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COMPTROLLER LEMBO PROJECTS $800,000 SURPLUS FOR FISCAL YEAR 2016 WITH AN EYE ON FINANCIAL MARKETS AND OTHER REVENUE UNCERTAINIES

Comptroller Kevin Lembo announced today that the volatility of the financial markets complicates the budget outlook for Fiscal Year 2016 at this early stage, but said the state is currently on track to end the fiscal year with an $800,000 surplus.

In a letter to Gov. Dannel P. Malloy, Lembo said he agrees with the Office of Policy and Management's (OPM) estimates at this early point in the year – though he shares OPM's concerns related to potential revenue shortfalls.

"The revenue accruals for Fiscal Year 2015 were not as strong as expected, and there is concern that this trend could continue into Fiscal Year 2016," Lembo said. "There are also numerous revenue policy changes in Fiscal Year 2016, including an estimated $13.6 million in new revenue from the roll-out of Keno gaming, which will be carefully monitored in the coming months. Undoubtedly, revenues will be adjusted in future months as trends become better defined."

The Fiscal Year 2016 budget also relies on $200.6 million in forced savings from state agencies, which Lembo said could be challenging given the savings extracted from agency budgets in prior fiscal years.

"The current volatility in financial markets has also complicated the budget outlook for Fiscal Year 2016," Lembo said. "Over the past several years, the state has experienced significant fluctuations in capital gains related receipts."

Lembo noted that in late 2012, investors turned over a large volume of long-term capital gains to take advantage of the expiring 15-percent tax rate, which increased to a top long-term rate of 23.8 percent on Jan. 1, 2013. As a result, the state realized a windfall on the capital gains driven portion of the income tax in Fiscal Year 2013. Because this left little in unrealized gains, this significant component of the income tax experienced a sharp drop in Fiscal Year 2014. As the market surged, investors were reluctant to take short-term gains because such gains are taxed at a higher ordinary income rate, Lembo said. Fiscal Year 2015 estimated and final tax receipts were below initial budget estimates.

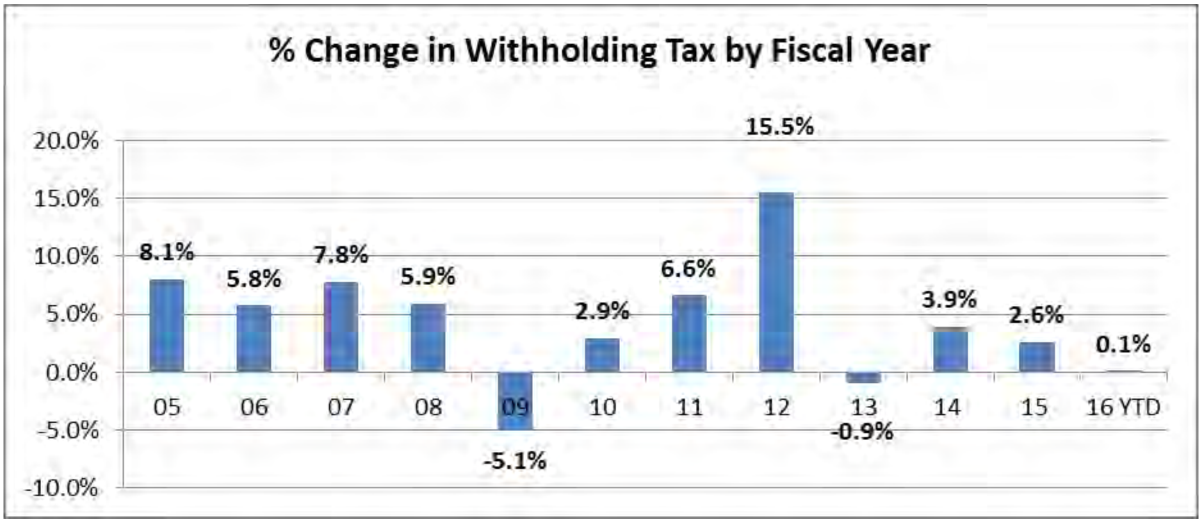
"The recent downturn in the market increased sales volume," Lembo said. "It remains to be seen if the increase in gains related to sales will help to mitigate the negative impact of the present market decline."

Pointing to a rebound in retail sales, automobile purchases and other indicators, Lembo said, "The fundamentals of the national economy continue to point to future economic growth."

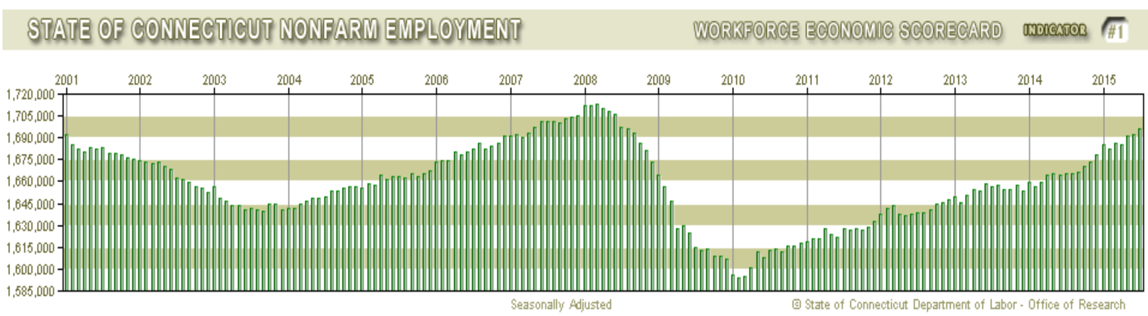
The latest economic indicators from federal and state Departments of Labor and other sources show:

Employment

- In Fiscal Year 2015, the withholding portion of the income tax was 2.6 percent above the prior fiscal year collections. For most of Fiscal Year 2015, withholding receipts ran slightly below the levels experienced in the prior fiscal year.
- Withholding receipts are the largest single source of state tax revenue, accounting for 61 percent of the total income tax receipts in Fiscal Year 2015 and almost 40 percent of total tax receipts in that year. As the graph below shows, with the exception of the increases experienced in Fiscal Years 2011 and 2012 that resulted from tax increases, withholding growth has been well below normal post-recession levels.
- The average annual growth in the withholding tax is approximately 3.5 percent below the level attained during the last economic recovery period. The below average wage growth resulted in a state revenue loss of about $195 million in Fiscal Year 2015 based on actual receipts data.



- According to the Department of Labor, preliminary figures show that Connecticut gained 4,100 payroll positions in July. This follows the addition of 600 jobs in June. Connecticut has gained 30,600 jobs over the past 12-month period, which brings total payroll employment in the state to 1,696,000. Over the entire calendar 2014 year, the state added 25,100 payroll positions.



- Connecticut has now recovered 102,000 positions, or 85.7 percent of the 119,000 seasonally adjusted total nonfarm jobs that were lost in the state during the March 2008 - February 2010 employment downturn. Connecticut's jobs recovery is 65 months old and is averaging about 1,569 jobs per month since February 2010. The private sector has recovered employment at a faster pace (approximately 1,665 per month) and has now replenished 108,200 (97.0 percent) of the 111,600 private-sector jobs that were lost during the same employment recession. The state needs to reach the 1,713,000 job level to enter a full nonfarm employment expansionary phase. This will require an additional 17,000 nonfarm jobs.

Job Gains Latest 12 Months		**Job Losses/No Change Latest 12 Months**	
<u>Sector</u>		<u>Sector</u>	

Leisure & Hospitality	6,200	Information	-200
Transp. & Public Utilities	6,000		
Prof. & Business Service	5,300		
Education & Health Svc.	5,200		
Financial Activities	2,600		
Construction	2,000		
Manufacturing	2,000		
Other Services	800		
Government	800		

- U.S. employment has been advancing at a rate of 2.1 percent over the 12-month period ending in June; Connecticut's employment growth was 1.8 percent for the same period.
- Connecticut's unemployment rate was 5.4 percent in July; the national unemployment rate was 5.3 percent. Connecticut's unemployment rate has continued to decline from a high of 9.5 percent in October 2010.
- There are 103,700 unemployed job seekers in Connecticut. A low of 36,500 unemployed workers was recorded in October of 2000. The number of unemployed state workers hit a recessionary high of 177,200 in December of 2010.

Wage and Salary income

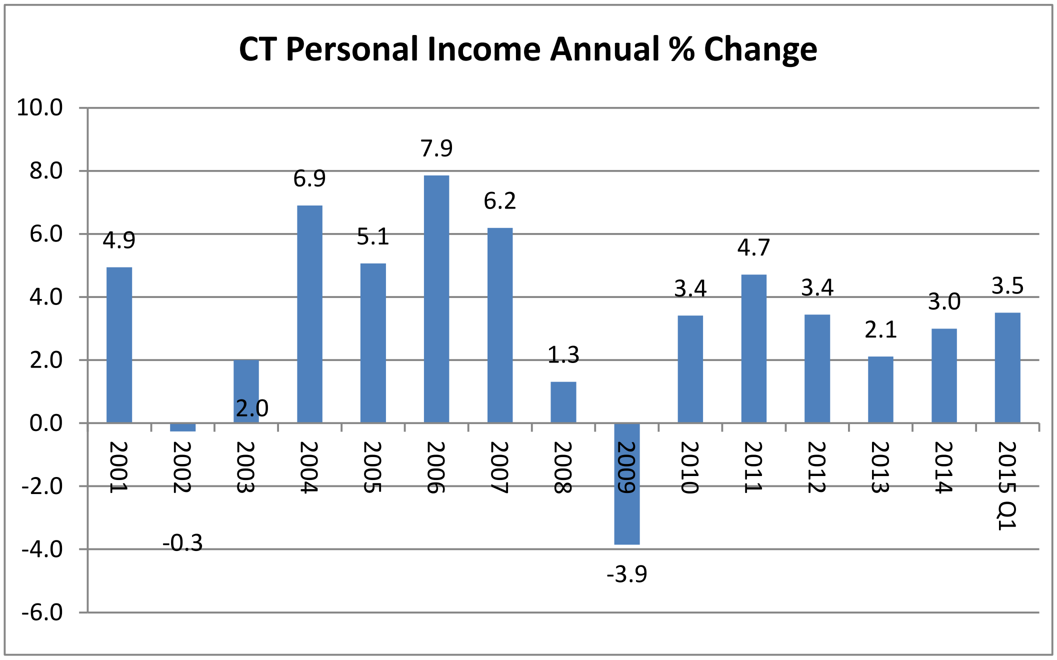
- The Department of Labor reports that average hourly earnings at $28.71, not seasonally adjusted, were up 81 cents, or 2.9 percent, from the July 2014 estimate. The resulting average private-sector weekly pay was figured at $958.91, up $18.68, or 2.0 percent higher than a year ago. The 12-month percent change in the Consumer Price Index for All Urban Consumers (CPI-U, U.S. City Average, not seasonally adjusted) in July 2015 was 0.2 percent.
- The graph below shows the monthly percent change from the prior year in the state's weekly earnings. Connecticut, like the nation, has struggled with stagnant wage growth. This graph provides monthly data through July 2015.

- Slow wage growth has placed pressure on the state budget, and on the growth of the larger economy. Household consumption accounts for roughly two-thirds of the U.S. economy as measured by GDP. During this latest recovery period, GDP has not attained an annual growth rate of 3 percent or better (although this level has been attained in certain quarters). Stagnant wage growth has produced lower-than-expected gains in consumer spending.

- Between 1947 and 2007 annual real household consumption grew by 3.6 percent, on average. Since 2008, growth has been closer to 1.5 percent.
- Slower wage growth may also play a role in the reluctance of consumers to take on debt. From the end of World War II up until the housing bubble burst, household debt grew at an average annualized rate of more than 9 percent. This rapid growth pushed debt-to-income ratios from 50 percent in the late 1950s to 130 percent by the time the housing bubble burst.
- Since coming out of the recession in the third quarter of 2009, household debt has been growing at less than a 1 percent annualized pace. Historically, household consumption has increased by roughly 0.2 percent for every 1 percent increase in household debt. Even as household balance sheets have strengthened during the recovery period, consumer spending is being deferred.
- Based on data released by the Bureau of Economic Analysis on June 22 for the first quarter of 2015, personal income in Connecticut grew at a rate of 3.5 percent from

the same quarter last year. This compares to a national growth rate of 4.4 percent. Connecticut was ranked 24th nationally in quarterly growth based on first-quarter data. Results for the second quarter will be released on Sept. 30.

- The chart below shows the annual trend in Connecticut personal income over time, which is well off the pace set during the last post-recessionary period.



Housing

- According to a report from the Connecticut Realtors Association released on Aug. 20, Connecticut single-family home sales rose 14.6 percent in July from the same month last year. The median home price fell over that period from $276,400 to $275,000. The sale of townhouses and condominiums in the state rose by 21.2 percent from July of last year. The median price of those units decreased to $165,000 from $175,000.
- Statistics released from the National Association of REALTORS on Aug. 20 show total home sales nationwide (includes single-family homes, townhomes, condominiums and co-ops) increased 10.3 percent in July from July of last year. The median home sales price is $234,000. Northeast home sales increased 9.4 percent during that period and the median sale price was $277,200. Mortgage rates remain at historically low levels.

Consumers

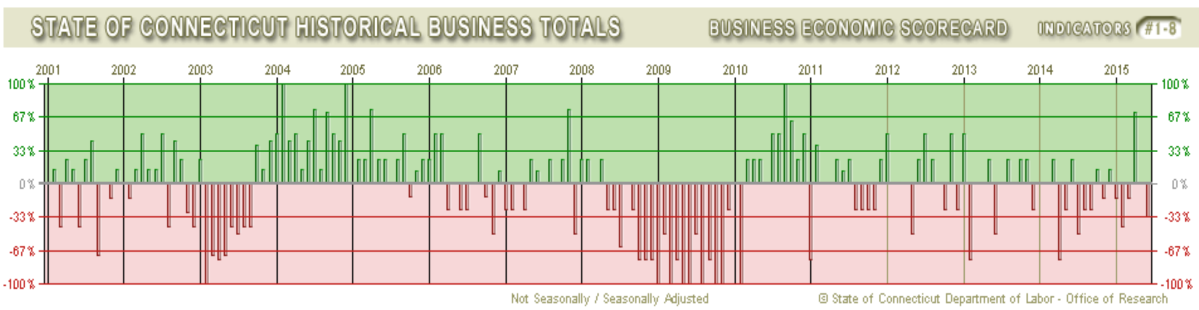
- Retail sales rebounded in July as households boosted purchases of automobiles and a range of other goods, suggesting solid momentum in the economy early in the third quarter. Retail sales increased 0.6 percent last month, broadly in line with economists' expectations. June's retail sales were revised up to show them unchanged instead of the previously reported 0.3-percent drop. Excluding automobiles, gasoline, building materials and food services, core retail sales rose 0.3 percent after a revised 0.2-percent gain in June. These core retail sales numbers correspond most closely with the consumer spending component of GDP.
- The Federal Reserve reported that consumer borrowing accelerated in June growing at an annual rate of 7.3 percent after posting growth of 5.8 percent in May. Revolving credit, mainly credit card debt, grew 7.4 percent in June. Non-revolving credit, which includes car loans and student loans, expanded at a 7.3-percent rate in June.
- On Aug. 25, the Conference Board reported that consumer confidence had rebounded in August, following a sharp decline in July. The Board stated that consumers' assessment of current conditions was considerably more upbeat, primarily due to a more favorable appraisal of the labor market. The uncertainty expressed last month about the short-term outlook has dissipated and consumers are once again feeling optimistic about the near future. Income expectations, however, were little improved.

Business and Economic Growth

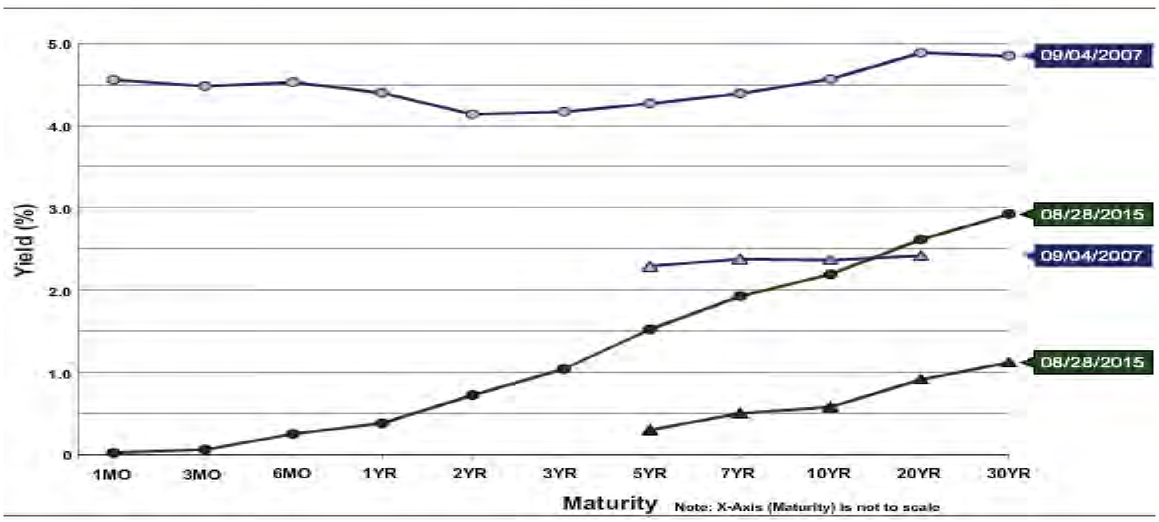
- On Aug. 27, the Bureau of Economic Analysis reported that the second estimate of GDP in the second quarter of 2015 showed growth of 3.7 percent (up from the preliminary estimate of 2.3 percent). Growth in the first quarter of 2015 was 0.6

percent. Due to the poor economic performance in the winter, it may be difficult for GDP to attain a growth rate of 3 percent or better for the year.

- Corporate profits were flat in the second quarter of 2015 compared to the same quarter last year. Corporate profit growth did not exceed 2 percent in 2013 or 2014.
- The Department of Labor's Connecticut Business Totals measures: monthly movement in housing permits, exports, manufacturing production and hours, air passenger counts, and gaming slot receipts. As can be seen from the graph below, during the last recovery the index was uniformly in positive territory. During this recovery, the results have been mixed.



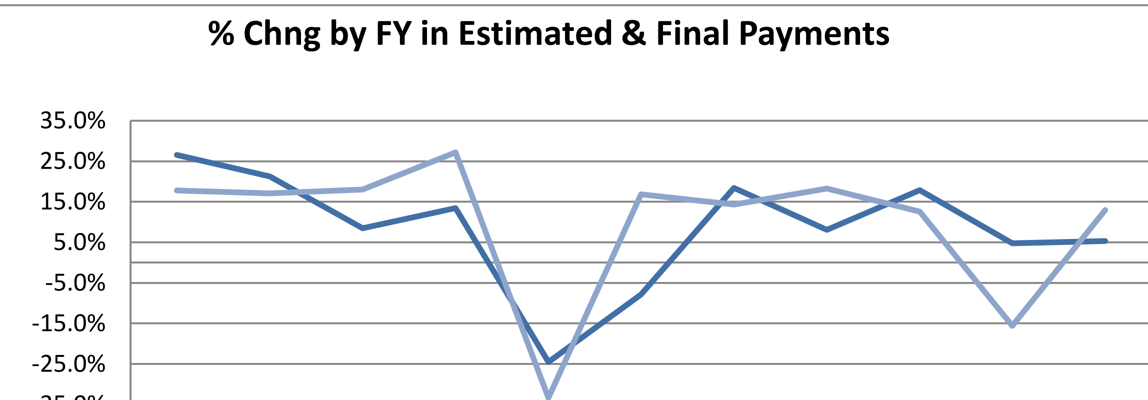
- Below is the yield curve showing the difference between short-term and long-term Treasury debt. The curve tends to flatten or invert prior to a recession. The top line is the curve prior to the last recession and the bottom line is the current curve. This curve is utilized by many analysts to evaluate the impact of a stock market correction on the larger economy.



Stock Market

- Estimated and final income tax payments account for approximately 40 percent of total state income tax receipts. These payments show a correlation to activity in equity markets relating to capital gains.

- Estimated income tax receipts increased 5.3 percent in Fiscal Year 2015 compared to the prior fiscal year. The first significant month of Fiscal Year 2016 estimated payments will be posted in September. This will be an initial opportunity to examine Fiscal Year 2016 trend relating to market volatility.
- Over the past several years, the state has experienced significant fluctuations in capital-gains-related receipts. In late 2012, investors turned over a large volume of long-term capital gains to take advantage of the expiring 15-percent tax rate, which increased to a top long-term rate of 23.8 percent (20-percent rate plus 3.8 percent on AGI above $200,000 related to the ACA) on January 1, 2013. As a result, the state realized a windfall on the capital-gains-driven portion of the income tax in Fiscal Year 2013. Because this left little in unrealized gains, this component of the income tax experienced a sharp drop in Fiscal Year 2014. As the market surged, investors were reluctant to take short-term gains because such gains are taxed at the higher ordinary income rate. Fiscal Year 2015 estimated and final tax receipts were below initial budget estimates.



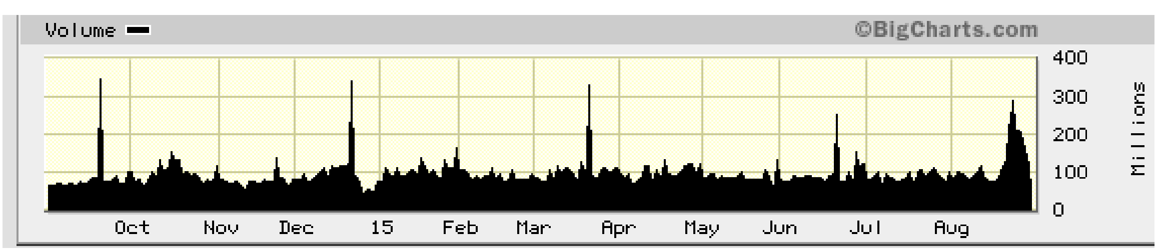
	05	06	07	08	09	10	11	12	13	14	15 YTD
Estimated	26.6%	21.3%	8.5%	13.4%	-24.5%	-7.9%	18.4%	8.0%	17.9%	4.8%	5.3%
Final	17.8%	17.0%	18.0%	27.2%	-33.4%	16.9%	14.3%	18.2%	12.6%	-15.6%	13.0%

- The impact of current market volatility is difficult to quantify two months into the new fiscal year. Trade volume has typically been high at lower market levels.
- Therefore, it is not certain that the recent market correction will result in a sharp drop in capital-gains-related payments to the state. It is possible that higher-volume gains taking could offset some of the negative state revenue impact associated with the correction.

- At this writing the market continues to experience significant adjustments. Over the past 12 months, the Dow has declined by almost 3 percent.

- On a year-to-date basis, the Dow has dropped 6.8 percent.

- There has also been a significant upturn in trading volume as displayed below.



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