News from:

COMPTROLLER KEVIN LEMBO

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Contact: Tara Downes
631-834-5234
Tara.Downes@ct.gov

COMPTROLLER LEMBO PROJECTS $197.7-MILLION DEFICIT; SAYS WALL STREET BONUSES COULD AFFECT OUTLOOK

Comptroller Kevin Lembo today projected that the state is on track to end the fiscal year with a $197.7-million deficit, but said there are factors that demand watch, including April receipts and significant growth in Wall Street bonuses over the last year.

In a letter to Gov. Dannel P. Malloy, Lembo said that his deficit projection is once again slightly higher than the Office of Policy and Management's (OPM) projection due to a larger anticipated deficiency (approximately $35 million) in the state's Adjudicated Claims account – the account responsible for paying the ongoing SEBAC v. Rowland claims, related fees and other state settlements.

The end of April will be a crucial time in understanding the state's outlook, after tax receipts are collected and the next consensus revenue forecast is projected (April 30).

In the meantime, Lembo said that it's still premature to classify growth in the personal income tax above budgeted expectations as an actual trend – but he said it may be related to a surge in Wall Street bonuses, which have historically propelled Connecticut's budget performance in the past.

"While I have not yet incorporated it into my projections, one development is providing reason for cautious optimism on the revenue front," Lembo said. "Growth in the withholding portion of the Personal Income Tax is trending above budget expectations year-to-date. January and February withholding receipts were particularly strong, a time period that coincides with the traditional season when bonuses are awarded. In part this may be due to a successful year for Wall Street and the stock market, which benefits Connecticut residents who work in the financial services industry.”

Lembo highlighted a recent annual release by the New York State Comptroller that revealed bonuses for the securities industry were up 17 percent over last year, with a total bonus pool of $31.4 billion and an average bonus of $184,220.

“Of course, broader and more sustained growth is needed to stabilize Connecticut’s budgetary position in light of the fiscal challenges facing our state,” Lembo said.

While the effects of Wall Street bonuses are worth watching, Lembo said that Connecticut continues to struggle in certain areas, including underperformance in the corporation tax and sales and use tax. Lembo said that these categories are offsetting potential gains in withholding and bear close scrutiny as the year progresses. The current revenue forecast projects a significant increase in estimated and final income tax payments – however, most of that growth is likely attributable to one-time events as opposed to a trend in growth.

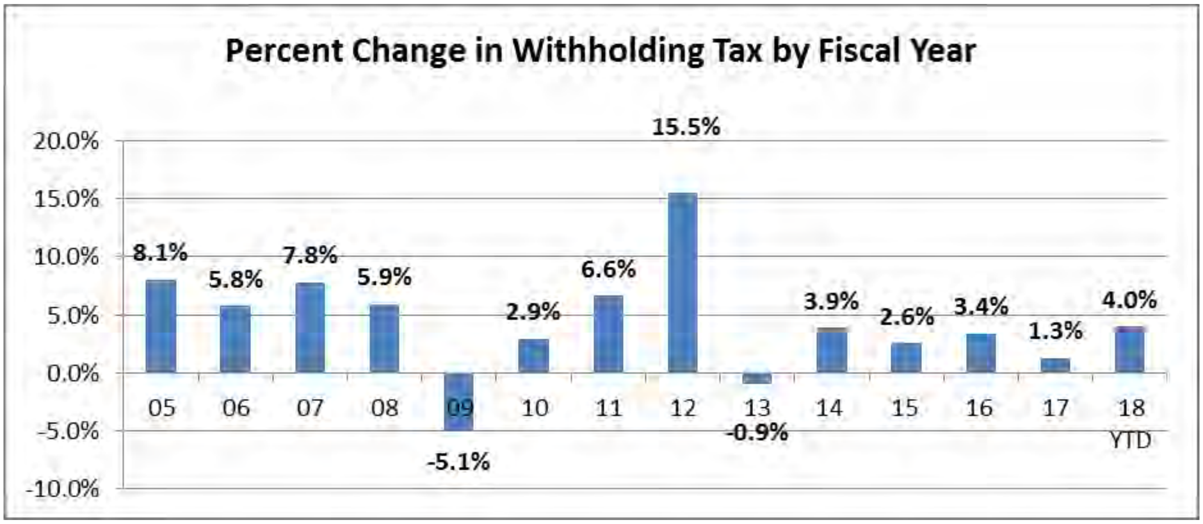
Despite significant increases in a number of fixed cost areas, General Fund expenditures through February are running a modest 0.4 percent higher than last year’s spending to this point. A combination of active budget management and legislative action will be needed to close the deficit prior to fiscal year-end.

“Ultimately, Connecticut’s overall budget results are largely dependent upon the performance of the national and state economies,” Lembo said.

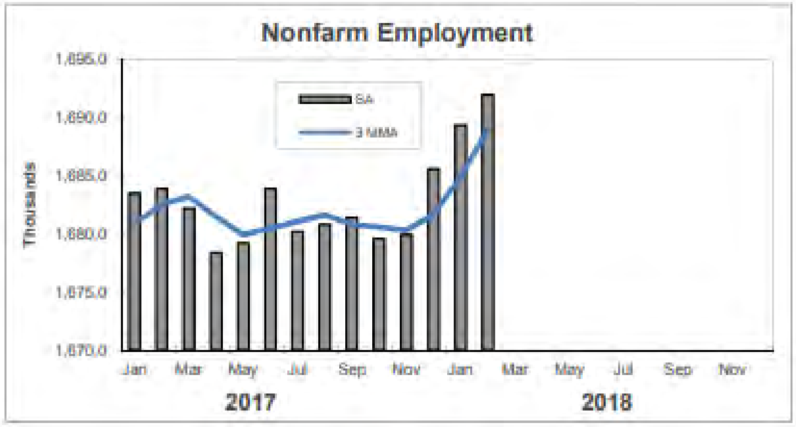
Lembo pointed to the latest economic indicators from federal and state Departments of Labor and other sources that show:

Employment

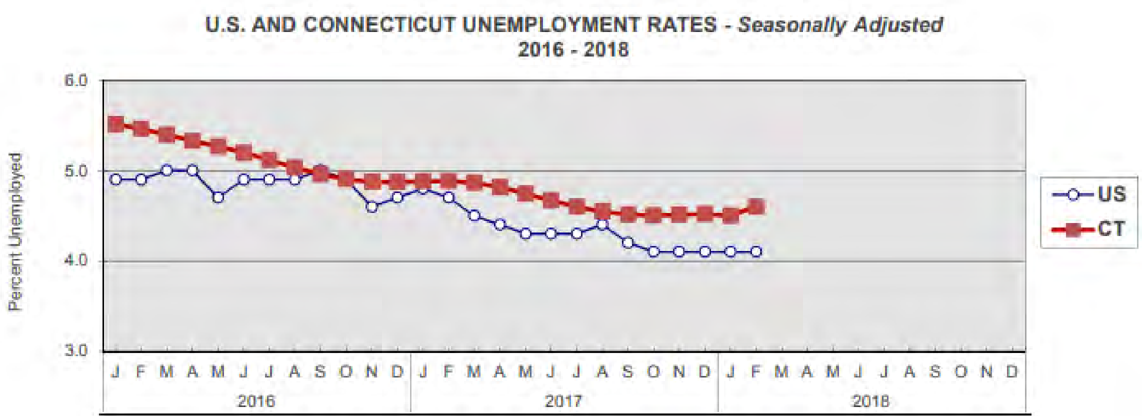
- Through the first eight months of FY 2018, withholding receipts were up a nominal 6.6 % compared with last fiscal year. However, this growth is somewhat overstated due to revenue accruals related to FY 2017 year-end adjustments and differences in the number of collection days. Accounting for this activity, the FY 2018 year-to-date growth in withholding collections is closer to four percent.



- As noted below, job growth has shown improvement in recent months, but overall wage growth still appears modest. Therefore, some of the increase in withholding receipts likely reflects a strong bonus season after the close of calendar 2017. In part, this may be due to a successful year for Wall Street and the stock market, which benefits Connecticut residents who work in the financial services industry. Last week, the New York State Comptroller reported that bonuses for the securities industry were up 17% over last year, with a total bonus pool of $31.4 billion and an average bonus of $184,220.
- On March 22nd, Connecticut DOL reported the preliminary Connecticut nonfarm job estimates for February 2018 from the business payroll survey administered by the US Bureau of Labor Statistics (BLS). DOL's Labor Situation report showed the state gained 2,600 net jobs (0.2%) in February, to a level of 1,692,000, seasonally adjusted. In addition, January's originally-released job gain of 3,400 was revised up by 400 by the BLS to a gain of 3,800 jobs for the month. February represented the fourth consecutive month of job growth for Connecticut.
- In terms of job growth for February, bright spots included construction with 1,500 net new jobs, leisure & hospitality with an increase of 1,100 net jobs, followed by financial activities, which added 700 net new jobs. On the downside, professional & business services lost 1,000 jobs in February.
- Over the year, DOL reported that nonagricultural employment in the state grew by 8,100 jobs on a seasonally-adjusted basis.



- Connecticut has now recovered 82.1% (97,800 payroll job additions) of the 119,100 seasonally adjusted jobs lost in the Great Recession (3/08-2/10). The job recovery is into its 96th month and the state needs an additional 21,300 jobs to reach an overall employment expansion. DOL notes that private sector job growth has outpaced that of the government sector. Connecticut's private sector has regained 102.7% (114,700) of private sector jobs lost in the same downturn.
- Connecticut's unemployment rate is estimated at 4.6 percent in February, up one-tenth of a percentage point from January 2018 and down three-tenths of point from a year ago when it was 4.9 %. Nationally, the unemployment rate was 4.1% in February 2018, unchanged from January. The chart below shows a comparison of the Connecticut and U.S. unemployment rates for the past three calendar years.



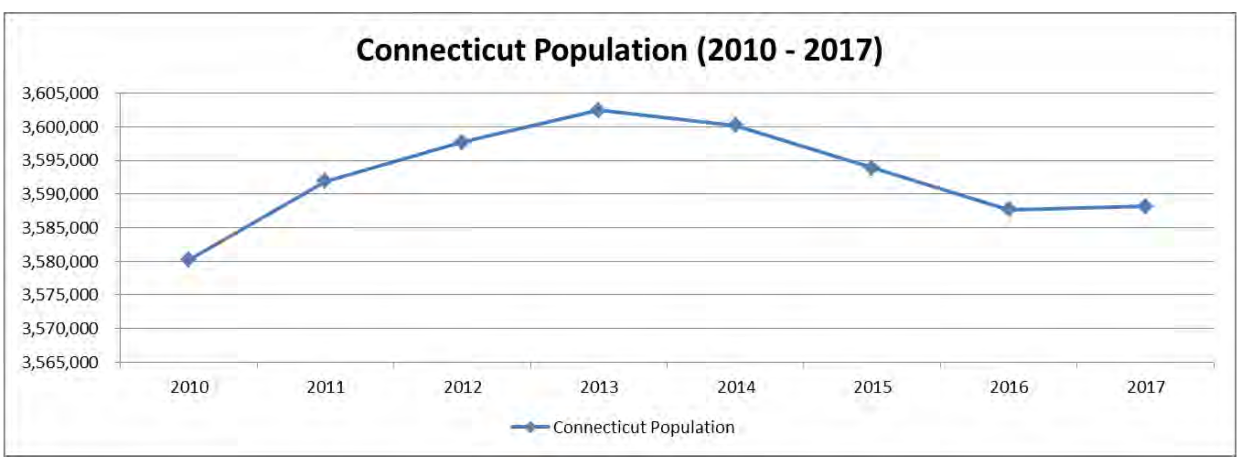
- DOL reports that February 2018 seasonally adjusted average weekly initial unemployment claims for first-time filers in Connecticut grew by 320 claimants (+9.4%) to 3,279 from January 2018, and were higher by 308 claims (+9.0%) from the February 2017 level of 3,421.

- Among the major job sectors listed below, six experienced gains and four experienced losses in February 2018 versus February 2017 levels.

Payroll Employment Trend				
Jobs in thousands				
Sector	**2/18 (P)**	**2/17**	**Gain/Loss**	**% Change**
Construction	58.6	58.7	-0.1	-0.2%
Manufacturing	163.1	157.6	5.5	3.5%
Transp. & Public Utilities	300.2	298.7	1.5	0.5%
Information	30.6	31.9	-1.3	-4.1%
Financial	128.7	128.3	0.4	0.3%
Prof. & Business Svc.	220.1	218.6	1.5	0.7%
Education & Health Svc.	337.9	333.5	4.4	1.3%
Leisure & Hospitality	155.8	156.2	-0.4	-0.3%
Other Services	65.6	64.8	0.8	1.2%
Government	230.8	235.0	-4.2	-1.8%

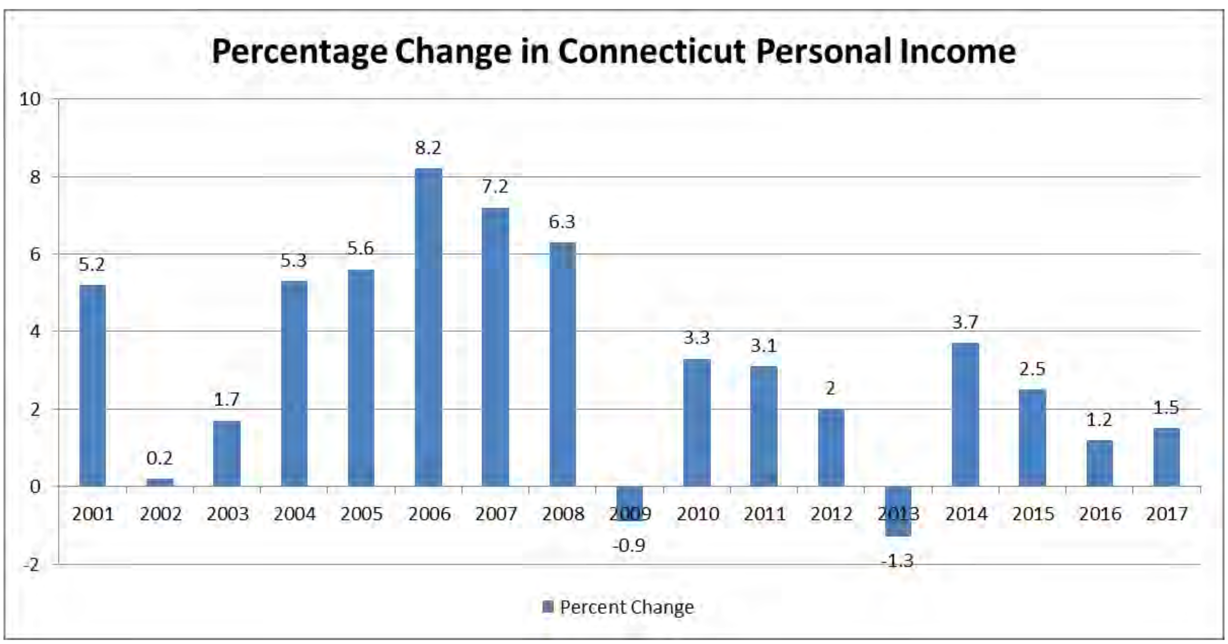
Population

- On Dec. 20, the U.S. Bureau of the Census released its population estimates for July 1, 2017. After three years of declines, there was essentially no change in Connecticut's population between 2016 and 2017. The state's population now stands at 3,588,184, which represented growth of 0.01% from the prior year's estimate. The Census Bureau reports Connecticut ranks 29th in the nation in terms of population. However, since 2010, Connecticut's population grew only 0.4%, which ranked 48th for the period among U.S. states.



Wage and $alary income

- February 2018 average hourly earnings at $31.43, not seasonally adjusted, were up $0.13, or 0.4%, from the February 2017 estimate. The resultant average private sector weekly pay amounted to $1,059.19, up $26.29, or 2.6% higher than a year ago.
- The 12-month percent change in the Consumer Price Index for All Urban Consumers (CPI-U, U.S. City Average, not seasonally adjusted) in February 2018 was 2.2%.
- On March 22, the Bureau of Economic Analysis reported that Connecticut's personal income grew by 1.5% between 2016 and 2017. This ranked Connecticut 44th nationally in 2017 income growth. However, BEA also showed the pace of Connecticut personal income growth accelerated at a rate of 1.1% between the third and fourth quarters of 2017. Based on these results, Connecticut ranked 26th nationally in personal income growth, equal to the national average for the quarter.



- On a positive note, Connecticut remains a wealthy state overall. Preliminary BEA estimates for 2017 rank Connecticut first in the nation in annual per capita personal income at $70,121, which represents 139 % of the national average.

Housing

- In its March 7 release, Berkshire Hathaway HomeServices reported mixed results for the Connecticut housing market for February 2018 compared with February 2017. Sales of single family homes declined 5.88 percent. However, the median sale price rose 7.11 percent.
- New listings grew by 4.70 percent in Connecticut and the median list price rose 6.59 percent to $249,900.
- Average days on the market increased 12.77 percent in February 2018 compared to the same month in the previous year (106 days on average, up from 94 days). Finally, the list to sell price rose slightly to 96.5 percent, compared with 96.1 percent a year ago. The table below contains more detailed data for the Connecticut housing market.

MARKET SUMMARY

FEBRUARY 2018 | SINGLE FAMILY HOMES

Market Summary	Month to Date			Year to Date		
	February 2018	February 2017	Percent Change	Year-To-Date 2018	Year-To-Date 2017	Percent Change
New Listings	4192	4004	4.7% ▲	7561	7976	-5.2% ▼
Sold Listings	1728	1836	-5.88% ▼	3870	4144	-6.61% ▼
Median Listing Price	$249,900	$234,450	6.59% ▲	$250,000	$237,670	5.19% ▲
Median Selling Price	$241,000	$225,000	7.11% ▲	$245,000	$229,000	6.99% ▲
Median Days on Market	82	66	24.24% ▲	81	64	26.56% ▲
Average Listing Price	$384,741	$370,349	3.89% ▲	$388,738	$378,138	2.8% ▲
Average Selling Price	$366,898	$351,813	4.29% ▲	$370,616	$359,121	3.2% ▲
Average Days on Market	106	94	12.77% ▲	105	92	14.13% ▲
List/Sell Price Ratio	96.5%	96.1%	0.44% ▲	96.7%	96.1%	0.6% ▲

The following chart from Berkshire Hathaway HomeServices shows the total number of Connecticut single family homes for sale in February 2018 distributed by list price:

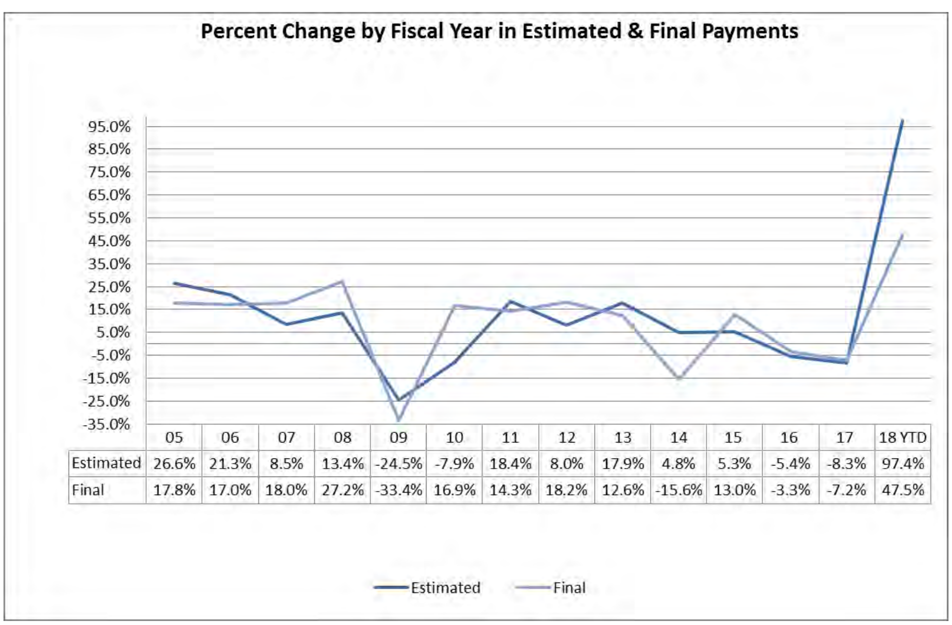
Stock Market

- After a steady rise and strong gains throughout calendar 2017, the stock market indices reached their peak in late January 2018. Since then, there has been significant turbulence in the markets throughout February and March 2018. Some analysts noted the initial stock sell-off occurred after a strong jobs report released on Feb. 2 by the Bureau of Labor Statistics. Total U.S. nonfarm payroll employment increased by 200,000 in January and average hourly earnings rose a strong 2.9 percent over January 2017. The better-than-expected wage growth sparked fears of inflation among investors, with worries about the Federal Reserve raising interest rates more aggressively than anticipated.
- More recently, investors have been nervous about the possibility of an escalating trade war as the Trump administration announced tariffs on products like steel and aluminum and threated to impose trade sanctions on China.
- Recent swings in the stock market are illustrated on the two charts that follow:

DOW

NASDAQ

- The performance of the stock market has a significant impact on the State of Connecticut revenues. Estimated and final income tax payments typically account for approximately 35 to 40% of total state income tax receipts, but can be an extremely volatile revenue source. Both estimated and final payments had negative growth rates in Fiscal Years 2016 and 2017.
- However, due to a combination of one-time events, estimated payment collections increased substantially in December and January, nearly doubling the year-to-date total from the prior year. For example, through February 2018 estimated payments totaled $2.18 billion versus $1.1 billion through February 2017. Year-to-date final payments through February grew by $127 million or 47.5 percent over the same period a year ago.

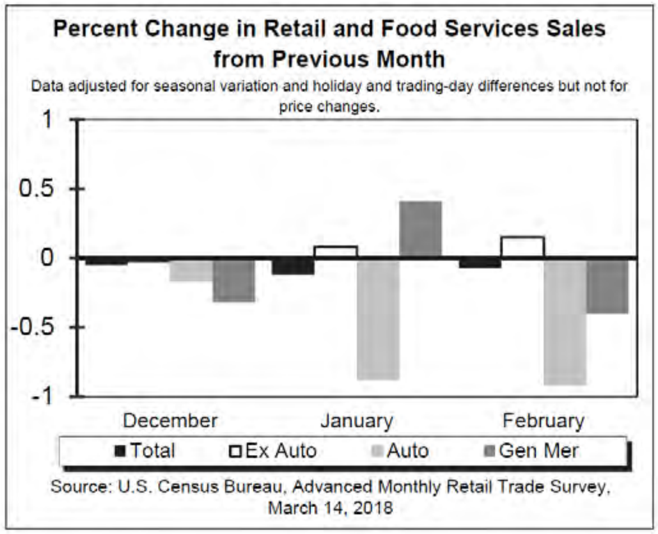


	05	06	07	08	09	10	11	12	13	14	15	16	17	18 YTD
Estimated	26.6%	21.3%	8.5%	13.4%	-24.5%	-7.9%	18.4%	8.0%	17.9%	4.8%	5.3%	-5.4%	-8.3%	97.4%
Final	17.8%	17.0%	18.0%	27.2%	-33.4%	16.9%	14.3%	18.2%	12.6%	-15.6%	13.0%	-3.3%	-7.2%	47.5%

- Two primary factors contributed to the significant increase in estimated payments year-to-date in FY 2018. The first is related to the recent Federal tax change that placed limits on the amount of state and local taxes (SALT) that can be deducted for Federal tax purposes. Based on this new provision, many Connecticut taxpayers made payments prior to the end of calendar 2017 to ensure these estimated income tax payments would be deductible for their Federal 2017 returns. Therefore, these payments probably represent a shift from collections that would likely have occurred in April 2018.
- The second factor was related to an October 2008 Federal law that eliminated a common mechanism used by hedge fund managers that enabled them to defer receipt of incentive or management fees earned by charging them to an offshore fund. Under the new rules (Internal Revenue Code Section 475A) hedge fund managers had to recognize these profits, earned prior to January 1, 2009, as income before December 31, 2017. Therefore, a significant amount of the estimated payments collected were related to hedge fund managers bringing these profits back to the United States from overseas. As such, they should be considered to be a one-time revenue source.
- Due to the new revenue volatility adjustment contained in Section 704 of Public Act 17-2, June Special Session, any estimated and final payment collections amount above $3.15 billion will be transferred to the Budget Reserve Fund (BRF). Based on this new statutory provision, if current revenue forecast totals are realized, $664.9 million will be deposited in the BRF, bringing the balance to $877.8 million, approximately 4.7 percent of General Fund expenditures.

<u>Consumer Spending</u>

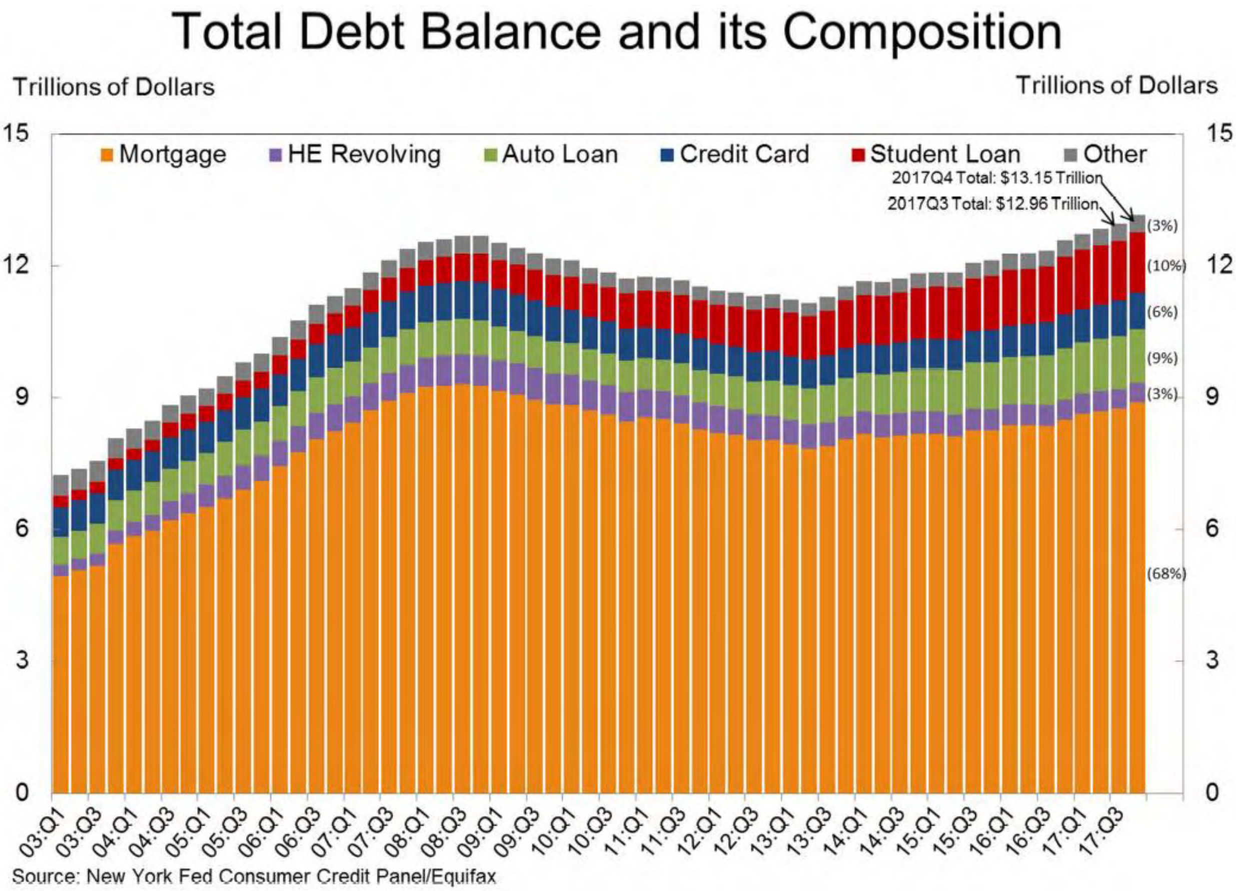
- Consumer spending is the main engine of the U.S. economy, accounting for more than two-thirds of total economic output.
- U.S. retail sales fell in February 2018, marking the third straight month of declines. The Commerce Department reported that advance retail sales decreased 0.1 percent last month. January data was revised to show sales dipping 0.1 percent instead of falling 0.3 percent as previously reported. Analysts note this may be a sign of slowing economic growth in the first quarter of 2018.



- In February, auto sales fell 0.9 percent after a similar drop in January. Receipts at service stations declined 1.2 percent, reflecting lower gasoline prices. There were also declines in sales at furniture stores, health and personal care stores and electronics and appliance stores.
- On the positive side, sales at building material stores increased 1.9 percent last month. In addition, receipts at clothing stores rose 0.4 percent and sales at online retailers grew 1.0 percent. Sales at restaurants and bars increased 0.2 percent, while receipts at sporting goods and hobby stores gained 2.2 percent from the previous month.
- In comparison to a year ago, the Commerce Department reported that retail sales were 4.2 percent above February 2017 levels.

<u>Consumer Debt and Savings Rates</u>

- According to the Federal Reserve Bank of New York, aggregate household debt balances rose to another new peak in the fourth quarter of 2017. Household debt has now grown in 14 consecutive quarters. As of December 31, 2017, overall debt – including mortgages, auto loans and student loans – hit a record $13.15 trillion. This represented a $193 billion (1.5%) increase from the third quarter of 2017.
- This report marks the fifth consecutive year of positive annual household debt growth. There were increases in mortgage (+1.6%), student (+1.5%), auto (+0.7%), and credit card debt (+3.2%) and another modest decline in home equity line of credit (HELOC) balances (decreasing by 0.9%).



- In its March 29 release, the Bureau of Economic Analysis (BEA) reported the personal-saving rate increased to 3.4 percent in February, up from 3.2 percent in January. However, this savings level is just over half of the recent peak of 6.3% in October 2015 and remains close to prerecession lows.
- Higher debt levels and lower savings point to U.S. wage gains that are not keeping up with consumers' needs and desires to spend. This also signals a more uncertain outlook for future consumer spending gains. One explanation for this trend is the so-called wealth effect. Consumers may feel richer because the stock market is rising and home values have increased in recent years.
- The graph below provides a long-term view of the U.S. savings rate from the beginning of 1959 through January 2018. As can be seen, there is a pronounced downward trend over the period. It should be noted that the U.S. Personal Saving Rate does not include capital gains from the sale of land or financial assets in its estimate of personal income. This effectively excludes capital gains – an important source of income for some.

- Despite the overall improvement in the nation's economy, income inequality continues to widen as wage growth remains modest. A number of economists see the dramatic decline in the personal savings rate as a red flag as consumers borrow more to fuel spending. This will leave little margin for error in case of a downturn, especially for families who are living from paycheck to paycheck.

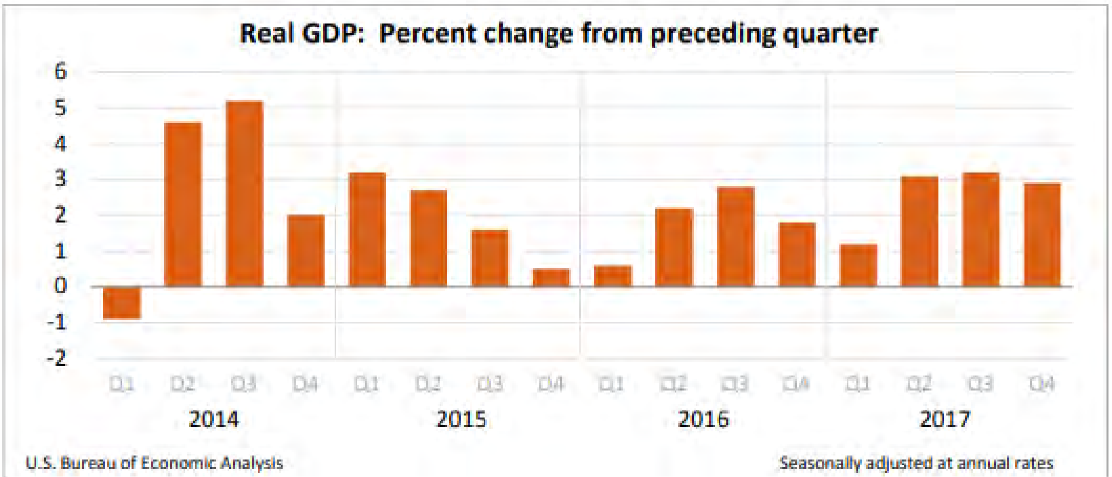
Consumer Confidence

- The U.S. consumer confidence index (CCI), published by the Conference Board, is an indicator designed to measure consumer confidence. This is defined as the degree of optimism on the state of the economy that consumers are expressing through their activities of savings and spending.
- The Conference Board reported that consumers' assessment of current economic conditions declined in March 2018, breaking a streak of two months of gains. The Index now stands at 127.7, down from 130.8 in January. The March rating came in below expectations based on a Reuters survey of economists.
- The primary reason for the decline related to business conditions. The board noted consumers' short-term expectations also declined, including their outlook for the stock market. However, overall expectations remain favorable by historical standards, including views of the labor market.

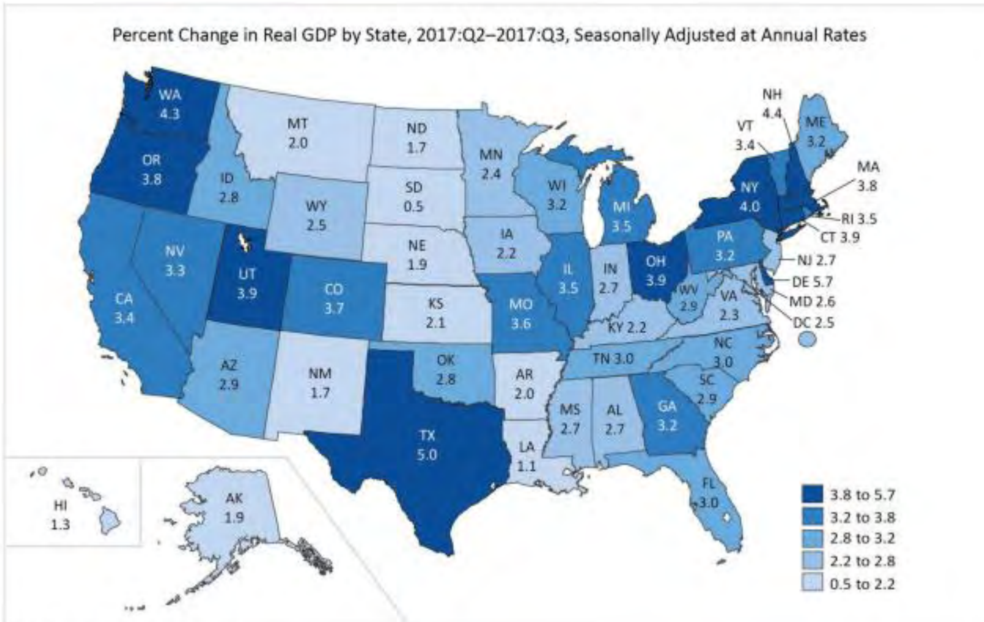
Business and Economic Growth

- According to a March 28 release from the Bureau of Economic Analysis, U.S. Real Gross Domestic Product increased at an annual rate of 2.9 percent in the fourth quarter of 2017. In the third quarter, real GDP increased 3.2 percent. For the year, the economy grew at 2.3 percent in 2017, up from the 1.5 percent growth rate experienced in 2016.

- The increase in real GDP in the fourth quarter reflected positive contributions from personal consumption expenditures (PCE), nonresidential fixed investment, exports, residential fixed investment, state and local government spending, and federal government spending that were partly offset by a negative contribution from private inventory investment. Imports, which subtract from GDP growth, increased at their fastest quarterly rate in more than seven years.

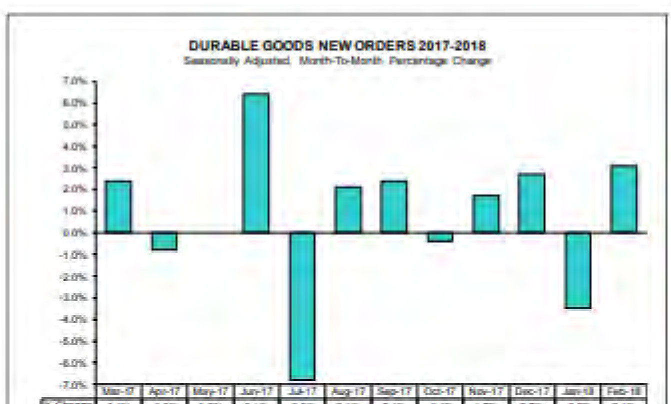


- BEA also reported that after-tax corporate profits increased at a 1.7 percent rate in the fourth quarter after rising at a 5.7 percent pace in the third quarter.
- In a January 24th report, the Bureau of Economic Analysis released Real Gross Domestic Product (GDP) results by state for the third quarter of 2017. Connecticut experienced a seasonally adjusted annual growth rate of 3.9 percent, which ranked 8th in the nation overall. This was a significant improvement from the second quarter of 2017, when Connecticut ranked 44th in the nation with annualized growth of 1.9 percent. The sectors that contributed most to Connecticut's strong third quarter performance were finance and insurance, durable goods manufacturing, and information services.



U.S. Bureau of Economic Analysis

- Updated data for Gross Domestic Product by State is scheduled to be issued on May 4, 2018. That release will cover fourth quarter GDP and preliminary annual results for 2017.
- According to a March 23 report by the U.S. Department of Commerce, new orders for durable goods increased $7.4 billion in February 2018 or 3.1 percent to $247.7 billion. This increase, the third in the last four months, followed a 3.5 percent decrease in January.



Source: U.S. Census Bureau, Manufacturers' Shipments, Inventories, and Orders, March 23, 2018.

- Transportation equipment led the increase, growing $5.5 billion or 7.1 percent to $83.5 billion. Excluding transportation, new orders increased 1.2 percent. Orders for non-defense capital goods excluding aircraft (a proxy for business spending) increased 1.8 percent last month after declining 0.4 percent in January.

- The March 22 Markit Flash Purchasing Manager's Index (PMI) reported that U.S. private sector companies experienced another strong increase in output, together with a solid growth in payroll in March.
- The March index of 54.3 was down from 55.8 in the previous month. However, any reading above 50 represents growth. The latest upturn in business activity driven by solid rises in both manufacturing production and service sector output.

Key findings:

- Flash U.S. Composite Output Index at 54.3 (55.8 in February). 2-month low.
- Flash U.S. Services Business Activity Index at 54.1 (55.9 in February). 2-month low.
- Flash U.S. Manufacturing PMI at 55.7 (55.3 in February). 36-month high.
- Flash U.S. Manufacturing Output Index at 55.2 (55.5 in February). 4-month low.

Data collected March 12-21

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