the appreciation of the housing stock, net of outstanding mortgages, to financing the eventual purchase of single family dwellings. Should it occur, housing price retraction, combined with high ratio mortgages, could reverse these recent market dynamics.

Chart 1



The number of seasonally adjusted CT permits issued for more affordable multiple units since 2003Q4 have been above their century average of 488 units per quarter, as shown in Chart 2. In the last two years, 25.6% of CT permits for private housing have been for multiple units but only 3.1% of all permits were for structures with more than one but less than five units. From the logical bounds of the monthly reports, at least 199 units of structures with five units or more had to be structures with less than 10 units such as row houses and carriage homes. This level of activity in multiple housing units assures only a modest availability of multi-unit starter homes accompanied by a greater availability of new apartments or condominiums constituting a base demand for starter white goods.

Chart 2



Source: CCEA based on Data from the Bureau of the Census

In addition to the decline in total permits for multiple units toward norms for this century, the short-term news for contractors is adversely influenced by the downward trend of single home permits since 2004Q4. In each of the last two quarters, the total number of housing permits, seasonally adjusted, has fallen by more than 400 units per quarter from a high of 2,896 in 2006Q1 to 2,057 in 2006Q3.

Downward adjustments in CT construction employment have begun. Seasonally adjusted construction employment in that quarter was off by 1,250 from its peak two quarters earlier at 66,000. This far, the 2006Q3 decline in seasonally unadjusted personal income in the CT construction sector to $7.53 billion has been marginal from its peak of $7.58 billion a quarter earlier. Along with national trends in housing, the declining trend in the number of single house permits is likely to perpetuate lower residential construction and supplier, albeit construction workers will benefit from increased non-residential activity.

Ongoing appreciations of house prices, recent CT RGSP growth, the continued availability of new starter homes, and the small decline of personal income in construction also auger for a soft landing despite the overall decline in residential construction employment and relatively sharp drop in housing permits. If lower gasoline prices are sustained or interest rates lowered, there may be room for a little more consumer confidence including housing expenditures.