News from:

COMPTROLLER KEVIN LEMBO

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COMPTROLLER LEMBO SAYS STATE ON TRACK TO END FISCAL YEAR 2017 WITH $107.2-MILLION DEFICIT

Comptroller Kevin Lembo today said that the state, despite mitigation efforts – including revenue transfers and spending reductions – is still on track to close Fiscal Year 2017 with a deficit of $107.2 million.

In a letter to Gov. Dannel P. Malloy, Lembo said that the state's Budget Reserve Fund will be reduced to $128.38 million after closing any remaining deficit, based on current projections.

"Long-term planning must be a priority to prepare for ongoing uncertainties and developing trends in the national and state economies that will likely influence future budgets as well," Lembo said. "Those factors include a statewide population decline and shift – as well as a plan announced by the Federal Reserve to reduce its balance sheet by $2 trillion from the end of this year through 2022. The Federal Reserve's plan could cause a disruption in the stock market, with unknown ramifications on the state and national economies."

Lembo said Connecticut has already experienced continued revenue deterioration from initial budget estimates in Fiscal Year 2017, most notably in the income tax and sales tax.

"Some of the diminishment in income tax revenue from capital gains may result from uncertainty about the possibility of federal tax changes that would lower the capital gains rate," Lembo said. "Investors may be reluctant to undertake transactions that generate taxable gains in light of the potential for future reductions in those tax liabilities."

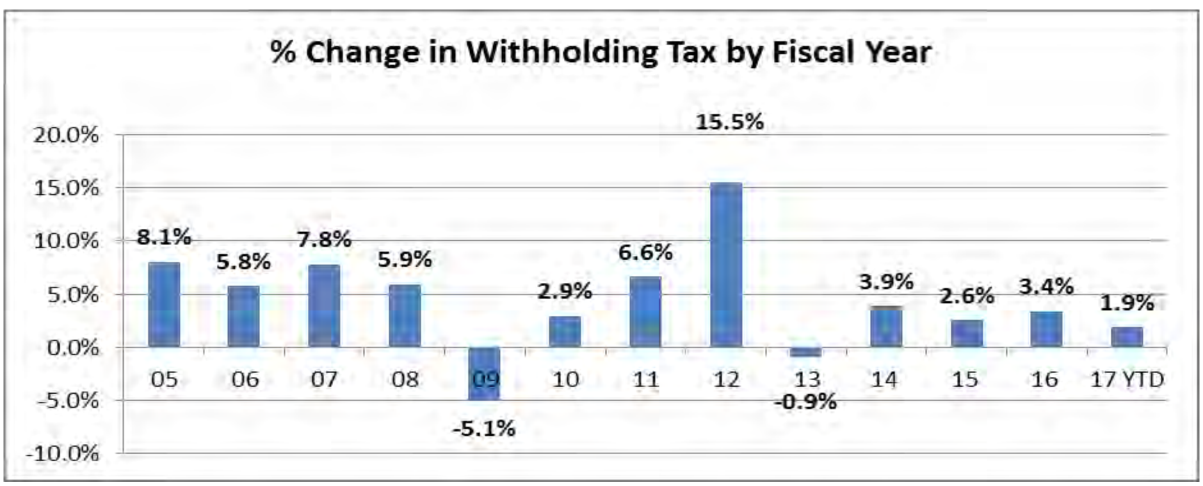
On the state spending side, net expenditures are estimated to be $125 million below the budget plan, with state payroll running almost 7 percent below last year's level and general agency operating expenditures down by more than 11 percent.

"Connecticut's overall budget performance is ultimately dependent upon the performance of the national and state economies," Lembo said.

Lembo 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 May of Fiscal Year 2017, these receipts were up 1.9 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 during the second half of this fiscal year. Withholding receipts throughout this recovery period have been running well below the increases experienced during the last recovery, with the exception of fiscal years that contained large tax increases.



- 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 added 6,700 jobs (0.4 percent) in May 2017, to a level of 1,688,300, seasonally adjusted. The April preliminary job loss numbers were revised downward from a loss of 1,500 positions to a loss of 3,100 jobs. Over the past 12-month period ending in May, the state has posted 11,000 new payroll jobs. During the last period of economic recovery, employment growth averaged over 16,000 annually.

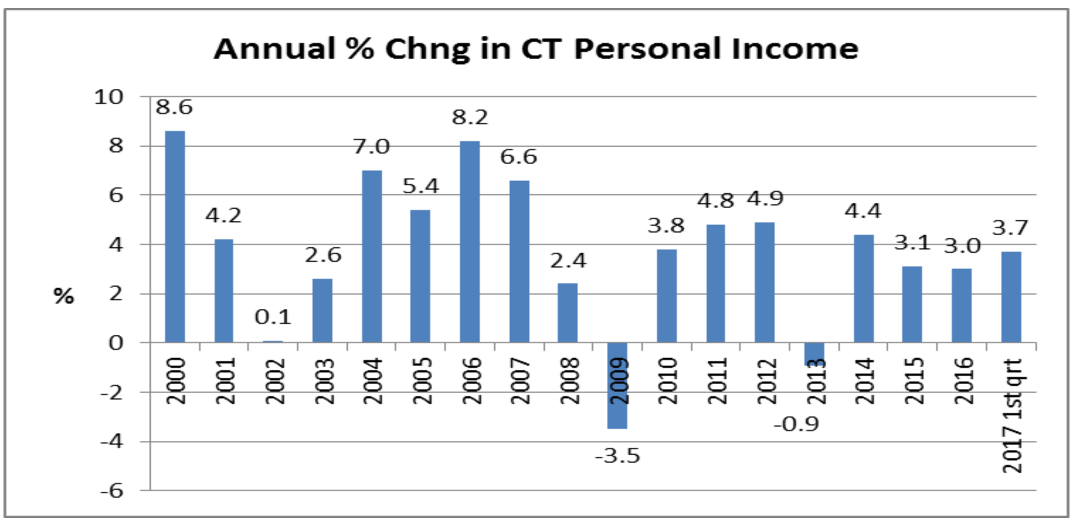
- Connecticut has now recovered 79.0 percent (94,100, or an average of 1,082 jobs per month) of the 119,100 seasonally adjusted jobs lost in the Great Recession (3/08-2/10). The job recovery is into its 87th month and the state needs an additional 25,000 jobs to reach an employment expansion. At the current job pace this will take over two years.
- Connecticut's unemployment rate for May was unchanged from last month at 4.9 percent. Nationally, the unemployment rate was 4.3 percent in May.

Payroll Employment Trend				
jobs in thousands				
Sector	5/17	5/16	Gain/Loss	% Chng.
Construction	61.1	59.1	2.0	3.4%
Manufacturing	155.8	156.1	-0.3	-0.2%
Transp. & Public Utilities	297.1	298.4	-1.3	-0.4%
Information	31.0	32.3	-1.3	-4.0%
Financial	132.6	129.8	2.8	2.2%
Prof . & Business Svc.	217.1	217.7	-0.6	-0.3%
Education & Health Svc.	333.4	327.3	6.1	1.9%
Leisure & Hospitality	158.0	153.3	4.7	3.1%
Other Services	67.7	64.5	3.2	5.0%
Government	233.9	238.2	-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 Salary income

- Average hourly earnings at $30.92, not seasonally adjusted, were up $0.21, or 0.7 percent, from the May 2016 estimate ($30.71). The resultant average Private Sector weekly pay amounted to $1,038.91, down $5.23, or 0.5 percent below 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 May 2017 was 1.9 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 28 report from the Bureau showed Connecticut personal income increasing at an annualized rate of 3.7 percent. This ranked Connecticut 37th nationally in personal income growth.



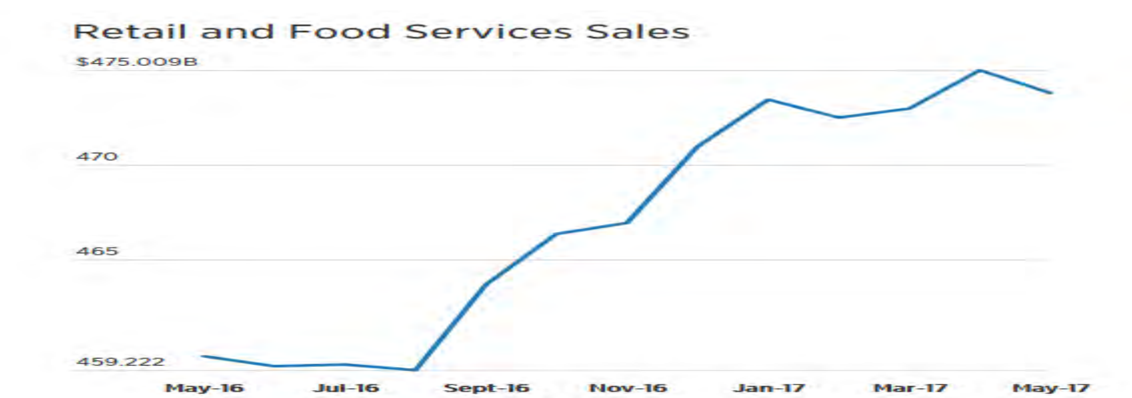
Housing

- According to a June 21 report from CT Realtors, the sale of single-family residential homes in Connecticut increased by 10 percent in May 2017 from the same month a year earlier. The median sales price of a home also increased 4 percent from $249,900 to $260,000. The May numbers reverse the declines experienced in April. The sale of townhouses and condominiums in the state posted an increased by 25.4 percent in May 2017. The median price was up 3.6 percent to $170,875.

- Nationally, existing-home sales in May increased 2.7 percent from May of last year. The median price of a home in May was $252,800.
- 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

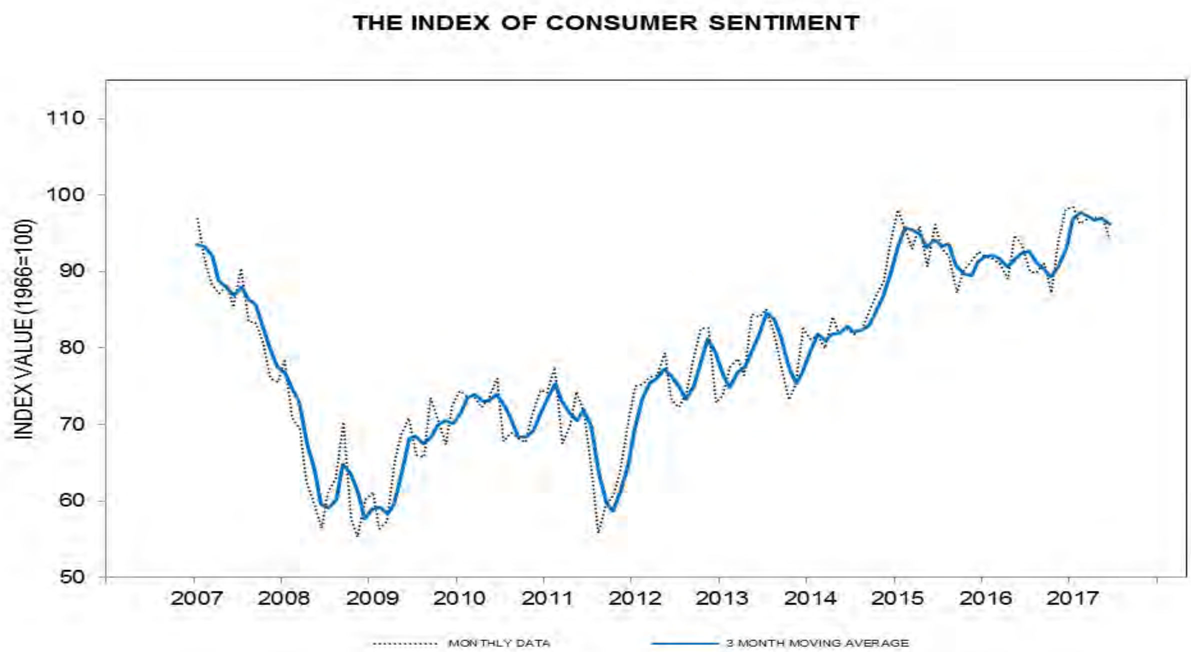
- The Commerce Department reported that U.S. retail sales fell 0.3 percent in May amid declining purchases of motor vehicles and discretionary spending after an unrevised 0.4 percent increase in April. May's decline was the largest since January 2016 and fell well short of economists' expectations for a 0.1 percent gain. Department stores saw a 1-percent decline, auto saw a 0.2-percent drop, and restaurants a 0.1-percent decline.
- Excluding automobiles, gasoline, building materials and food services, retail sales were unchanged last month after an upwardly revised 0.6 percent rise in April. This core retail sales number correspond most closely with the consumer spending component of gross domestic product.



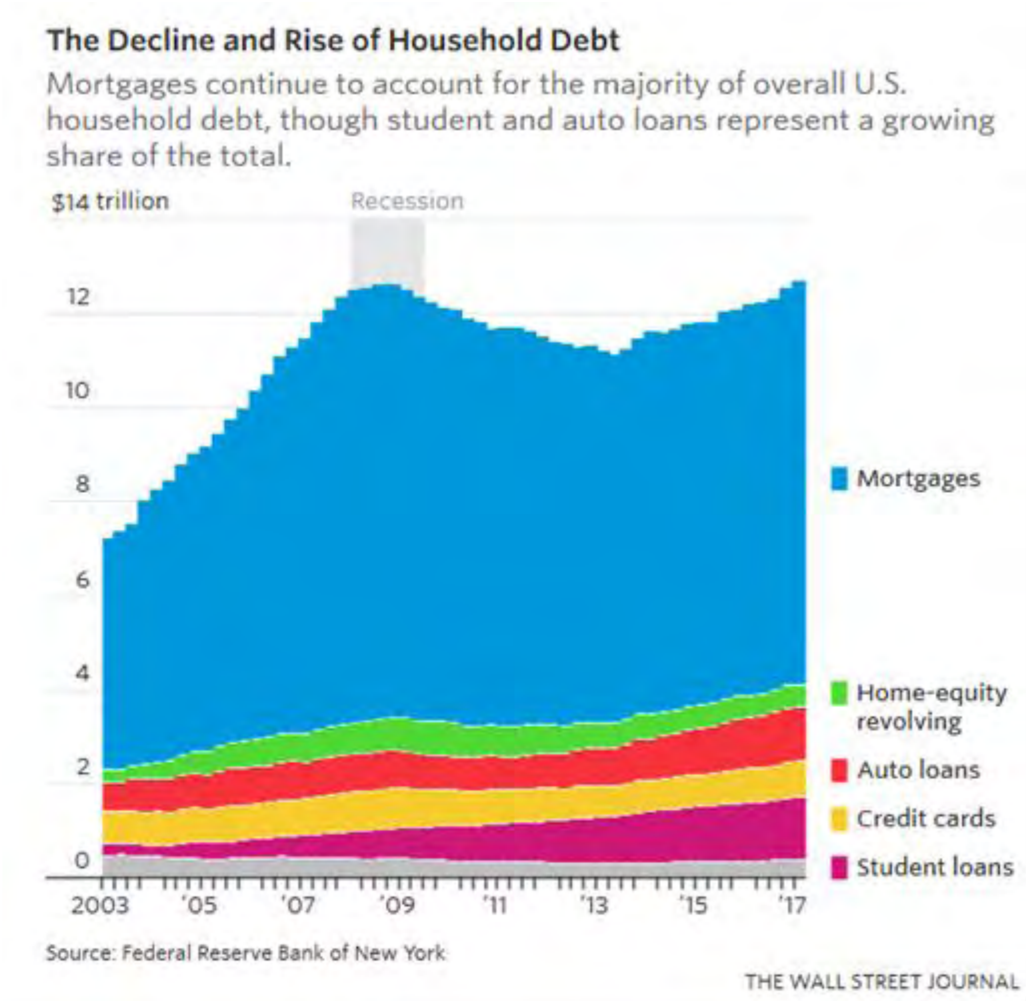
- The preliminary publication of the data for June from the University of Michigan's Consumer Survey Center showed that consumer sentiment fell to 94.5 from 97.1

Preliminary Results for June 2017

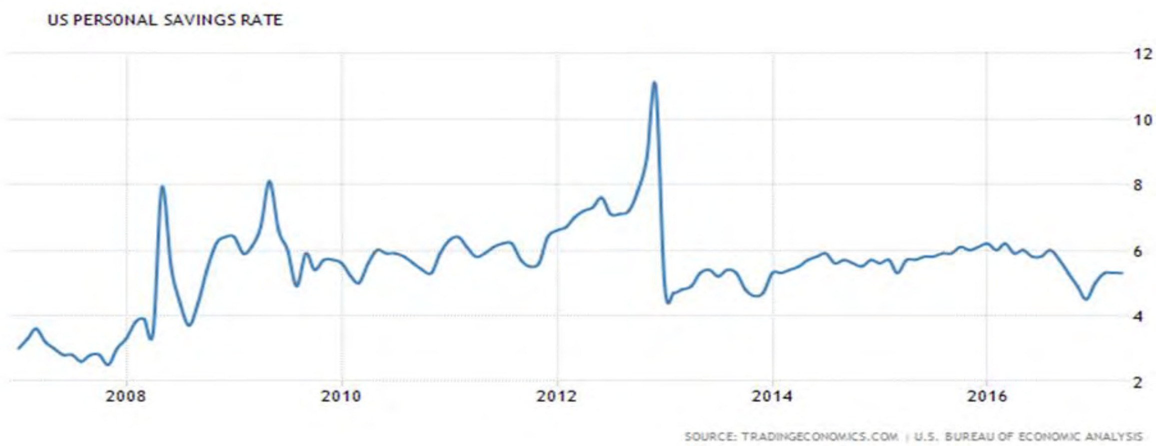
	Jun 2017	May 2017	Jun 2016	M-M Change	Y-Y Change
Index of Consumer Sentiment	94.5	97.1	93.5	-2.7%	+1.1%
Current Economic Conditions	109.6	111.7	110.8	-1.9%	-1.1%
Index of Consumer Expectations	84.7	87.7	82.4	-3.4%	+2.8%



- 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.
- 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% of GDP in the third quarter of 2008.

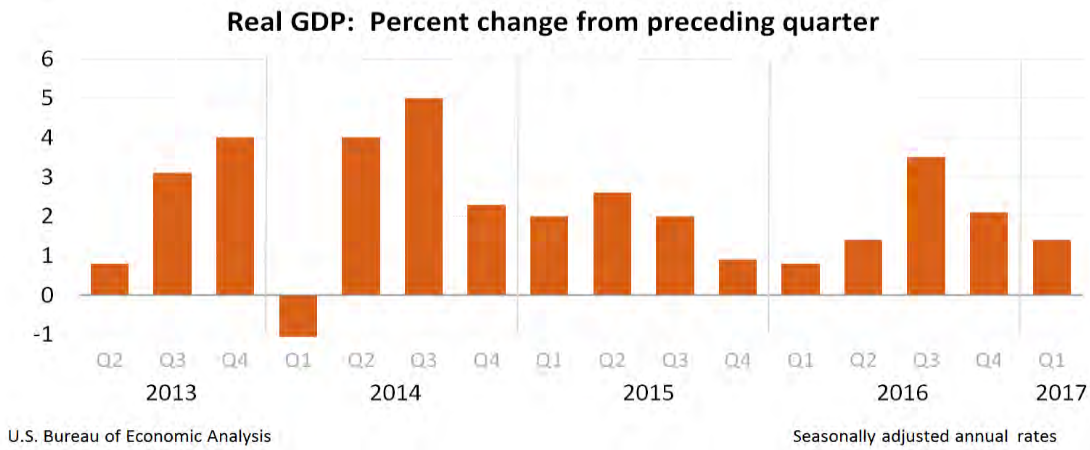


- Americans reduced their debts during and after the 2007-09 Recession to an unusual extent: a 12-percent decline from the peak in the third quarter of 2008 to the trough in the second quarter of 2013. New York Fed researchers, looking at data back to the end of World War II, described the drop as an aberration from what had been a 63-year upward trend thus reflecting the depth, duration and aftermath of the Great Recession.
- Americans owe over $1.4 trillion in student loan debt, spread out among about 44 million borrowers. That's about $620 billion more than the total U.S. credit card debt. In fact, the average Class of 2016 graduate has $37,172 in student loan debt, up six percent from 2015. The student loan delinquency rate of 11.2 percent is high and has been growing (90+ days delinquent or in default). The delinquency rate was below 5 percent during the last economic recovery period.
- In recent years, the personal saving rate in the United States has fallen sharply adding an impetus for higher levels of debt financing.



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 June 29 third estimate from the Bureau of Economic Analysis, real GDP in the first quarter of 2017 grew at a 1.4-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 downturn in private inventory investment, a deceleration in personal consumption expenditures, and a downturn in state and local government spending that were partly offset by an upturn in exports, an acceleration in nonresidential fixed investment, and a deceleration in imports.



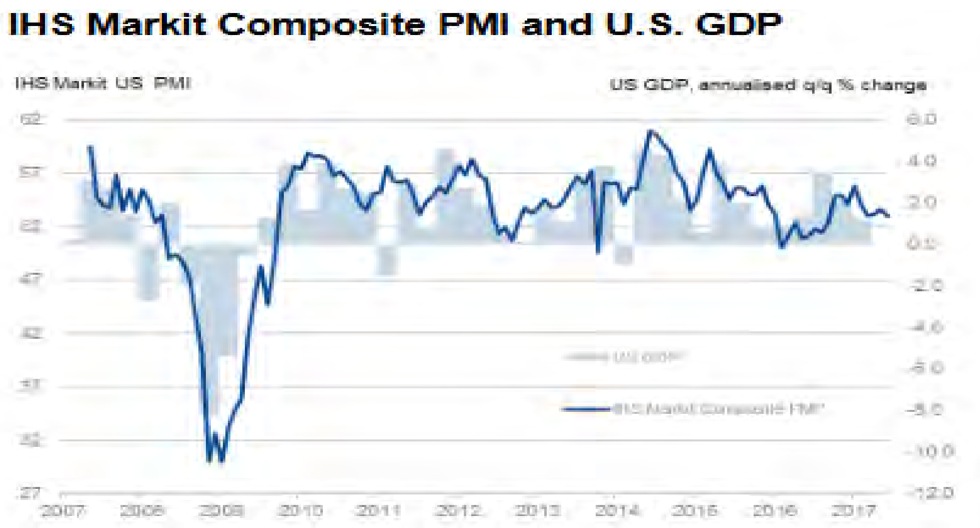
- Corporate profits after tax with inventory valuation and capital consumption adjustments fell at an annual rate of 2.7 percent in the first quarter after rising at a 2.3-percent pace in the prior three months. The Commerce Department said first-quarter profits were depressed by several legal settlements, 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.
- New orders for key U.S.-made capital goods unexpectedly fell in May and shipments also declined, suggesting a loss of momentum in the manufacturing sector halfway through the second quarter.
- The Commerce Department's June 26 report showed that overall orders for durable goods, items ranging from toasters to aircraft that are meant to last three years or longer, fell 1.1 percent in May, the biggest decline since November. They dropped 0.9 percent in April.
- Non-defense capital goods orders excluding aircraft, a closely watched proxy for business spending plans, dropped 0.2 percent in May, the largest decline since December.
- Civilian aircraft orders declined 11.7 percent and bookings for defense aircraft and parts plummeted 30.8 percent.

- The Markit Flash Purchasing Manager's Index (PMI) for June followed the same trend as the durable goods data. The major findings were as follows:

Key findings:

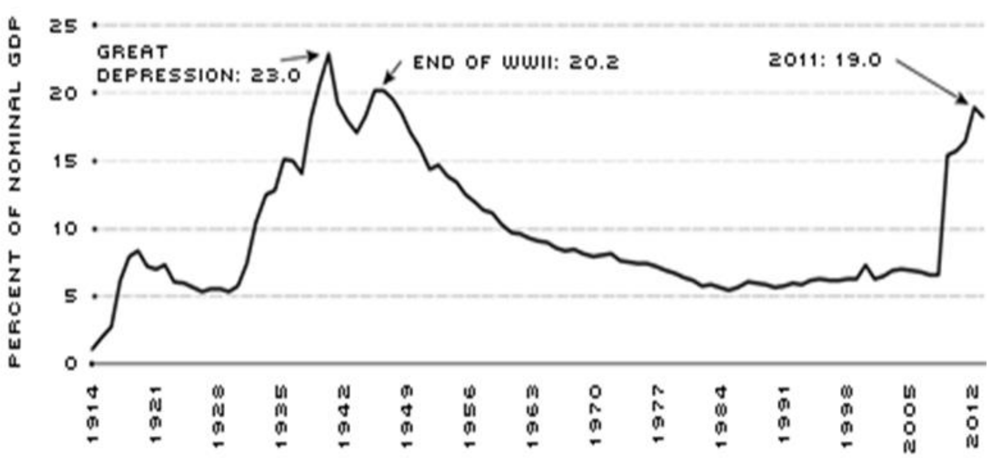
- Flash U.S. Composite Output Index at 53.0 (53.6 in May). 3-month low.
- Flash U.S. Services Business Activity Index at 53.0 (53.6 in May). 3-month low.
- Flash U.S. Manufacturing PMI at 52.1 (52.7 in May). 9-month low.
- Flash U.S. Manufacturing Output Index at 52.9 (53.7 in May), 9-month low.

Data collected June 12-22



- 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

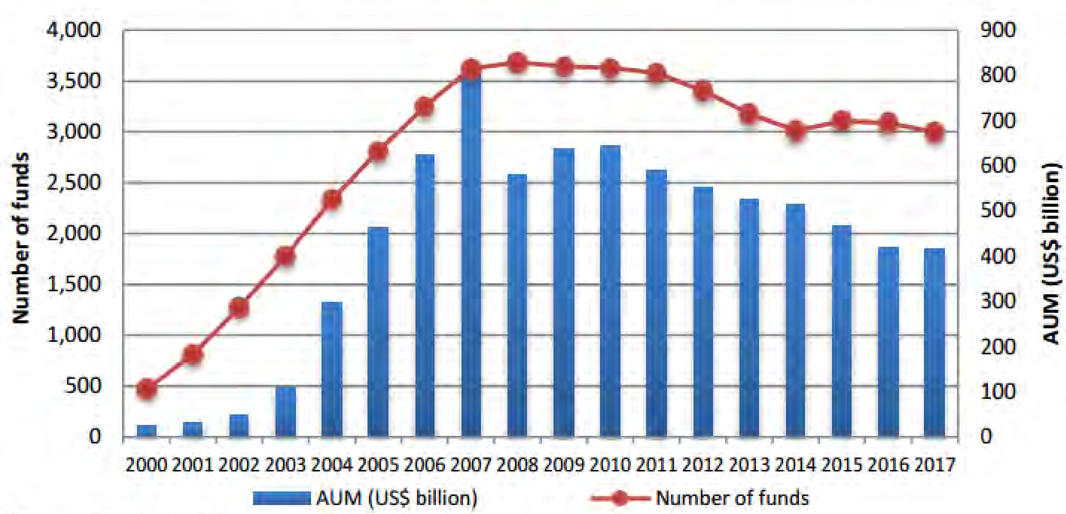


- For a bit of perspective, the Fed's holdings total $4.5 trillion; the entire commercial banking sector holds about $1.7 trillion in mortgage backed securities and Treasuries. That's all commercial banks' combined holdings.
- The Federal Reserve has published a plan to reduce its balance sheet by $2 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

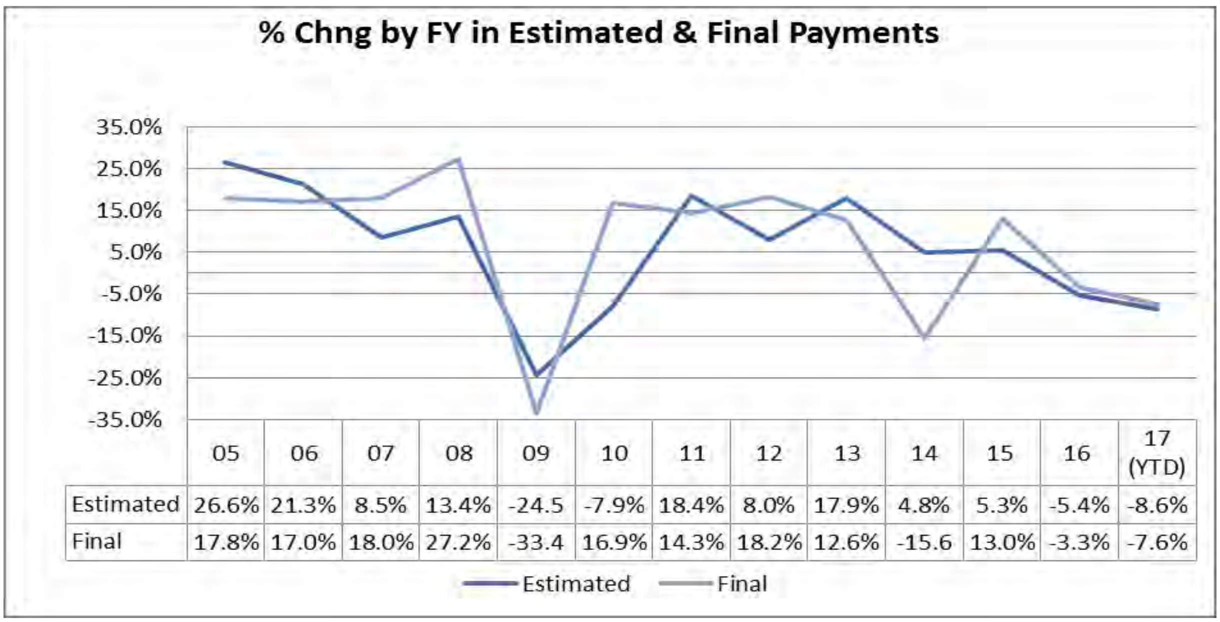
- Estimated and final income tax payments account for approximately 40 percent of total state income tax receipts. Both the estimated and final payments had a negative rate of growth in Fiscal Year 2016 and that has continued into Fiscal Year 2017.
- Over $200 million of the drop in receipts came from the state's closely monitored top 100 income earners, who are the source of an outsize proportion of the state's revenue. 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

- 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.
- It now appears that estimated and final income tax payments will be about 8 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%	-8.6%
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%	-7.6%

- Shifts in equity portfolio allocations following the presidential election and a run-up in equity values have not resulted 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*****