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Connecticut by the numbers

Market Concerns, State Rankings May Yet Lead to Economic Growth

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The reverberations from the Wall Street roller coaster of market highs and lows can have a significant impact on Connecticut's budget balance, as tax revenues meet or miss projections due to fluctuations in tax revenue. That, in turn, can create the need for unanticipated budget cuts – which then can affect a range of state services.

It can also take a toll on the state's overall economy, in part because of the concentration of jobs in the financial services industry, and the significant wealth in Fairfield County impacted by the market.

Connecticut's economic growth was ranked worst in the nation in 2012, with total state GDP dropping about $250 million compared to the previous year, according to data published this month by the **United States Bureau of Economic Analysis**. Among the decline's biggest factors, the report cited, were government austerity and challenges in real estate businesses, financial services and insurance.

Connecticut traditionally emerges slowly from national recessions, usually lagging other states – which appears to be true yet again, as the state's unemployment rate of 8.0% remains above the national average.

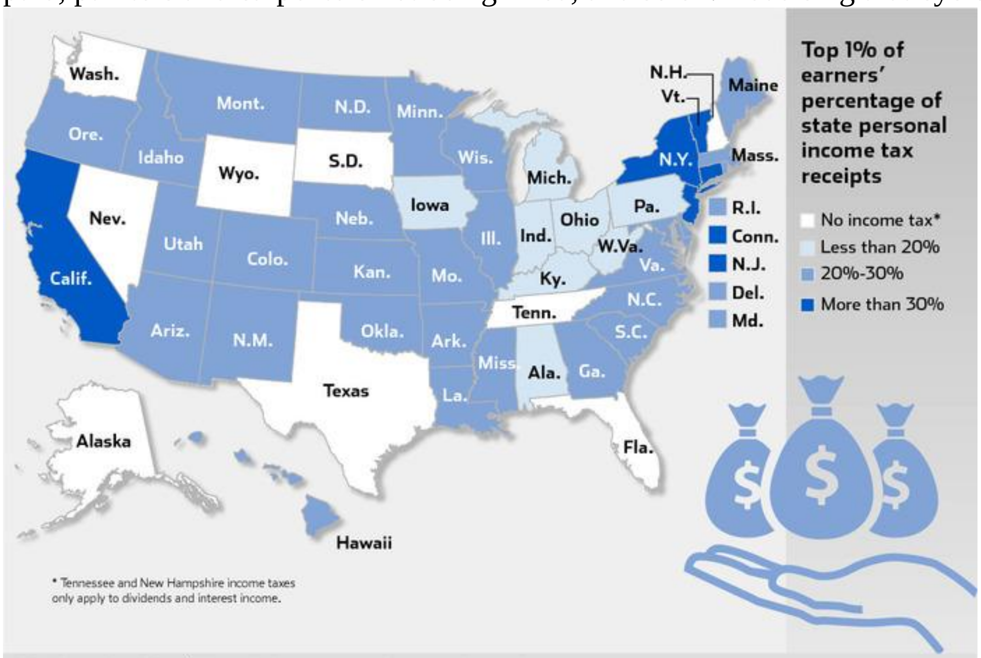
All of which explains why recent market drops have been the cause of consternation and concern. Last week, the Dow had dropped 6 percent since hitting its all-time high in May, according to CNBC, and the S&P 500 dropped more than 7 percent from its all-time high in May. Stocks declined by more than 2 percent last Thursday, as the S&P 500 recorded its biggest daily decline since November 11, 2011, Reuters reported, and 94 percent of stocks traded on the New York Stock Exchange down for the day and more than four-fifths of Nasdaq-listed shares ending lower.

However, **Joseph Matthews**, First Vice President at Morgan Stanley Wealth Management, and supervisor of the firm's Fairfield office, says the disquiet in recent days, attributed to the Federal Reserve's intention to eventually ease off in its monetary policy, is nothing more than a "mid-course" correction. "Change creates anxiety," he says, noting that while sluggish, the economy is grinding along. Connecticut has gained jobs in four of the first five months of 2013, only losing employment during the blizzard-impacted month of February.

In responding to the state's economic ranking this month, **Governor Dannel Malloy** pointed out that "one of the things that Connecticut has done, which is showing up in these numbers, is shrink the size of government faster than just about every other state. That is not generally understood. So that has a negative impact [on the economy] and specifically had a negative impact in 2012."

Matthews concurs. In his view, the decision to reduce the size of government provides an opportunity for the private sector to "drive growth" in the future – and he says the strategy may have the appearance of bad news but could ultimately improve the state's economic prospects as the private sector steps up.

A graduate of Fairfield University with a B.S. in Accounting and an M.A. in Organizational Communication, Matthews assists institutions with the development and maintenance of definable and repeatable investment processes. With both Chartered Financial Analyst (CFA) and Certified Financial Planner™ professional designations, he has a history analyzing the markets and living in the midst of the Connecticut economy. He says a vacuum in consumer confidence – such as in the aftermath of the 2008 recession – “cuts very deeply here.” He stresses that the “one-two punch” of jobs and housing, which brings a negative multiplier effect, citing homes not being purchased, moving companies not being hired, closing fees not being paid, painters and carpenters not being hired, and so on. Reversing that cycle takes time.



Taxing the Top | How high-earners fare in selected states

STATE	PERCENTAGE OF STATE REVENUE MADE UP BY INCOME TAXES	HIGHEST INCOME TAX RATE	INCOME LEVEL WHERE IT KICKS IN	PERCENTAGE OF INCOME TAX RECEIPTS PAID BY TOP 1%
California	43.9%	10.3%	$1 million	45%
Connecticut	49.3	6.5	500,001	40
Hawaii	28.4	11.0	200,001	20
Illinois	31.4	5.0	All income	25
Maryland	42.8	5.5	500,001	25
New Jersey	39.2	8.97	500,000	41
New York	56.7	8.97	500,001	41
Vermont	21.3	8.95	373,651	34

Sources: Institute on Taxation and Economic Policy; Federation of Tax Administrators; Tax Policy Center, Urban Institute and Brookings Institution

Earlier this year, Stateline reported that many states were likely to see their income tax revenue increase for 2012 and then fall in 2013 because taxpayers decided to sell off capital assets before the end of 2012 in anticipation of higher capital gains rates imposed by the federal government. Nine states ended fiscal 2012 with tax collections that were anywhere between 10 percent and 20 percent lower than their high point before the recession, according to the latest figures from the

Nelson A. Rockefeller Institute of Government. Topping the list are Arizona and Louisiana. **Connecticut** is outside the top 10 most severely impacted states.

In 2011, the Wall Street Journal reported that “New York, New Jersey, Connecticut and Illinois—states that are the most heavily reliant on the taxes of the wealthy—are now among those with the biggest budget holes. A large population of rich residents was a blessing during the boom, showering states with billions in tax revenue. But it became a curse as their incomes collapsed with financial markets.”

Fast forward to 2013. Matthews sees consumer confidence returning, and with it increasing tolerance for risk in the market. That, combined with Connecticut’s policy to reduce government and incentivize business, could be a beneficial combination.

According to the state **Department of Labor**, overall, Connecticut has recovered 48.3% of the (seasonally adjusted non-farm) jobs that were lost in the state in the March 2008 to February 2010 employment downturn. The private sector, however, has been more upbeat and has recovered 59.2% of the private jobs that were lost during the same employment recession.

Matthews stresses he’d rather have investment dollars in the hands of businesses and consumers, rather than government – which appears to be what’s happening in Connecticut. And uneasiness with revisions to Fed monetary policy notwithstanding, recent market drops may prove fleeting, as the Fed stays in the game and confidence builds – even in Connecticut.