The 2014 Economic Outlook

As is customary at the beginning of the year, this issue of the Digest looks at the economic prospects for 2014. This outlook attempts to interpret recent data and their trends, and to offer some insights about what they mean for the U.S. and Connecticut economies in the year ahead.

The Nation

The outlook for the U.S. economy is reasonably optimistic pending a positive resolution of two fiscal deadlines that loom early in the year, notably the January 15, 2014 end of the continuing resolution funding of the federal government, and the February 7, 2014 end of the nation’s borrowing authority. A short-term slowdown in Q4-2013 resulting from the partial government shutdown in October is likely only temporary. Otherwise, the U.S. Gross Domestic Product (GDP) has grown for four and a half years since the “Great Recession” ended in Q2-2009. The Real Gross Domestic Product (RGDP), or constant dollar value of all goods and services produced by labor and capital located in the U.S., since then has averaged 2.3% at an annual rate from the preceding quarter (Figure 1). After growing 2.5% in 2010, 1.8% in 2011, 2.8% in 2012, and an estimated 3.6% in Q3-2013, RGDP growth near 3.0% is likely in 2014. The New England Economic Partnership (NEEP), based on Moody’s Analytics underlying macroeconomic forecast, sees RGDP growth at 3.2% in 2014.2 The National Association of Business Economists (NABE) outlook panel forecasts “3.0% in the spring through the autumn quarters of 2014.”3

In November...

Nonfarm Employment

Connecticut .......... 1,655,300
Change over month .... +0.24%
Change over year .... +1.0%

United States .......... 136,765,000
Change over month .... +0.15%
Change over year .... +1.7%

Unemployment Rate

Connecticut .......... 7.6%
United States .......... 7.0%

Consumer Price Index

United States .......... 233.069
Change over year .......... +1.2%
U.S. Employment and Unemployment

Total seasonally-adjusted nonfarm payroll employment, since the end of the recession, has increased by nearly 7 million jobs, after averaging losses of 201,000 jobs a month in Q3-Q4 2009, gains of 148,000 jobs a month in 2010-2012, and improving to 189,000 jobs per month through November in 2013 (Figure 2). This improved job growth trend should continue in 2014. In 2013, the U.S. unemployment rate fell to 7.0% in November from 7.8% in November a year ago, the lowest in five years, and a declining unemployment rate will likely continue in 2014.

The Conference Board Leading Economic IndexTM (LEI) for the U.S. in 2013 continued to post gains. Kathy Bostjancic, Director of Macroeconomic Analysis at The Conference Board said: “The recent increase in the index supports our forecast that the U.S. economy is poised to grow somewhat faster at 2.3 in 2014 compared to 1.6 percent in 2013.” Ken Goldstein added: “Overall, the data reflect strengthening conditions in the underlying economy. However, headwinds still persist from the labor market, accompanied by business caution and concern about federal budget battles. The biggest challenge to date has been relatively weak consumer demand, which continues to be restrained by weak wage growth and slumping confidence.”

The Federal Reserve

The other issue that has been of national concern for much of the past year is the announced plan of the Federal Reserve Open Market Committee (FOMC) to “taper,” or begin reducing, its $85 billion per month bond buying program. The likelihood of tapering was rumored since last summer and was initially expected in September. The Fed has cautioned all along, however, that it would do so only commensurate with a real improvement in the labor market and pending no serious risk of inflation. Indications are that such a reduction in the bond buying program may occur in 2014. Such a decision would likely begin a gradual increase in interest rates, but have the potential to raise rates associated with capital investment borrowing and home mortgages, prospects that would not be welcome in an only sluggishly recovering economy. The Fed has pursued a deliberate low interest rate policy throughout the recovery. So it...
remains to be seen the degree and the pace that the FOMC will adopt in the year ahead, but it is surely a factor in any outlook for 2014.

A related issue is the successor to Fed Chairman Ben Bernanke whose term expires January 31, 2014. In October, the President made a nomination of the current Fed Vice Chairwoman, Janet Yellen, for the post. Her likely confirmation suggests that the FOMC policy is less likely to change with any immediate urgency. A consistently strong supporter of Bernanke, she is also considered the architect of the once almost unprecedented original course of action that the Fed took in initiating the rounds of so-called “quantitative easing” (QE). Stock and bond market investors have reacted mostly favorably to her selection. Late in 2013, the Dow Jones Industrial Average was up +24.08% for the year-to-date. The S&P Index was up +27.30% and the NASDAQ above 4,000 for the first time since 2000.

**Growth Prospects**

The forecast embodied in this article will assume any U.S. budget and debt ceiling issues are resolved, because there are a number of positive developments going into 2014. Growth prospects remain positive for a number of reasons. These include the 54th consecutive monthly expansion through November 2013 of the overall economy based on the Manufacturing ISM Report on Business®; the ISM report noted that: “Comments from the panel are generally positive and optimistic about increasing demand and improving business conditions.” Moreover, November’s PMI [Purchasing Managers Index] registered 57.3 percent, the highest of the year. A reading above 50% indicates that the manufacturing economy is generally expanding; below 50% indicates that it is generally contracting. Consumer spending also saw gains with average monthly increases of 1.9% in 2013 from the same month a year ago. The Thomson Reuters/University of Michigan final Index of Consumer Sentiment slipped late in the year, but had advanced to 85.1 in July 2013, the highest level in six years. The Conference Board Consumer Confidence Index® reached a five- and-a-half year high of 81.8 in August 2013. The Index decreased sharply to 72.4 (1985=100) after the federal government shutdown and debt-ceiling crisis in October, and declined again in November. The Index now stands at 70.4 (1985=100). Real exports of goods and services increased 1.6% in Q2-2013 from the year-ago quarter, compared with 0.7% in Q1-2013. Real nonresidential fixed investment (purchases of plant and equipment) gained 2.4% in both Q1 and Q2-2013, compared with Q1 and Q2-2012. New homes sales grew 20.6% through mid-year from a year ago, jumped by 25.4% in October, and new building permits climbed 6.2% in October to the highest level in more than five years, while U.S. home prices rose 0.7% in September. Construction spending climbed 7.1% for the year to an annual rate of $915.1 billion in August — a four-and-a-half year high, according to the Commerce Department. Retail sales in October were up 3.9% from the same month last year. There is also continued momentum in car sales, up 8.9% YTD through October 2013 over 2012. Meanwhile U.S. inflation remains tame; Social Security recipients, for example, will receive a Cost of Living Adjustment (COLA) in 2014 of only 1.5%, one of the smallest increases since automatic adjustments were adopted in 1975.

**Connecticut**

Connecticut’s economy should continue to experience modest growth in 2014. Connecticut’s real state gross domestic product (SGDP), the broadest measure of the state’s economic health, decreased 0.1% in 2012 (the latest year available), making Connecticut the only state to see a decline. The next release of GDP by state is scheduled for the summer of 2014. The release will include revised statistics for 1997-2012 and advance statistics for 2013. When released for 2013, Connecticut should see positive growth again that should continue into 2014. Personal income grew 0.9% in Q2-2012, seasonally adjusted at quarterly rates, declined by 0.5% in Q3-2012, grew 3.1% in Q4-2012, declined again by 1.6% in Q1-2013, but grew again at 0.9% in Q2-2013, all relative to the preceding quarter. As forecasted by the Connecticut Department of Labor, Personal Income for Q1-2014 will increase by 2.7% from Q1-2013. Increases in Personal Disposable Income indicate sustained growth in consumer spending which can lead to additional job gains.

The Connecticut recession from March 2008 through February 2010 saw the loss of 121,200 seasonally-adjusted non-farm jobs (Figure 3). Jobs regained through November 2013 numbered 63,500 (52.4%), or 1,411 jobs per month since February 2010 when the recovery began. The private sector has recovered somewhat faster and has regained 71,900 (62.8%, 1,591 per month) of the 114,000 private jobs that were lost during the same period. NEEP forecasts Connecticut will gain about 18,700 jobs, or 11% in 2014. The state’s unemployment rate, after peaking at 9.4% for five consecutive months in 2010 and hovering around 8.0% for much of 2013, declined to 7.6% in November 2013. NEEP forecasts Connecticut’s unemployment rate will be 7.5% in 2014. Seasonally adjusted average weekly initial claims for unemployment insurance peaked at 7,561 in March 2009, but declined to 4,674 (-38.0%) by November 2013. Through October Connecticut’s total non-farm employment was up
every month over the same month a year ago.

**Connecticut’s Fiscal Outlook**

The state’s fiscal outlook is vastly improved for 2014 evidenced by a FY 2013 surplus of $398.8 million, based on Generally Accepted Accounting Principles (GAAP). A new biennial budget for fiscal years ending in 2014-2015, introduced in February 2013 is in place. Moreover, the state is currently on track for a $117.1 million surplus in FY 2014.

**Connecticut Budget Outlook**

In September 2013, the governor’s budget office estimated the General Fund for fiscal year 2014 “reflects a [year-end] $4.4 million balance from operations” on a GAAP basis.16 “Consensus Revenues” for FY 2014 were estimated to be $17,249.6 million.17 The Connecticut legislature’s Office of Fiscal Analysis (OFA) projects a $117.1 million surplus for FY 2014, as shown in Table 1.18

**Housing**

The state’s housing market experienced modest growth in 2012 and the U.S. Census-reported residential permit data through October 2013 had grown by 20.0% compared to the same period a year ago. Moreover, the “data seems to indicate that the gradual growth will continue.”19 NEEP expects Connecticut housing permits that peaked at 12,269 in Q3-2005 and reached bottom at 3,173 for all of 2011 will rebound to 5,496 in 2013, and likely reach 6,810 in 2014. According to NEEP, existing Connecticut single family median home prices peaked at $326,000 in Q2-2007, but fell to $239,000 in 2012, and are expected to average $270,000 for 2014. Existing home sales might show a gain from 40,000 in 2013 to 44,400 in 2014.20

**Initiatives**

The Connecticut economy benefitted from an aggressive campaign to strengthen small business. The Small Business Express Program (EXP) provides loans and grants to Connecticut’s small businesses to spur job creation and growth and has seen vigorous activity since its inception. The state has assisted 957 companies with more than $114 million in loans and grants. With this much-needed capital, up to 3,159 jobs are expected to be created and 9,119 retained. Likewise the state’s “First Five” and “Next Five” job initiatives have promised substantial growth in employment and capital investment in Connecticut. At year’s end (2013), eleven business deals had been announced as part of the ongoing expansion program, which leveraged nearly $1.3 billion in private investment. Among the eleven companies — Cigna, ESPN, NBC, Alexion Pharmaceuticals, CareCentrix, Sustainable Building Systems LLC, Deloitte, Bridgewater Associates, Charter Communications, Navigators Group, Inc., and Pitney Bowes — up to 5,248 jobs are expected to be created and 12,690 retained.

**Conclusion**

Connecticut and the nation’s recoveries are affected by large uncertainties. Many of the issues are the same as in past years: the fiscal and economic effects of financial and healthcare reform, immigration reform, Eurozone debt, and China, as well as other geopolitical risks to the global economy. Yet, expansionary monetary policies in both Europe and Japan are likely to boost the outlook for economic growth in both of those regions. Internationally and domestically recent trends point to 2014 building on the progress of 2013 —continued slow growth but gradual improvement in the unemployment rate. The housing market saw improvement in terms of sales and permits in 2013 and the data suggest that will likely continue in 2014. The combination of the state’s jobs agenda and the uptick in capital investments will continue to improve the business climate.
Connecticut’s growth in total output that put it behind 49 other states in 2012 is expected to turn around by 2014. The “Connecticut Bioscience” initiative, which has already produced additional interest in this industry, is an indicator of potential success ahead. On balance, therefore, we should expect generally favorable developments in 2014.


6 See Note 5.


18 Table extracted from OFA, “Fiscal Accountability Report to the Appropriations and Finance Committees as required by CGS Sec. 2-36b,” November 15, 2013, p. 1.


20 NEEP, See Note 2.

### GENERAL ECONOMIC INDICATORS

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<th>General Drift Indicator (1986=100)*</th>
<th>3Q 2013</th>
<th>3Q 2012</th>
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<td>United States</td>
<td>156.93</td>
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Sources: *The Connecticut Economy, University of Connecticut **Farmington Bank ***Federal Reserve Bank of Philadelphia

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 Farmington 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.

The Philadelphia Fed’s Coincident Index summarizes current economic condition by using four coincident variables: nonfarm payroll employment, average hours worked in manufacturing, the unemployment rate, and wage and salary disbursements deflated by the consumer price index (U.S. city average).