Economic and Revenue Outlook

Presented to
Coalition of Washington Business Organizations

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December 15, 2014
Olympia, Washington
Forecast summary

- Forecasted growth in wages, personal income and employment is somewhat lower than historical averages
- Forecasted revenue growth is also lower than historical averages, partially due to low forecasted rates of inflation
Economic news continues to suggest risks to forecast

• **Upside:**
  - Declining initial unemployment claims
  - Net monthly employment gains average over 200,000 jobs this year
  - Lower gasoline prices
  - Lower mortgage rates

• **Downside:**
  - Wage growth slow to recover
  - Lackluster housing activity
  - Slowing Chinese, Japanese, European economies
  - Instability in Middle East, Ukraine/Russia
Real GDP is forecasted to grow close to its average rate in 2015 but at a slower pace through 2019.
Great Recession was a notable deviation from potential economic activity

Sources: CBO August 2014, ERFC November 2014; forecast 2014 - 2019
Unemployment claims are at pre-recession levels

Weekly initial unemployment claims, SA

Source: U.S. Dept. of Labor; data through December 6, 2014
Job creation continues to strengthen

Average monthly employment change

Source: Bureau of Labor Statistics, data through November 2014
Manufacturing activity continues to expand both nationally and in the state.

An index greater than 50 implies growth.

Source: Institute of Supply Management; data through November 2014
Gasoline prices are falling

Regular, price per gallon (U.S. average)

Source: Dept. of Energy, weekly data through December 8, 2014
Oil prices are forecasted to recover slowly from recent decline.

Source: DOE, ERFC November 2014 forecast; historical data through 2014Q3
Mortgage rates have trended down slightly since January

30 year fixed mortgage rates

Source: Freddie Mac, data through November 2014
Housing starts are trending up but remain below historic average

Source: U.S. Census; data through October 2014
China’s 2014 & 2015 GDP growth expected to be below 2013 rate

Source: Blue Chip, IMF; data and forecasts through October 2014; World Bank, June 2014 forecast
Japan’s GDP growth has been negative in three of the last four quarters.

The International Monetary Fund forecasts real GDP growth of 0.8% for 2015.

Source: Japan Cabinet Office, data through 2014Q3.
Small business optimism and sales expectations getting back to pre-recession levels

Source: National Federation of Independent Business; data through November 2014
Consumer confidence improving but also below pre-recession levels

Source: University of Michigan; Conference Board, data through November 2014
Non-transportation equipment export growth remains weak

Washington Exports
Percent Change, year ago


Total Total excluding Transportation Equipment

Source: Wiser Trade Data; through 2014Q3
Washington new vehicle registrations slumped in Nov. despite growth trend

Source: Dept. of Licensing, ERFC; data through November 2014
Seattle area employment is growing much faster than the rest of the state.

Source: Employment Security Department, ERFC; data through October 2014
Seattle continues to have the lowest unemployment rate among state metropolitan areas

Unemployment rate

Source: Employment Security Dept., October 2014
Average annual wages, Seattle metro area and rest of state

Growth between 2004Q1 and 2014Q2:

King & Snohomish = 46%
Rest of WA = 32%

Source: BLS, ERFC; data through 2014 Q2
Revenue Act collections were up 7.2% year-over-year for 3rd quarter activity.

4th quarter growth is forecasted at 5.5%.

Revenue Act taxes consist of retail sales, use, B&O, public utility, and tobacco products taxes.

* Adjusted for large one-time transactions, amnesty payments and reporting frequency change, current definition of Revenue Act

Source: DOR and ERFC; monthly data through October 2014 activity (collections of December 10)
Sales tax growth has been strong in the last two quarters

Adjusted sales tax collections were up 8.7% year-over-year for 2nd quarter activity and 8.4% for 3rd quarter activity.

4th quarter growth is forecasted at 7.3% but Q4 2013 was very weak.

Growth has been strong in construction, auto sales, and building materials.

Adjusted for large payments/refunds, amnesty payments and taxpayer reporting frequency change

Source: ERFC; Monthly data through October 2014 preliminary activity
Adjusted B&O tax collections were up 6.5% year over year for third quarter activity.

B&O tax growth will be slowed somewhat in the next two quarters due to the effects of lower oil prices on the gross receipts of refiners, gas stations and other petroleum products dealers/manufacturers.

Adjusted B&O tax collections were up 6.5% year over year for third quarter activity.

Source: ERFC; Monthly data through September 2014 preliminary activity

Adjusted for taxpayer frequency shift, amnesty payments, and recent large refunds
REET activity continues to be elevated by large commercial sales

Sales transactions show little year-over-year growth but the value per transaction is higher due to the proportion of large commercial sales.

Sales of property worth $10 million or more totaled $2.3 billion in the last three months.

Source: ERFC; Monthly data through November 2014 preliminary
WA housing permits forecasted to approach “normal” levels in 2017

Source: ERFC November 2014 forecast; historical data through 2014Q3
Sales prices of existing U.S. homes are forecasted to flatten for several quarters.

Source: Global Insight November 2014 forecast; historical data through 2014Q3
Average employment growth for 2014 to 2019 is forecasted at 1.8%.

Growth from 2011Q2 to 2014Q3 averaged 2.3% (SAAR).

Source: ERFC November 2014 forecast; historical data through 2014Q3.
Forecasted Washington personal income growth is steady

Average income growth for 2014 to 2019 is forecasted at 5.6%

Source: ERFC November 2014 forecast; historical data through 2014Q3
The surge from liquor privatization is over.

Source: DOR, ERFC November 2014 forecast; historical data through 2013 Q3.
Cannabis revenue is above forecast, but still needs to pick up

Source: LCB, ERFC September 2014 forecast; historical data through 2013 Q3
The number of cannabis establishments continues to grow

26% of Producers are also Processors

Growth in Establishments: (July to November)

- Producer: 8 to 31
- Processor: 16 to 129
- Retail: 18 to 74

Source: LCB, ERFC; data through November 2014

Economic & Revenue Outlook
December 15, 2014
### GF-S cannabis revenue estimates

<table>
<thead>
<tr>
<th>$Millions</th>
<th>November Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2013-15</td>
</tr>
<tr>
<td>GF-S share of excise tax and license fees</td>
<td>$5.7</td>
</tr>
<tr>
<td>Retail sales tax and B&amp;O</td>
<td>$5.2</td>
</tr>
<tr>
<td><strong>Total General Fund</strong></td>
<td><strong>$10.9</strong></td>
</tr>
<tr>
<td><strong>Total Non-GF</strong></td>
<td><strong>$31.8</strong></td>
</tr>
</tbody>
</table>

*Detail may not add to total due to rounding

Source: ERFC, LCB, BOTEC Analysis

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**Total change from September forecast:**
- **2013-15** +$17.3 M
- **2015-17** +$29.6 M
- **2017-19** +$10.6 M
### 2013-15 Biennium alternative forecasts – cash basis

<table>
<thead>
<tr>
<th></th>
<th>2013-15 Biennium</th>
<th>Difference From the baseline</th>
</tr>
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<tbody>
<tr>
<td>November Baseline (55%)</td>
<td>$33,440</td>
<td></td>
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</table>

#### November 2014 Alternative Forecasts

<table>
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<tr>
<th></th>
<th>2013-15 Biennium</th>
<th>Difference From the baseline</th>
</tr>
</thead>
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<tr>
<td>Optimistic (20%)</td>
<td>$34,110</td>
<td>$670</td>
</tr>
<tr>
<td>Pessimistic (25%)</td>
<td>$32,638</td>
<td>($802)</td>
</tr>
<tr>
<td>Probability Weighted Average</td>
<td>$33,373</td>
<td>($66)</td>
</tr>
</tbody>
</table>

GCEA* $33,445 $6

*Based on the Governor’s Council of Economic Advisors’ assumptions
The GF-S forecast for the 2013-15 biennium has increased by $655 million (2.0%) since the June 2013 forecast that was the basis of the initial biennial budget (not including the $123 million in revenue-generating legislation that accompanied the budget).

Source: ERFC February 2012 – November 2014 forecasts

Gray area indicates total noneconomic change
## 2015-17 Biennium alternative forecasts – cash basis

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<th>$Millions</th>
<th>2015-17 Biennium</th>
<th>Difference From the baseline</th>
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</thead>
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<tr>
<td>November Baseline (55%)</td>
<td>$36,319</td>
<td></td>
</tr>
<tr>
<td><strong>November 2014 Alternative Forecasts</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Optimistic (20%)</td>
<td>$39,353</td>
<td>$3,033</td>
</tr>
<tr>
<td>Pessimistic (25%)</td>
<td>$32,982</td>
<td>($3,336)</td>
</tr>
<tr>
<td>Probability Weighted Average</td>
<td>$36,092</td>
<td>($227)</td>
</tr>
<tr>
<td>GCEA*</td>
<td>$36,229</td>
<td>($91)</td>
</tr>
</tbody>
</table>

*Based on the Governor’s Council of Economic Advisors’ assumptions*
General Fund-State* forecast by fiscal year

Biennial growth rates:

- 2007-09A: 0.1%
- 2009-11A: (5.4%)
- 2011-13A: 8.6%
- 2013-15F: 9.1%
- 2015-17F: 8.6%
- 2017-19F: 9.0%

$billions

General Fund-State Revenue

Forecast

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>General Fund-State Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY07</td>
<td>$16.36 billion</td>
</tr>
<tr>
<td>FY08</td>
<td>$17.51 billion</td>
</tr>
<tr>
<td>FY09</td>
<td>(9.6%) $15.28 billion</td>
</tr>
<tr>
<td>FY10</td>
<td>(4.1%) $14.97 billion</td>
</tr>
<tr>
<td>FY11</td>
<td>7.9% $16.36 billion</td>
</tr>
<tr>
<td>FY12</td>
<td>1.5% $16.57 billion</td>
</tr>
<tr>
<td>FY13</td>
<td>6.1% $17.66 billion</td>
</tr>
<tr>
<td>FY14</td>
<td>3.8% $18.31 billion</td>
</tr>
<tr>
<td>FY15</td>
<td>4.1% $18.98 billion</td>
</tr>
<tr>
<td>FY16</td>
<td>4.0% $19.38 billion</td>
</tr>
<tr>
<td>FY17</td>
<td>4.8% $20.86 billion</td>
</tr>
<tr>
<td>FY18</td>
<td>4.4% $21.30 billion</td>
</tr>
<tr>
<td>FY19</td>
<td>4.0% $22.00 billion</td>
</tr>
</tbody>
</table>

*General Fund-State & Related Funds for FY 07-09, General Fund-State new definition for FY 10-19
Source: ERFC forecast, November 2014
GF-S revenue as share of personal income forecasted to reach record low.

*Current definition of Revenue Act

Source: ERFC; data through FY 2014, November 2014 forecast
Real per capita General Fund-State* forecast by fiscal year

Biennial growth rates:
- 2007-09A: (6.9%)
- 2009-11A: (9.5%)
- 2011-13A: 2.2%
- 2013-15F: 4.0%
- 2015-17F: 3.1%
- 2017-19F: 2.7%

*General Fund-State & Related Funds for FY 07-09, General Fund-State new definition for FY 10-19
Source: ERFC forecast, November 2014

WASHINGTON STATE ECONOMIC AND REVENUE FORECAST COUNCIL
## Tax exemptions/credits expiring in fiscal year 2015

<table>
<thead>
<tr>
<th>Description</th>
<th>Exp. Date</th>
<th>Ct.</th>
<th>FY 15</th>
<th>FY 16</th>
<th>FY 17</th>
<th>FY 18</th>
<th>FY 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>R&amp;D spending by high-tech firms (B&amp;O Cred.)</td>
<td>1/1/15</td>
<td>600</td>
<td>11.6</td>
<td>28.4</td>
<td>29.7</td>
<td>30.9</td>
<td>32.3</td>
</tr>
<tr>
<td>High technology deferral (RST)</td>
<td>1/1/15</td>
<td>50</td>
<td>15.0</td>
<td>36.8</td>
<td>39.1</td>
<td>41.4</td>
<td>43.6</td>
</tr>
<tr>
<td>Clean fuel motor vehicles (S/U Ex.)</td>
<td>7/1/15</td>
<td>0.0</td>
<td>12.3</td>
<td>16.3</td>
<td>19.0</td>
<td>21.8</td>
<td></td>
</tr>
<tr>
<td>Manufacturing fresh fruits &amp; vegetables (B&amp;O Ex.)</td>
<td>7/1/15</td>
<td>185</td>
<td>0.0</td>
<td>4.9</td>
<td>5.3</td>
<td>5.3</td>
<td>5.3</td>
</tr>
<tr>
<td>Manufacturing dairy products (B&amp;O Ex.)</td>
<td>7/1/15</td>
<td>17</td>
<td>0.0</td>
<td>1.1</td>
<td>1.2</td>
<td>1.2</td>
<td>1.2</td>
</tr>
<tr>
<td>Manufacturing seafood products (B&amp;O Ex.)</td>
<td>7/1/15</td>
<td>41</td>
<td>0.0</td>
<td>0.6</td>
<td>0.7</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>26.5</strong></td>
<td><strong>84.0</strong></td>
<td><strong>92.3</strong></td>
<td><strong>98.6</strong></td>
<td><strong>104.9</strong></td>
</tr>
</tbody>
</table>
Conclusion

- We expect the moderate pace of the economic recovery to continue in both the U.S. and Washington economies.

- The level of uncertainty in the baseline remains high, with greater risks on the downside than on the upside.
Questions