THE CONNECTICUT ECONOMIC DIGEST

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IN THIS ISSUE...

In November...

Nonfarm Employment
- Connecticut 1,6
  - Change over month 0.06%
  - Change over year .... -4.2%
- United States 13
  - Change over month .... -0.14%
  - Change over year .... -4.0%

Unemployment Rate
- Connecticut .... 8.
- United States 10.2%

Consumer Price Index
- United States 2
  - Change over year .... -0.2%

The Economic Outlook for 2010

By Stan McMillen, Ph.D., Managing Economist, and Mark Prisloe, Associate Economist, DECD

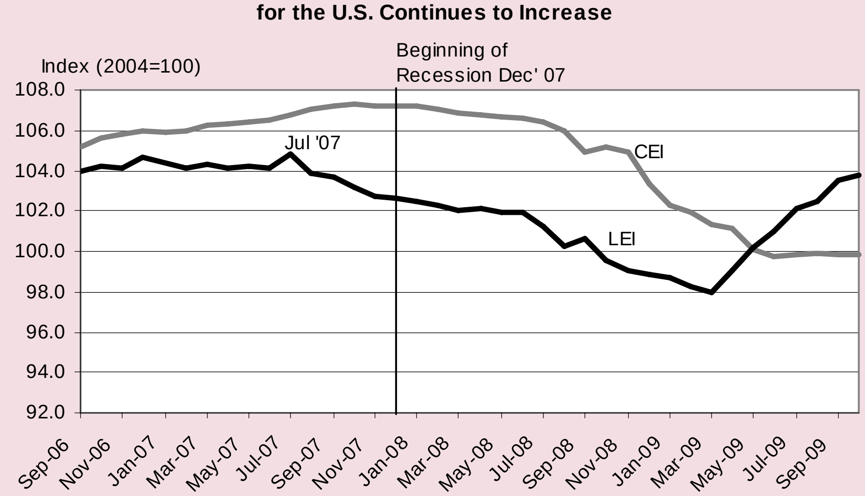
The Nation

In 2010, the U.S. economy will begin recovering from the current severe recession that began in December 2007. This outlook is supported by historic experience and recent positive developments. Since World War II, the average length of U.S. recessions has been 10.5 months with the longest lasting 16 months. The current recession is already longer and some observers consider it to have ended in the third quarter of 2009 (Q3-2009). They note that quarter-over-quarter real gross domestic product (RGDP) grew at an annualized rate of 2.8% from Q2-2009 according to the revised estimate released by the Bureau of Economic Analysis (BEA). In Q2-2009, RGDP declined by 0.7%, moderating from Q1-2009 when RGDP declined by 6.4%.

In addition, the Conference Board's Leading Economic Index (see Figure 1 below) began an upward trend in April 2009 and has been rising for seven months, while the coincident indicator bottomed and flattened beginning in June 2009. Increasing employment usually lags GDP growth, and the nation is not expected to see positive job growth until the second half of 2010, and then only gradually for several years. At some point, if the leading indicator continues to rise, we should see the coincident indicator also begin to rise reflecting increasing economic activity and job growth.

Forecasts of real (inflation-adjusted) GDP growth in the first six months of 2010 range from -0.5% to +0.2%, with an 80% chance the growth rate will be between -2.1% and +2.5% according to the Financial Forecast Center (FFC).[1] The New England Economic Partnership (NEEP) projects real GDP to grow no more than 2.0% during 2010.[2] The National Association for Business Economics (NABE) believes the

Fig. 1: The Conference Board Leading Economic IndexTM (LEI) for the U.S. Continues to Increase



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ECONOMIC DIGEST

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recession has ended but recovery will likely see modest GDP growth of 3.2% in 2010.[3] Moody's Economy.com also says the national recession is over, but does not see "self-sustaining" growth beginning until Q1-2011 (see footnote 2).

Unemployment, at 10.2% in October, will remain above 10% in early 2010 and likely climb to 10.8% by mid-2010 according to Moody's Economy.com. Counting the unemployed, marginally attached, discouraged workers, and people working part-time, the unemployment rate was 17.5% in September.[4] The four-week average initial claims for unemployment insurance fell 6,500 to 514,000 in mid-November, the eleventh straight week of decline, and remained near its lowest level since early January 2009, down from the 674,000 peak reached in March 2009.

Interest rates should remain steady in 2010 as the Federal Reserve will maintain near-zero rates. The Federal Open Market Committee's (FOMC) target range for the federal funds rate is 0 to 0.25% in view of economic conditions that are "likely to warrant exceptionally low levels of the federal funds rate for an extended period."[5] The FOMC program to purchase agency mortgage-backed securities and its expansion up to the established maximum $1.25 trillion by the end of 2009 will slow, implying expansionary monetary policy at least through the end of Q1-2010.

The 2010 outlook for capital spending, or Gross Private Domestic Investment (GPDI), is mixed. The auto industry, for example, appears poised to gear up spending to meet new demand,[6] but the recent pattern of GPDI is decidedly downward. GDPI plunged $524 billion in Q1-2009 from Q4-2008, representing a drop in the average annual growth rate of 50.5 % in Q1-2009 and of 23.7% in Q2-2009 compared to the preceding quarter's annual average growth rate.[7] In 2010, GPDI will likely see an uptick as inventories are reduced, businesses regain confidence, and interest rates remain low. NABE expects GPDI to increase, foreseeing "Business investment will contribute to the economic rebound."[8] According to NEEP, investment spending will lead the recovery as consumers adjust their balance sheets by saving more, paying down debt and consuming less.

The 2010 outlook for residential fixed investment or the housing market is not all bleak. Housing starts plummeted 10.6% in October to their lowest level in six months,[9] but improvement in 2010 will result in part by greater affordability as prices continue to fall.[10] The construction industry expects gradual recovery in non-building activity as credit improves and as additional infrastructure projects are started by the economic stimulus plan and from gains in export sales as the dollar slowly declines relative to a basket of currencies.[11]

The outlook for prices in 2010 is one of little or no inflation. The Consumer Price Index for All Urban Consumers (CPI-U) decreased 0.2 % on a not seasonally adjusted basis over the 12 months ending in October 2009. For the first time since 1973 when legislation created a cost of living adjustment (COLA), there will be no COLA for Social Security and Supplemental Security Income (SSI) recipients in 2010. The decline in the food price index was the first 12-month decrease in over 40 years. Producer prices are likely to fall by 1.9% as they did from October 2008 to October 2009 representing the eleventh consecutive month of year-over-year declines.[12]

An obstacle to stronger retail sales is a lack of consumer confidence. The Conference Board's Index of Consumer Confidence, which averaged 103.4 in 2007 and 58.0 in 2008, stood at 49.5 in November 2009 and has remained below its May level of 54.8 for six months. One component of the index was the lowest in 26 years, meaning consumers are expecting business and labor market conditions to worsen in the months ahead. However, total retail and food services sales for August through October 2009 increased by 1.5% from the same period a year ago. Exports and imports increased as well.[13]

Connecticut

Connecticut's economy will see little or no growth in 2010. Connecticut has experienced 12 recessions since 1939, including the last contraction from July 2000 to April

2003 (34 months). By historical standards, Connecticut's recessions have lasted an average 20 months. On that basis, the recession that began in March 2008 should have ended in October 2009. However, as yet there is no observed turn-around in job losses, although they are cumulatively increasing at a decreasing rate.

Connecticut's state Gross Domestic Product (SGDP), a broad annual measure of the state's economic health, declined by 0.4% in 2008 and when next reported is likely to be negative for 2009.[14] Connecticut is not alone: real GDP growth slowed in 38 states. Forecasters estimate Connecticut may barely be able to eke out slightly positive growth rate by year's end, perhaps 1.4% according to NEEP.[15]

Unemployment will continue to rise in 2010, until business confidence strengthens and firms see sustained demand. Until then, firms will adjust to changing conditions by adjusting hours and the workweek. Employment peaked in Connecticut in March 2008 at 1,709,400 jobs and has declined since then by 5.0% to 1,624,000 jobs in Q4-2009. Manufacturing employment in Connecticut declined by 16,100 jobs (-8.3%) and service-providing employment shrank by 42,400 jobs (-2.9%) over the 12 months ending October 2009. Unemployment in Connecticut increased in 2009 from 7.3% in January to 8.8% in October. It has remained consistently below the national rate notwithstanding that since March 2008, 85,400 jobs have been lost (-5.0%). The Governor's Council of Economic Advisors believes another 15,000 jobs will be lost before gains ensue, possibly in the third quarter of 2010. Initial claims for unemployment insurance jumped 75.5% from 16,268 to 28,551, the highest number since the 1991-1992recession.[16]

Connecticut's Chapter 7 bankruptcy filings spiked in Q2-2009, 38.2% higher than in Q1-2009, 43.8% higher in the first half of 2009, and through Q3, a 51% jump over the same period a year ago and the highest bankruptcy rate in four years.[17] One in every 281 Connecticut housing units was in a foreclosure filing in Q3-2009, up 69% from Q2.[18] Commercial real estate will likely suffer in 2010 when experts predict values will ultimately drop 40% to 50% from 2007 peaks.[19]

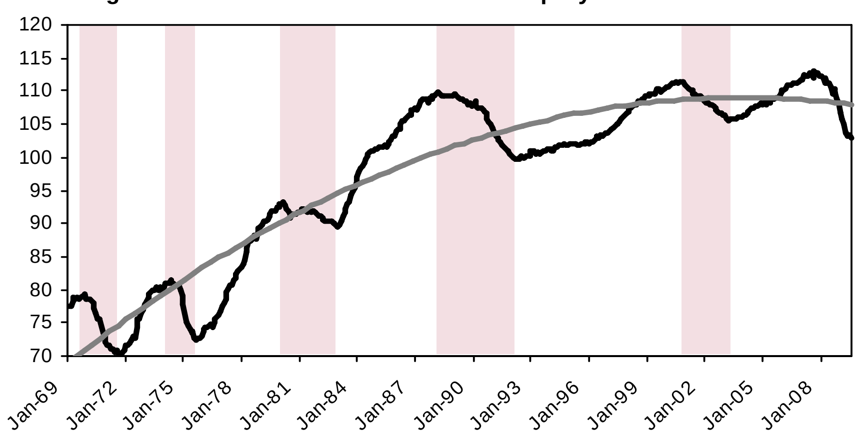
The outlook for Connecticut's personal income growth in 2010 is increasingly precarious. The BEA recently released revised estimates of the states' personal income with major downward revisions for Connecticut. BEA forecasts 2010 personal income to decline by 4.25% in Connecticut (year-over-year), more than twice the previously estimated 2.1% drop, and the single largest decrease in the history of this series dating to 1969. This will have deleterious implications for income and sales tax revenues in 2010 and likely 2011.

Figure 2 below shows a disconcerting trend underlying the Connecticut coincident employment indicator. The challenge of forecasting the 2010 economy is that this contemporaneous activity indicator whose (cubic) trend approximately peaked in 2004 exhibits an underlying dynamic that has been drifting downward since. Connecticut's fortunes will improve only as the recovering national economy strengthens and as the state leverages its educational and workforce assets.

Structural and demographic changes will shape the pace and form of recovery. Connecticut's "dependency ratio," the number of children (age 0 to 19) plus elderly (age 65 and over) per 100 workers (age 20 to 64), will rise from 64 in 2010 to 82 in 2030, indicating increasing dependence on the "working population."[20] Connecticut possesses the 8th "oldest" (by median age) population among the states and District of Columbia[21] entailing repercussions for entitlements such as Social Security and Medicare as well as the pension funds for retired state workers and public school teachers. As Connecticut's boomer population retires, it will spend less as it receives lower total compensation and it will have increased demands for smaller and more affordable and efficient housing. This portends lower state tax revenue and shifting housing demands. And, some retirees will leave the state.

Moreover, major structural changes will impact Connecticut's major industries such as finance and insurance, defense, and transportation far into the future. Global competition and the retirement of 76 million "baby boomers" will profoundly impact the U.S. and Connecticut economies.[22] In the past four decades there has been an effective doubling of the world labor force in a single generation. The U.S. and other developed countries, unlike in previous recessions, now find themselves in unsettling competition with the workforces of China, India, Brazil, among others. Many unemployed will not easily find work because their specialization has been eliminated (think hedge fund managers and certain manufacturing occupations). Though this recession may be technically "over," recouping job losses to reach prior payroll employment peaks took an average

Fig. 2: The Connecticut Coincident Employment Indicator



The distance from peak to trough, indicated by the shaded areas, measures the duration of an employment cycle recession. The vertical scale is an index with 1992=100.

--Continued on page 5--

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of 10 months before 1990, but took 23 and 39 months in the last two recessions and is a reason we expect a slow and "jobless" recovery.[23] ■

[1] The Financial Forecast Center is a small, independent, privately-owned corporation located in Houston that has produced and published economic and financial market forecasts since 1997 exclusively on the Internet. The forecast models are 100% quantitative and use a global, long-range economic dataset. See www.forecasts.org/gdprealgrowth.htm.

[2] Augustine Faucher, Moody's Analytics, "From the Great Recession to the New Normal," New England Economic Partnership ("Bluebook"), November 10, 2009, and "Though Worst is Over, Slow, Weak Recovery Expected across New England," New England Economic Partnership press release, November 10, 2009.

[3] National Association for Business Economics, NABE Outlook: "Recession Is Over, but a Muted Recovery to Follow," October 12, 2009.

[4] Marginally attached workers are those who are currently not working nor looking for work, but indicate that they want and are available for a job and have looked for work sometime in the recent past. Discouraged workers, a subset of the marginally attached, are those who have given a job-market related reason for currently not looking for a job, as well as persons who want and are available for full-time work and have had to settle for a part time schedule.

[5] William T. Gavin, Federal Reserve Bank of St. Louis, *National Economic Trends*, September 22-23 meeting released October 14, 2009, p. 9.

[6] According to automotive consultants CSM Worldwide and J.D. Power and Associates analyst Jeff Schuster, the forecast of auto sales for 2010 is brighter. Comcast.net Finance reports that "the forecast for a recovery in 2010 comes at a time when the industry is gearing up to increase output on the view that sales are headed for a slow but gradual recovery." Soyoung Kim, "2010 auto sales seen up at least 15 percent." Reuters, October 21, 2009. www.comcast.net/articles/finance/20091021/BUSINESS-US-AUTOS-FORECASTS.

[7] Christopher Swann, BEA, "GDP and the Economy: Second Estimates for the Second Quarter of 2009." *Survey of Current Business*, September 2009, pp. 1-10. http://www.bea.gov/scb/pdf/2009/09%20September/0909_gdpecon.pdf.

[8] See Note 2.

[9] Mark Vitner, "Housing Starts Pull Back Sharply in October," Wells Fargo Securities, November 18, 2009. See http://mediaserver.fxstreet.com/Reports/4487e573-e46b-4539-bdb0-b4e1cee4b873/c806d092-9f3c-4c13-b02d-1eaa6547e321.pdf.

[10] Congress extended and expanded the $8,000 first-time homebuyer tax credit beyond November 30, 2009.

[11] National Association of Home Builders, www.reedconstructiondata.com/news/2009/10/economic-recovery-in-mid-2009-leads-to-construction-recovery-early-in-2010.

[12] BLS http://stats.bls.gov/news.release/ppi.nr0.htm.

[13] U.S. Census Bureau, "Advance Monthly Sales for Retail and Food Services," November 16, 2009. See www.census.gov/retail/marts/www/marts_current.pdf and "U.S. International Trade in Goods and Services," September 2009. See http://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf.

[14] BEA, News Release: GDP by State: "Economic Slowdown Widespread among States in 2008 — Advance 2008 and Revised 2005–2007 GDP–by–State Statistics," June 2, 2009. See www.bea.gov/newsreleases/regional/gdp_state/gsp_newsrelease.htm.

[15] New England Economic Partnership, Fall 2009 Forecast, November 10, 2009. Bluebook, p. 16.

[16] Initial claims are seasonally adjusted by Connecticut DOL. See http://www.ctdol.state.ct.us/lmi/laborsit.pdf.

[17] Data from the Warren Group. Cara Baruzzi, "Bankruptcy filings rise 51% in last 9 months," *New Haven Register*, October 20, 2009. See www.nhregister.com/articles/2009/10/20/business/d1-biz-bankrupt20.txt.

[18] Realtytrac, "Foreclosure Activity Hits Record High in Third Quarter," October 15, 2009. See http://www.realtytrac.com/foreclosure/foreclosure-rates.html.

[19] PricewaterhouseCoopers and the Urban Land Institute, "Survey: 2010 Will Be Buyers' Market for Commercial Real Estate," *MortgageMag News*, November 9, 2009.

[20] Connecticut State Data Center, "RPO Projections 2005 up to 2030." See http://ctsdc.uconn.edu.

[21] 2008 American Community Survey (ACS).

[22] Kevin Kliesen projects that real U.S. GDP growth will slow from an average of 3.0%per year from 1990-2006 to 2.5% per year from 2007-2017 and then to 2.2% per year from 2018-2028. See: "As Boomers Slow Down, So Might the Economy," *The Regional Economist*, Federal Reserve Bank of St. Louis, July 2007, pp. 12-13, http://research.stlouisfed.org/publications/regional/07/07/boomers.pdf.

[23] Neal Soss and Henry Mo, Credit-Suisse, "U.S. Economics," *Economics Research,* 09-2009. See www.credit-suisse.com/researchandanalytics.

GENERAL ECONOMIC INDICATORS

(Seasonally adjusted)	3Q 2009	3Q 2008	CHANGE NO.	CHANGE %	2Q 2009
Employment Indexes (1992=100)*					
Leading	114.5	117.9	-3.4	-2.9	113.6
Coincident	102.8	109.9	-7.1	-6.5	103.5
General Drift Indicator (1986=100)*					
Leading			0.0	###	
Coincident			0.0	###	
TD Bank Business Barometer (1992=100)**	118.3	124.6	-6.3	-5.0	119.3

*Sources: *The Connecticut Economy, University of Connecticut   **TD Bank*

The Connecticut Economy's **General Drift Indicators** are composite measures of the four-quarter change in three coincident (Connecticut Manufacturing Production Index, nonfarm employment, and real personal income) and four leading (housing permits, manufacturing average weekly hours, Hartford help-wanted advertising, and initial unemployment claims) economic variables, and are indexed so 1986 = 100.

The **TD Bank Business Barometer** is a measure of overall economic growth in the state of Connecticut that is derived from non-manufacturing employment, real disposable personal income, and manufacturing production.