OFFICE of the STATE COMPTROLLER
CONNECTICUT ECONOMIC UPDATE

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State Comptroller
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In this month's edition

Outlook: One month into the new Trump Administration, consumers are feeling less confident. Recent data has shown falling consumer sentiment and future inflation expectations rising from 3.3% to 4.3%. The Consumer Confidence Index dropped by 7.0 points in February, the largest monthly decline since August 2021. Advance retail sales also fell 0.9% for the month in January, following a strong December. The economy is facing headwinds from likely reductions to federal spending (including job losses for federal workers and contractors), stubborn inflation, and policy uncertainty as President Trump makes major foreign policy changes and continues to consider a raft of new tariffs.

Why are electric rates so high? In this month's feature, we discuss some of the structural, economic and regulatory factors that make Connecticut's electric rates 62% to 107% more expensive than the U.S. average (Oct. 2024 data), depending on market segment. As the state moves towards electrification, large investments to produce much more clean energy and to update the electric grid are likely to keep prices high. Canadian energy tariffs could make matters worse.

CPI inflation picked up to 3.0% in January, likely putting further interest rate cuts on hold until it falls closer to the Federal Reserve's 2% target. CPI core inflation and the Producer Price Index also ticked up. New Englanders continue to face higher inflation (at 4.0%), with prices growing faster for housing, medical care, and utilities compared to the U.S. average. Consumer and business loans have not necessarily gotten cheaper from the Fed's full percentage point reduction to its short-term interest rate since September, as long-term bond yields remain elevated.

Commercial real estate conditions in the Hartford region: The Industrial and Multifamily segments are performing well, while the struggling Office sector has seen regional conditions improve over the past year.

Connecticut has the third lowest residential rental vacancy rate in the country at 2.2%, helping drive the 5.4% YoY rent increases here for new leases, while rent growth has flatlined nationally. In the housing market, 73% of Americans with a mortgage are "locked in" with rates below 5% according to the latest federal data from 2024 Q3, though that share is falling as buyers and sellers accept that higher mortgage rates are likely to persist.

Federal Funding at Risk: The federal government had funding obligations of $116.5 billion to Connecticut recipients last year, which is about $31,700 per capita or equal to 33% of the state's gross domestic product (GDP). It's unclear how much of that funding may be at risk as Republicans in Congress look to offset planned tax cuts and President Trump cancels programs.

KEY DATES THIS MONTH

3/7 – March U.S. jobs report
3/14 – February CT jobs report
3/12 – March CPI inflation report
3/27 – March CT jobs report & U.S. GDP 2024Q4 3rd Estimate
3/28 – CT GDP 2024Q4 1st Estimate

Did you know?

On February 5th, Governor Ned Lamont presented his recommended budget for the Fiscal Year 2026-2027 Biennium. As detailed in the Economic Report of the Governor, the budget assumes that Connecticut's economy, as defined by real gross state product (GSP), will grow by 1.6% this fiscal year (FY 2025), and by 1.0%, 1.1%, and 1.3% in the next three fiscal years respectively—slower than the 2.8% growth in FY 2024. Growth in personal income in Connecticut is projected at 4.7% in FY 2025, 5.1% in FY 2026, 4.5% in FY 2027, and 4.4% in FY 2028, after growing 5.6% in FY 2024.

About OSC

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The mission of OSC is to provide accounting and financial services, to administer employee and retiree benefits, to develop accounting policy and exercise accounting oversight, and to prepare financial reports for state, federal and municipal governments and the public.

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ELECTRICITY COSTS IN THE SPOTLIGHT

In the past year, many businesses and residents in Connecticut have faced a significant increase in their electricity bills. A combination of record hot summer weather driving increased usage, a notable hike in the Public Benefits Charge, and the usual increase for winter rates led to a steep rise. Connecticut already had some of the highest electricity rates in the country, and this latest surge brought financial strain to residents and businesses still reeling from inflation.

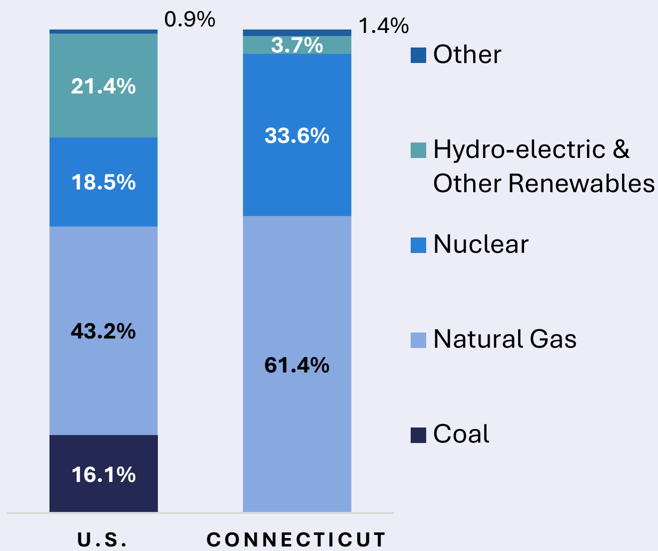
Why Connecticut's Electricity Costs So Much

Connecticut faces unique challenges that make its electricity among the most expensive in America, ranking third highest after Hawaii and California. Understanding these costs requires looking at four key factors that shape the state's energy landscape. See the appendix for prices over the past 6 years.

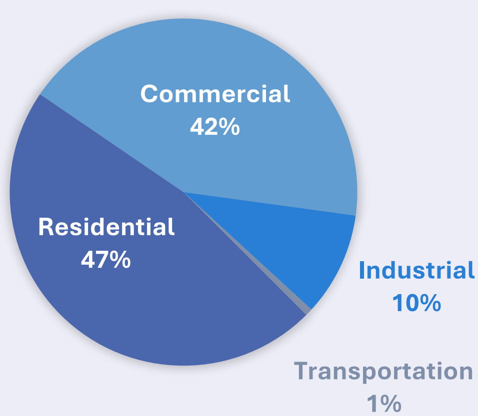
Natural Gas Dependence Drives Volatility

Connecticut relies heavily on natural gas for about 60% of its electricity generation. Without in-state storage facilities and limited pipeline capacity, winter prices spike when heating demand competes with power generation. This particularly impacts businesses, which often see their highest energy bills during peak winter periods.

NET GENERATION BY SOURCE



CONNECTICUT RETAIL SALES OF ELECTRICITY BY SECTOR



Source: Energy Information Administration, 2023

Infrastructure: Complex and Costly

The state's dense population requires an extensive network of power lines and substations. Aging infrastructure needs constant upgrades and trees must be trimmed away from wires. Extreme weather events lead to storm damage and recovery costs. These necessary costs get passed directly to consumers and businesses through their utility bills.

Changing Power Sources

Connecticut's energy mix is in transition as the state moves towards a goal of 100% clean energy by 2040.

Nuclear power from Millstone provides 34% of generation, offering stable, zero-carbon emission baseline power. The shift to renewables requires significant upfront investment and often locks in higher rates in long-term contracts, with natural gas still generally cheaper to build and operate. For example, the state's fixed-price purchase agreement with Millstone's owner results in ratepayer costs when market electricity prices are lower than the fixed price. While clean energy sources promise long-term benefits, the transition period brings higher costs.

Future Demand Challenges

While electricity demand had been falling for years, that pattern has now changed. According to grid operator, ISO New England, "Over the next 15 years, the region needs to add almost twice as much new generation as it added in the last 25 years." By the early 2030s, the annual energy needed to heat buildings and charge electric vehicles is expected to be more than 20 times higher.

ELECTRICITY COSTS, CONTINUED

What does it mean for residents and businesses? While some of the recent spike in electricity costs is temporary (for repaying pandemic-era unpaid bills until April 30th), the forces making Connecticut's electricity some of the most expensive in the nation are unlikely to change anytime soon. The state currently imports electricity from Canada that will become more expensive if proposed tariffs go into effect, driving additional costs.

For both consumers and businesses, there are programs and resources to help improve energy efficiency, which is the most direct way to reduce electricity costs. Several programs are supported through the public benefit charge on electric bills, so taking advantage of those is a way to benefit from some of that expense.

The Public Benefits charge is a usage-based component of your electric bill. It reflects costs for energy efficiency, renewables, hardship assistance, contracts to ensure reliability in the system, and other state energy policy directives.

Its dramatic increase for Eversource customers from 1.82 cents to 8.4 cents per kilowatt-hour (roughly $13 to $59 on an average bill) in mid-2024 was for two reasons, amounting to over $800 million for Eversource to recover from its customers over only ten months. The first, associated primarily with the Millstone nuclear power station, represents 77% of the late-2024 public benefits charge. The second, repaying the utilities for unpaid bills during the State's four-year pandemic moratorium on electricity shut offs, as well as the usual public benefit charge programs, account for the remaining 23%. The repayment of pandemic-era unpaid bills is expected to end on April 30th of this year, giving some relief.

The Millstone Agreement

Millstone nuclear power station in Waterford supplies the New England grid with reliable, zero-emission clean energy. In 2017, facing competition from lower-cost natural gas generators, Millstone's owner threatened to shut it down, which would have been a huge blow to the State's efforts to transition to zero-emission electricity by 2040.

With bipartisan support, the State entered into a 10-year power purchase agreement that required Eversource and United Illuminating Co. to purchase about half of Millstone's output (for 2019 through 2029) at 5 cents per kWh. The utilities then resell that power to the grid at market prices. The losses or gains are reflected in ratepayer bills as part of the nonbypassable federally mandated congestion charge (NBFMCC). When energy prices in the open market are higher than 5 cents per kWh, the Millstone contract saves money for ratepayers. When energy market prices are lower than 5 cents per kWh, the Millstone contract costs ratepayers.

The table below, from the Department of Energy and Environmental Protection (DEEP), shows the utilities' actual costs or savings over the first 5 years of the contract. The first year, for example, the utilities had a combined loss of $47 million because the cost to buy Millstone's power at 5 cents per kWh was higher than what they could sell that power for on the open market. When the price of natural gas spiked following Russia's invasion of Ukraine in 2022, the agreement gave the utilities access to cheap electricity, generating a $277.2 million gain. Aside from 2022, the fixed rate has been expensive. **Over the first 5 years, the Millstone agreement resulted in net costs of $131.4 million, driving increases in the Public Benefits Charge most years.**

Connecticut Electric Utilities' Actual Costs/(Savings) from First 5 Years of the Millstone Contract ($ Millions)

Electric Distribution Company	2019	2020	2021	2022	2023	Total 5 Years	Annual Average
Eversource	37.7	188.6	43.5	(232.4)	64.4	101.8	20.4
United Illuminating Co.	9.2	46.1	9.3	(44.8)	9.8	29.6	5.9
Total	47.0	234.6	52.8	(277.2)	74.2	131.4	26.3

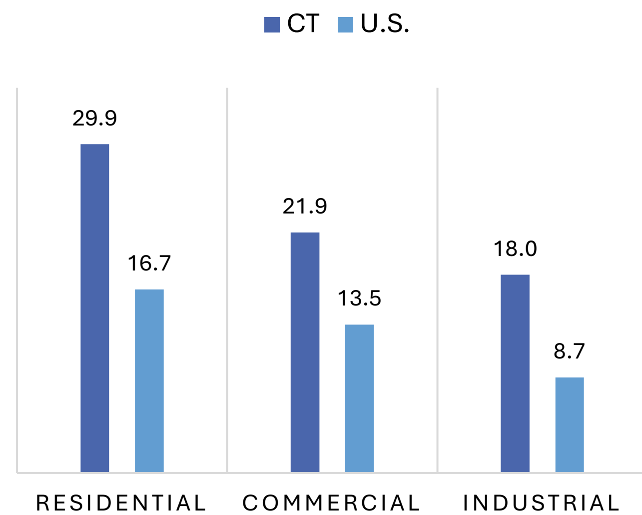
Source: DEEP

Whether by necessity or chance, Connecticut's economy is less reliant on energy than most other states. Connecticut ranks 9th among states for using the lowest amount of energy on a per capita basis, and 5th for using the lowest amount of energy per dollar of gross domestic product (GDP).

The Department of Energy and Environmental Protection recently released a white paper that explains some of the factors driving Connecticut's high transmission charges. Check it out.

"New England spends $5.90 on transmission for every MWh of demand served, which is higher than in any other U.S. region."

AVERAGE RETAIL ELECTRICITY PRICES (CENTS PER KWH)



Source: EIA, Q3 2024 data

CONSUMER CONFIDENCE FALLS IN FEBRUARY

Consumers are feeling less confident this month, as many worry about more inflation and the anticipated impact of tariffs. The Conference Board's Consumer Confidence Index dropped sharply from 105.3 to 93.3 in February (1985=100).

"In February, consumer confidence registered the largest monthly decline since August 2021," said Stephanie Guichard, Senior Economist, Global Indicators at The Conference Board. "This is the third consecutive month on month decline, bringing the Index to the bottom of the range that has prevailed since 2022. Of the five components of the Index, only consumers' assessment of present business conditions improved, albeit slightly. Views of current labor market conditions weakened. Consumers became pessimistic about future business conditions and less optimistic about future income. Pessimism about future employment prospects worsened and reached a ten-month high."

Another measure, the Index of Consumer Sentiment from the University of Michigan, also showed sentiment falling. It plunged 9.8% from January to February, with deterioration across age, income and wealth groups.

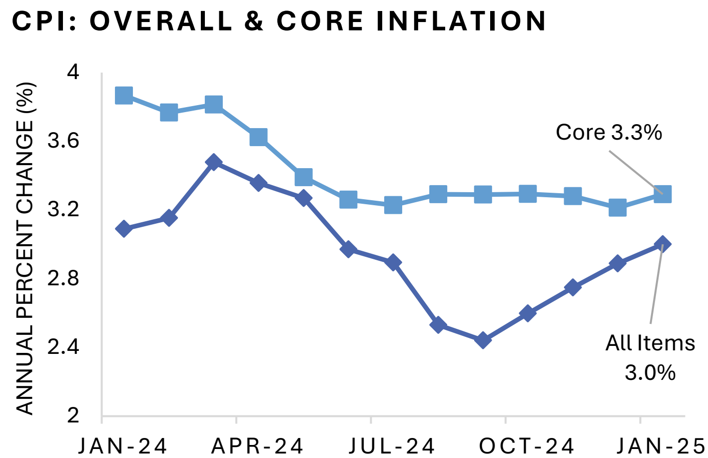
Consumer spending drives the U.S. economy, so signs consumers may start pulling back are watched closely. However, the track record of these indices in predicting consumer behavior since the pandemic has been mediocre, as people have generally felt negative about the economy but continued to spend.

A more troubling reading relates to inflation expectations. How much inflation consumers expect next year rose significantly (from 3.3% to 4.3% on average) according to the University of Michigan, marking the highest reading since November 2023 and the second month in a row of unusually large increases.

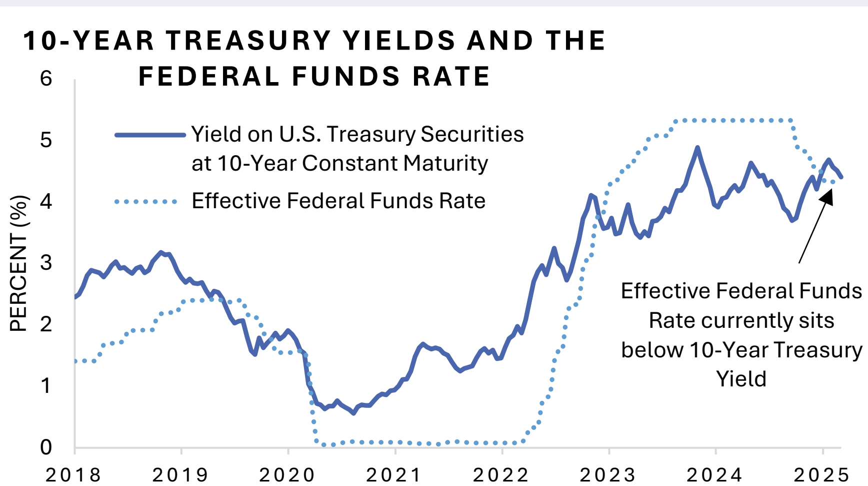
Future inflation expectations matter because they can act as self-fulfilling prophesies. If people buy more now (to get ahead of price increases in the future) that increases demand. If there are supply constraints, increased demand pushes up prices, resulting in inflation. If inflation shows signs of taking off again, the Federal Reserve may need to raise interest rates – exactly the opposite of the plan laid out in September to slowly make borrowing less expensive by lowing interest rates.

STUBBORN INFLATION AND INTEREST RATES

The latest Consumer Price Index (CPI) report showed that inflation is still elevated, lowering expectations for the Federal Reserve to further reduce short-term interest rates in the coming months. The CPI rose 0.5% from December to January, which is the largest single month increase in over a year. Consumer prices rose 3.0% for the year (up from 2.9% in December). Eggs have seen a sky-high price surge of 53% since last January, thanks to reduced supply related to avian flu. Core inflation, which excludes volatile food and energy costs, rose to 3.3% annually (up from 3.2% the prior month). It has proven to be sticky, remaining at 3.2% or 3.3% since June.



New Englanders continue to face higher inflation, with the New England CPI growing 4.0% year-over-year in January (up from 3.3% in December). Housing, which accounts for a third of the index, continues to see higher annual price growth compared to the U.S. average. Medical care and utility prices are also rising faster in the Northeast.



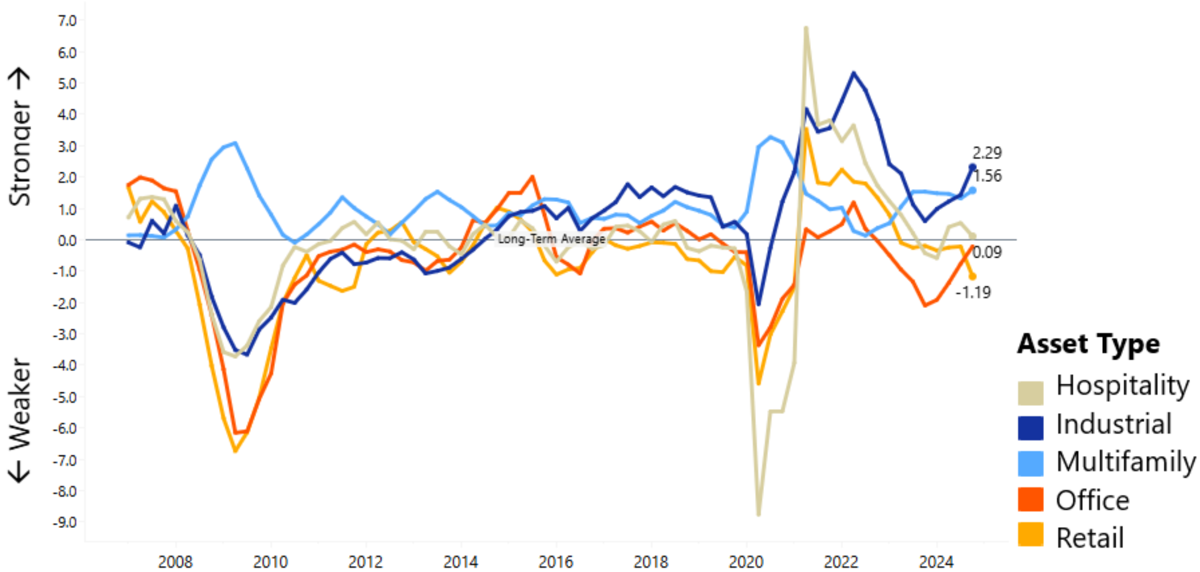
The Federal Reserve Open Market Committee is expected to wait for progress towards its 2% inflation target before further cutting the federal funds rate. The rate at which banks can borrow is approximately 4.3%, down from 5.3% in early September. Rates on longer-term consumer and business loans are higher and do not necessarily move in tandem, as they are influenced by other factors like the yield on U.S. Treasury bonds (now 4.3% for the 10Y). Inflation expectations, which ticked up among consumers this month, expectations about economic growth, and budget deficits matter.

COMMERCIAL REAL ESTATE: HARTFORD REGION

Commercial real estate (CRE) is one sector of the economy that is highly sensitive to interest rates for financing deals and refinancing debt. Higher rates combined with pandemic shutdowns, the shift to remote work, and rising demand for apartments, have taken the commercial real estate market on a wild ride, with performance varying by sector. This month we look at CRE in the center of the state – the Hartford core business statistical area (CBSA).

The Federal Reserve Bank of Atlanta publishes a Commercial Real Estate Market Index (CREMI), with index values for each quarter indicating a local CRE market's health relative to that segment's long-term local average. Positive values indicate a segment is performing above its own long-term average. The index reflects both CRE indicators (e.g., occupancy rates, market cap rates, changes in asset values, net absorption) and a few economic indicators.

Federal Reserve Bank of Atlanta Commercial Real Estate Market Index
CREMI Scores Over Time: Hartford, CT



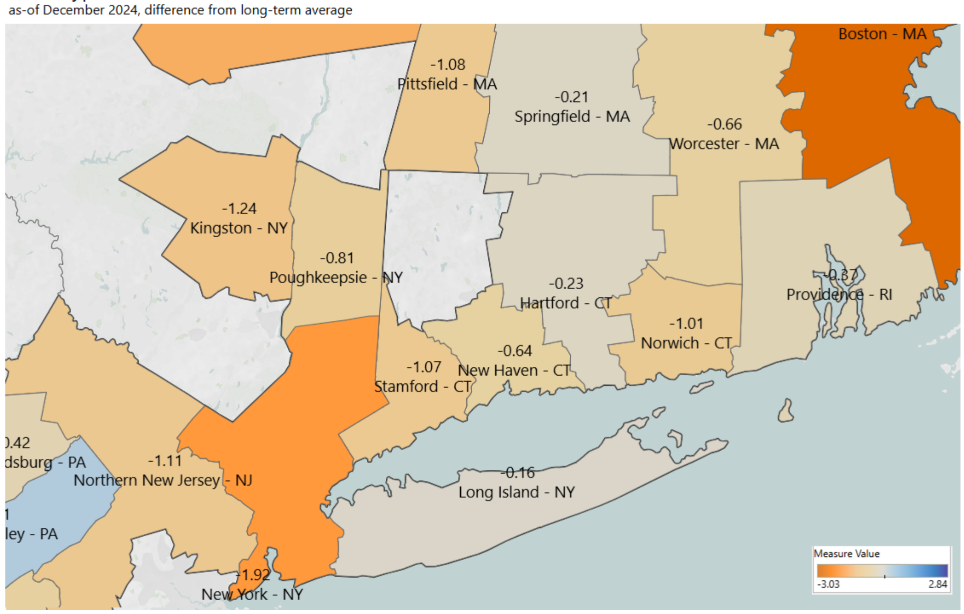
The graph of CREMI values shows that for the Hartford area, the Industrial and Multifamily market segments are doing very well, with both seeing further improvement in 2024 Q4. Demand for warehousing and logistics, part of Industrial, has been driven by the boom in online shopping. Strong housing demand has supported the Multifamily market.

On the other hand, the Retail segment (i.e., stores) is under-performing and saw worsening conditions at the end of 2024. Enclosed mall locations are hurting. Hospitality (i.e., hotels) saw the most extreme impact from the pandemic but is back to business as usual this year.

Based on the CREMI, the Office market in Greater Hartford has been improving since 2023 Q4 but remains below its long-term average. It was also badly affected by the pandemic, as staff going remote led many companies to reassess their office space needs. That prompted a decline in property valuations, especially for lower-quality office space, which made refinancing difficult amidst higher interest rates after 2022. Several downtown Hartford office buildings are in receivership, and the central business district's vacancy rate is 32.8%. It's not clear how that will improve. Still, the Office market for the wider Hartford region is seeing improvement based on CREMI.

Facing similar pressures, the Office market is performing below its long-term average in the whole region, as shown by the map below. The other Connecticut markets (Stamford, New Haven, and Norwich) were below their historical averages by more than Hartford in 2024 Q4, and New York City and Boston were significantly lower (around two standard deviations below).

Atlanta Federal Reserve Bank: Commercial Real Estate Market Index (CREMI)
Asset Type: Office
as-of December 2024, difference from long-term average



Connecticut Housing Market Trends

January 2025

+4.0%
Homes Sold YoY
Redfin

+3.3%
Active Listings YoY
Realtor.com

+3
Days on Market YoY
Realtor.com

$415,500
+9.9%
Median Sales Price, YoY
Redfin

+5.4%
Statewide Median Rent YoY
Apartment List

CONNECTICUT HOUSING MARKET

Connecticut has one of the lowest rental vacancy rates in the country, driving rent increases here while rent growth has flatlined nationally. The U.S. Census Bureau reported that the Connecticut rental vacancy rate was 2.2% in the last quarter of 2024, third lowest behind Rhode Island and Maine. On average, Connecticut rents in January were up 5.4% year-over year, according to Apartment List, versus -0.5% nationally. Responding to that demand, Connecticut multifamily housing building permits increased 10.3% in 2024.

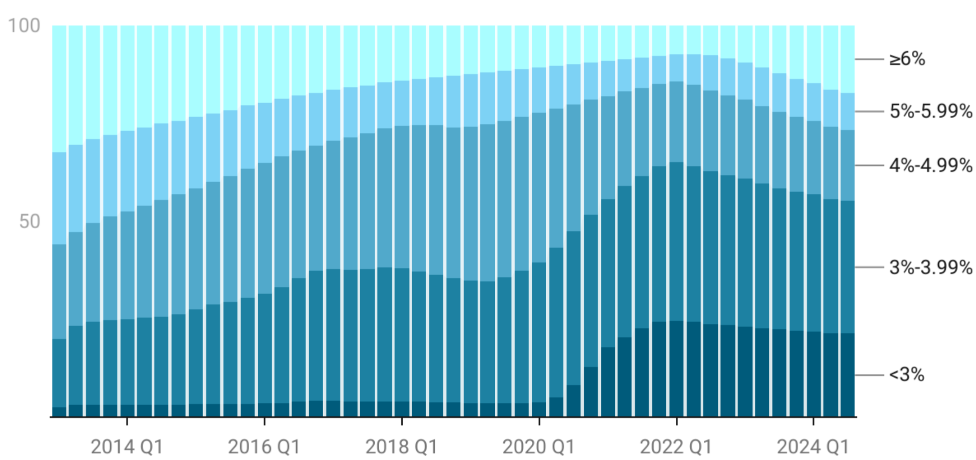
Rising housing costs are less of an issue for existing homeowners, most of whom locked in lower cost mortgages before rates surged in 2022. 73% of Americans with a mortgage have rates below 5% according to the latest federal data from 2024 Q3, as analyzed by Redfin. Mortgage rates have averaged 6.8% since last February, discouraging homeowners with lower rates from giving them up, and significantly slowing sales activity. See the graph showing the proportion of U.S. mortgage holders with different rates below.

Now, the share of people with sub-5% mortgage rates is shrinking as both buyers and sellers come to terms with the reality that higher interest rates are likely to here to stay. With little improvement in rates and no improvement in home prices expected this year, Connecticut sales are picking up compared to a very sluggish 2023. Connecticut's population grew by 32,000 residents last year according to the latest estimates, which is also contributing to higher demand and thus prices for all types of housing.

Connecticut home sales increased 4.0% in January on a year-over-year basis according to Redfin, marking four straight months of improvement over last year. Homes are also spending a few more days on the market. The median home price is $415,500 in Connecticut according to Redfin.

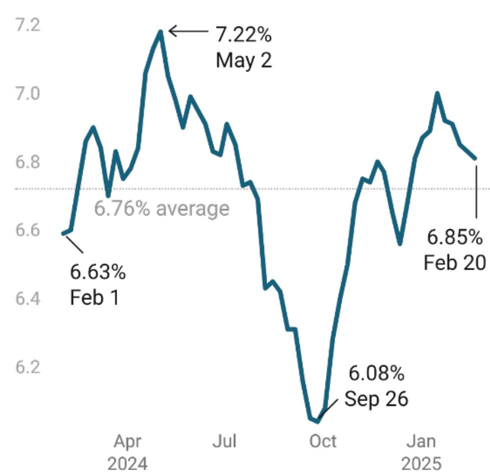
73% of Mortgage Holders Have an Interest Rate Below 5%

Share of outstanding U.S. mortgage loans by mortgage rate



Source: FHFA data as analyzed by Redfin • Created with Datawrapper

30-Year Fixed Rate Mortgage Average: Past Year



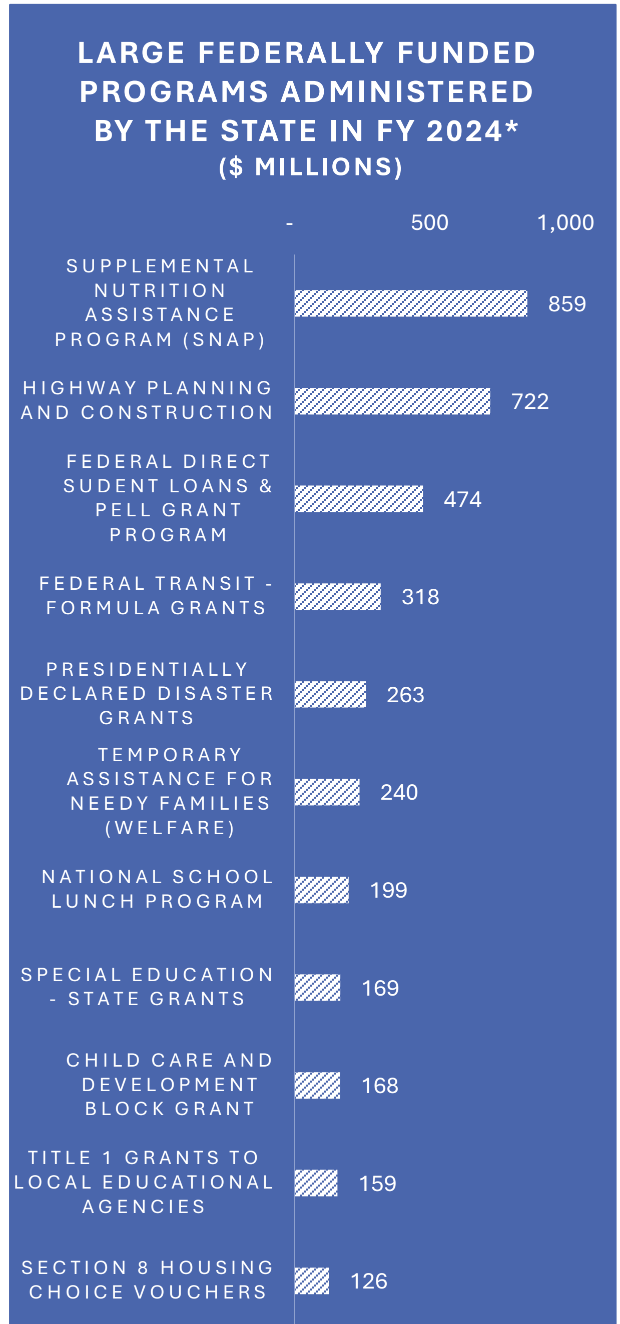
Source: Freddie Mac • Created with Datawrapper

HOW MUCH FEDERAL FUNDING FLOWS TO CONNECTICUT?

Federal funding plays a major role in Connecticut's economy, supporting essential programs and jobs across the state. When the federal Office of Management and Budget ordered a pause in federal payments in late January, it highlighted just how important that funding is. As the federal government eliminates programs that don't align with President Trump's agenda and Congress looks for savings to offset tax cuts, fewer federal dollars may flow into the state.

In Connecticut, federal funding accounted for just over a third of state revenue in the fiscal year ending June 30th, 2024. The State disbursed $14.3 billion in federal funds in FY 2024 for hundreds of different programs, with just under half of that ($6.7 billion) supporting Medicaid. Also known as HUSKY, the program provides public health insurance mostly for the poor and is jointly funded by the state and federal governments. It covers nearly 1 in 4 state residents and pays for two thirds of nursing home bills nationally.

The graph shows other high-dollar federally funded programs that pass through the state. Local governments likewise receive federal funding that is crucial for balancing their budgets. Given budget constraints, there is limited capacity for the State to replace lost funds.



*Not shown includes Medicaid, Coronavirus State & Local Fiscal Recovery Funds, Unemployment Insurance, and Education Stabilization Fund, which were also among the largest programs in FY 2024.

But federal funding has a much larger impact on the Connecticut economy. The federal government made spending commitments to Connecticut recipients worth $116.5 billion between July 2023 and June 2024 (state FY 2024), according to USASpending.gov. For a sense of scale, that amount is roughly 33% of the State's gross domestic product (GDP), which was $356.4 billion in FY 2024. GDP measures the total value of all final goods and services produced in the state in a year.

The bulk of that funding comes from the Department of Health and Human Services (60.4%), which pays for Medicare and Medicaid, and the Social Security Administration (15.2%). Social Security supports the daily living expenses of about 20% of the state's population. Medicare and Medicaid spending support healthcare jobs and needed patient care.

The Department of Defense (DOD) had the second-highest obligations among federal agencies in FY 2024 at $20.4 billion (17.5%) as Connecticut's economy is powered by military contracts for jet engines, helicopters, and submarines. Connecticut ranks 4th in the nation for defense contracts, and first on a per capita basis. There are approximately 47,000 Connecticut jobs in the Transportation Equipment Manufacturing sector, which delivers on most of those federal contracts.

In Connecticut, 18,626 employees worked for the federal government as of June 2024, with about 5,700 doing public administration jobs. The current downsizing of the federal workforce is likely to cost some federal jobs here. Thousands more jobs could be affected among federal contractors and organizations that rely on federal funding. Other impacts, like reduced scientific research and skyrocketing student loan payments, could also impact the state's economy.

APPENDIX

Connecticut Housing Market	Jan-25	Jan-24	% Change or Change
Home Sales (Redfin)	2,412	2,319	4.0%
Median Sales Price (Redfin)	415,500	377,900	9.9%
Active Listing Count (Realtor.com)	3,271	3,167	3.3%
New Listing Count (Realtor.com)	2,254	2,128	5.9%
Freddie Mac U.S. 30-Year Fixed Rate Mortgage Average (%) (Week ending 2/20/25 and 1/25/24)	6.85	6.77	0.08
Median Days on Market (from listing to close, Realtor.com)	62	59	3
Average Sale-to-List Price Ratio (Redfin)	100.6%	101.3%	-0.7%
Median Rent for New Leases (Apartment List)	1,664	1,579	5.4%
Single-family Housing Permits YTD-December (Census Bureau)	2,114	1,960	7.9%
2+ Unit Structures Housing Permits YTD- Dec. (Census Bureau)	3,629	3,289	10.3%

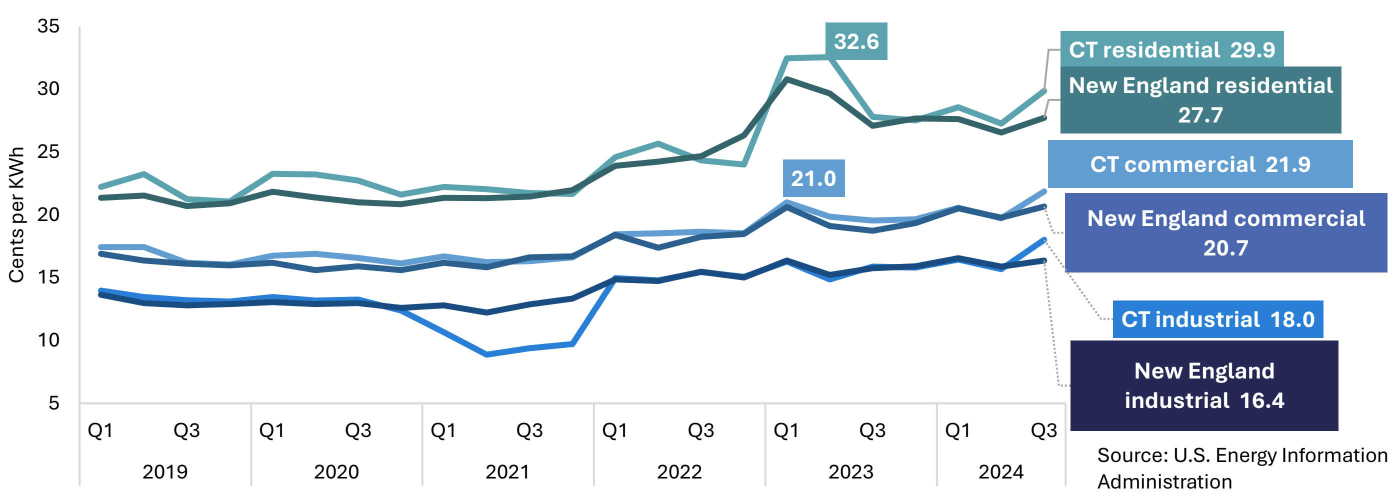
Some Data Retrieved from FRED, Federal Reserve Bank of St. Louis

Connecticut Labor Market: Most Recent Data	Dec-24	Nov-24	Dec-23
Unemployment Rate	3.0%	3.0%	4.2%
Total Unemployed	57,400	56,900	79,900
Total Nonfarm Employment	1,715,900	1,710,800	1,695,800
Job Growth	5,100	1,800	-3,900
Job Openings to Unemployed Ratio	1.3	1.4	1.1
Quit Rate	1.6	1.5	2.1
Average Monthly Initial Unemployment Claims	5,603	2,837	4,933
Labor Force Participation Rate	64.4%	64.1%	64.3%
Average Hourly Wage	$38.98	$38.30	$36.93

Data Source: Bureau of Labor Statistics & CT Department of Labor

Average Retail Electricity Prices: 2019 through 2024 Q3

Cents per Kilowatt hour (kWh)



Source: U.S. Energy Information Administration