Economic and Revenue Update

October 17, 2023

Office of Economic and Revenue Forecasts
&
City Budget Office

City of Seattle

Presentation Outline

Part I: Update on economic developments since the August Forecast

Part II: Summary of October <u>Economic</u> Forecasts

- National Economy – summary of results from S&P Global's (IHS Markit) national economic model
- Regional Economy – summary of results from the Forecast Office's regional economic model

Part III: Summary of October <u>Revenue</u> Forecast

- General Fund (GF) Revenues
- Non-GF "General Government" Revenues – including JumpStart Payroll Tax and REET
- Non-GF Transportation Revenues

Part 1

Economic Update – Recent Developments

Since August, the National Economy Has Generally Remained Strong

Overall Economic Output (GDP)

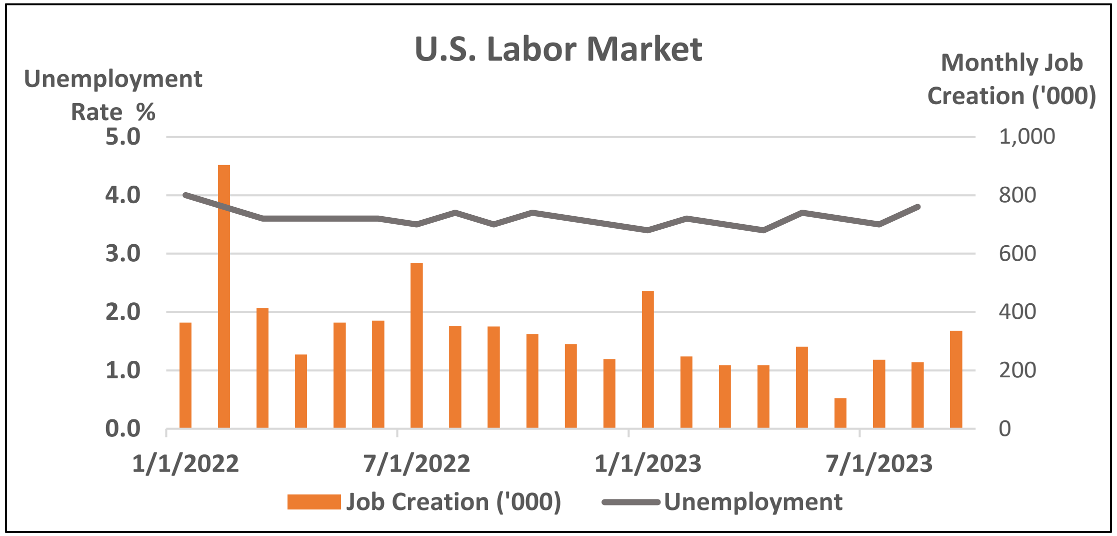
- As we reported in August, GDP grew by 2.1% in the 2nd Quarter.
- The most current S&P forecast anticipates that near-term momentum will lead to robust 3rd Quarter growth of 4.0%.
- That said, the longer-run projections still reflect expectations of a cooling economy, with GDP growth of just 1.5% in 2024, and 1.3% in 2025.

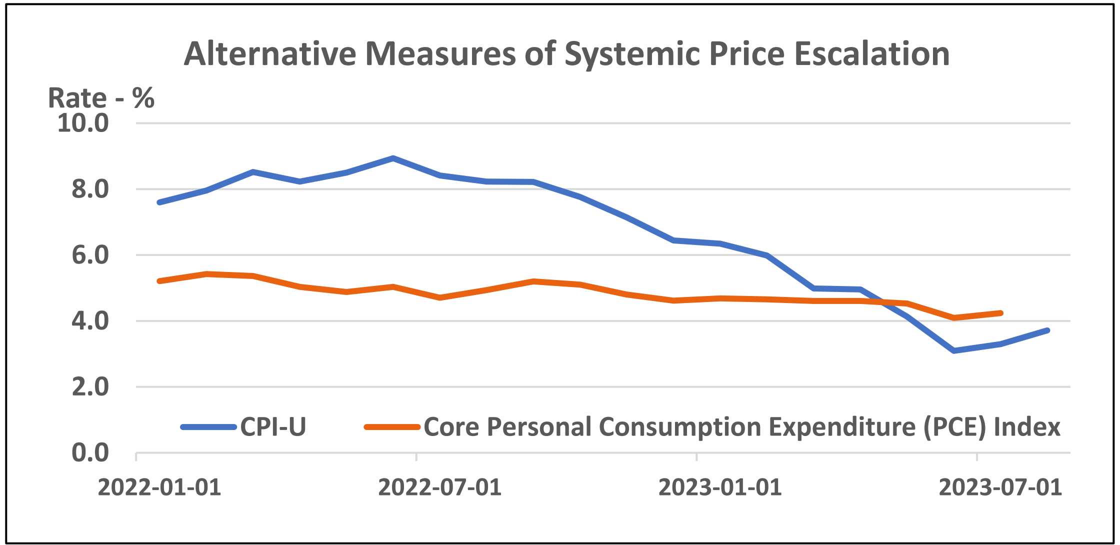
Employment

- The economy continues to produce jobs at a steady pace. The rate of growth has generally been slowing, although September's results showed surprising strength.
- Unemployment has remained steady at +/- 3.6% since early 2021.

Inflation

- Through June, inflation had been on a steady downward trend, but increased to 3.7% in August, and maintained that rate in September. Much of the recent increase is directly attributed to higher gas prices.
- The Fed's preferred measure of inflation is the core PCE index. This measure has been slower to respond to the Fed's interest rate increases, but it has been declining since late last year.





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However, Economic Risks Have Grown Since August

United Auto-Workers (UAW) Strike

- Economic impacts will depend on scope and duration, but will be largest in auto-producing states.
- Striking workers most directly impacted, as they will only be partially compensated by strike fund.
- Suppliers, dealers, etc. will feel impacts as well.
- Moody's estimates if all 150,000 UAW works were to strike for 6 weeks, 4Q GDP growth would be reduced by ~0.2%

War and Military Conflict – Impact on Energy Prices and Other Commodities

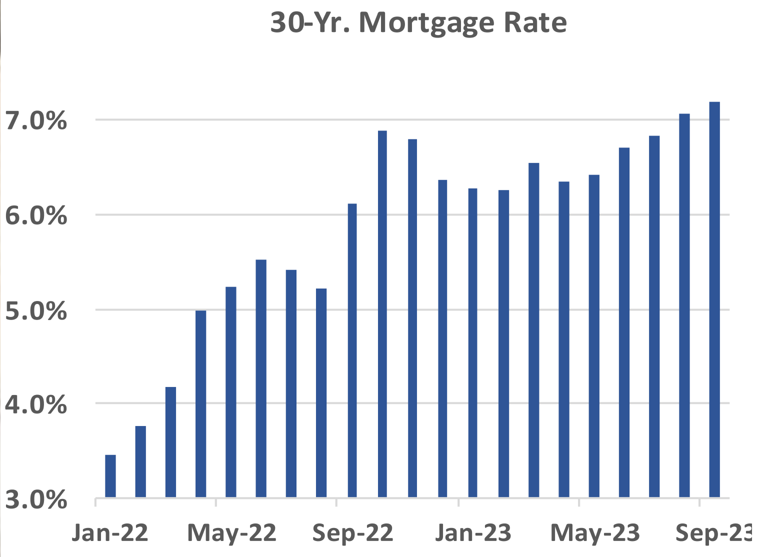
- Oil prices have increased from less than $75/bbl in June, peaked at ~$95/bbl, and are running at ~$85/bbl currently.
- Higher fuel costs directly reduce discretionary consumer spending on other goods, and increased transportation costs lead to higher prices across the economy.

Government Shutdown / Congressional Chaos

- Impacts of any shutdown will depend on its duration.
- Each week of shutdown has been estimated to reduce GDP growth by ~0.1%.

Increasing longer term interest rates

- Even as inflation is coming down, long-term interest rates are increasing. Suggesting concern about longer-term price trends and overall uncertainty.
- Higher long-term interest rates discourage major consumer purchases and also dampen business investment, whether that be for R&D or capital spending on factories, offices, equipment, etc. This then slows long-term economic growth.



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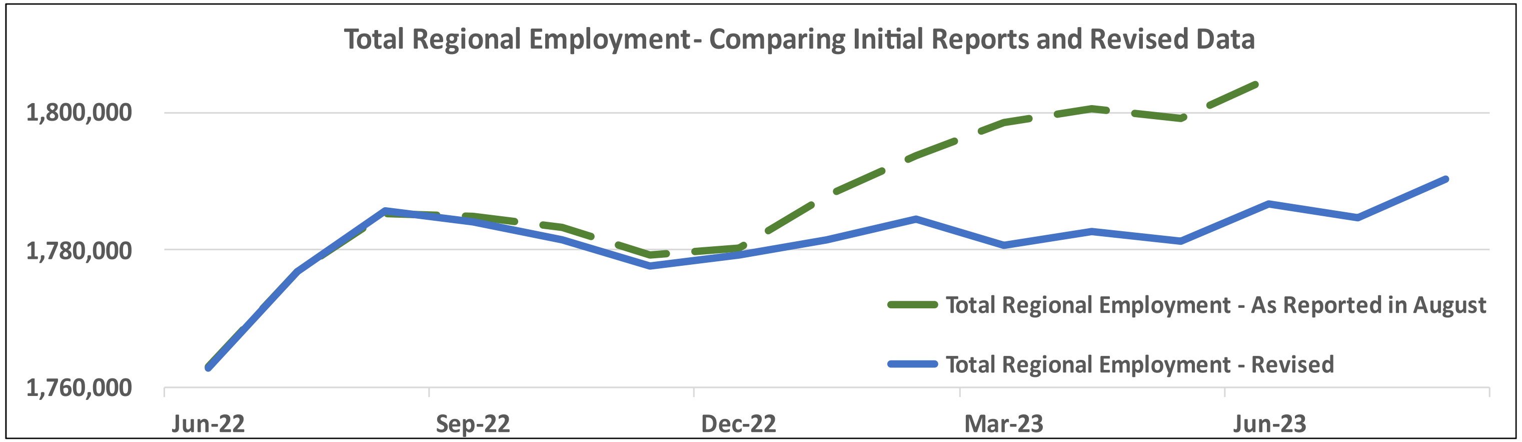
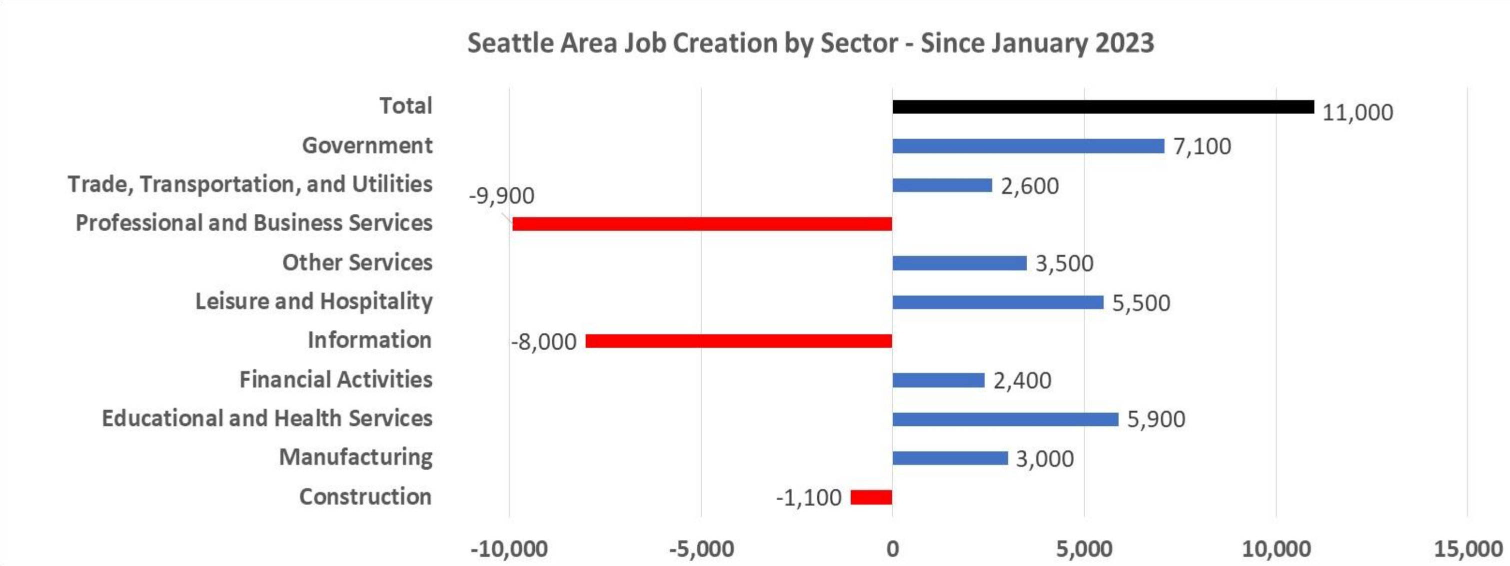
Revised Employment Data Highlight Slowing Growth in the Seattle Region

Employment

- Revised data from Washington State Employment Security Department reveal that Seattle region has added significantly fewer jobs in the last 12 months than we first understood.
- Initial data indicated that almost 42,000 jobs had been added regionally in the 12 months ending in June of this year. Revised data reveal that total to be just under 24,000. This implies job growth of just 1.4%, compared to the 2.4% reflected in the uncorrected data.
- Deeper analysis also reveals that the slowdowns in both the technology and construction sector have affected employment more than had been previously understood.
- On the other hand, overall tax revenues have been tracking close to August forecast, despite these disappointing results.





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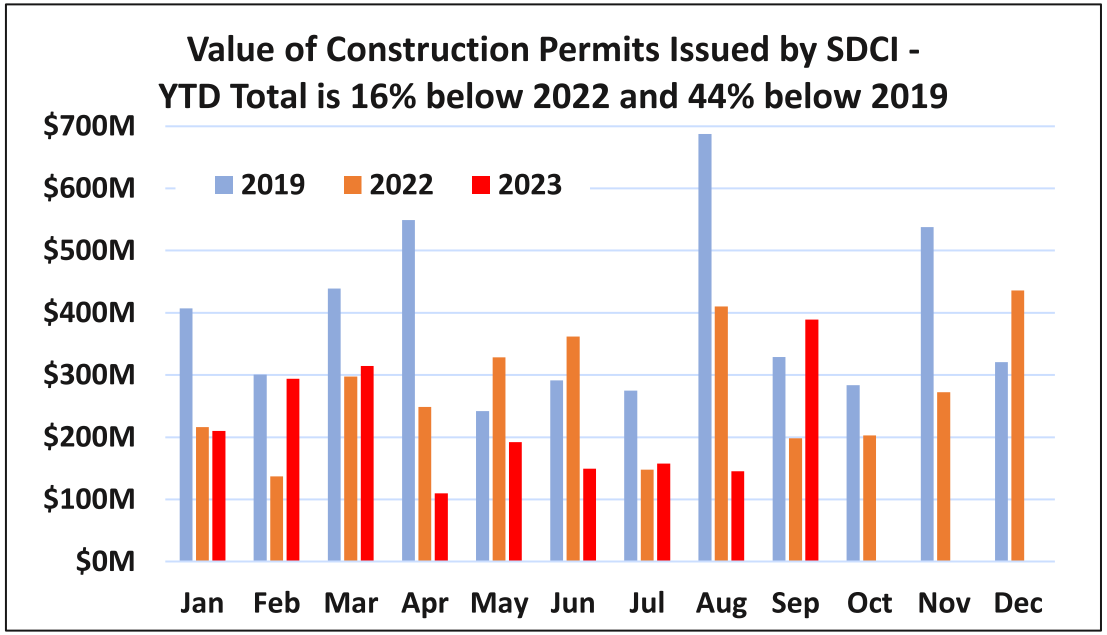
Local Results Highlight Slowing Economic Growth in Seattle Region (cont.)

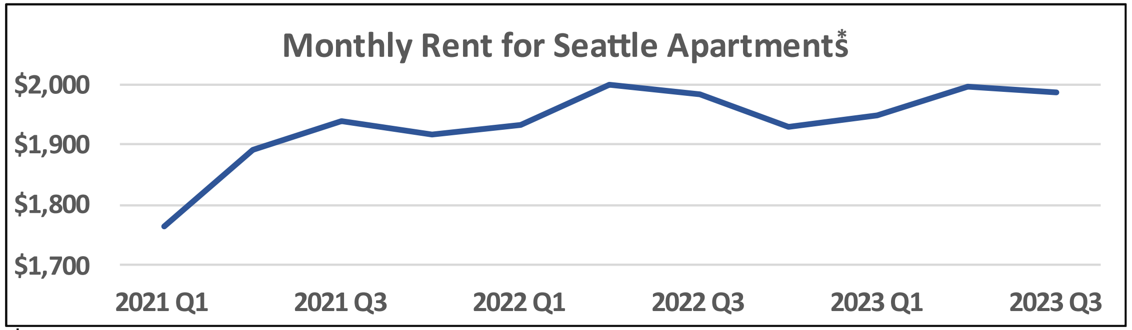
Construction and Permitting

- SDCI data for issued permits reveals slowing of planned construction activity. Despite a strong showing in September, the value of issued permits is down 16% from last year. If the $192M Swedish Hospital project which pushed up the September results is excluded, the overall YTD total of issued permit value is down almost 50%.
- Softening demand and higher interest rates are affecting both commercial and residential construction activity. Focusing on large projects, namely those with a value of more than $10M, the YTD value of issued permits is down about 30% for commercial projects, and more than 50% for residential projects, relative to last year.



Inflation

- Although the regional CPI-U inflation ticked up slightly to 5.4% in August, it has otherwise been in steady decline since hitting a high of 10.1% last year June.
- The relative stability of rental rates, which make up ~30% of the CPI's representative "basket of goods", is helping to cool local inflation.



* Source: CoStar

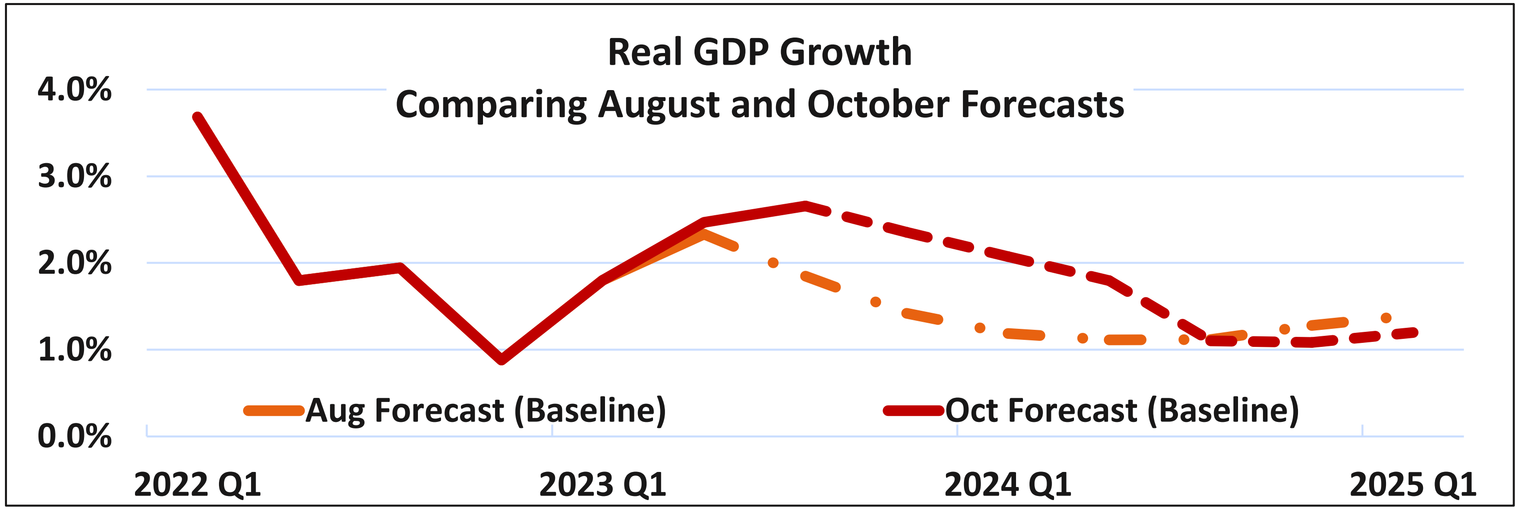
Part 2

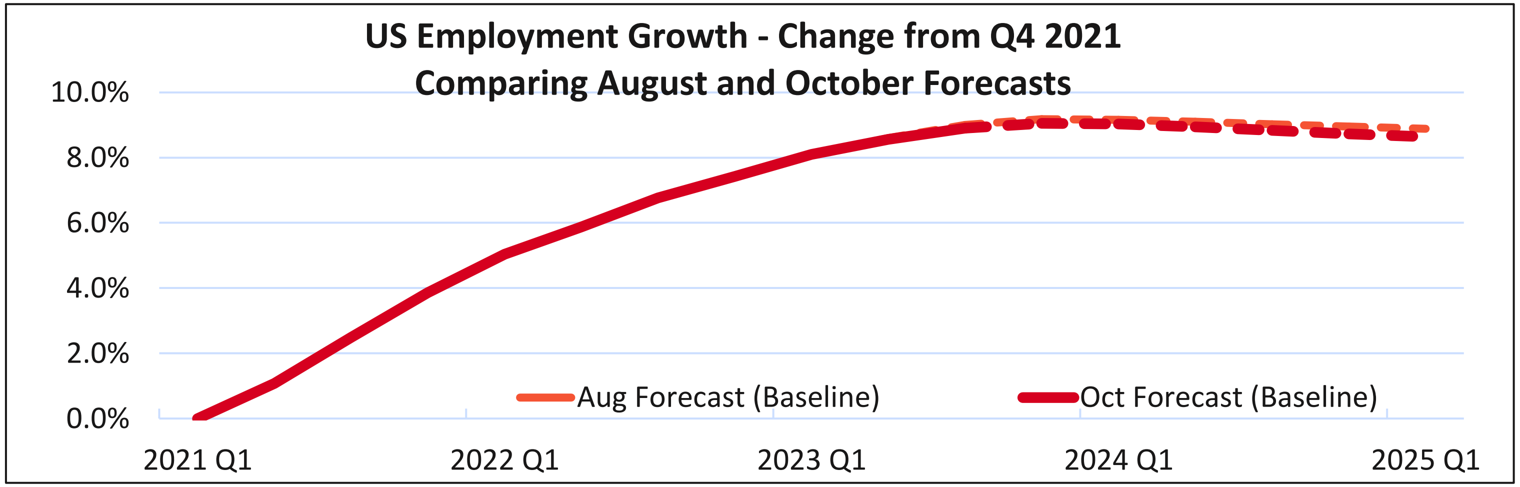
National and Regional Economic Forecasts - Looking Forward

Baseline National Forecast Acknowledges Economy's Recent Strong Performance, But Forward-Looking Projections Remain Largely Unchanged from August

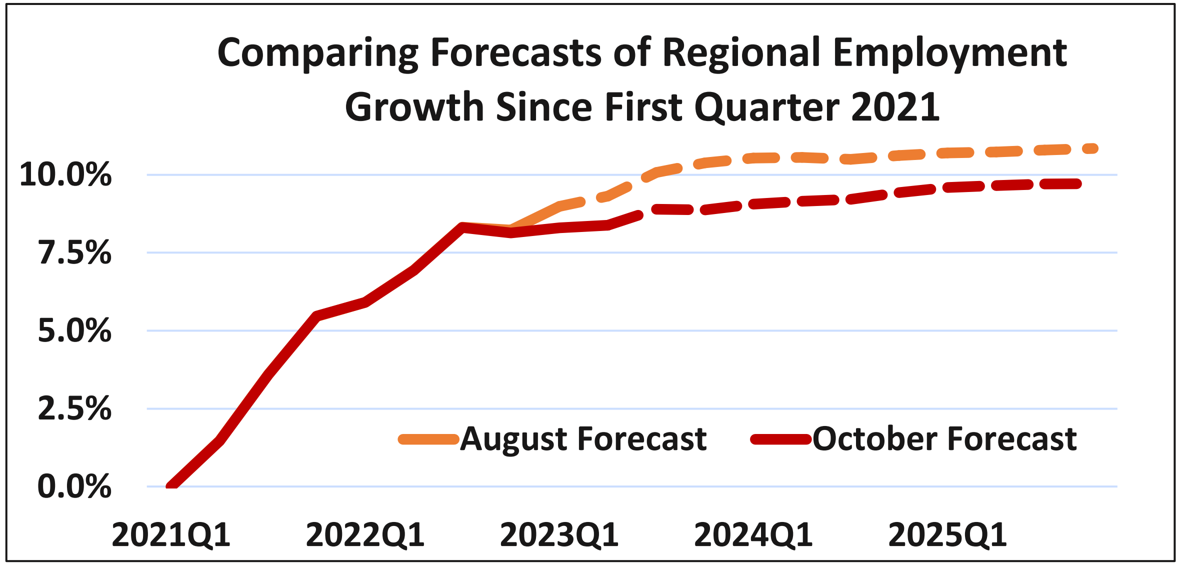
- S&P Global's national modeling has acknowledged the stronger than expected growth in 2023, but it still anticipates an extended period of slow growth beginning in the middle of 2024.

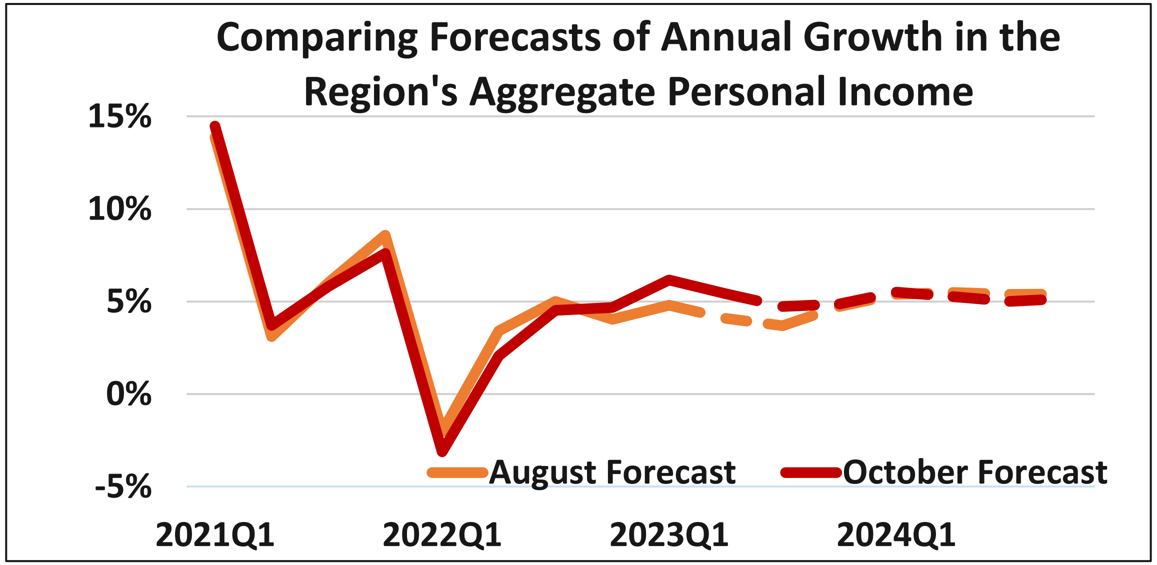
- The forecast anticipates that higher interest rates will begin to constrain growth, and the Federal Reserve will not decrease rates quickly as inflation is expected to persist at elevated levels. Recent escalation in fuel prices and persistently strong growth in wage rates reinforce this view.





Regional Forecast Is Largely Unchanged, But Has Been Adjusted to Reflect Revised Employment and Income Data from the State





- Revised employment data show that regional job growth has been significantly slower over the last 12 months than we has assumed in August
- Given that the regional labor market is currently less robust than previously understood, the forecast now anticipates somewhat slower job growth for the remaining of this year and the first half of 2024. However, forecast growth rates beyond that period are essentially unchanged.

- Aggregate personal income data from the State have been also revised. Income is an important input to the models that forecast revenues. The revisions show less robust income growth in 2022 but somewhat stronger growth so far this year.
- Relative to August, our estimates of current income and forecasts for future income, reflect somewhat stronger income growth through the first quarter of next year, but then dropping back to levels at or below those projected previously. The change in the longer-term forecast is toward marginally slower income growth.

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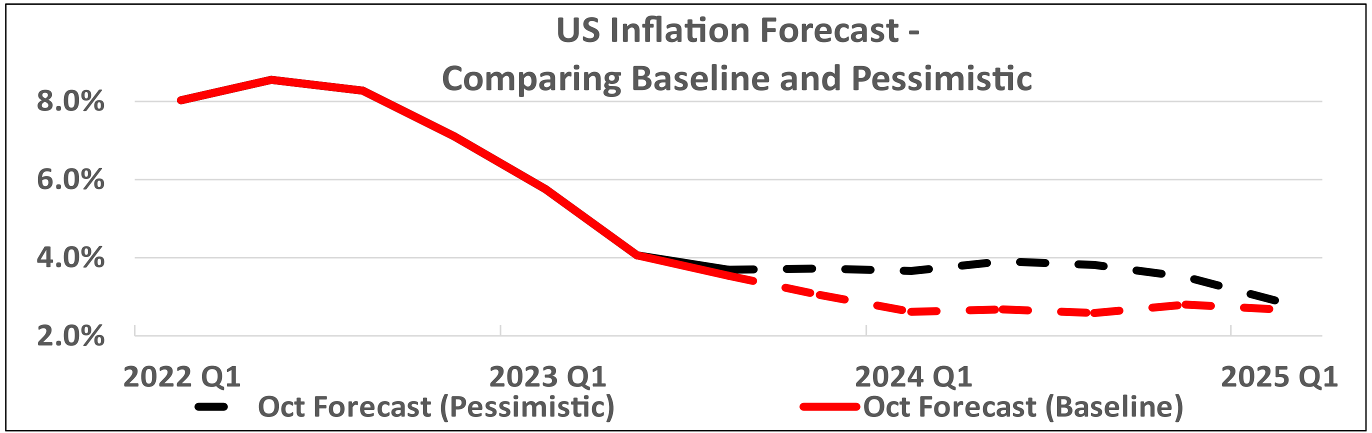
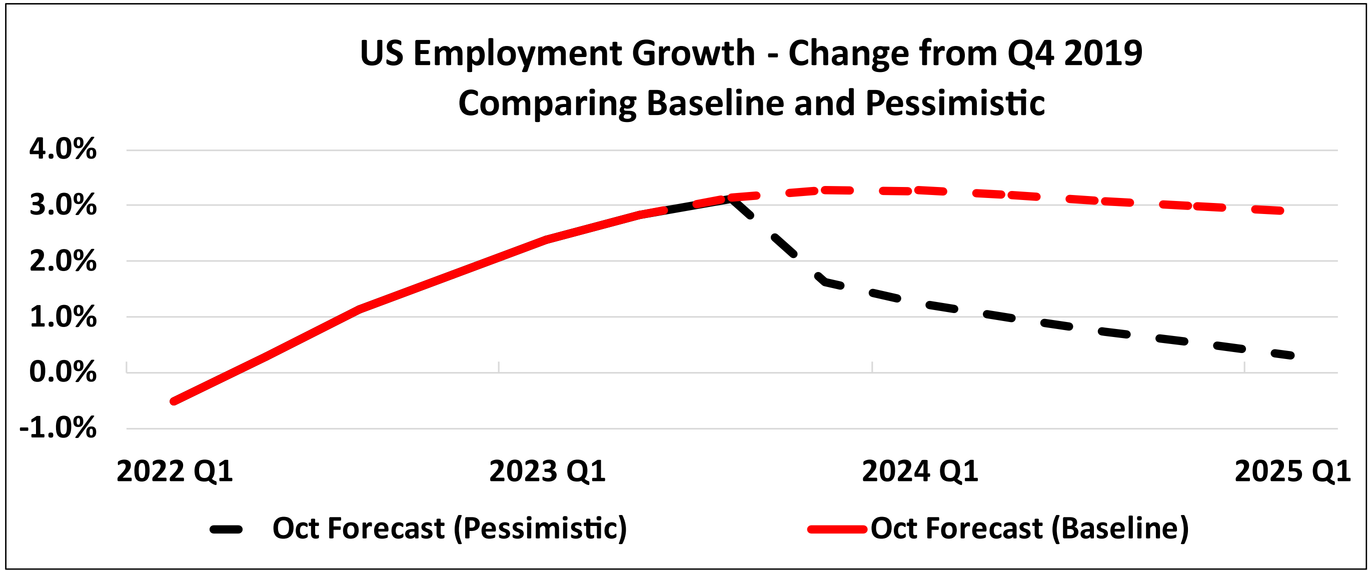
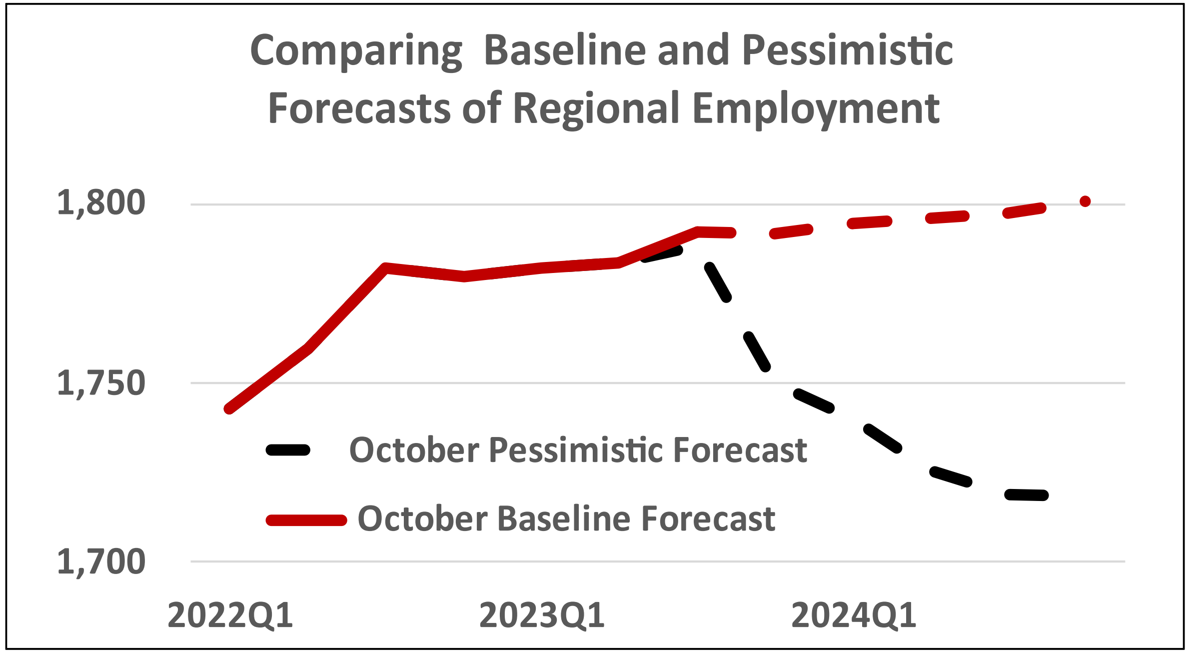
National Forecast: Baseline vs. Pessimistic

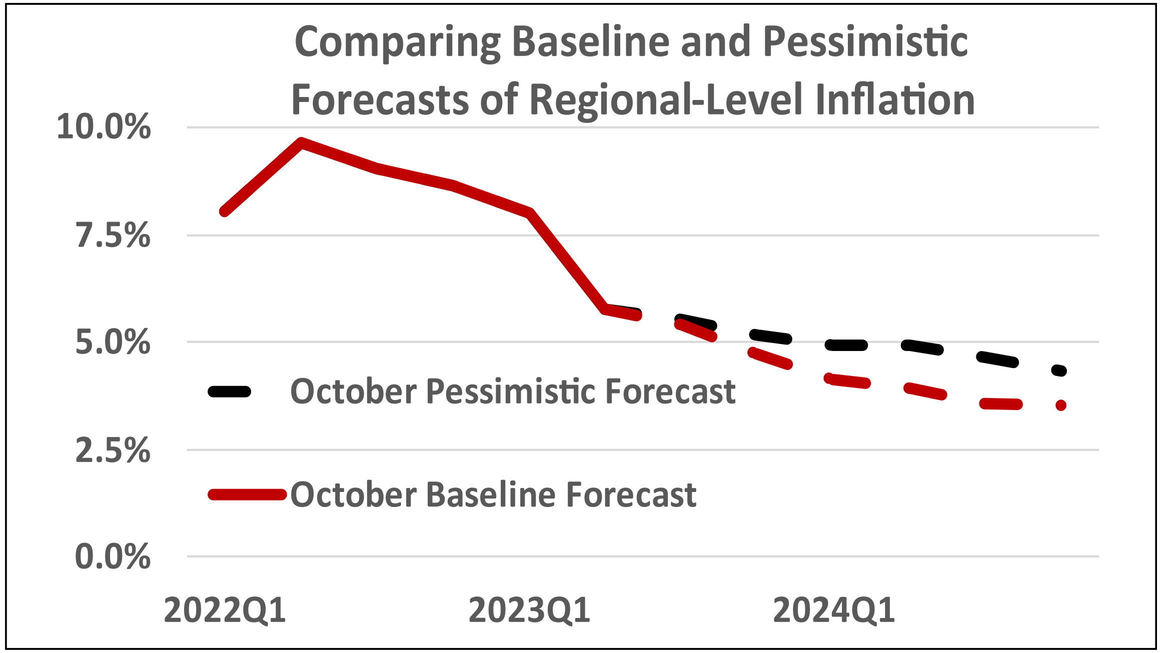
- S&P Global assigns a 30% probability to a pessimistic scenario in which instability in the banking sector leads to more restrictive lending, and Russia's war against Ukraine leads to higher sustained energy prices. The conflict that has emerged in Israel and the Gaza Strip increases this risk.
- The results is reduced spending for large, credit-dependent purchases, and less disposable income for more minor purchases, as higher energy costs and higher systemic inflation reduce discretionary spending.
- In turn, reduced spending leads to a slowdown in business investment and a net decrease in employment, relative to current levels.





Reginal Forecast: Baseline vs. Pessimistic





- Driven by the implications of S&P Global's pessimistic forecast, our regional pessimistic scenario projects a significant decline in local employment, if lending conditions tighten and energy prices drive up inflation.

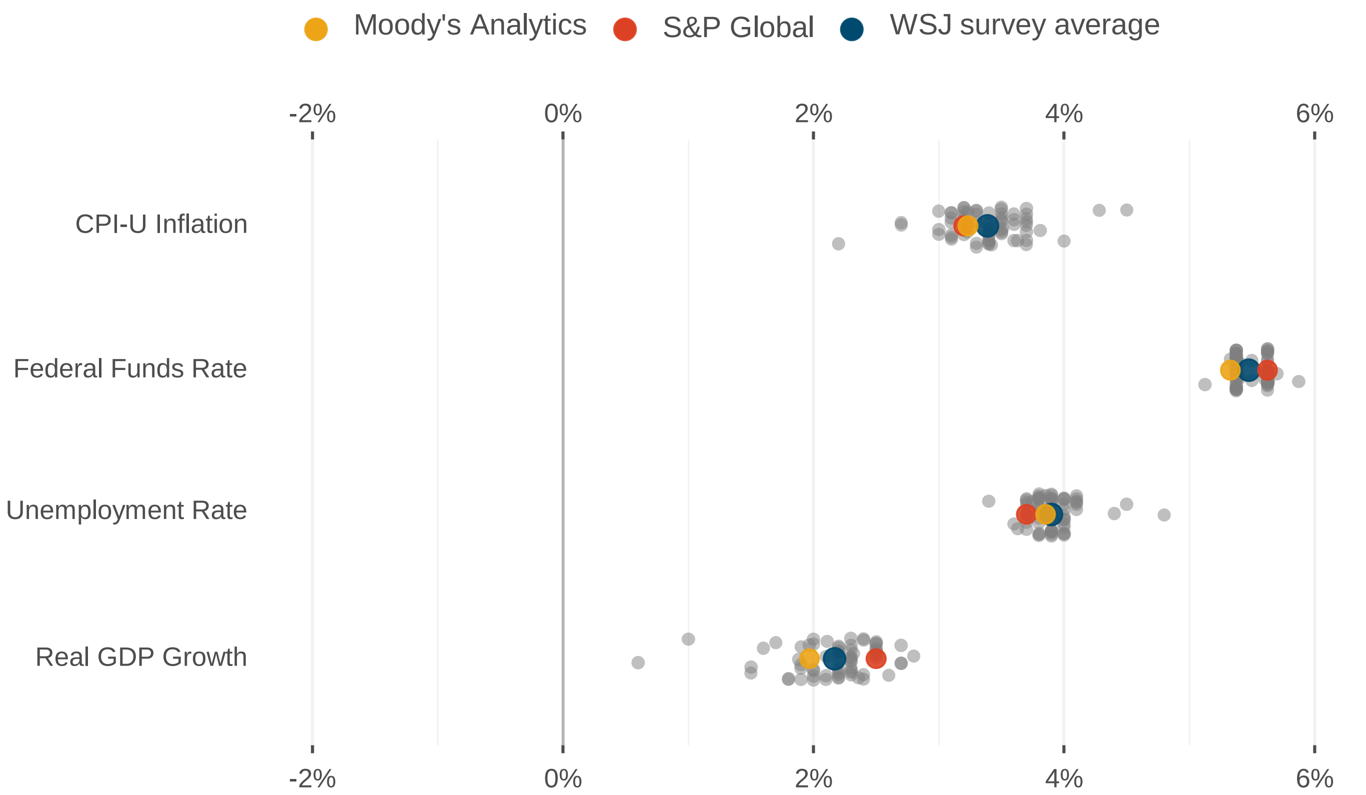
- Under this scenario, higher energy prices would contribute to increased inflation, even with our cooling labor market and stabilizing rental rates.

Which Forecast is Most Appropriate?

- The chart to the left compares S&P forecasts for year-end 2023 with those from Moody's analytics and the Wall Street Journal's quarterly survey of academic and private-sector economists.

- Note the S&P's projections are generally close to those from Moody's and near the mid-point of the range of the results from the WSJ survey.

U.S. economic forecast for year-end 2023



Source: Wall Street Journal Economic Forecasting Survey, October 2023

Economic Scenario Recommendation

Context

- Despite the strong economic performance seen in the 2nd and 3rd quarters at the national level, S&P's baseline forecast still anticipates significant slowing in late 2023 and the first half of 2024. Thus, the baseline forecast is not particularly aggressive, in terms of its predictions for overall growth.

- Our regional economic projections are consistent with the slow growth forecast at the national level, and they have been adjusted to reflect revised information about employment and income provided by the State.

- Although revised data from ESD have revealed significantly slower regional job growth over the past 12 months and the net loss of a significant number of jobs in the technology sector, realized revenues have largely met or exceeded our forecasts over this same period.

- Although we have identified a number of emerging risks, none of them are individually likely to have a significant impact on the regional forecast, particularly not for 2023 and 2024.

Conclusion

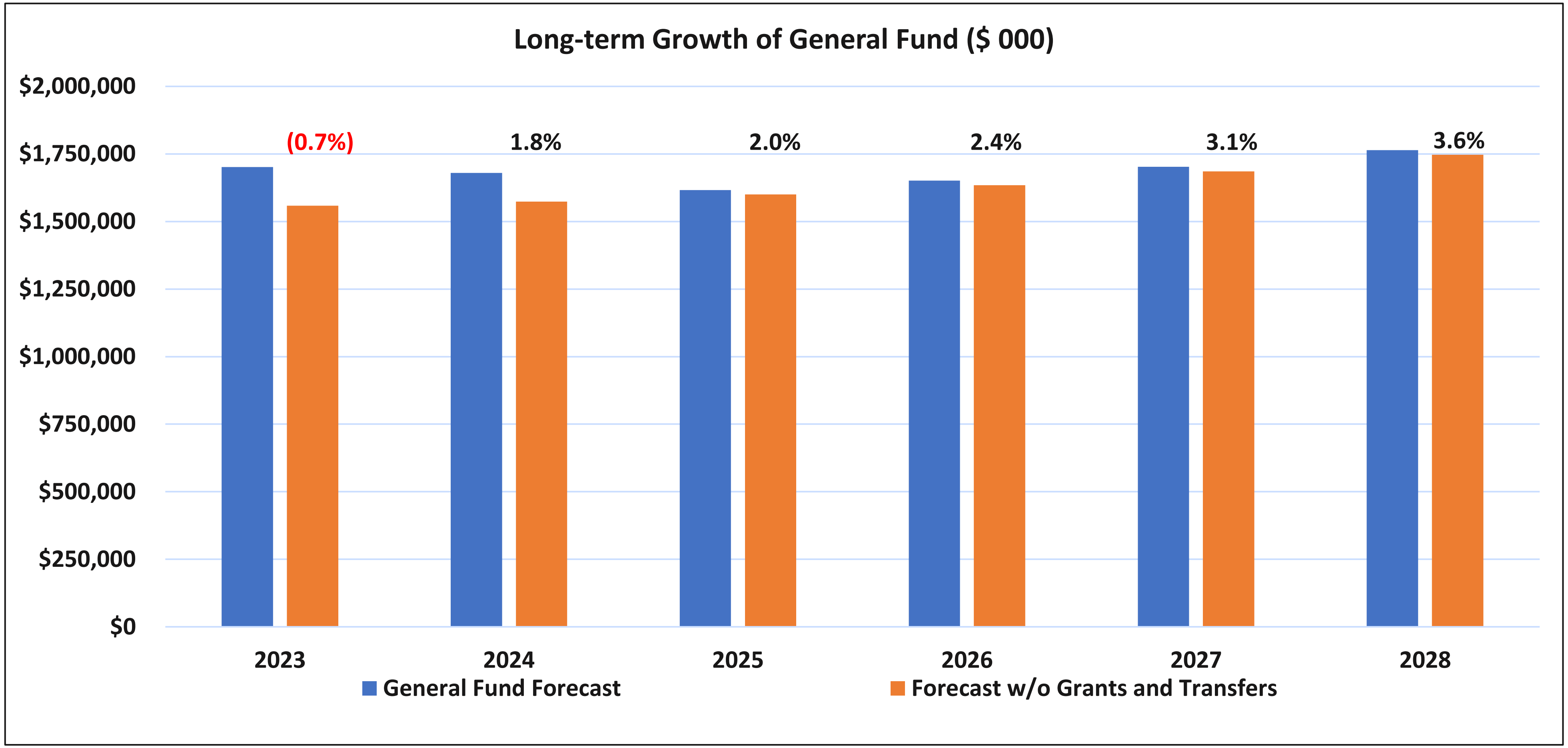
<u>The Forecast Office recommends using the baseline economic scenario for the October 2023 Revenue Forecast</u>.

Part 3: Revenue Forecast

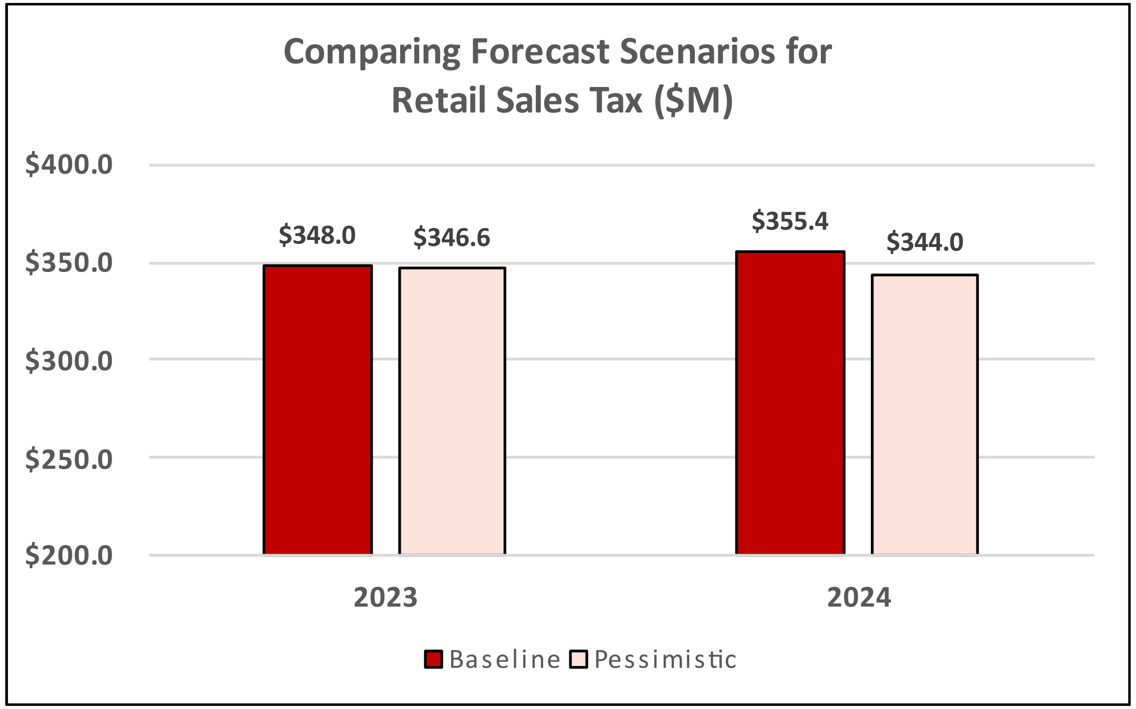
General Fund Revenues – 2023 and 2024 ($ '000)

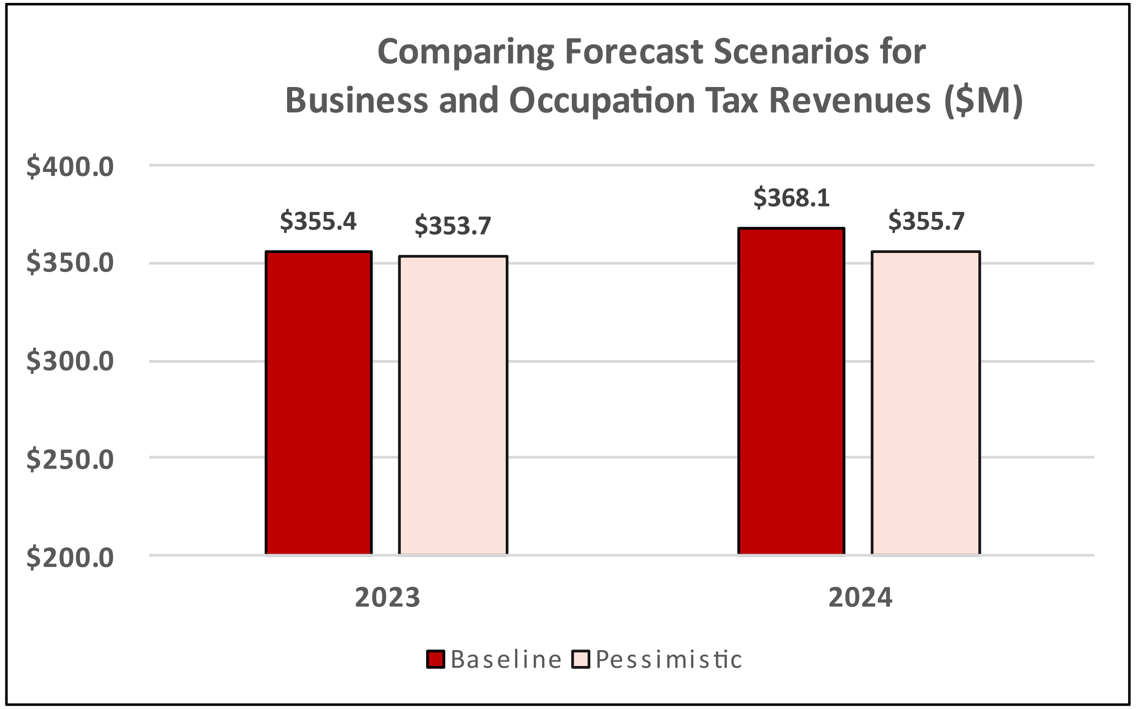
	2022	2023			2024			Total
Revenue Source	**2022 Actuals**	**2023 - Revised**	**2023 - Oct Forecast**	**Diff: Oct vs. Revised**	**2024 - Proposed**	**2024 - Oct Forecast**	**Diff: Oct vs. Proposed**	**2-Year Total Difference**
Property Tax (Including Medic One Levy)	$371,770	$379,270	$379,290	$20	$385,270	$385,480	$210	**$230**
Retail Sales Tax	$331,220	$344,460	$348,010	$3,550	$348,200	$355,390	$7,190	**$10,740**
Business & Occupation Tax	$331,580	$353,730	$355,420	$1,690	$367,460	$368,070	$610	**$2,300**
Utility Tax - Private	$41,850	$42,550	$42,550	$0	$38,440	$38,440	$0	**$0**
Utility Tax - Public	$192,850	$194,630	$192,870	($1,760)	$198,790	$198,790	$0	**($1,760)**
Other City Taxes	$14,540	$13,900	$13,840	($60)	$13,470	$13,380	($90)	**($150)**
Parking Meters	$23,860	$36,650	$36,650	$0	$46,270	$45,740	($530)	**($530)**
Court Fines	$13,340	$21,210	$22,310	$1,100	$18,280	$19,620	$1,340	**$2,440**
Revenue from Other Public Entities	$18,420	$18,950	$18,900	($50)	$19,090	$19,040	($50)	**($100)**
Grants	$23,330	$57,270	$57,270	$0	$17,580	$17,580	$0	**$0**
Fund Balance Transfers	$150,940	$86,000	$86,000	$0	$88,220	$88,220	$0	**$0**
Service Charges & Reimbursements	$132,480	$72,040	$73,050	$1,010	$72,730	$73,060	$330	**$1,340**
Licenses, Permits, Interest Income and Other	$50,940	$76,710	$74,720	($1,990)	$68,390	$68,390	$0	**($1,990)**
Payroll Tax	$44,980	$2,270	($440)	($2,710)	$0	$0	$0	($2,710)
Total	**$1,742,100**	**$1,699,640**	**$1,700,440**	**$800**	**$1,682,190**	**$1,691,200**	**$9,010**	**$9,810**
Difference w/o Grants and Transfers				**$800**			**$9,010**	**$9,810**
Annual Growth w/Grants and Transfers			**(0.7%)**			**1.8%**		

Long-Term Slow Growth of General Fund Remains a Key Feature of the Forecast



How Do Forecasts Vary Across Economic Scenarios?





- The most significant differences between the Baseline and Pessimistic scenarios are reflected in Retail Sales and B&O taxes.
- Given that we nearing the end of 2023, the differences between the two scenarios are more evident in 2024. The total difference over 2023 and 2024 for these two key revenue sources amounts to nearly $27 million.

Summary of Selected General Government Revenues

	2022	2023			2024			Total
Revenue Source	**2022 Actuals**	**2023 - Revised**	**2023 - Oct Forecast**	**Diff: Oct vs. Revised**	**2024 - Proposed**	**2024 - Oct Forecast**	**Diff: Oct vs. Proposed**	**2-Year Total Difference**
General Government Revenues:								
Payroll Tax^	$253,060	$274,590	$268,770	($5,820)	$289,860	$309,830	$19,970	**$14,150**
Admission Tax	$21,650	$22,650	$23,510	$860	$23,400	$24,400	$1,000	**$1,860**
Sweetened Beverage Tax	$20,240	$20,930	$20,930	$0	$21,250	$21,250	$0	**$0**
Short-Term Rental Tax	$9,870	$10,860	$11,070	$210	$11,790	$11,860	$70	**$280**
REET	$91,420	$50,680	$48,820	($1,860)	$53,920	$52,260	($1,660)	**($3,520)**
Transportation-Specific Revenues:								
Trans. Ben. Dist. - Sales & Use Tax	$51,950	$53,900	$54,370	$470	$54,460	$55,400	$940	**$1,410**
Trans. Ben. Dist. - Vehicle License Fee	$15,980	$18,260	$16,640	($1,620)	$20,610	$20,610	$0	**($1,620)**
Commercial Parking Tax	$37,660	$48,380	$47,380	($1,000)	$50,240	$48,860	($1,380)	**($2,380)**
SSTPI - School Zone Speed Enforcement	$8,470	$13,240	$12,960	($280)	$11,560	$9,420	($2,140)	**($2,420)**

^ Excludes late 2021 payments deposited into GF in 2022

JumpStart Payroll Expense Tax Forecast

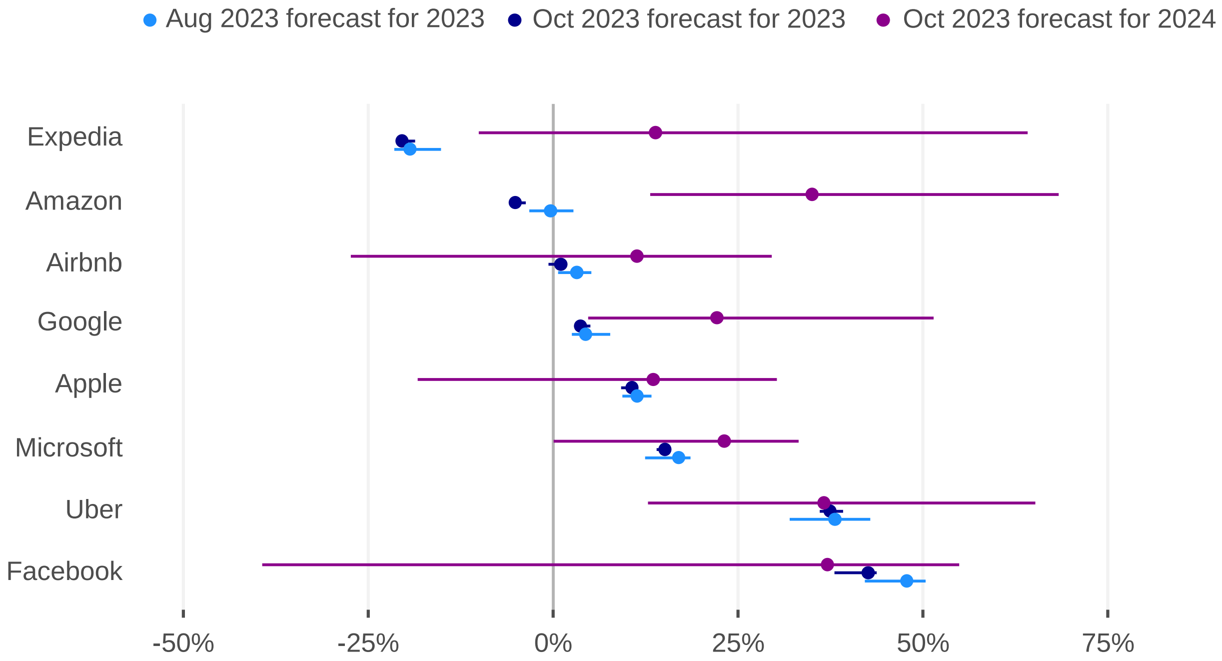
Forecast Update

- ➢ 2023 forecast has been updated to reflect most current data on “return to the office”, as well as updated forecasts for stock values. We have seen that stock values are an important driver of overall JumpStart Payroll Expense Tax revenue.
- ➢ The forecast has also been updated to reflect a significant refund that City Finance expects to pay before year-end.

- ➢ In the April and August forecasts, the 2024 JumpStart/Payroll projections were based on projected Technology Sector growth, relative to the 2023 forecast. For the October forecast, we have developed estimates that directly reflect:
  - — Projected 2024 stock valuations;
  - — Recent developments in “return to the office”; and
  - — An estimate of the incremental revenue associated with the sunsetting of the deduction currently available to non-profit health-care entities. Eliminating this deduction adds ~$4.5M to the 2024 forecast.

Predicted stock price changes

Year-over-year expected change in stock price; low, average and high estimates



Source: Wall Street Journal, stock price targets from analyst ratings

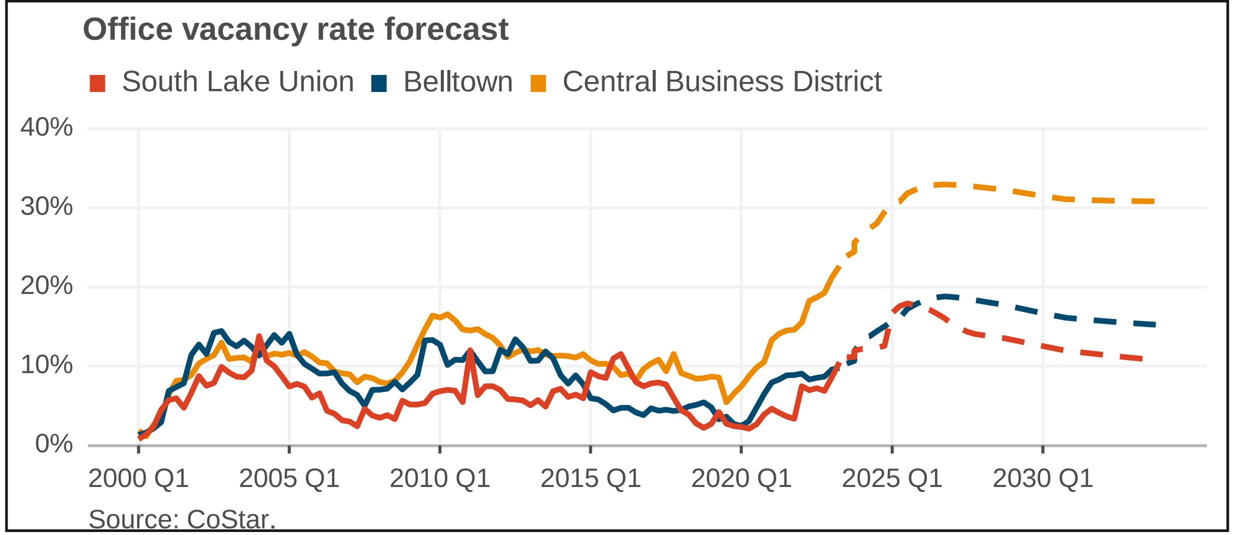
JumpStart Payroll Expense Tax Forecast (cont.)

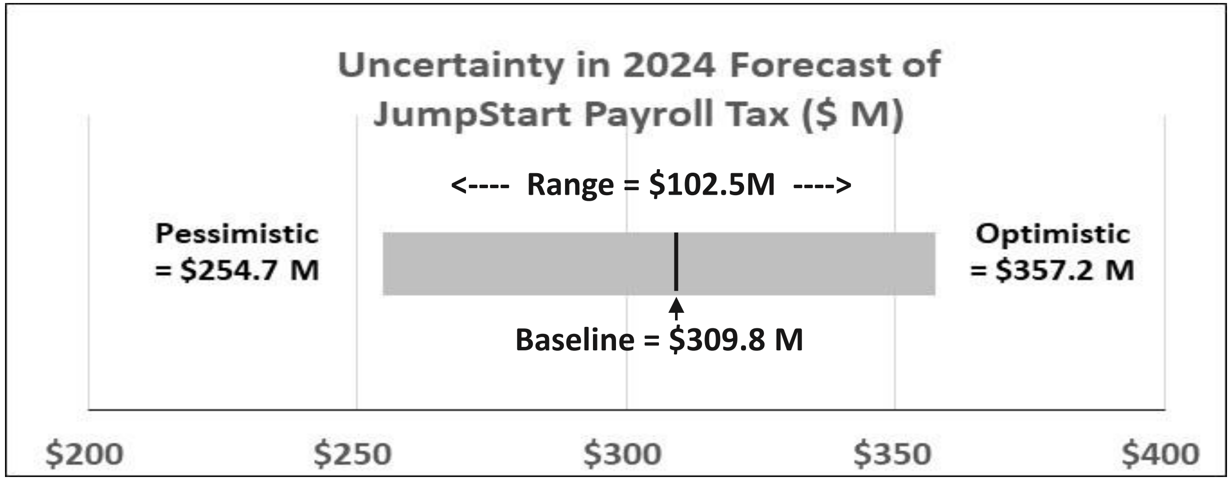
Return to the Office

- The JumpStart Payroll Expense Tax only applies to work that occurs within Seattle limits. Therefore, for non-resident employees, "return to office" behavior is important for forecasting revenues. Using aggregate cellphone data, we have been tracking this behavior.
- Recent data show that employees are working more in the office, but these data also indicate that attendance may be plateauing. The local office vacancy forecast from CoStar, shown at right, is consistent with this observation as vacancy rates are expected to increase even further before stabilizing. A long-term shift away from City office locations will constrain potential JumpStart Payroll Expense Tax revenues.

Uncertainty

- As highlighted in the previous slide, there is significant uncertainty in the range of projected stock values. The examples provided are only designed to be illustrative, but comparable uncertainty exists in the projections for the major payers included in our modeling. The chart at the lower right illustrates the resulting range in forecast revenues.
- And note that the chart only shows the uncertainty due to differences in stock price expectations. Beyond that, there is considerable additional uncertainty not captured in the forecast:
  - Businesses continue to evaluate their need for office space and to decide which expiring leases not to renew; and
  - Because we only have two years of tax revenue data and still do not have access to the payroll data from ESD, we do not have a detailed view of what additional factors are driving changes in each company's tax payments.





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Questions?