News from:
COMPTROLLER KEVIN LEMBO

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COMPTROLLER LEMBO PROJECTS SMALL SURPLUS BUILT ON VOLATILE REVENUE AND PROGRAM CUTS THAT MAY HAVE LONG-TERM CONSEQUENCES

Comptroller Kevin Lembo today said the state is now on track to close the 2017 fiscal year with a small surplus – but warned that it's based on volatile revenue, including the inheritance and estate tax, and program cuts that may have long-term economic ramifications.

In a letter to Gov. Dannel P. Malloy, Lembo said this small $35.7-million surplus – an improvement of $142.9-million from last month – may be good news in the short term, but potentially problematic in the long run.

"Today's small gain could be tomorrow's great pain when state program cuts – particularly those to early childhood programs – produce long-term economic problems," Lembo said. "This small surplus is no measure of success, but simply the result of one-time volatile revenue and potentially damaging cuts to early childhood education."

Lembo pointed to research by the W.E. Upjohn Institute for Employment Research, which found that universal preschool provided early in life has – in the long run – more than twice the projected annual impact on state job growth than direct business subsidies.

"This could be a big problem in Connecticut where state budget constraints have derailed millions of dollars to fund a long-term high-quality preschool plan, even as the state borrowed tens of millions of dollars to deliver incentive packages to the two largest hedge funds in the world.

"The facts tell us this: when we prioritize the game of picking corporate winners and losers over early childhood education, then everyone loses," Lembo said. "Connecticut must keep a close eye on the long-term ramifications of short-term fixes."

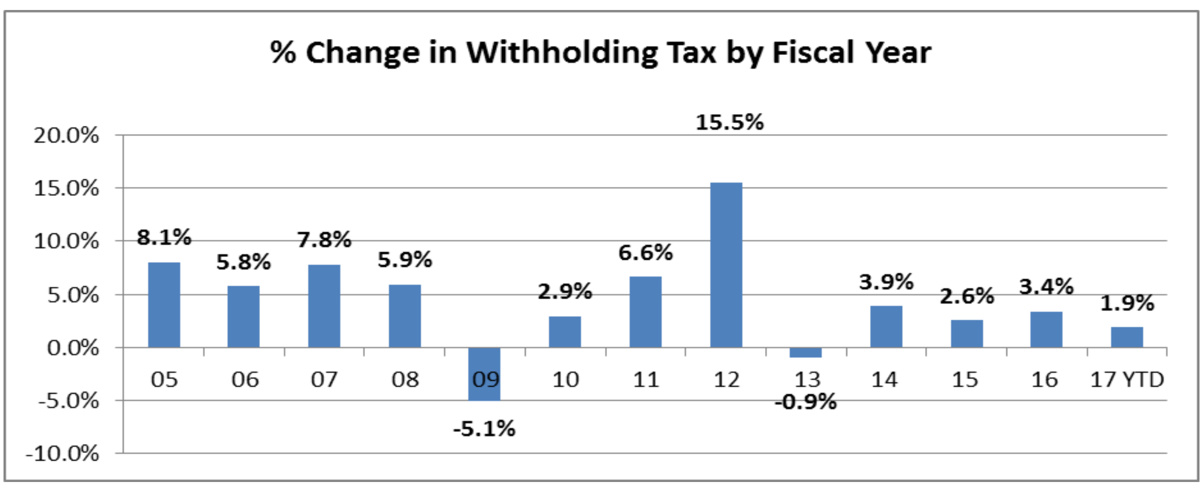
Overall, Fiscal Year 2017 saw revenue decline from initial budget projections, Lembo said. The income tax is expected to fall $532.2 million short of the budget plan and the sales tax is expected to fall $136.8 million below expectations.

On the spending side, following deficit mitigation efforts, net expenditures are estimated to be $181.6 million below the budget plan. State payroll is running almost seven percent below last year's level and general agency operating expenditures were down by over 10 percent.

"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

- Through June of Fiscal Year 2017, withholding receipts were up 1.9 percent from last year. This figure does not yet include accruals that represent deposits made in Fiscal Year 2018 that were earned in Fiscal Year 2017.



- In calendar year 2016, Connecticut lost 200 jobs. 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.
- Preliminary data for June 2017 show that Connecticut added 7,000 jobs during the month to a level of 1,694,200, seasonally adjusted. The May preliminary job addition numbers were revised downward from a gain of 6,700 positions to a gain of 5,600

jobs. Over the past 12-month period ending in June, the state has posted 15,400 new payroll jobs. During the last period of economic recovery, employment growth averaged over 16,000 annually.

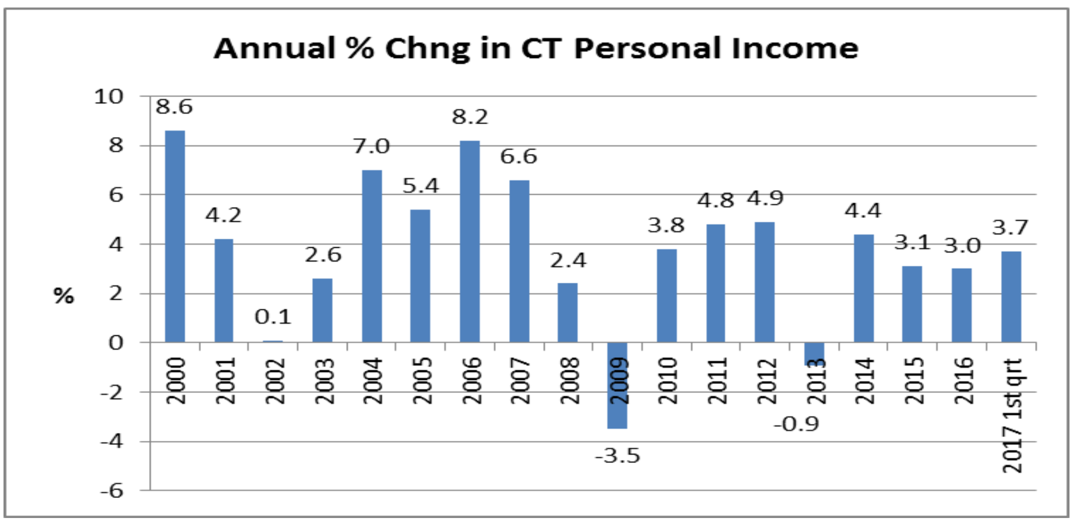
- Connecticut has now recovered 84.0 percent (100,000, or an average of 1,136 jobs per month) of the 119,100 seasonally adjusted jobs lost in the Great Recession (3/08-2/10). The job recovery is into its 88th month and the state needs an additional 19,100 jobs to reach an employment expansion.
- Connecticut's unemployment rate for June was up slightly from last month now at 5 percent. Nationally, the unemployment rate was 4.4 percent in June.

Payroll Employment Trend				
jobs in thousands				
Sector	6/17	6/16	Gain/Loss	% Chng.
Construction	60.4	58.9	1.5	2.5%
Manufacturing	156.0	156.1	-0.1	-0.1%
Transp. & Public Utilities	297.8	297.3	0.5	0.2%
Information	31.9	32.4	-0.5	-1.5%
Financial	133.1	129.8	3.3	2.5%
Prof . & Business Svc.	216.9	218.2	-1.3	-0.6%
Education & Health Svc.	334.4	328.8	5.6	1.7%
Leisure & Hospitality	161.1	153.9	7.2	4.7%
Other Services	68.2	64.7	3.5	5.4%
Government	233.8	238.1	-4.3	-1.8%

- 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.
- In June, the Census Bureau reported that the state's population age 65 and over grew from 14.2 percent to an estimated 16.2 percent of the total population between 2010 and 2016. That's an increase from about 508,000 to 577,000 people. Nationally, the 65 and over population represented 15.3 percent of the total.
- This aging of the population has important implications for state tax revenue because as the baby boom generation retires, the labor force participation rate in states is expected to decline and, with it, income and spending.
- Most people earn less and spend less during retirement, suggesting that an aging population could reduce government revenue, particularly from sales taxes and individual income taxes. These sources of revenue make up more than 75 percent of total state government revenue in Connecticut.

Wage and $alary income

- Average hourly earnings at $30.67, not seasonally adjusted, were up $0.63, or 2.1 percent, from the June 2016 estimate. The resultant average Private Sector weekly pay amounted to $1,030.51, up $21.17, or 2.1 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 June 2017 was 1.6 percent.
- The Bureau of Economic Analysis reported that Connecticut's personal income grew by 3 percent between 2015 and 2016. This ranked Connecticut 33rd nationally in 2016 income growth.
- A June 27 report from the Bureau showed Connecticut personal income increasing at an annualized rate of 3.7 percent in the first quarter of 2017. This ranked Connecticut 37th nationally in personal income growth.



- Results for the second quarter will be released on Sept. 26.

Housing

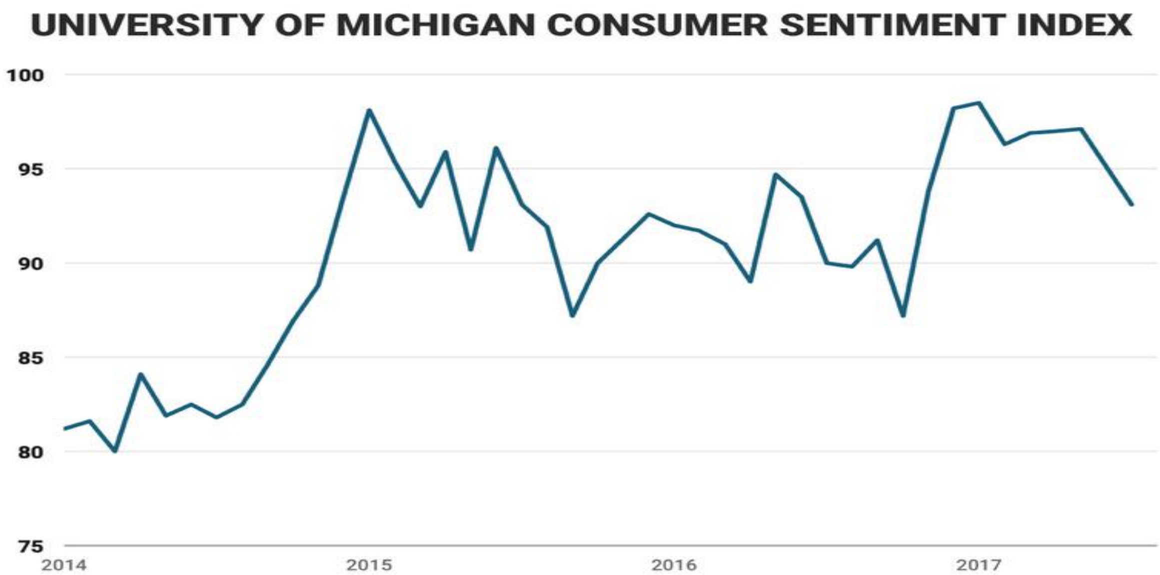
- According to a July 25 report from CT Realtors, the sale of single-family residential homes in Connecticut increased by 6.4 percent in June 2017 from the same month a year earlier. The median sales price of a home also increased 1.8 percent to $280,000. The sale of townhouses and condominiums in the state posted an increased by 8.9 percent in June 2017. The median price was up 8.8 percent to $185,000.
- Nationally, existing-home sales in June increased 0.7 percent from June of last year.

The median price of a home in June was $263,800.
- 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

- The Commerce Department reported that retail sales fell 0.2 percent in June, weighed down by declines in receipts at service stations, clothing stores and supermarkets. Americans also cut back on spending at restaurants and bars, as well as on hobbies.
- Excluding automobiles, gasoline, building materials and food services, retail sales slipped 0.1 percent last month after being unchanged in May. These so-called core retail sales correspond most closely with the consumer spending component of gross domestic product.
- Industry data showed sales of cars and light trucks eased in June to a 16.4 million pace, the slowest in more than two years, from a 16.6 million rate a month earlier.

- The University of Michigan's preliminary survey of consumers for July declined for the second straight month. The headline consumer sentiment index, at 93.1, was the lowest since mid-November.
- The declines recorded are now consistent with just above 2 percent GDP growth in 2017. Lower consumer confidence could translate into more frugal spending habits, and data on retail sales suggests that this is already happening.

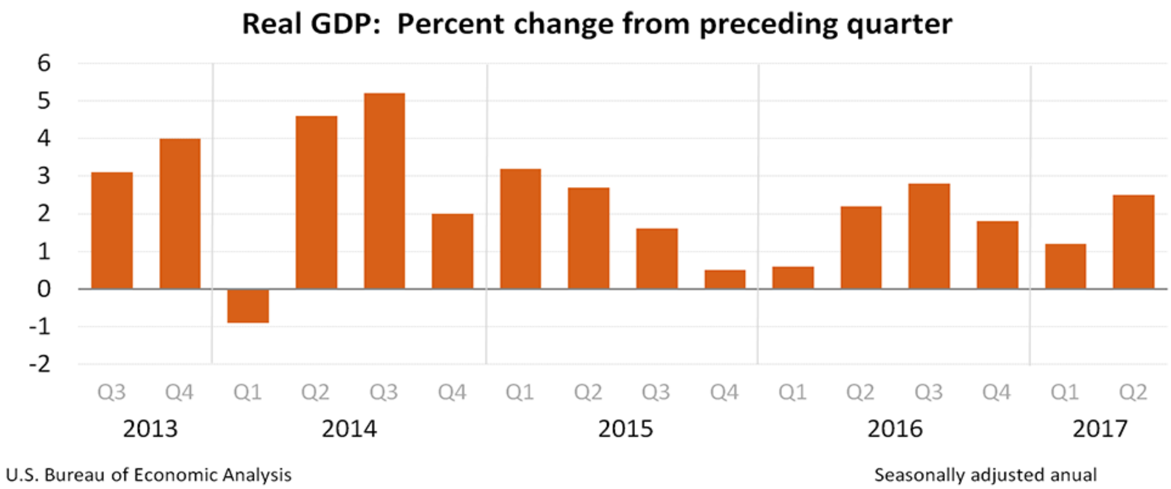


- The U.S. household savings rate is beginning to edge up. Personal Savings in the United States averaged 8.32 percent from 1959 until 2017, reaching an all time high of 17 perent in May of 1975 and a record low of 1.90 percent in July of 2005.

Business and Economic Growth

- On July 26 the Bureau of Economic Analysis released GDP data for the first quarter of 2017 by state. Connecticut ranked 37th nationally in growth with an annualized rate of just over 2.4 percent.
- Real gross domestic product increased at an annual rate of 2.6 percent in the second quarter of 2017. In the first quarter, real GDP increased 1.2 percent (revised).

- The increase in real GDP in the second quarter reflected positive contributions from personal consumption expenditures (PCE), nonresidential fixed investment, exports, and federal government spending that were partly offset by negative contributions from private residential fixed investment, private inventory investment, and state and local government spending.



- Corporate profits after tax with inventory valuation and capital consumption adjustments fell at an annual rate of 2.7 percent in the first quarter after rising at a 2.3-percent pace in the prior three months. 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 4.1 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.
- Orders for long-lasting U.S. factory goods posted the biggest gain in nearly three years last month, pulled up by a surge in demand for civilian aircraft.
- The Commerce Department reported on July 27 that orders for durable goods — which are meant to last at least three years — climbed 6.5 percent in June, reversing two straight monthly drops. The June increase was the biggest since July 2014.
- The Markit Flash Purchasing Manager's Index (PMI) for July reported the following findings:

Key findings:

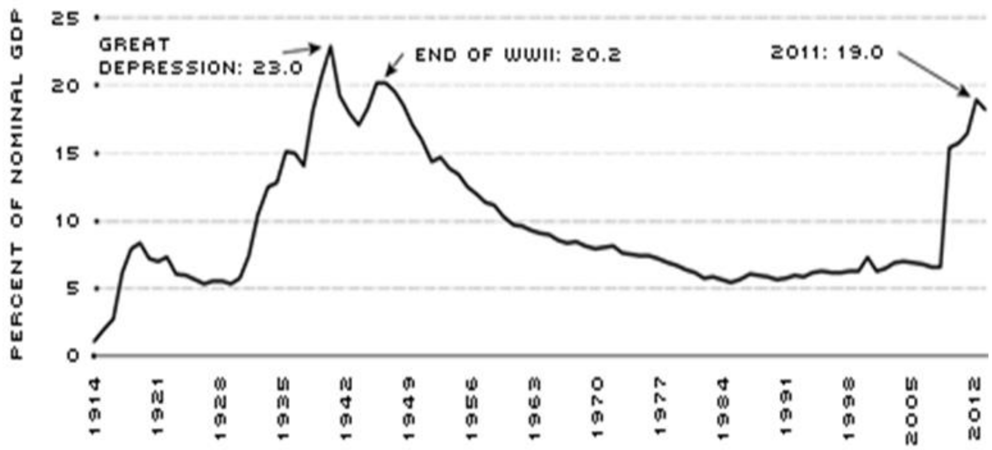
- Flash U.S. Composite Output Index at 54.2 (53.9 in June). 6-month high.
- Flash U.S. Services Business Activity Index at 54.2 (54.2 in June). Unchanged vs. last month.
- Flash U.S. Manufacturing PMI at 53.2 (52.0 in June). 4-month high.
- Flash U.S. Manufacturing Output Index at 54.3 (52.6 in June), 4-month high.

Data collected July 12-21

IHS Markit Composite PMI and U.S. GDP

- Current and future Federal Reserve policy will significantly impact the direction of the economy. The enormous size of the Fed's balance sheet—both real and relative—is cause for concern. The Fed has significantly expanded its footprint in credit markets between 2008 and 2014 to leverage economic growth.
- In response to the Great Recession, the Fed approved several unconventional monetary policies intended to promote economic recovery. Of these policies, "quantitative easing" (the purchase of large assets such as mortgage backed securities and long-term Treasuries) led to the largest expansion of the Fed balance sheet since World War II.
- The Fed has stipulated that the expansion of the balance sheet is a temporary policy stance and that holdings will return to normal as the recovery progresses.

FED BALANCE SHEET AS A PERCENTAGE OF GDP



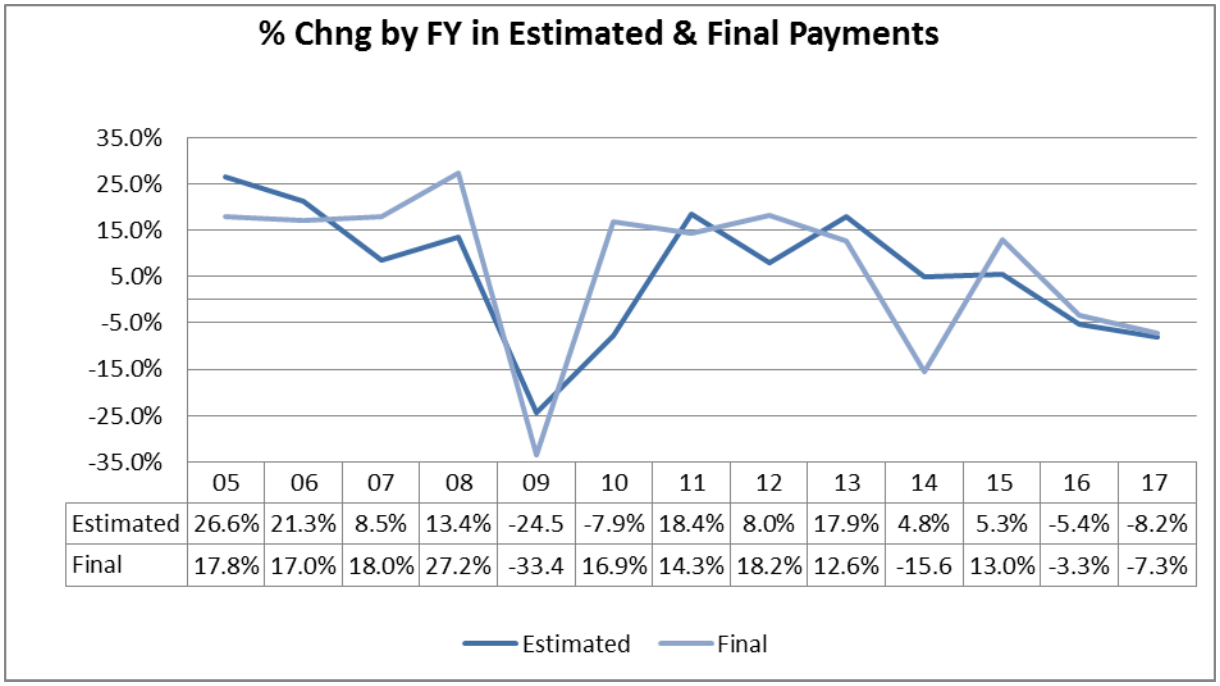
- For a bit of perspective, the Fed's holdings total $4.5 trillion; the entire commercial banking sector holds about $1.7 trillion in mortgage backed securities and Treasuries. That's all commercial banks' combined holdings.
- The Federal Reserve has published a plan to reduce its balance sheet by $2 trillion from the end of 2017 through 2022.
- Going back to the 1950s, there are very few instances in which the US Federal Reserve was a net seller of assets that did not correspond to a notable decline in equity markets.
- It is not immediately knowable if there is enough slack in the monetary system for the Fed to sell $2 trillion in assets and not cause a major stock market disruption. How the Fed would react to such a disruption is also unclear. This is a significant risk factor that will be closely watched by analysts.

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.
- 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 population loss and 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 from 2011. The department says fewer than five of its top 100 taxpayers have fallen out of the ranking since 2014.

- Estimated and final income tax payments were about 9 percent below the level attained in Fiscal Year 2016.



	05	06	07	08	09	10	11	12	13	14	15	16	17
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%	-8.2%
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%	-7.3%

- 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

NASDAQ

- 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 engaging 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.

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