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By Edward J. Deak

As an economic forecaster, I often feel that my tasks are like those of a circus spotlighter, who must light up the movements of the aerial trapeze artists. To get it right, you must know where the performers are now, and anticipate where they will be in the next few seconds. A pre-show script of aerial movements, and a reliance on the stable forces of physics sure help.

A Forecasting Conundrum

That's what makes economic forecasting such a problem. The forecaster is often uncertain of where the economy is headed and not always clear where it is right now. Accurate data on the current level of activity is a precursor to estimating correct trends and turning points. But getting good data is a slippery task, because it runs into problems from human reporting, technical method, and cost. And good data produces good estimates only when the model is specified properly, that is, when we've got a good picture of how the economy's pieces fit together. But while we're busy trying to get the figures right, the economy is busy changing—sometimes in very fundamental ways. Recent Connecticut experiences illustrate both these problems.

Where Are We?

During the most recent expansion and recession we never measured accurately how good things were or how bad they were becoming. In the early to mid-1980s it was almost impossible to make the forecast too optimistic—despite the obvious decline in manufacturing employment. Service, trade, and construction jobs exploded with external funding, state spending, capital from bank expansion, declining inflation and interest rates, and a rapid rise in health care spending. Help wanted signs appeared everywhere, while housing values rose, creating the wealth for equity loans. Most Connecticut residents were certain that "Yankee ingenuity" and hard work triggered the prosperity.

But 1988 brought early signs that our situation might not be so solid. As interest rates rose, new homes, condo's, and office buildings couldn't be sold or rented. Growing state budget deficits, defense cuts, and financial pressures faced key segments of the state's economy. By early 1990, the worm had turned, and it seemed that you couldn't make the forecast pessimistic enough. I recall speaking to a large community business group in late 1989, telling them that 1990 might be a recession year for Connecticut. I can still see the disbelief on their faces—most of them were still enjoying the fruits of the 1980's boom.

But the recession did come, and it was long and severe. Subsequent revisions in employment data showed that it actually started early in 1989. In retrospect, my New England Economic Project forecasts were late in recognizing the excesses of the boom, and weak in alerting state residents to the depth of the oncoming decline. I remember newspaper articles and television reports comparing events in Connecticut to the early 1980's economic collapse in the Southwest. We assured ourselves it couldn't happen here. Our economy was too diversified, too stable, too wealthy, and lacked the near fraudulent characteristics of Texas-style real estate and banking speculation. How wrong we were.

As Connecticut's decline gained momentum, it was joined and reinforced by the Gulf War-aided U.S. recession. The national economy bottomed out early in 1991, but Connecticut continued to shed jobs steadily. Connecticut employment averaged 1,574,000 jobs in the first quarter of 1991. But by the fourth quarter of 1992 the number had fallen by 50,000. Nearly a third of Connecticut's job losses occurred after the national recovery had begun.

What Happened?

At this point it became apparent that Connecticut's problems were not just a phase of the business cycle, or the corrective reaction to the excessive boom period. Instead, structural problems were eating away at the state's key employment pillars. The economy was changing fundamentally, making it doubly difficult to develop forecasts we could have faith in.

Everyone knew about the cuts in defense spending that were slicing jobs at Electric Boat, Colt, Textron, Hamilton Standard, Pratt & Whitney, and Norden. Massive financial losses in commercial airlines led to the cancellation of billions of dollars of engine orders and options. And, while state defense employers won important parts of new defense awards, the Comanche, Seawolf, and F-22 contracts could not offset other funding cuts.

Early in the 1990's we awoke realizing that part or all of dozens of old line manufacturing employers had left the state. Carpenter Steel, General Electric, Bryant Electric, New Departure, Bridgeport Brass, Scoville, Uniroyal, Dictaphone, among others, were gone. While the erosion of manufacturing employment was an object of lament in the booming 1980's, it became an event of grave concern in the 1990's.

The structural elements of our decline didn't stop there. What started out as a real estate induced "credit crunch" quickly became a full banking crisis. Bank assets plunged in value or became worthless, and bank capital disappeared. Consequently, there was a near absence of loans for small and medium sized businesses, even sound ones. And dozens of banks, big and small, failed, or were forced into mergers. A major real estate investment trust collapsed with many of its realty assets, and most of its investors in the state. Almost overnight, thousands of state residents lost all or part of their life's savings. As the Fleet-Shawmut merger attests, bank restructuring continues even today.

If the above structural forces aren't enough to distort even the best cyclical forecast, remember the decades old view that in all of Connecticut, Hartford alone was closest to being immune to a recession. After all, it enjoyed the employment stability of the insurance industry. Insurance, like municipal police and fire, was a source of jobs in good times and bad. Today, some of these insurance giants are gone, some are different, but almost every one has a smaller presence in Connecticut than it did just 10 short years ago.

Finally, the state's financial picture deteriorated to the point where the only immediate solution was the imposition of a personal income tax. That tax, some claim, further eroded the state's competitive position by absorbing buying power from Connecticut residents during a recession.

What Can We Expect?

So, what do we know about the Connecticut economy's current performance and its prospects? We know of plans for structural downsizings over the next 12-24 months. Electric Boat, Fleet, SNET, Sikorsky, and some insurance firms, among others, have announced impending job cuts. It will take no small amount of growth just to stay even in the job count. And these cuts will occur at a time when the Fed is pushing the nation into an economic "soft landing." Remember, the 9-10,000 new jobs at the Foxwoods Casino accounted for virtually half the net job growth from the end of our recession to the end of 1994. Connecticut still has a long way to go to reestablish itself as the preeminent location from which to do business.

We know the state's continued population loss may threaten economic expansion and job creation. Connecticut has been one of only two states to see its population fall for the past three years in response to recession and shrinking employment opportunities. A state like Nevada, on the other hand, has enjoyed rapid expansion and population growth. This outflow may have held down the state's unemployment rate but it may also have reduced the pool of skilled, educated labor new employers find attractive.

We don't know with any precision, however, exactly where the economy will be one quarter, one year or one decade from today. It is hard for any cyclical model based upon historical data and contemporary national macroeconomic events to serve up reliable short-term point estimates for employment, income, gross state product, housing, etc. Sometimes, the best we can do is provide a range of possible values or even just a direction for movement. While getting the turning points right is an important part of cyclical forecasting, it's not always easy in the face of data revisions and structural changes.

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