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In April...

Nonfarm Employment

Connecticut 1,660,200
Change over month +0.13%
Change over year +0.4%

United States 138,252,000
Change over month +0.21%
Change over year +1.7%

Unemployment Rate

Connecticut 6.9%
United States 6.3%

Consumer Price Index

United States 237.072
Change over year +2.0%

Is It Just the Weather?

Connecticut's Baseline Forecast Suggests Slower Growth in 2014 and 2015

By Daniel W. Kennedy, Ph.D., Senior Economist

In April 2014, the U.S. economy added 288,000 jobs and the unemployment rate (UR) fell by 0.4 percentage points, to its lowest level in five years, and the numbers for February and March were revised upward. However, after increasing in March, 806,000 left the labor force in April, making a shrinking labor force the principal reason for the declining UR.¹ And the first estimate of U.S. GDP for 2014Q1² showed that U.S. economic growth rapidly decelerated. Many have pointed to the harsh winter weather as the principal culprit, and expect that the April jobs report indicates that the U.S. economy will bounce back in the second quarter. But is it just the weather?

Housing and the Recovery

This slow recovery is due to the persistent drag on the economy from the bursting of the housing bubble, which produced two effects: (1) Negative Wealth Effects from the asset-side of households' balance sheets from the bursting of the housing bubble, and (2) the Default and Deleveraging Process from the liabilities side of households' balance sheets from the accumulation of unsustainable debt-levels.³ But it is not just over this cycle that housing has played a critical role; housing has

always been an important driver of the business cycle.⁴ And due to the bursting of the housing bubble, that driver has been absent over this recovery.

In 2005Q3, Real U.S. Residential Investment peaked at \$881.9 billion⁵ before the popping of the housing bubble; it then fell to a low of 41.74% of its peak value in 2010Q3. It then began a modest recovery until it reached 56.61% of its peak in 2013Q3. But then it began to fall again over the next two quarters of available data, and by 2014Q1 it was at 54.63% of its value in 2005Q3. The 2013Q3 decline in Residential Investment coincided with the deceleration in New Home Sales after 2013Q2⁶ and Existing Home Sales after 2013Q3.⁷ In addition, the Pending Home Sales Index (PHSI) began declining after June 2013, although in March 2014, it increased by 3.73% for the first time in eight months, but was still down by 7.85% from March 2013.⁸ It is clear that all these indicators began decelerating or declining in the summer of 2013, before the on-set of the harsh winter. So, just what is going on in the housing sector? Is the "recovery" over, or was it an illusion to begin with?

As Fed Chair Janet Yellen said in her May Congressional testimony, "The recent flattening out in housing activity could prove more protracted than currently expected, rather than resuming its

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earlier pace of recovery.”⁹ There are several reasons why it may be more protracted than expected.¹⁰ But what drove the “recovery” in the first place? The answer seems to be investors, and not “typical” homebuyers. When home values bottomed out and started to rise in 2013, as sales picked up, much of it was driven by investors buying homes at fire-sale prices to hold onto and rent out, profiting from the rental income. However, rising interest rates made such investments less profitable.¹¹ By the summer of 2013, investors began retreating, and that coincides with the deceleration and decline in the housing indicators discussed above.

Further, in 2014Q1, mortgage lenders saw the weakest quarter in 14 years.¹² As a consequence, there may not be enough demand from ordinary buyers to support price gains throughout 2014.

Connecticut certainly did not participate in the housing bubble to the extent of the epicenter states. At the peak fallout from the bubble (June 2012), 70.51% of Nevada’s houses sold at a loss,¹³ and even surrounding states like Massachusetts and Rhode Island, after the bubble burst, had at one point more than 60% of their homes selling at a loss.¹⁴ Connecticut’s bottom was March 2012 when 45.25% of its homes sold for a loss. Though that fell to 31% by March 2014, that still

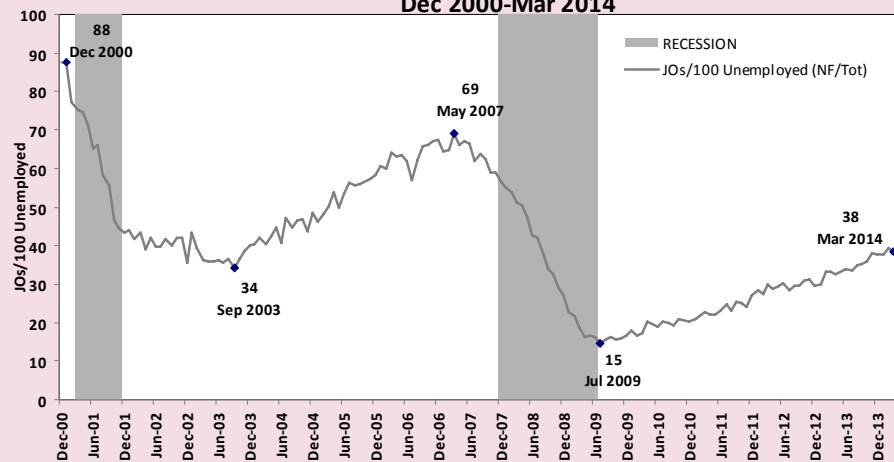
made Connecticut the sixth highest of the 36 states and the District of Columbia that Zillow had data on.¹⁵ And in a study by the HAAS Institute at the University of California, of the cities with metro areas with a population of one million or more, Connecticut had two cities that ranked in the top ten with the highest percent of homeowners with a mortgage underwater. Number one is Hartford (56% underwater), and tenth is Bridgeport (42% underwater).¹⁶ So even though the housing bubble was less severe in Connecticut, the State seems to be taking longer to recover from it.

Labor Market Conditions in the First Half of 2014

How has the housing bust affected the labor market? A crucial indicator for providing a clue as to the state of direct demand for the goods and services produced in the economy, which generates businesses’ derived demand for labor to meet that demand, is the Job Openings and Labor Turnover Survey (JOLTS) from the U.S. Bureau of Labor Statistics (BLS).

Graph 1 shows the number of Job Openings (JO) in the U.S., per 100 unemployed, as measured by the official U3 category, from December 2000 to March 2014, the latest period of available data.

GRAPH 1: Job Openings / 100 Unemployed: Dec 2000-Mar 2014



The weak aggregate (direct demand, and consequent weak derived demand for labor, is clearly reflected in the JOLTS data depicted in Graph 1. As of March 2014, there were still only 38 JO's for every 100 unemployed (down from 39 in February). Further, this is only four above the previous recession's low of 34 in September 2003, though certainly above the 15 at the bottom of the recent recession in July 2009. Nevertheless, it is far below the 69 JO's per 100 unemployed at the peak of the last expansion, and far below the 88 in December 2000, when the national UR was at 3.90%.

The Outlook for Connecticut's Job Growth: 2013Q4-2015Q4

Given the pick-up in U.S. job growth in April, the U.S. economy may very well bounce back in the second quarter from the harsh winter, but the forecast based on the UI tax employment data, known as the Quarterly Census of Employment and Wages (QCEW), assumes that growth will return to a slower pace going into the third and fourth quarters, tempering growth for 2014. Further, the forecast assumes that the slowdown in housing, which began in the summer of 2013, will continue, given rising interest rates, no active fiscal policy on the horizon, and especially given that 2014 is an election year. Therefore, the baseline forecast for Connecticut employment over the eight-quarter 2013Q4-2015Q4 period projects a slowing of Connecticut job growth over the forecast horizon.

Graph 2 presents the eight-quarter recession period (2007Q4-09Q4), the two eight-quarter recovery periods (2009Q4-11Q4 and 2011Q4-13Q4, which also serves as the base period for the forecast), and the eight-quarter forecast period (2013Q4-15Q4). After adding around 19,000 jobs over the 2009Q4-11Q4 period, Connecticut's job growth

accelerated to nearly 31,000 between 2011Q4 and 2013Q4. The forecast projects that the State's job growth will slow to under 20,000 between 2013Q4 and 2015Q4.

Scratching Below the Surface

Table 1 presents the 2013Q4-2015Q4 Connecticut forecast by the nine major industry sectors, with Panel (A) showing the 4th quarter employment levels and Panel (B) presents the 4th Quarter-to-4th Quarter changes in employment.

Education-Health Care and Social Assistance (Ed-HCSA) is expected to make the largest contribution to Connecticut's job growth over the forecast horizon. After a slowdown in 2011Q4-13Q4 from the 2009Q4-11Q4 pace, job growth in Ed-HCSA is expected to pick up somewhat over the forecast period. Of the nearly 20,000 additional new jobs, Ed-HCSA is expected to add 8,795 new jobs, or 45% of the growth, driven by Social Assistance from the HCSA sub-sector, in particular, Individual and Family Services (NAICS Industry 6241), and Ambulatory Care (NAICS Industry 621) in the Health Care sub-sector. Growth in Individual and Family Services has been driven by Services for the Elderly and Those with Disabilities (NAICS 62412), and

that strong growth is expected to continue over the forecast horizon, adding 3,624 new jobs. Ambulatory Care (NAICS 621), in the Health Care sub-sector, which includes medical practitioners, is also expected to continue growing strongly adding 2,722 new jobs.

Leisure-Hospitality is expected to contribute the second greatest number of jobs over the forecast period (+5,056), though this is slightly down from its 2011Q4-13Q4 pace. From the beginning of the recovery, this major sector's job growth has been driven by the Accommodation and Food Services sub-sector, particularly Food Services and Drinking Places (NAICS 722). Frequently, over this recovery, it has accounted for virtually all of the growth in Accommodation and Food Services, and even the entire the Leisure-Hospitality major sector.

The Professional and Business Services (Prof-Bus Services) major sector has experienced the largest deceleration in growth of the major sectors adding jobs over Connecticut's current recovery. After subtracting 21,159 jobs from the State's economy, between 2007Q4-09Q4, Prof-Bus Services then came roaring back over the first eight quarters of recovery, adding 11,463 new jobs between 2009Q4 and 2011Q4, the largest gain of any major sector. That pace then decelerated to 7,399

GRAPH 2: 4th Qtr-to-4th Qtr Change in CT Jobs- Actual and Forecast: 2007Q4-2015Q4

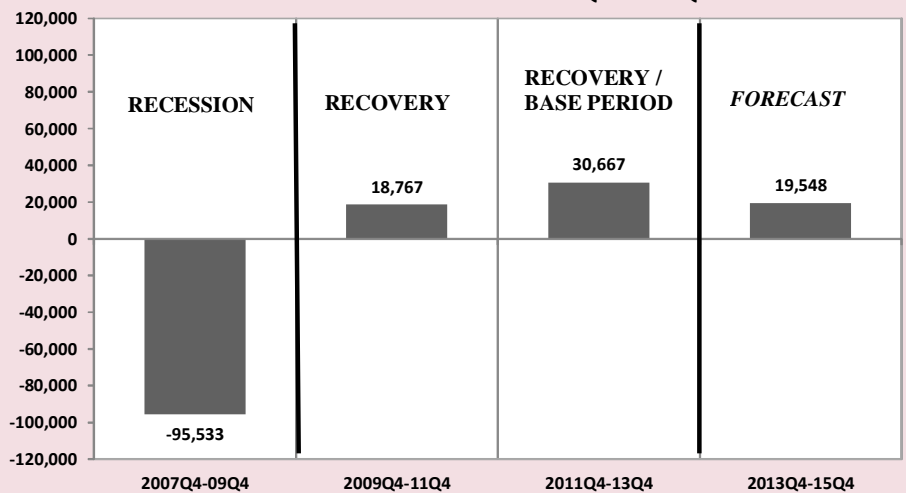


TABLE 1 : CT. 4th Qtr-to-4th Qtr Job-Growth Actual and Forecasts: 2007-15

(A)-CT 4th-Quarter Employment Levels (NSA)						(B)-CT 4th Qtr-to4th Qtr Job-Changes			
	U.S./CT. RECESSION		U.S./CT. RECOVERY		FORECAST	RECESSION	U.S./CT. RECOVERY		FORECAST
Major Sector	2007Q4	2009Q4	2011Q4	2013Q4	2015Q4	2007Q4-09Q4	20094-11Q4	2011Q4-13Q4	2013Q4-15Q4
Total Non-Agri*	1,723,100	1,627,567	1,646,333	1,677,000	1,696,548	-95,533	18,767	30,667	19,548
Goods Prod	261,873	221,030	220,203	218,776	217,440	-40,843	-827	-1,426	-1,336
Trade-Trns-Util	326,168	303,058	305,182	310,104	313,165	-23,110	2,124	4,922	3,061
Information	38,133	34,020	31,285	31,938	31,142	-4,113	-2,735	653	-796
Financial Serv	143,803	135,680	132,320	129,081	126,916	-8,123	-3,360	-3,239	-2,165
Prof-Bus Serv	210,499	189,340	200,802	208,201	213,000	-21,159	11,463	7,399	4,799
Educ-HCSA	433,524	444,969	452,278	458,004	466,799	11,445	7,309	5,726	8,795
Leisure-Hosp	155,678	150,690	155,007	161,726	166,782	-4,988	4,318	6,718	5,056
Other Serv	58,648	56,556	57,197	58,905	59,966	-2,092	641	1,708	1,061
Government	79,334	77,380	75,768	76,907	76,821	-1,954	-1,612	1,140	-86
Unknowns	826	198	289	629	485	-628	91	340	-144

U.S. BLS, CTDOL-Research, and Author's calculations

*NOTE: The major sectors do not sum to Total Non-Agri Employment due to Presumed Non Covered (PNC's), and other adjustments not included in the QCEW Employment data..

between 2011Q4 and 2013Q4, which contributed to the slowdown in the State's job growth from 2012 to 2013. The forecast projects a further slowing, with 4,799 jobs added over the 2013Q4-15Q4 forecast period. This major sector's volatility appears to be driven by Computer Systems and Design (NAICS 5415) under Professional and Technical Services, and Employment Services (NAICS 5613), which includes Temporary Help, under Administration-Support and Waste Management. These two four-digit industries have displayed large amplitudes over the entire cycle, and their growth slowed in 2013. The forecast expects this slowing to continue.

Trade-Transport-Utilities is expected to add 3,061 jobs over the 2013Q4-15Q4 forecast period. This is stronger than the 2,124 jobs added over the 2009Q4-2011Q4 initial recovery period, but not as strong as the 2011Q4-13Q4 base period in which Trade-Transport-Utilities added 4,992 new jobs. Growth is expected to be fairly evenly split between Wholesale and Retail Trade, with a slight decline in Utilities.

The two major sectors projected to make significant subtractions from Connecticut's

job growth between 2013Q4 and 2015Q4 are Financial Services (-2,165) and Goods Producing (-1,336). Three industries are expected to account for virtually all of the losses: Insurance (NAICS Industry 524, -867), Securities, Commodities, and Brokers (NAICS Industry 523, -844), and Credit Intermediation (NAICS Industry 522, -303), with modest losses in Real Estate.

The Goods Producing major sector is projected to shed 1,336 jobs between 2013Q4 and 2015Q4. Off-setting the losses in the Manufacturing sub-sector, over the forecast horizon, is growth in the Construction sub-sector, which is expected to continue to add jobs as it has since job-losses turned around after 2011Q4. Virtually all of the 1,108 new jobs over the forecast period are expected to be in Specialty Trades Contractors (NAICS Industry 238, +1,478), which continues the trend since the turn-around.

Manufacturing drives all the job losses projected for the Goods Producing major sector, and is expected to subtract another 2,418 jobs between 2013Q4 and 2015Q4. The Durable Goods is projected to eliminate 1,465 jobs, and employment is expected to

decline by 953 in Non-Durable Goods. Although nearly half of all of Connecticut's merchandise exports in 2013 were in Transport Equipment (NAICS Industry 336), that has not necessarily translated into new job growth for the State. The forecast expects that Transport Equipment will eliminate another 1,861 jobs between 2013Q4 and 2015Q4. Four other Durable Goods industries are expected to each shed between 500 and 1,000 jobs. The expected losses in Non-Durable Goods are spread over a number of industries, in particular, employment in the Printing and Related Industries (NAICS Industry 323) is projected to decline by 632.

Risks to the Forecast

There are both *positive risks* (the baseline under-forecasts State job growth), and *negative risks* to the forecast (the baseline over-forecasts job growth). The biggest positive risk to the forecast is housing. The forecast assumes (as noted above), that there could be a second-quarter bounce back from the weather-depressed economic activity. But the third and fourth quarters should return to slower growth. However, if the housing market gets a "second

wind” then growth could be stronger than expected in the last half of 2014, making the forecast too pessimistic.

The biggest negative risk to the forecast is potentially the expiration of the Federal transportation bill, if Congress does not act by September.¹⁷ This could potentially be a big hit to the economy.¹⁸ And this is an election year, both nationally and at the state level, implying even more political deadlock, which does not bode well for economic policy. In addition to other international crises that could deliver a blow to the World’s economy in 2014, Connecticut has a particular economic interest in the deflation that is unfolding in the EU.¹⁹ In 2013, more than one-third of the State’s exports went to the EU (including the UK). These negative risks, as well as how rising interest rates affect the market, could make even the baseline’s modest growth forecast overly optimistic. ■

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² U.S. BEA, GROSS DOMESTIC PRODUCT: FIRST QUARTER 2014 (ADVANCE ESTIMATE) (April 30, 2014) U.S. Department of Commerce: Washington

³ Boshara, Ray and William Emmons, *AFTER THE FALL: Rebuilding Family Balance Sheets; Rebuilding the Economy* (May 2013), 1. INTRODUCTION, Center for Household Financial Stability: Federal Reserve Bank of St. Louis < http://www.stlouisfed.org/publications/ar/2012/pages/ar12_2a.cfm > Accessed on April 1, 2014

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⁶ Table Q1. New Houses Sold by Sales Price: United States, U.S. Census < <http://www.census.gov/construction/nrs/> > Accessed on May 8, 2014.

⁷ Existing Home Sales by Region, National Association of Realtors (April 22, 2014) < <http://www.realtor.org/topics/existing-home-sales/data> > Accessed on May 8, 2014.

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¹³ Zillow Research Data < <http://www.zillow.com/research/data/> > Accessed on May 8, 2014, and Author’s calculations.

¹⁴ *ibid*.

¹⁵ *ibid*.

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GENERAL ECONOMIC INDICATORS

<i>(Seasonally adjusted)</i>	1Q	1Q	CHANGE		4Q
	2014	2013	NO.	%	2013
General Drift Indicator (1986=100)*					
Leading	NA	NA	NA	NA	NA
Coincident	NA	NA	NA	NA	NA
Farmington Bank Business Barometer (1992=100)**	127.6	125.8	1.8	1.4	128.2
Philadelphia Fed's Coincident Index (July 1992=100)***	APR	APR			MAR
<i>(Seasonally adjusted)</i>	2014	2013			2014
Connecticut	157.78	152.97	4.81	3.1	157.36
United States	157.83	153.26	4.57	3.0	157.35

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).