

CONNECTICUT ECONOMY

By Donald Klepper-Smith

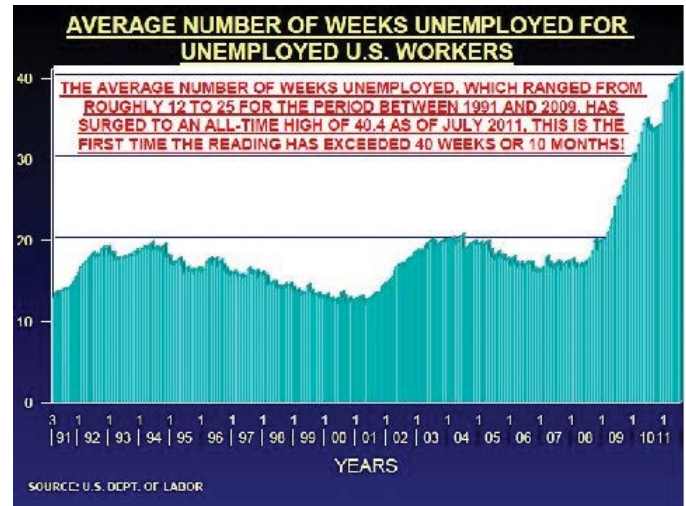
When I think of August and all that happened, the first things that come to mind are the S&P downgrade, the debacle in Congress over the debt ceiling, and wild weather. It all spells one word: uncertainty! And historically, uncertainty is a job killer. So where do we stand in Connecticut on jobs recovered relative to those lost during recession? The Connecticut job recovery rate--defined as jobs gained back as a percentage of those lost during the recession – is now slightly lagging the national averages given August data. Domestically, we presently have a recovery rate of 21.6% vs. 20.3% in Connecticut. The data shows that the domestic economy lost 8.750 million jobs in the last recession, equating to a loss of 6.3% of our domestic employment base. But we have now added back 1.886 million new US jobs since the lows. In Connecticut, we have now added back 24,200 jobs since the revised low recorded in January 2010, following the loss of 119,200 jobs on a peak to trough basis.

The August numbers for Connecticut were far below my expectations given the fact that we saw no effective change in the U.S. job numbers. It's been a growing concern in recent months that we're now teetering on the edge of another recession. It's very easy to see a "slow growth" economy turn into a "no growth" economy in the space of a heartbeat. I point out that if we do enter another downleg, it will be a separate and independent event, not an extension of the previous recession. In 2007-09 it was primarily the private sector with consumers, businesses, and many financial institutions at risk. Today, the focus is on governments. The public sector – federal, state, and local government - is now engaged in the same deleveraging exercise that the private sector went through several years ago. One common theme, however, is the extreme loss of confidence – business confidence, consumer confidence, and investor confidence.

The State's unemployment was recorded at 9.0% in August, roughly on par with the domestic average of 9.1%, down one-tenth from last month. As I've mentioned previously, the job numbers are far more important than the unemployment numbers because of linkages to incomes, spending, and consumer confidence.

My current expectation is that unemployment statewide will range from about 8.5% to 9.5%, but remain high by historical standards over the next several years as profound structural changes and modest demand for labor keeps unemployment high for the foreseeable future.

Connecticut's economic recovery continues in 2011 at a well below average pace. Typically, the State posts average annual gains in the 3%-4% range for our key measure of economic growth- the Farmington Bank Business Barometer (FBBB) – but this year I expect that we'll see growth in the 1% to 1.5% range, about HALF of the typical gains seen during prior expansions.



Some other data points worth noting for the month:

Our broadest measure of CT consumer spending power, **CT real disposable income**, which is income after taxes adjusted for inflation, is now up a slight 1.0% YTD for the year after eight months of data. In effect, it's hard to make the argument for a robust economic recovery when incomes gains are literally "crawling along". On the auto front, **CT new auto registrations** are up a healthy 29% YTD through August, while **New England Consumer Confidence** as reported by the Conference Board came in at 35.1 in August, the lowest level since June 2009.

What really matters is jobs, confidence, consumer spending power, and the level of uncertainty that is now prompting businesses to hold back on spending plans and hiring, while also putting a damper on personal consumption.

Bottom line: Consumer confidence is still 20-25 points away from what would be deemed economic recovery. As mentioned on multiple occasions in previous newsletters, massive structural changes have come to bear on the domestic labor situation, and it is taking longer and longer to recover jobs lost in recession. These structural changes include costs of doing business, health care costs, outsourcing, use of temp workers, the growing use of the Internet, globalization, offshoring, demographic shifts, DC bureaucracy, and the substitution effect of capital for labor.

I also have a major concern that the traditional tools for stimulating economic growth, namely monetary and fiscal policy, are increasingly ineffective or politically less palatable, meaning that it is going to be harder to stimulate the economy this time around. This means that the next recession could be a problem for many consumers and businesses. In effect, heading into the 2012 elections, it is very likely that the economy you see today is the economy you get down the road! After the fiasco and missteps in Congress about raising the debt

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ceiling, the growing concern about fiscal discipline, and only the modest success of the \$787 billion stimulus package, I think there is little appetite for another fiscal stimulus package. This is not surprising when you consider we should have seen 4%-5% growth in real GDP as a result, but only wound up with gains in the 3% range. Rather than have the U.S. government allocate stimulus monies on a political basis, I think it makes far more sense to let the marketplace determine whom the winners and losers will be. Therefore, let's put the money back into the hands of the private sector where it will do the most good. The role of government should not be to pick winners or losers, but to create an environment that is conducive to growth for all businesses and let the marketplace make that determination. Going forward, "too big to fail" isn't going to sit well in the small business sector, that's for sure.

Regarding monetary policy, the Fed can't really do any more than what it has done, and interest rates can't go any lower. Moreover, the Fed has been very clear with its recent FOMC statements, and there is little comfort in Bernanke's assessment of the situation. I also have some concerns about how consumers are ill-prepared to weather another recession following one of the worst economic downturns dating back to WWII.

In the US and across Connecticut, savings have been depleted, stock portfolios have been damaged, and the broadest measures of consumer spending power are underperforming thus far in economic recovery. And even with oil prices coming down, folks are struggling. CT real disposable income- the broadest measure of consumer spending power in CT- is up a modest 1.2% on a YTD basis, when we should be seeing gains of 4%-5%. Moreover, you cannot have tangible growth in the local housing markets without substantive improvement in the local labor markets, so jobs will be key.

Investment Outlook

Here are some very insightful remarks from **Bill Gross** of **PIMCO** in his monthly newsletter on the structural roadblocks to our economy:

- 1) Globalization has hollowed developed economy labor markets, 2) technology has outdated entire industries that produce physical as opposed to "cloud"- oriented goods and services – books, records, postal letters and DVDs among the most recent dinosaurs, and 3) an aging demographic is now favoring savings as opposed to consumption in almost all developed nations.

Almost all remedies proposed by global authorities to date have approached the problem from the standpoint of favoring capital as opposed to labor. If the banks could just be stabilized, if the "markets" could just be elevated back in the direction of peak 401(k) levels, if interest rates could just be lower so that borrowers would inevitably take the bait, then labor – job creation – would inevitably follow. It has not. The explanation for why not must at least include the rationale that Wall Street and Main Street are symbiotically connected and if one benefits at the expense of the other, then both ultimately can falter.

- Long-term profits cannot ultimately grow unless they are partnered with near equal benefits for labor.
- There is only a New Normal economy at best and a global recession at worst to look forward to in future years.
- If global policymakers could focus on structural as opposed to cyclical financial solutions, New Normal growth as opposed to recession might be possible.

SBA: CT borrowing soared in fiscal 2011

Connecticut small businesses boosted their borrowing to \$223.7 million in federally-backed loans in fiscal 2011, mirroring the national trend of rising access to credit, new data shows.

Waterbury's Webster Bank was the state's most active SBA 7a lender in 2011, issuing 70 loans totaling \$17 million. Farmington Bank followed with 46 loans for \$8.8 million; No. 3 was RBS Citizens Bank's 40 loans for \$3.7 million; No. 4 Fairfield County Bank made 39 loans totaling \$5.3 million; and No. 5 TD Bank issued 36 loans for \$18.9 million.

Farmington Bank Chairman and CEO John Patrick Jr. said his institution consciously boosted its SBA lending as a means of widening credit access to businesses and stimulating job growth in its markets.

"Through these (SBA) numbers, we're demonstrating that we're leading the way," Patrick said. It's the same picture nationally, SBA officials say.

"SBA-backed lending continued the upward trend we saw last year," SBA Administrator Karen Mills. "Due to the Small Business Jobs Act and a return to pre-recession lending levels, over 61,000 small businesses had access to capital."