News from:

COMPTROLLER KEVIN LEMBO

FOR IMMEDIATE RELEASE THURSDAY, JUNE 1, 2017

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

COMPTROLLER LEMBO PROJECTS $325.4-MILLION DEFICIT, CAUTIONS AGAINST BORROWING

Comptroller Kevin Lembo today said that, following spending rescissions last month, the state is on track to end the current fiscal year in deficit by $325.4 million.

The Budget Reserve Fund has a current balance of $235.58 million, which is insufficient to cover the deficit.

In a letter to Gov. Dannel P. Malloy, Lembo said that his deficit projection remains slightly higher than the deficit reported by the Office of Policy and Management (OPM) because Lembo believes the state will spend more than initially planned on ongoing settlement payments related to the SEBAC vs. Rowland case.

Lembo cautioned against borrowing to close the deficit, as the state continues to bear the burden of this approach from several years ago.

"Connecticut cannot afford to repeat past mistakes that continue to burden our budgets today," Lembo said. "The state should avoid using economic recovery notes to finance any residual deficit, as interest rates are likely to rise and the state continues to pay the costs of debt service payments on $915.8 million in recovery notes that were issued in 2009 to close a deficit at that time."

A portion of those economic recovery notes were refinanced in October 2013. The remaining balance on those notes at the end of Fiscal Year 2016 was $352.6 million, with a payment this fiscal year of $167.7 million.

As Lembo first projected earlier this year, the income tax revenue has fallen significantly short of the budget plan, by $532.2 million. Since the inception of the income tax, Connecticut averaged 9-percent annual growth in the income tax through 2008, at which point the average has been 2 percent. As the state Department of Revenue Services (DRS) reported, following each of the past two income-tax increases, the average tax liability for the state's wealthiest residents increased in one year, and then fell the next.

"This pattern following consecutive income-tax increases suggests those wealthy residents either adjusted tax strategies or earned less money in the down years," said Lembo, who has long advocated legislation to tame revenue volatility. Lembo's revenue volatility and responsible spending measure, however, has a delayed effective date of 2020.

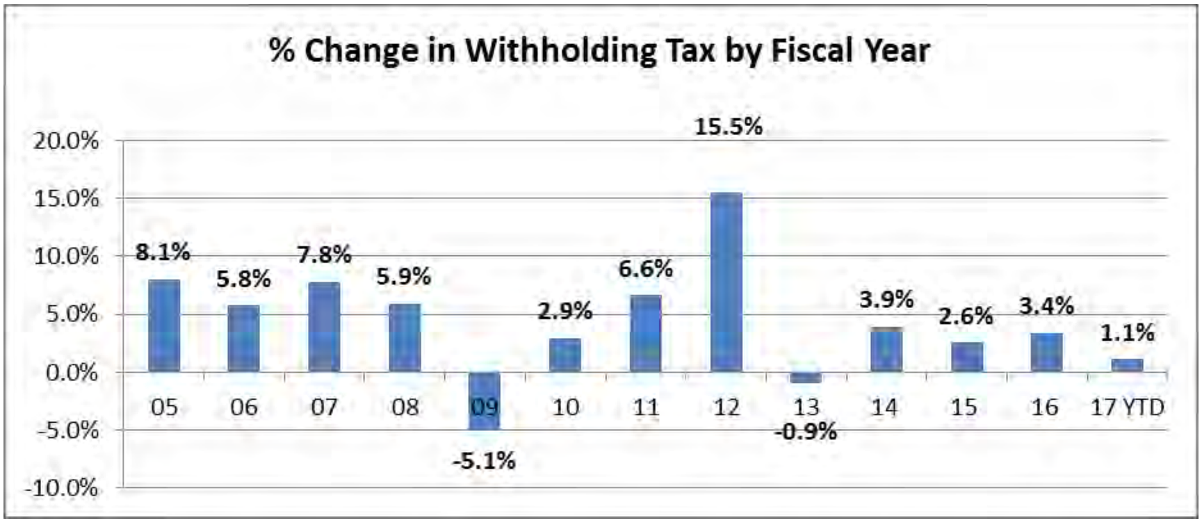
Lembo also said that the state's population loss has likely contributed to downward pressure on state tax receipts.

On the spending side, the state is on track to spend $57.1 million below its budget plan.

"Connecticut's overall budget performance is ultimately dependent upon the performance of the national and state economies," Lembo said. He pointed to latest economic indicators from federal and state Departments of Labor and other sources that show:

Employment

- In Fiscal Year 2016 the withholding portion of the income tax increased 3.4 percent from the prior fiscal year. Through April of Fiscal Year 2017, these receipts were up 1.1 percent from last year. Adjusting for timing differences between fiscal years in deposit days by month, the withholding tax trend has been running below last fiscal year and decelerating in recent months.



- According to 2016 benchmark revisions by the U.S. Bureau of Labor Statistics, Connecticut lost 200 jobs in calendar year 2016. After strong first-quarter employment growth, the employment situation in the state became more erratic. The final quarter of 2016 posted a net loss of jobs.
- The business payroll survey showed that the state lost 1,500 net jobs (-0.1 percent) in April 2017, to a level of 1,683,200, seasonally adjusted. The March preliminary job gain numbers were revised downward from 1,300 added positions to an increase of 600 jobs. Over the past 12-month period ending in April, the state has posted 5,500 new payroll jobs.
- Connecticut has now recovered 74.7 percent (89,000, about 1,035 jobs per month) of the 119,100 seasonally adjusted jobs lost in the Great Recession (3/08-2/10). The job recovery is into its 86th month and the state needs an additional 30,100 jobs to reach an employment expansion. The state's Private Sector employment has recovered at a better pace, recouping 92.7 percent (103,500, or about 1,203 per month) of the 111,700 private sector jobs lost in that same employment recession.
- Connecticut's unemployment rate for April increased by one tenth of a point from last month's reading to 4.9 percent. While the unemployment rate moved up in March, the labor force also expanded as discouraged job seekers re-entered the labor market.
- The 12-month change in employment activity through the month of April is provided below.

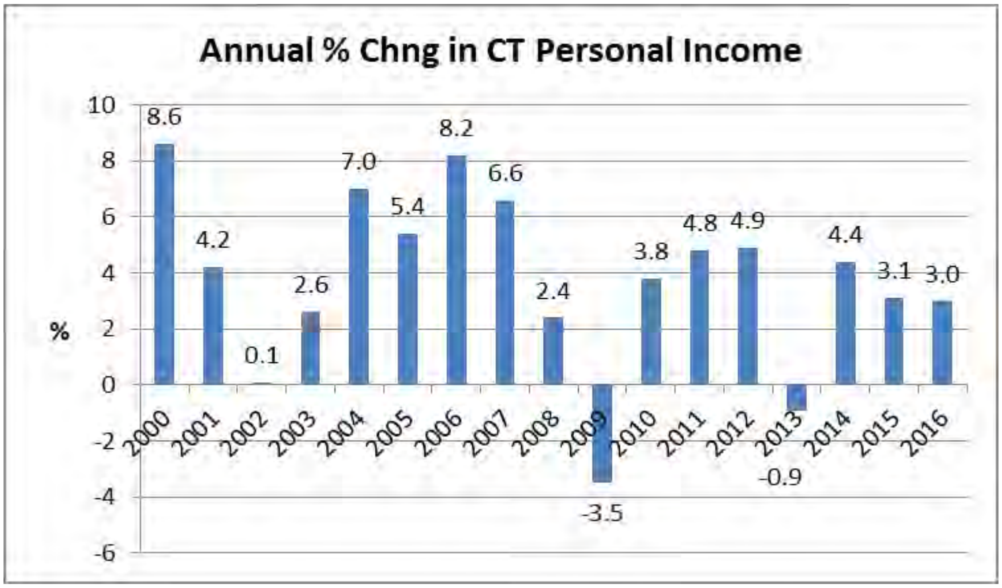
Payroll Employment Trend				
jobs in thousands				
Sector	4/17	4/16	Gain/Loss	% Chng.
Construction	61.9	59.4	2.5	4.2%
Manufacturing	156.0	156.2	-0.2	0.1%

Transp. & Public Utilities	297.9	298.7	-0.8	-0.3%
Information	31.2	32.2	-1	-3.1%
Financial	131.2	130.2	1.0	0.8%
Prof . & Business Svc.	215.7	217.9	-2.2	-1.0%
Education & Health Svc.	330.1	327.6	2.5	0.8%
Leisure & Hospitality	158.0	152.6	5.4	3.5%
Other Services	67.4	64.7	2.7	4.2%
Government	233.2	237.6	-4.4	-1.9%

- All of the employment and labor force data must be considered in light of the erosion in the state's total population over recent years. According to U.S. census data, Connecticut saw a decline in population of 8,278 residents between July 1, 2015 and July 1, 2016. Connecticut was one of only eight states to experience a decline in population during this period. Connecticut has now posted three consecutive years of population decline.

Wage and $alary income

- Average hourly earnings in Connecticut at $31.84, not seasonally adjusted, were up $1.32, or 4.3 percent, from the April 2016 estimate ($30.52). The resultant average Private Sector weekly pay amounted to $1,073.01, up $53.64, or 5.3 percent higher than a year ago.
- The Consumer Price Index (CPI-U) was 2.2 percent in April, which is down slightly from the 2.7-percent pace in March.
- According to a March 28 release from the Bureau of Economic Analysis, Connecticut's personal income grew by 3 percent between 2015 and 2016. This ranked Connecticut 33rd nationally in 2016 income growth. Connecticut had the slowest rate of growth in New England. However, Connecticut ranked number one nationally in per capita personal income in 2016 with income of $71,033.



- Connecticut's fourth quarter results for 2016 were better than the full year results. The fourth-quarter growth annualizes to a rate closer to 4 percent, which ranked the state at 21 nationally for fourth-quarter growth. Results for the first quarter of 2017 will be available on June 27.

Housing

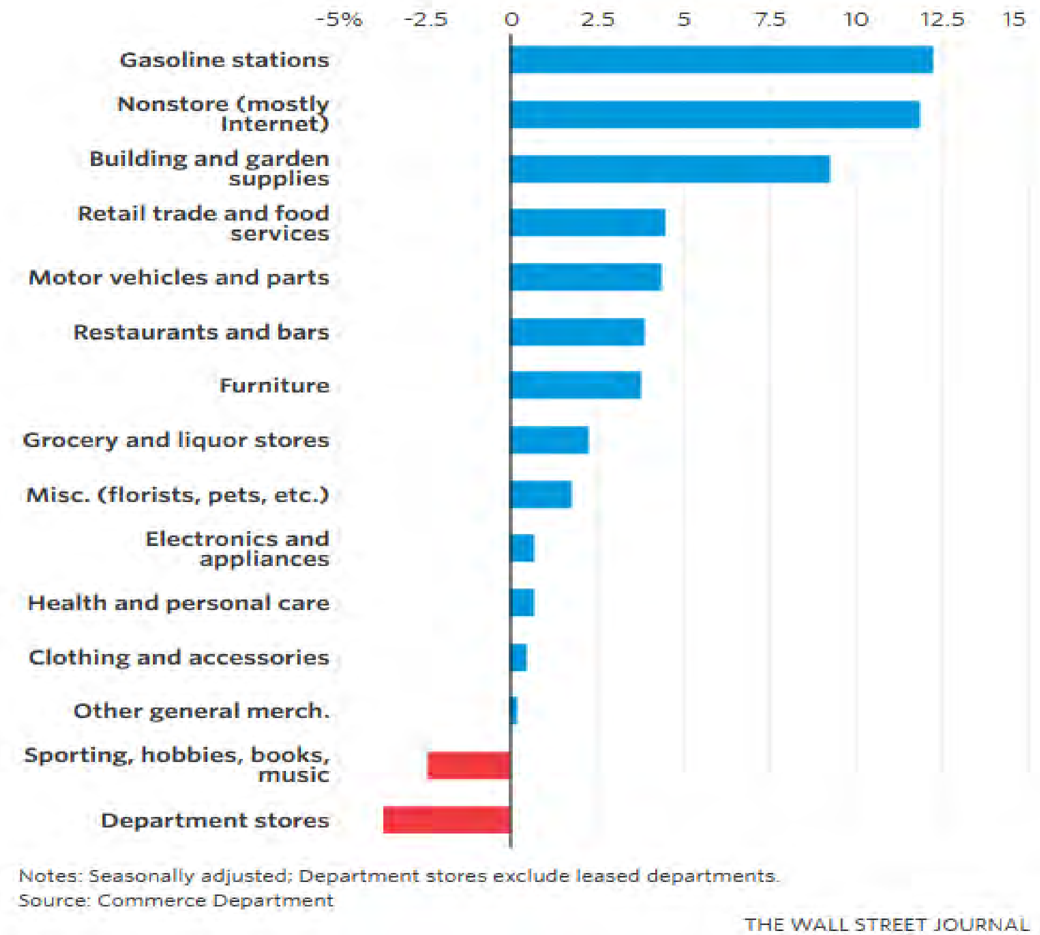
- According to a May 24 report from CT Realtors, the sale of single-family residential homes in Connecticut decreased by 5.4 percent in April 2017 from the same month a year earlier. The median sales price of a home also fell slightly from $247,000 to $246,000. Connecticut has been in a sustained period of sales volume gains since 2012 so April's decline is an anomaly; prices had also been rebounding in recent months. Townhouse and condominium sales dropped 3 percent in April with the median price up 1 percent at $156,500.
- Nationally, existing-home sales in April increased 1.7 percent from April of last year. The median price of a home in April was $244,800.
- With mortgage rates moving up, many economists have forecasted that 2017 will be a slower year for the housing market than 2016. Some of the strongest sales numbers in more than a decade were seen in 2016.

Consumers

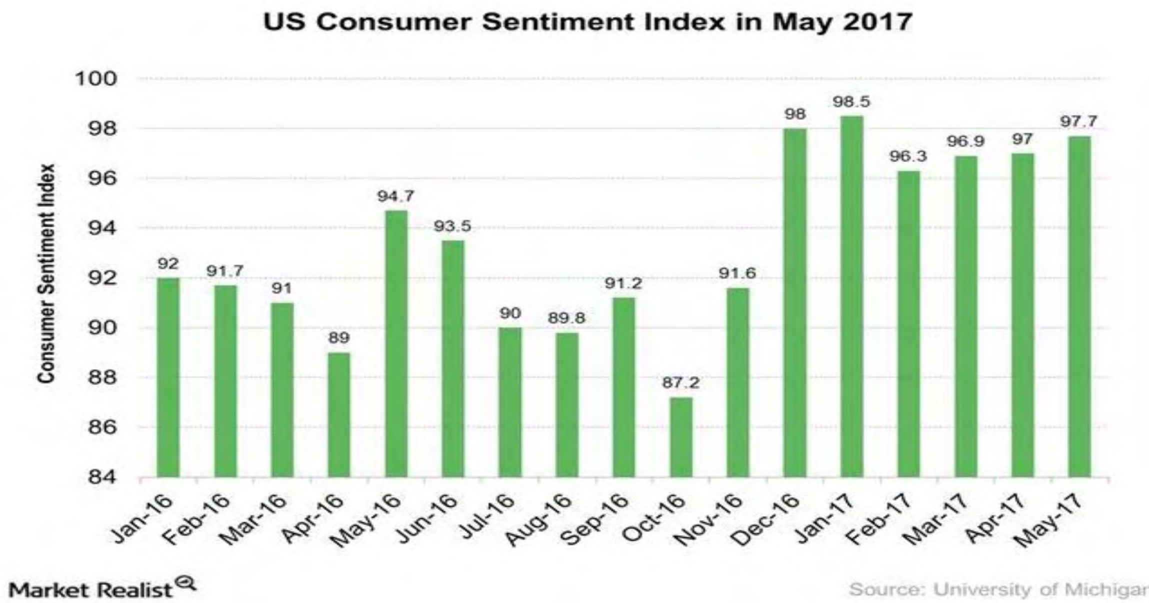
- According to data provided by the United States Census Bureau on May 12, U.S. consumers increased their spending in April at auto dealers, hardware stores and ecommerce outlets as retail sales rebounded from two sluggish months. Retail sales increased 0.4 percent in April from March. Sales were up just 0.1 percent in March and fell in February.

- The increase suggests that consumers may spur faster growth in the April-June quarter after the economy barely expanded in the first three months of the year.

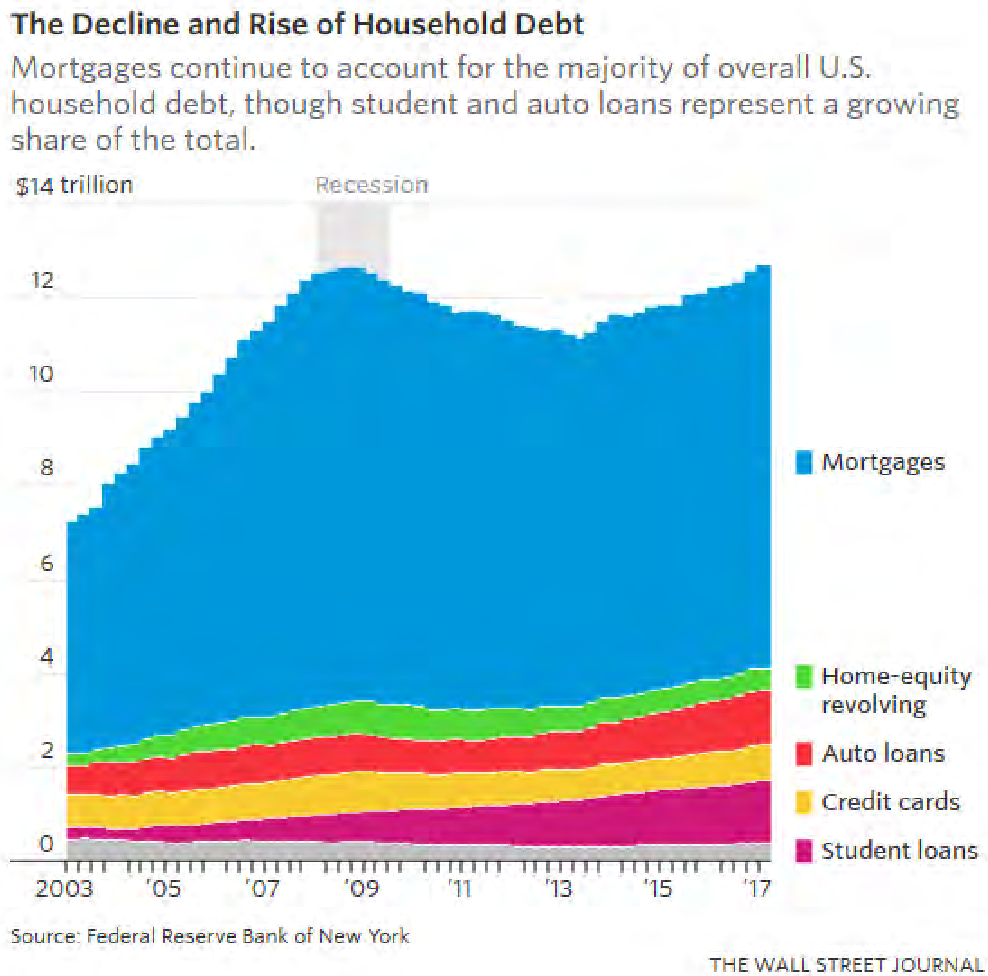
% change from one-year ago by retail category



- The University of Michigan Consumer Sentiment Index, released on May 12, rose to 97.7 from 97.0 in April. The May reading beat the preliminary market expectation of 97.0.
- An improved financial situation was reported by 50 percent of all respondents in both the March and April surveys, the most in at least 15 years. Americans continue to feel optimistic about a solid job market, with expectations of falling unemployment the most favorable since 1984. Higher home values were cited by 62 percent of homeowners, the largest share since 2006.



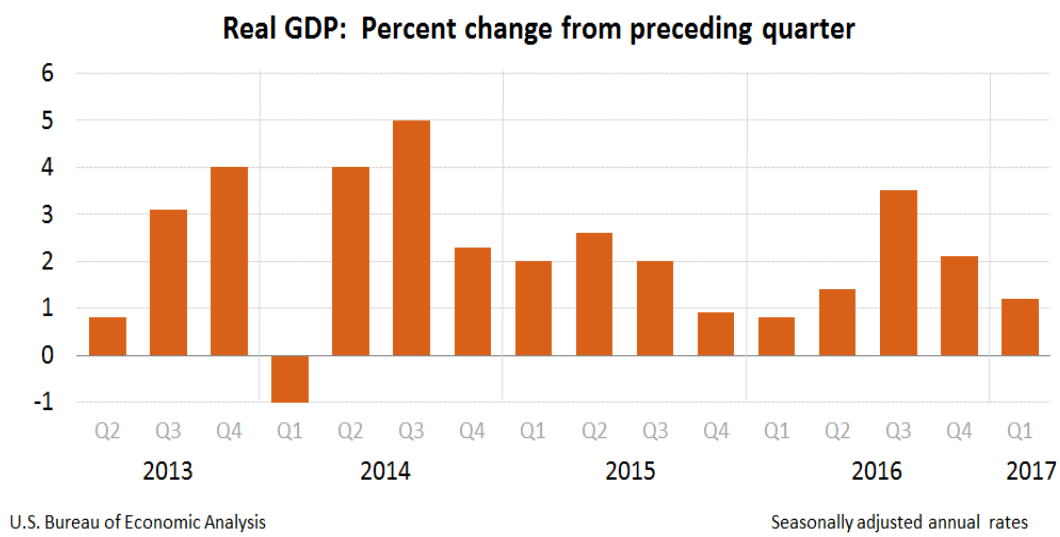
- The total debt held by American households reached a record high in early 2017, exceeding its 2008 peak after years of retrenchment in the face of financial crisis, recession and modest economic growth.
- Mortgages remain the largest form of household borrowing but have become a smaller share of total debt as consumers take on more automotive and student loans.
- The data were not adjusted for inflation, and household debt remains below past levels in relation to the size of the overall U.S. economy. In the first quarter of 2017, total debt was about 67 percent of nominal gross domestic product versus roughly 85 percent of GDP in the third quarter of 2008.
- Less than 5 percent of outstanding debt was delinquent at the end of the first quarter, which was close to the 2016 percentage. Seriously delinquent debt in the first quarter (debts over 90 days past due) were 3.4 percent of outstanding debt. The overall seriously delinquent rate remains well below levels seen in the recession's immediate aftermath, though delinquencies have climbed recently for credit-card debt and auto loans and remain high for student loans.
- Americans reduced their debts during and after the 2007-09 recession to an unusual extent: a 12-percent decline from the peak in the third quarter of 2008 to the trough in the second quarter of 2013. New York Fed researchers, looking at data back to the end of World War II, described the drop as an aberration from what had been a 63-year upward trend thus reflecting the depth, duration and aftermath of the Great Recession.



Business and Economic Growth

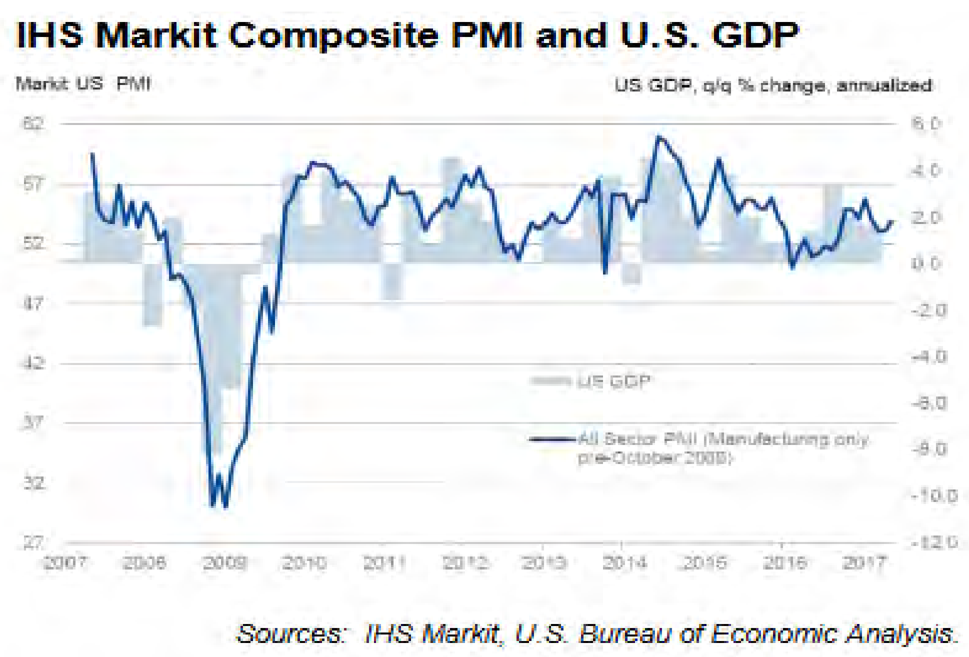
- On May 11, the Bureau of Economic analysis released its data on GDP by state through the fourth quarter of 2016. Between 2013 and 2016, Connecticut's GDP grew at an annual rate of 1 percent, ranking the state 32nd nationally in growth. Between 2015 and 2016, Connecticut's GDP also grew at a 1-percent rate. However, growth accelerated between the third and fourth quarters of 2016 with annualized growth of 2 percent. The strongest contributor to GDP growth came from the finance and insurance sector. This sector has been adding jobs recently, but still remains 14,400 below its pre-recession payroll employment level.
- According to the May 26 second estimate from the Bureau of Economic Analysis, real GDP in the first quarter of 2017 grew at a 1.2-percent annual rate. In the fourth quarter of 2016 GDP grew at a 2.1-percent rate.
- The deceleration in real GDP in the first quarter reflected a deceleration in personal consumption expenditures and downturns in private inventory investment and in

state and local government spending that were partly offset by an upturn in exports and accelerations in both nonresidential and residential fixed investment.



- After-tax profits, without inventory valuation and capital consumption adjustments, fell 0.3 percent in the first quarter of 2017 from the fourth quarter of last year to a seasonally adjusted annual rate of $1.736 trillion. The profits pullback came after four consecutive quarterly gains. The Commerce Department said first-quarter profits were depressed by several legal settlements, including federal penalties on U.S. subsidiaries of Deutsche Bank and Credit Suisse and an environmental-regulation settlement with automaker Volkswagen.
- From a year earlier, after-tax profits were up 11.9 percent in the first three months of 2017.
- For all of 2016, profits rose 4.3 percent after falling 8.5 percent in 2015. Earnings fell in 2015 as exports declined on a strengthening dollar, energy prices and other commodity prices softened and global growth weakened. But oil prices stabilized last year and the global outlook has brightened, helping bolster U.S. businesses.
- The Commerce Department reported that durable goods orders fell 0.7 percent in April after rising 2.3 percent in March. The April downturn was the first since durable goods orders fell 4.6 percent in November.
- Orders for transportation equipment fell 1.2 percent last month, pulled down by a 9.2-percent drop in the volatile commercial aircraft category. Orders for military aircraft jumped 7.1 percent. Orders for cars, trucks and auto parts rose 0.3 percent last month after falling in February and March.
- Orders for capital goods, excluding aircraft and military equipment, were flat for the second straight month — potentially worrisome because that category offers clues about where business investment is headed.

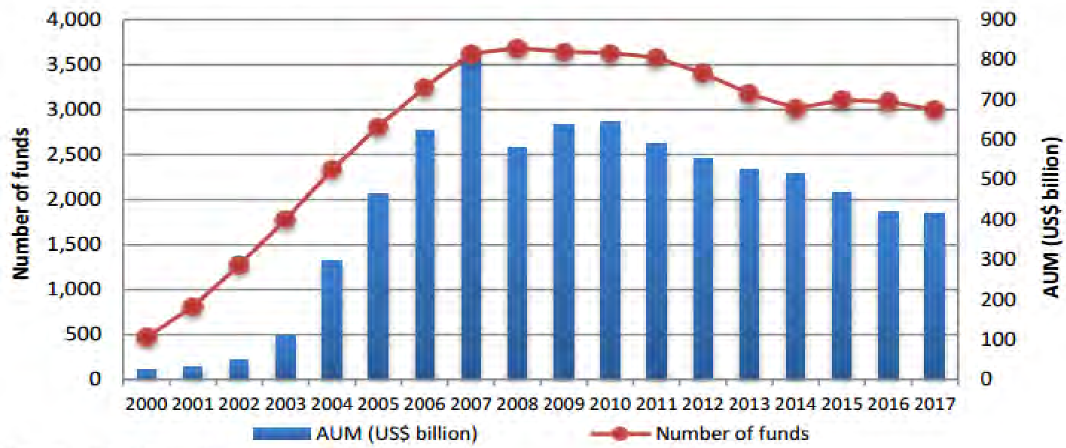
- The seasonally adjusted Markit Flash U.S. Composite PMI Output Index revealed a modest rebound in private sector business activity growth in May. At 53.9, up from 53.2 in April, the headline index pointed to the strongest upturn in U.S. private sector output since February.



Stock Market

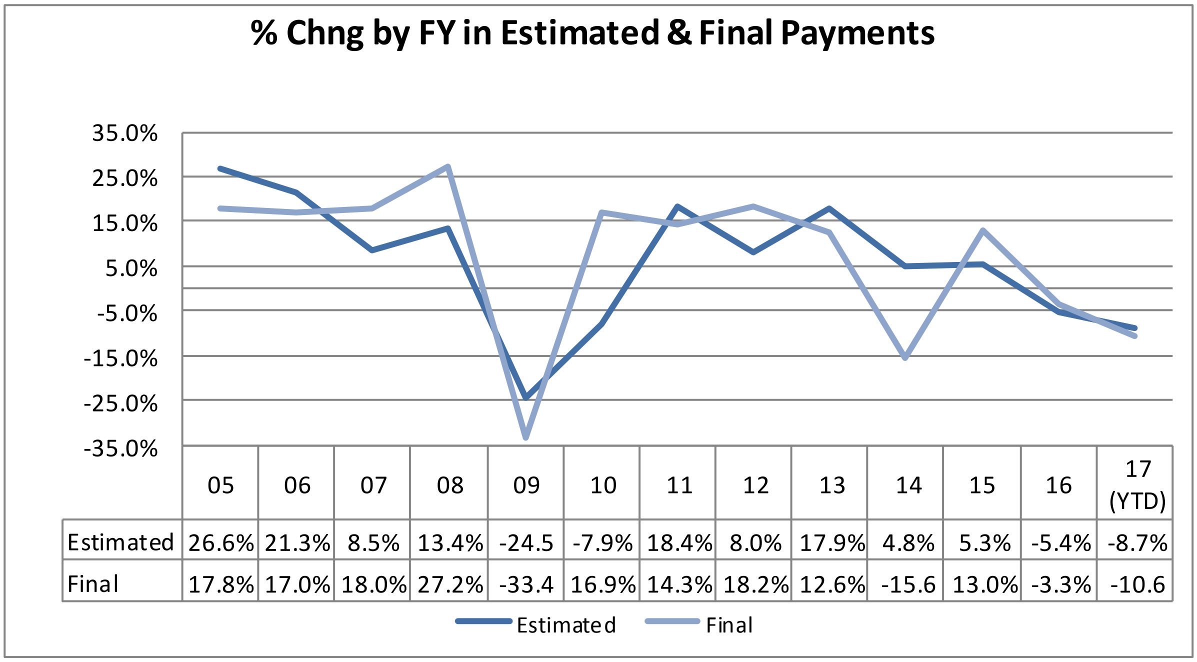
- Estimated and final income tax payments account for approximately 40 percent of total state income tax receipts. Both the estimated and final payments had a negative rate of growth in Fiscal Year 2016 and that has continued into Fiscal Year 2017.
- Over $200 million of the drop in receipts came from the state's closely monitored top 100 income earners, who are the source of an outsize proportion of the state's revenue. Many of the state's richest residents work for hedge funds, which have been hurt by a downturn in the industry. The graph below illustrates the downward pressure that hedge funds have experienced both from the perspective of assets under management (AUM) and the total number of funds.

Figure 1a: Global funds of hedge funds industry



Source: Eurekahedge

- Some states that rely heavily on the wealthy for income taxes, such as New York, also have growing populations, which may better prepare them to weather bad times. Unfortunately, Connecticut's population has been in decline since 2013.
- Connecticut began to phase in the income tax in 1991. Income-tax growth averaged 9 percent annually from 1993 through 2008. Since then, the average has been 2 percent annually. Two income-tax increases were enacted, in 2011 and 2015, raising the top rate to 6.99 percent.
- According to Revenue Services, after each of the past two income-tax increases the average tax liability for the state's 100 wealthiest residents increased in one year and then fell. This pattern suggests those wealthy residents either adjusted their tax strategies or earned less money in the down years.
- Despite the tax increases, data from the Department of Revenue Services shows the number of full-time Connecticut tax filers with income of $1 million or more grew to 11,223 in 2015, a 21-percent increase over 2011. The department says fewer than five of its top 100 taxpayers have fallen out of the ranking since 2014.
- It now appears that estimated and final income tax payments will be approximately 10 percent below the level attained in Fiscal Year 2016.



	05	06	07	08	09	10	11	12	13	14	15	16	17 (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%	-8.7%
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%	-10.6

- Shifts in equity portfolio allocations following the presidential election and a run-up in equity values have not resulted in capital gains related revenue increases for the state.

DOW

S&P

- Some of the diminishment in revenue from capital gains may be attributed to the increasing use by investors of tax-advantaged vehicles such as Exchange Traded Funds (ETF). The increase in these investments is shown in the graph below. Investors may also be awaiting federal tax reform legislation before engaing in large scale selling of equity positions.

Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Mar-17
# ETFs	123	157	207	350	608	704	778	902	1,093	1,161	1,259	1,377	1,570	1,706	1,734
# ETFs/ETPs	134	169	221	381	673	845	925	1,099	1,369	1,447	1,536	1,662	1,845	1,970	2,000
ETF assets	151	228	305	416	586	498	706	893	938	1,212	1,612	1,918	2,060	2,465	2,710
ETF/ETP assets	157	237	311	433	621	539	790	1,009	1,060	1,347	1,698	2,002	2,130	2,549	2,798

Source: ETFGI data sourced from ETF/ETP sponsors, exchanges, regulatory filings, Thomson Reuters/Lipper, Bloomberg, publicly available sources and data generated in-house. Note: "ETFs" are typically open-end index funds that provide daily portfolio transparency, are listed and traded on exchanges like stocks on a secondary basis as well as utilising a unique creation and redemption process for primary transactions. "ETPs" refers to other products that have similarities to ETFs in the way they trade and settle but they do not use a mutual fund structure. The use of other structures including grantor trusts, partnerships, notes and depositary receipts by ETPs can create different tax and regulatory implications for investors when compared to ETFs which are funds.

*****END*****