

Economic and Revenue Update

August 10, 2023

**Office of Economic and Revenue Forecasts
&
City Budget Office**

Presentation Outline

Part I: Update on economic developments since the April Forecast

Part II: Summary of August Economic 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 August Revenue Forecast

- General Fund Revenues
- Non-GF “General Government” Revenues – including JumpStart Payroll Tax and REET
- Non-GF Transportation Revenues



Part 1

Economic Update - Recent Developments



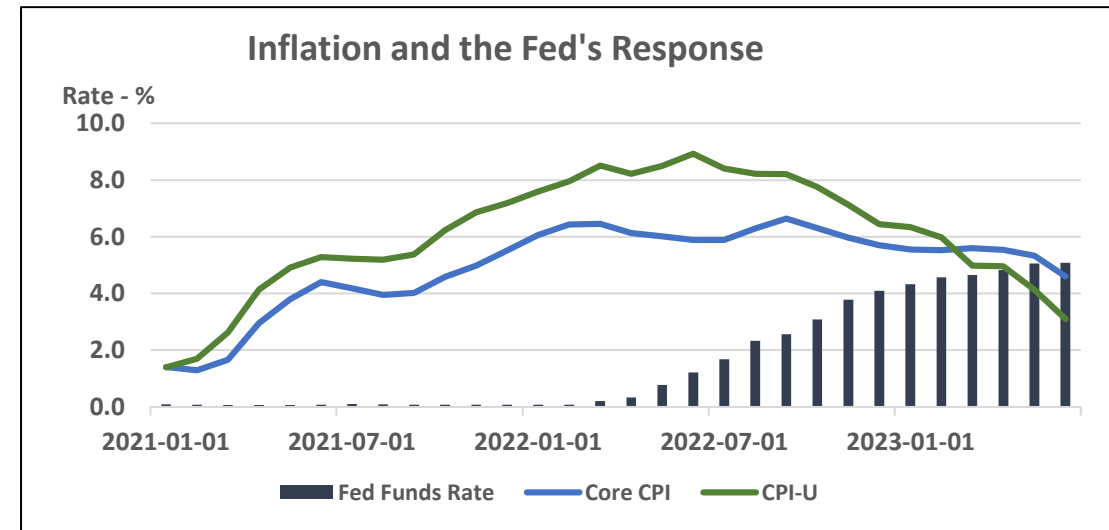
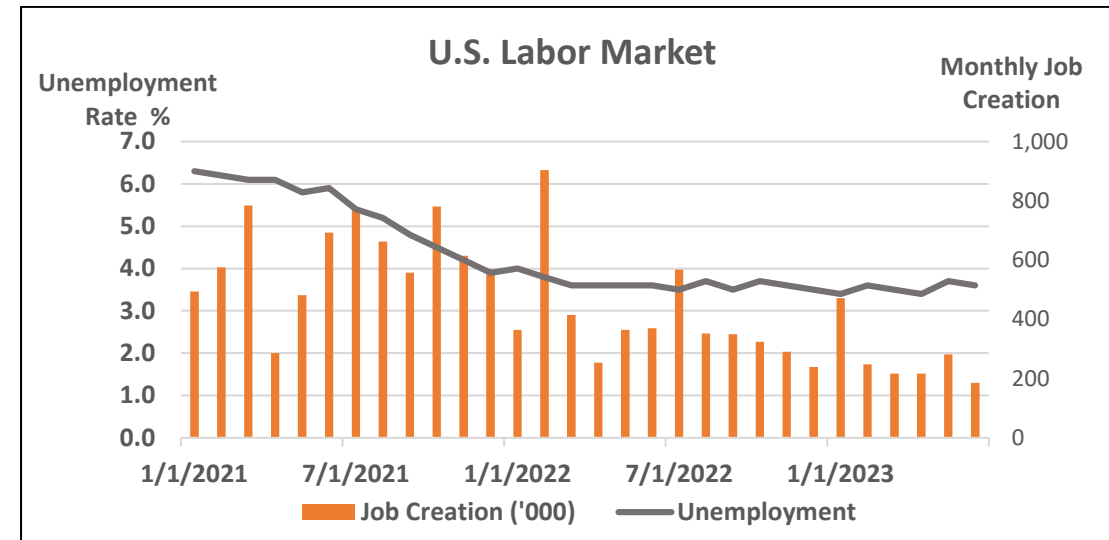
Brace Yourselves for ... a Soft Landing?

Employment: Through the first half of this year, the national economy has continued to grow and create jobs at a modest, but healthy rate.

- Over the last 3 months, job creation has averaged 218,000 per month. Job creation has generally been slowing.
- But unemployment has been stable at ~3.5% since March of last year.
- Wages are continuing to grow, but the rate growth has begun to slow. Second quarter growth was 4.4%, compared to 5.6% in 2Q of last year.

Inflation: Overall, inflation had been on downward trend since the Federal Reserve (Fed) began aggressively raising interest rates last year.

- CPI, which is the most general measure of inflation, has fallen from a peak annual level rate of ~9% last June, to just 3% a year later.
- However, “core” inflation, which excludes food and energy, has remained relatively high, down from a high of 6.6% to a more persistent ~5+%, although it did drop to 4.6% in June.
- Slowing rent growth bodes well for further inflation declines later this year.



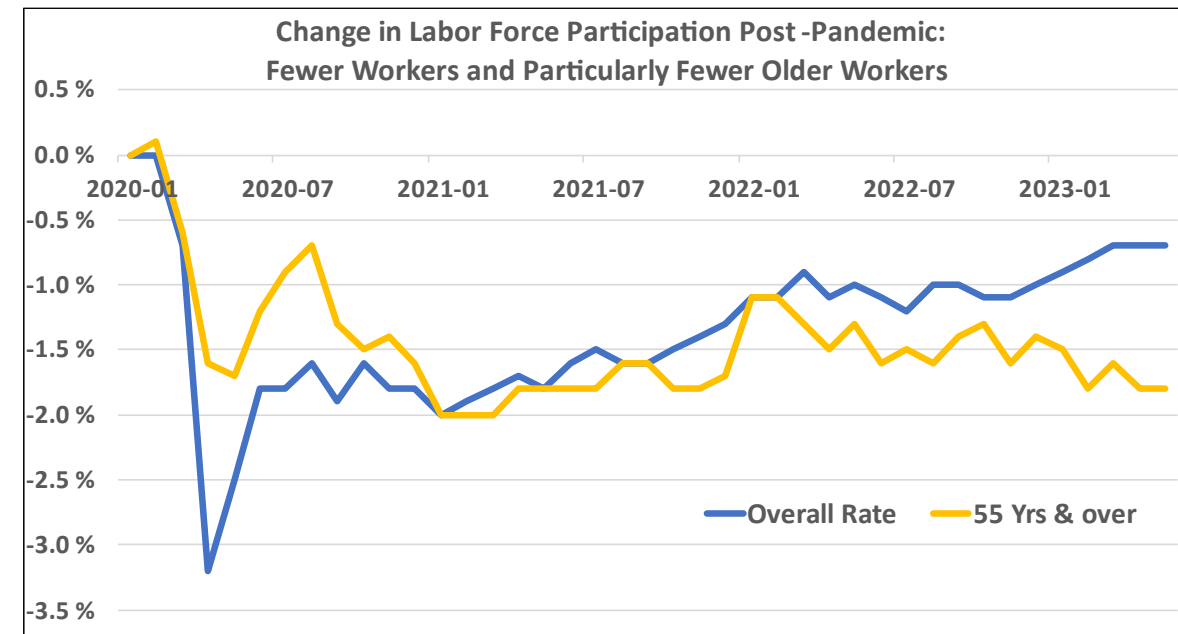
Why is a Slowdown Still Expected and Why Hasn't it Happened Yet?

A Slowdown is Still Forecast Because the Fed Remains Committed to Cooling the Economy and Reducing Inflation

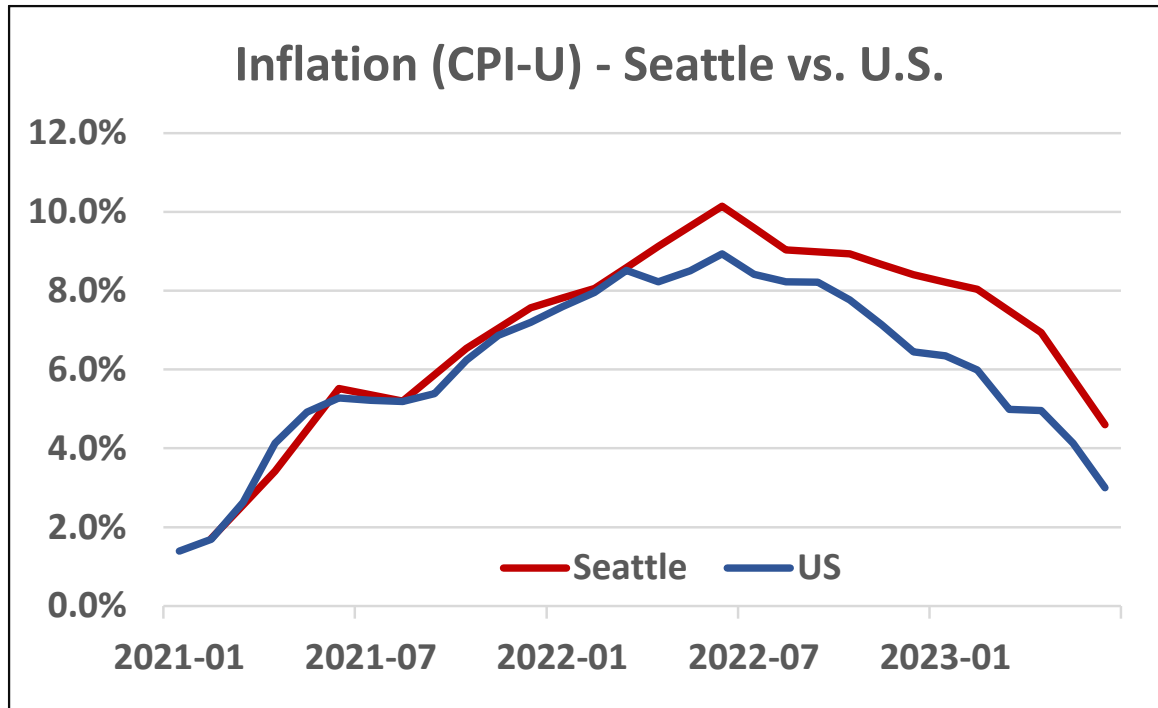
- Raising interest rates generally cool overall economic activity via the following path:
 - Sectors that are dependent on access to borrowed dollars (e.g., construction, real estate, and automobile sales) slowdown as financing costs increase.
 - In turn, as demand in these sectors falls, companies respond by reducing employment and investment.
 - These decisions then reduce demand for goods and services across the economy, slowing labor markets and reducing price increases.
- The Fed “paused” on rate increases in June, but raised rates another 0.25% in July. Bottom-line, the Fed intends to increase interest rates until it induces a slowdown. *This is the key reason the national forecasts still predict further economic cooling.*
- For example, S&P Global now anticipates GDP growth of ~2+% in 2023, slowing to ~1.4% in 2024, and then holding at ~1.5% for several years following.

So Why Has the Fed's Strategy Taken So Long to Take Hold?

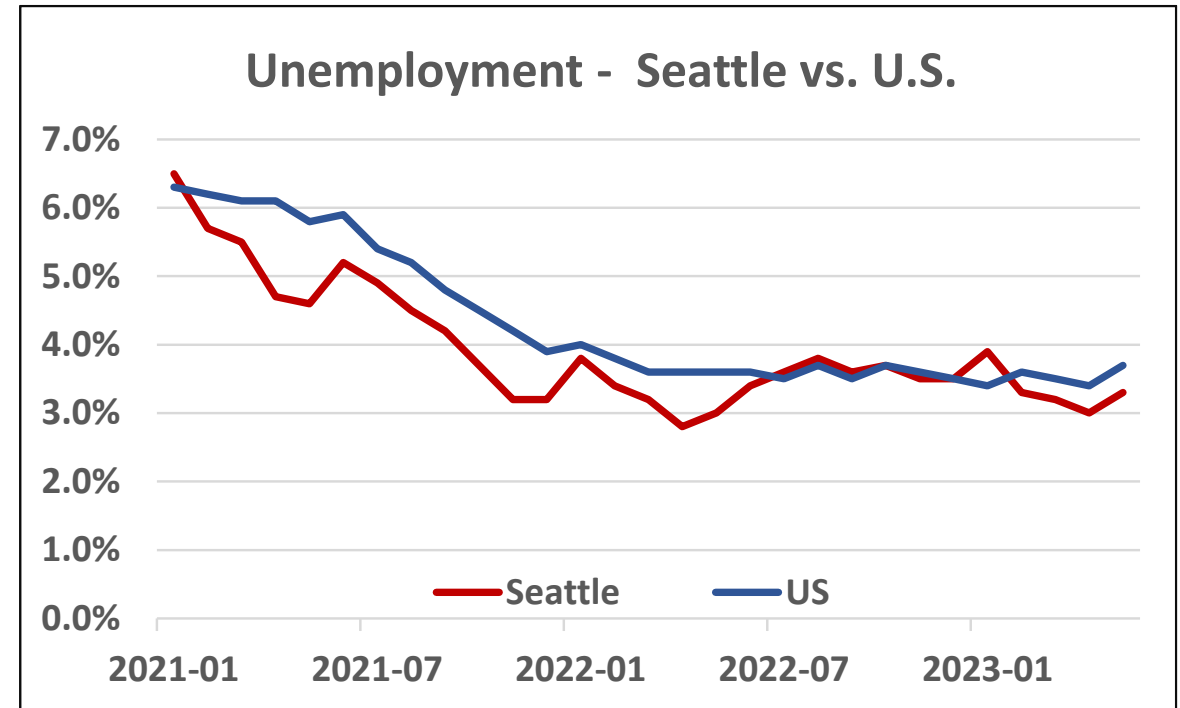
- In general, the interest rate increases takes about a year to affect the real economy.
- Energy prices have fallen after the spike caused by the Russian invasion of Ukraine. This has provided a form of economic stimulus.
- Consumers had significant pent-up savings, in part created by federal COVID stimulus programs.
- With supply chain issues resolved, the automobile market is showing unusual strength, despite higher interest rates.
- The pandemic has significantly disrupted labor markets, such that labor demand remains strong, relative to labor supply. However, the recent slowing of wage growth likely results from workers continuing to return to the workforce, and an increasing number of immigrants in the workforce.



To Date, the Regional Economy Has Generally Shown Comparable Strength



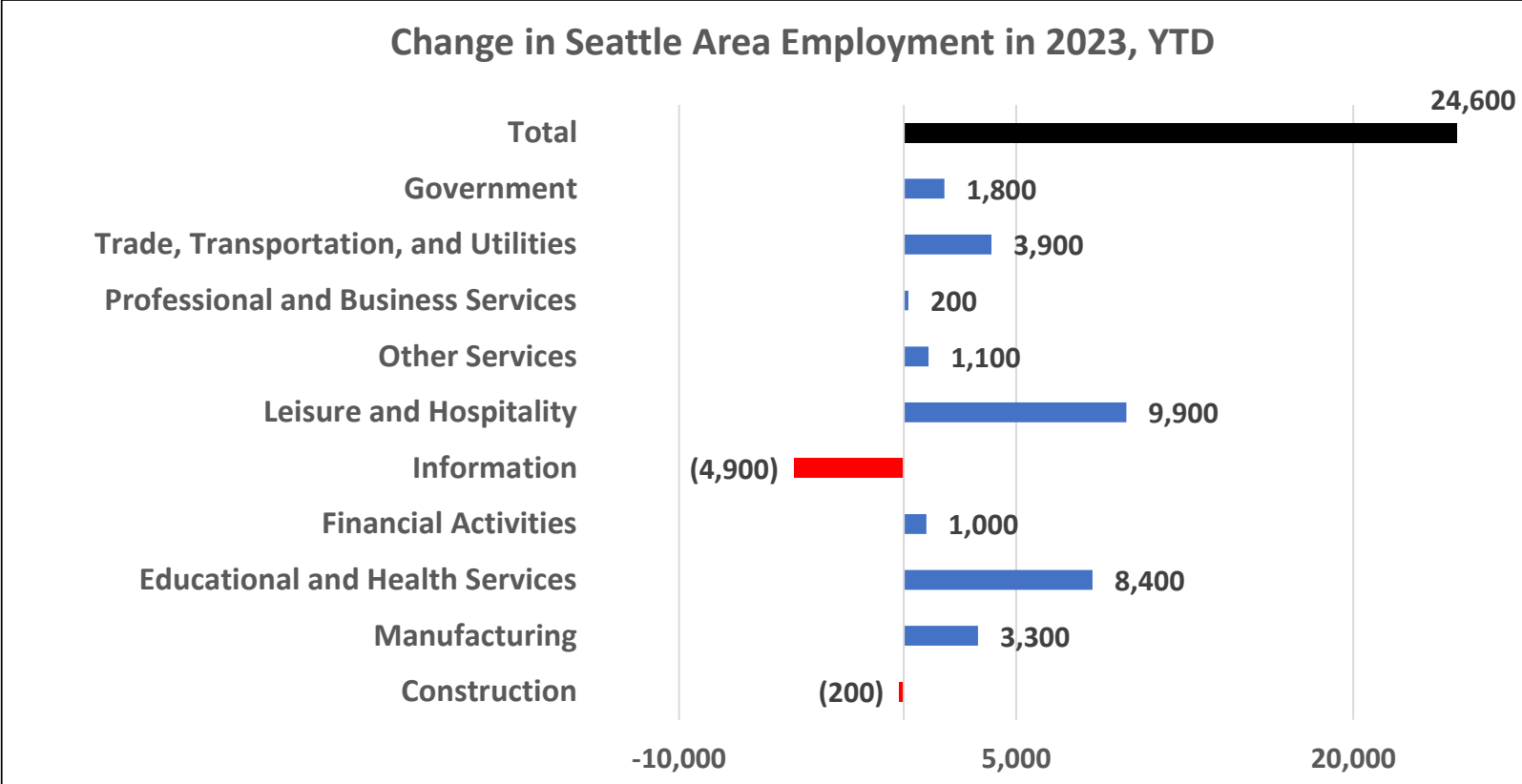
- Local inflation has exceeded national levels since early last year, but it has been falling quickly in recent months.
- Seattle's cooling residential rental market should narrow the gap to the national rate over the coming months.



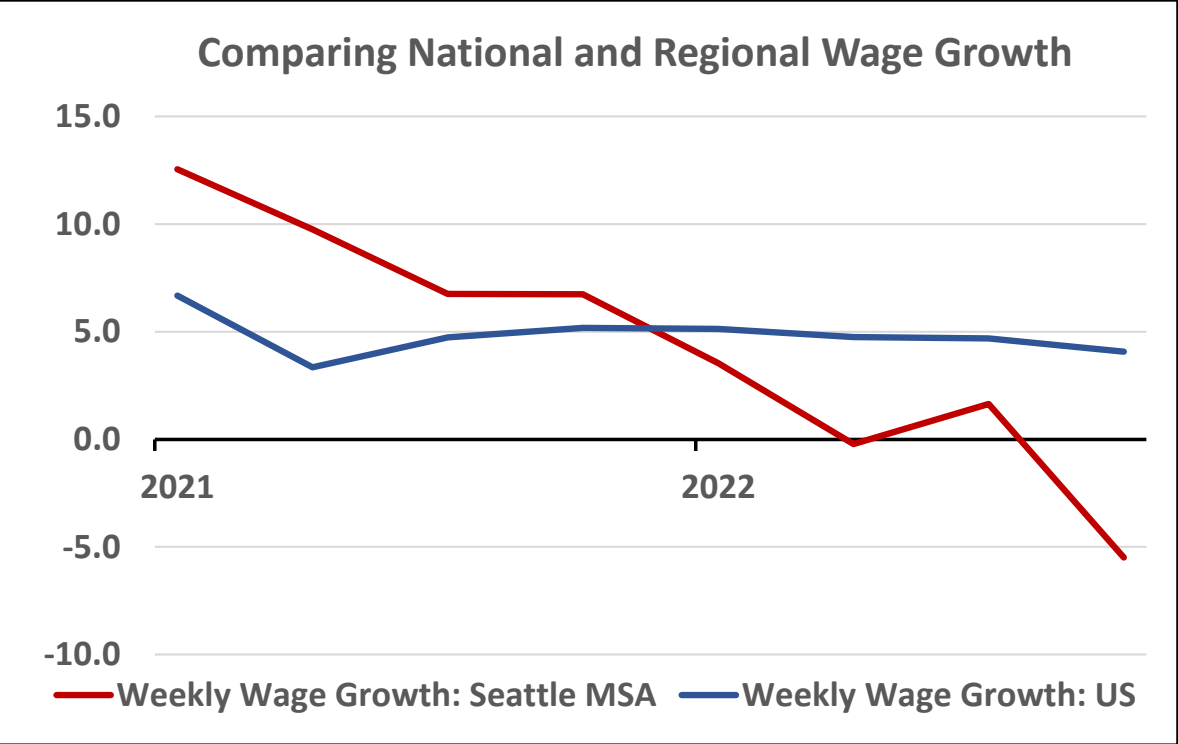
- Local unemployment has been at or below national levels since early 2021.

However, Slowing in Key Sectors Highlights Significant Differences in Local Economy

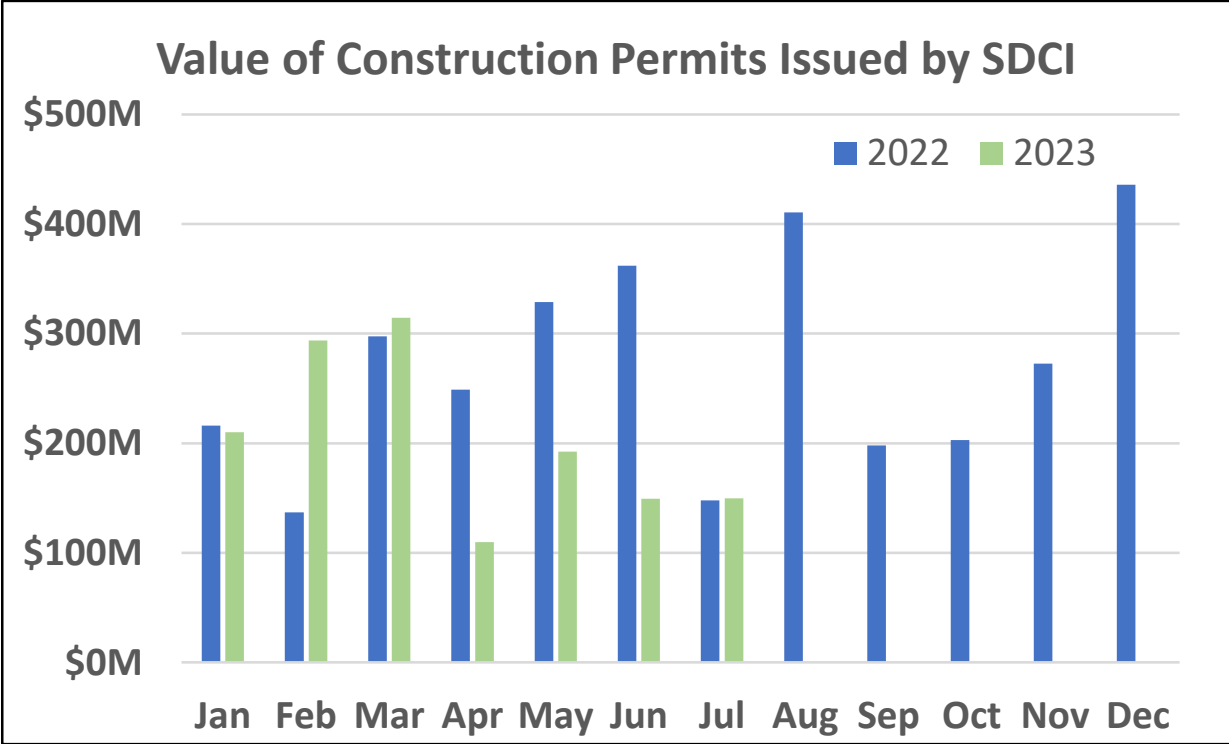
- The local economy has added almost 25,000 jobs since the beginning of the year; an increase of ~1.5%.
- Job growth has occurred across all sectors, with the notable exception of the Information and Construction sectors, and the near stagnation of Professional and Business Services.
- Given that technology hiring led the local post-pandemic economic recovery, the loss of jobs in the high-paying Information sector is particularly significant.
- While the decline in Construction Sector employment has been small, SDCI permit data suggest that a further slowdown in the Construction Sector is likely coming.
- And finally, note that the Leisure and Hospitality sector is continuing its strong recovery, although total employment is still below pre-pandemic levels.



Tech Slowdown Hurting Overall Wage Growth & Construction Permits Show Signs of Slowing



- After outpacing the nation in wage growth with the post-pandemic spike in technology-related hiring, regional wage growth has recently fallen below the national average, and actually shifted negative in the second half of 2022.



- The value of issued permits has declined substantially in recent months, relative to last year.
- Low demand for office is now compounded by high interest rates.
- YTD, permit value is down almost 20% compared to 2022, and has declined more than 35% for projects valued at \$1M or more.

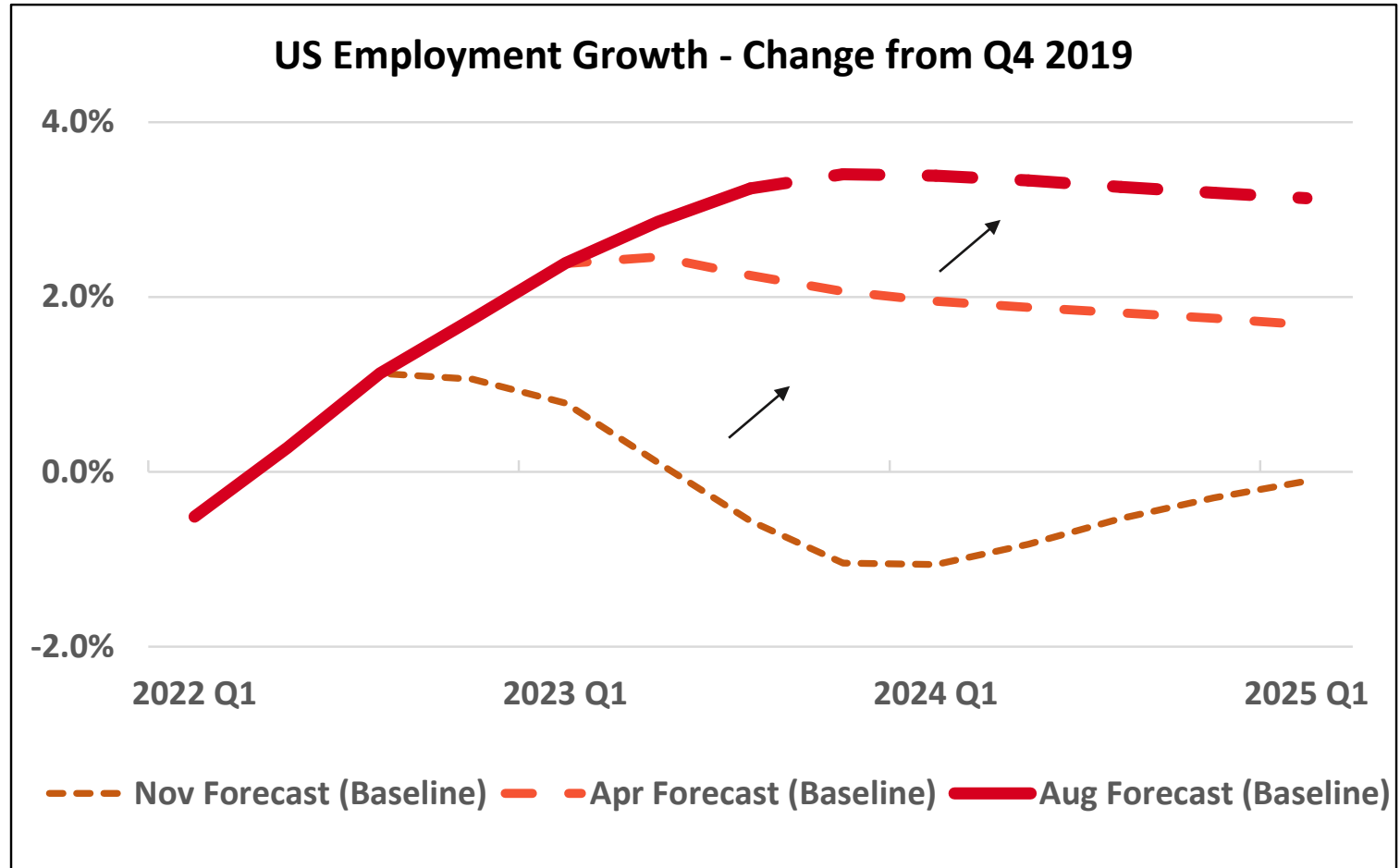
Part 2

National and Regional Economic Forecasts - Looking Forward



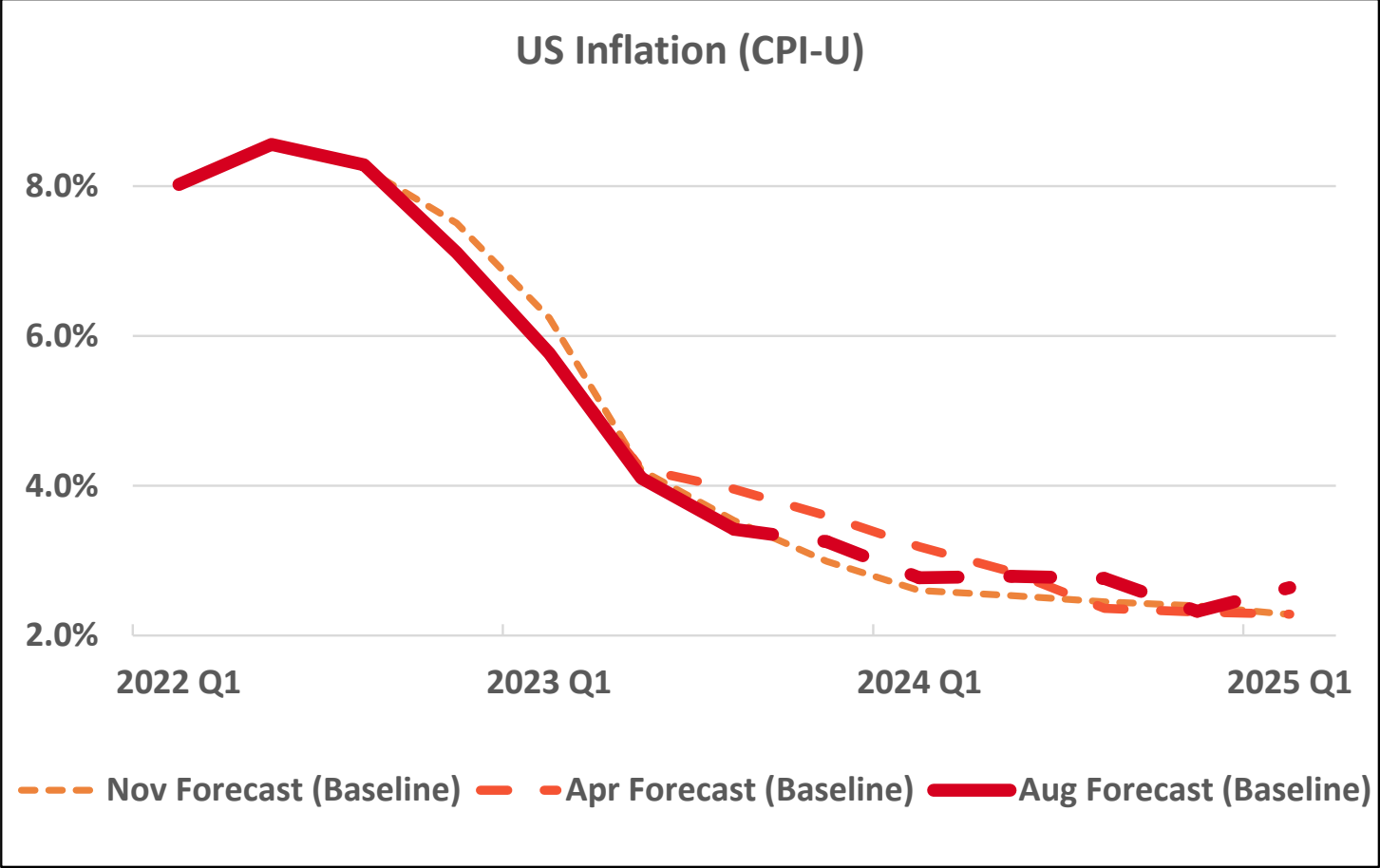
Baseline National Forecast ~~Now~~ Still Anticipates a "Soft Landing", But Now a Bit Softer

- S&P Global's national forecast has been updated over the past nine months to reflect the realized strength of the US. economy, and an increasing probability of a period of slow-growth, rather than a recession.
- Forecast assumes that the Fed will manage interest rates with the goal of slowing wage growth to ease inflationary pressures, and that this can be done without reducing total employment, but rather just slowing its rate of growth.



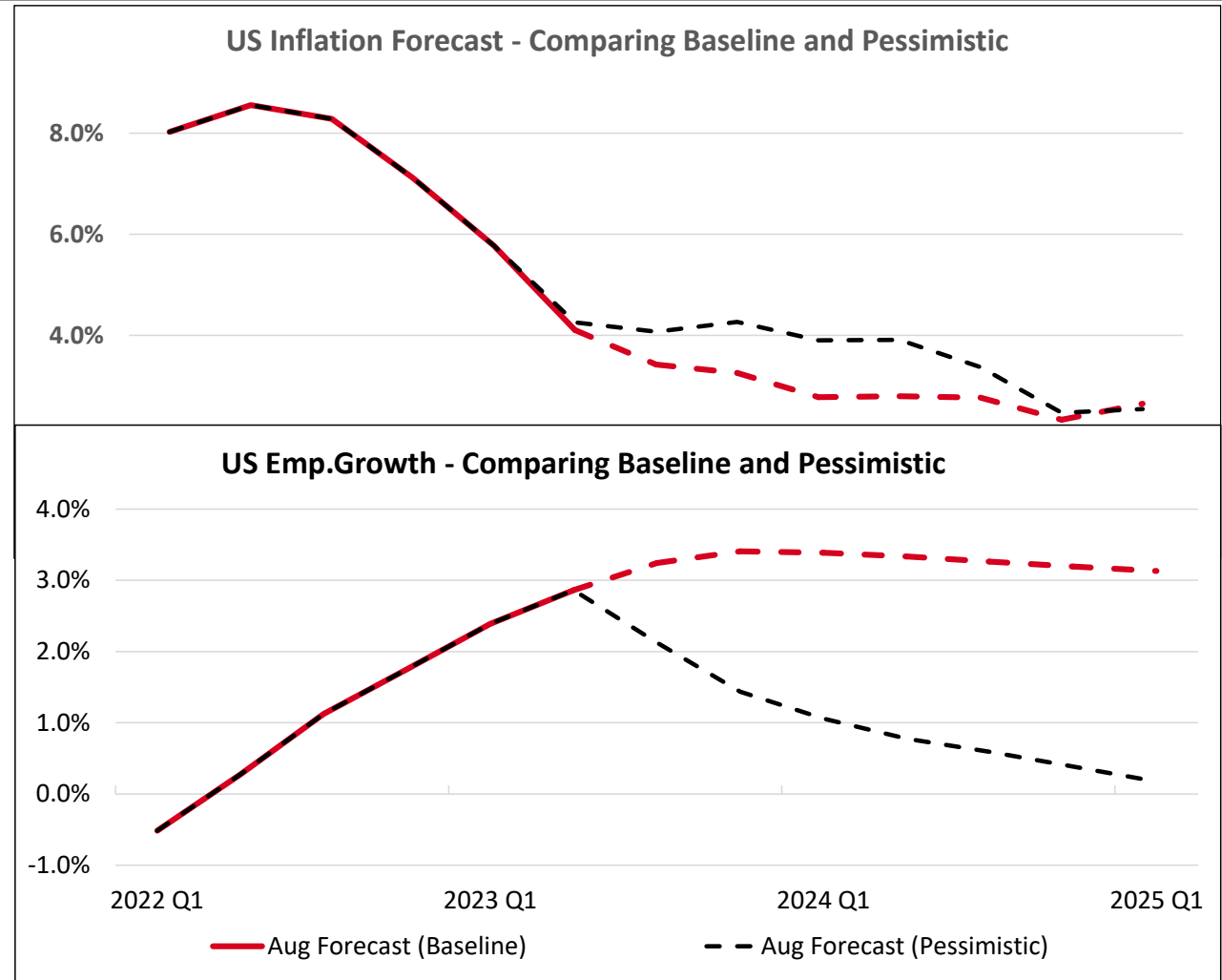
Baseline Inflation Forecast at the National Level

- S&P Global’s inflation forecast remains largely unchanged from April, consistent with the view that Fed will be managing interest rates with the aim of cooling inflation toward a ~2% target by the middle of next year.
- Although recent news on inflation has generally been good, the Fed is still focused on “core” inflation and the Personal Expenditure Index (PCE), which are designed to capture longer-term price trends. Accordingly, the Fed did return to raising interest rates at its July meeting.

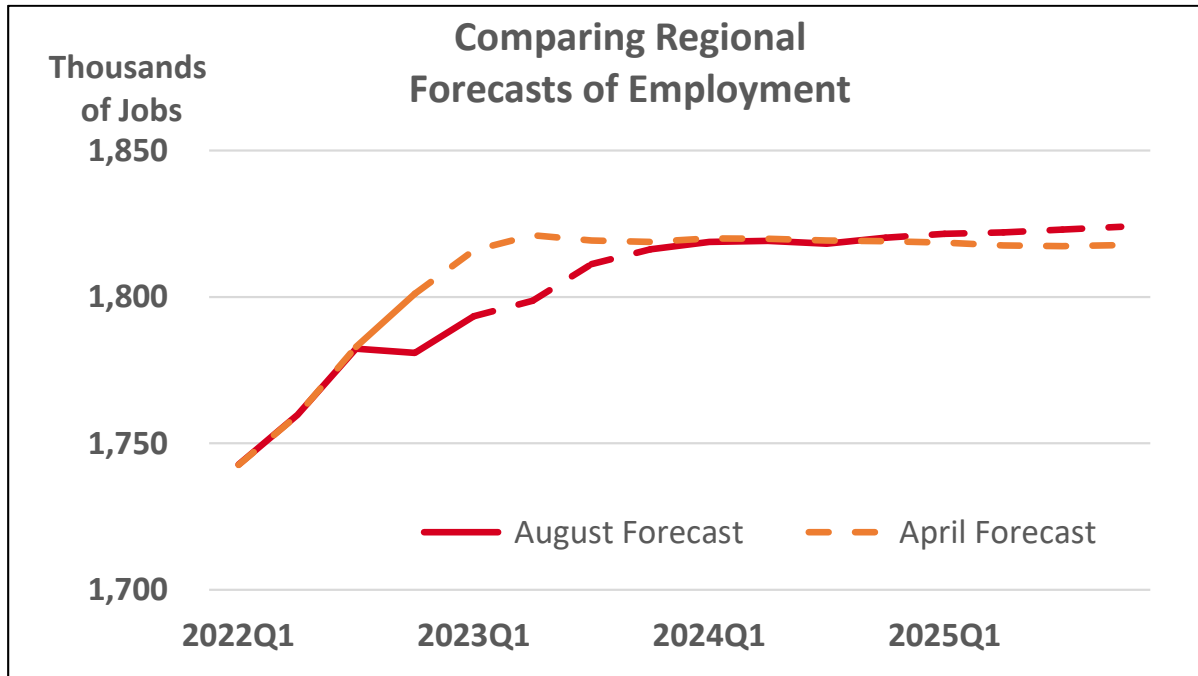


National Forecast: Baseline vs. Pessimistic

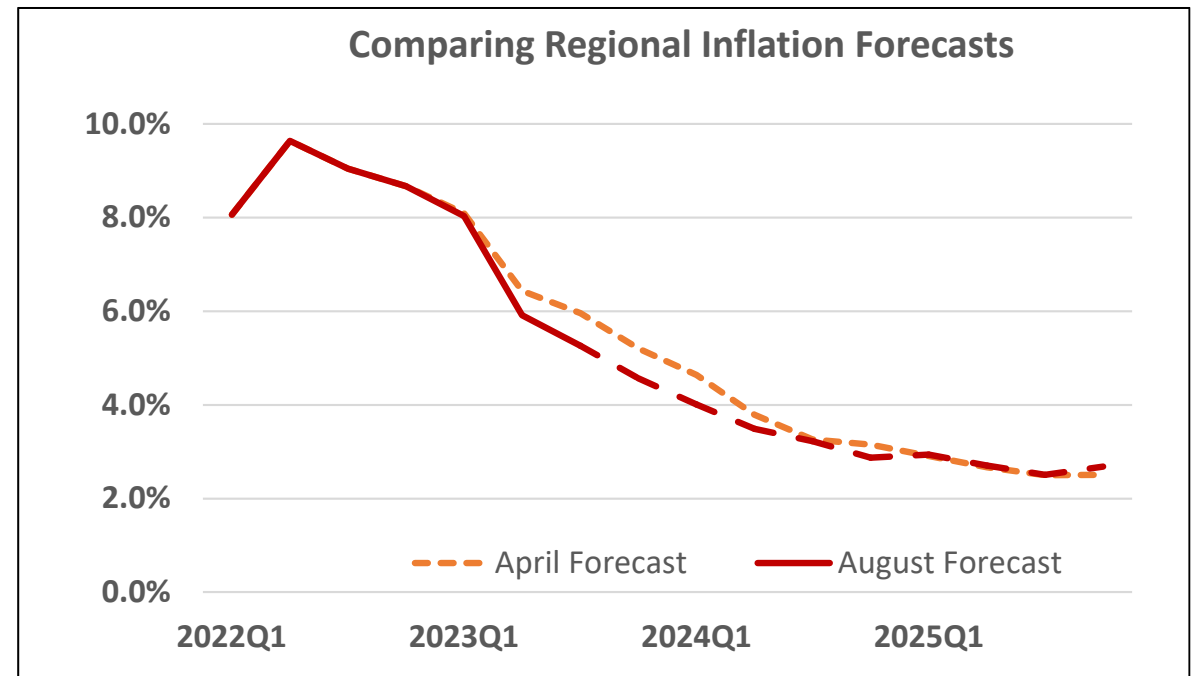
- S&P Global assigns a 25% probability to a pessimistic scenario under which further escalation of Russia's war on Ukraine is combined with banking sector instability brought on by escalating interest rates.
- The results is reduced spending for large, credit-dependent purchases, and less disposable income for more minor purchases, as higher energy costs consume discretionary income.
- In turn, reduced spending leads to a slow down in business investment and employment growth.



Regional Forecast Is Largely Unchanged, But Has Been Adjusted to Reflect Revised Employment Data and More Rapidly Cooling Inflation

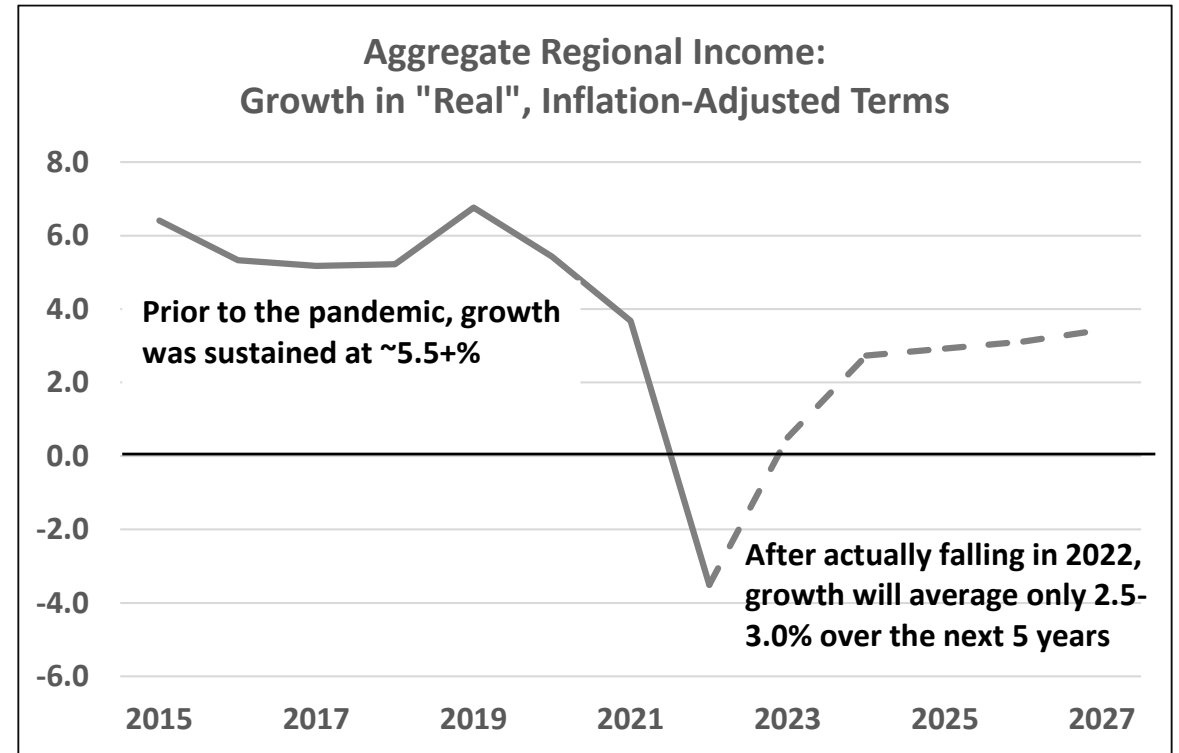
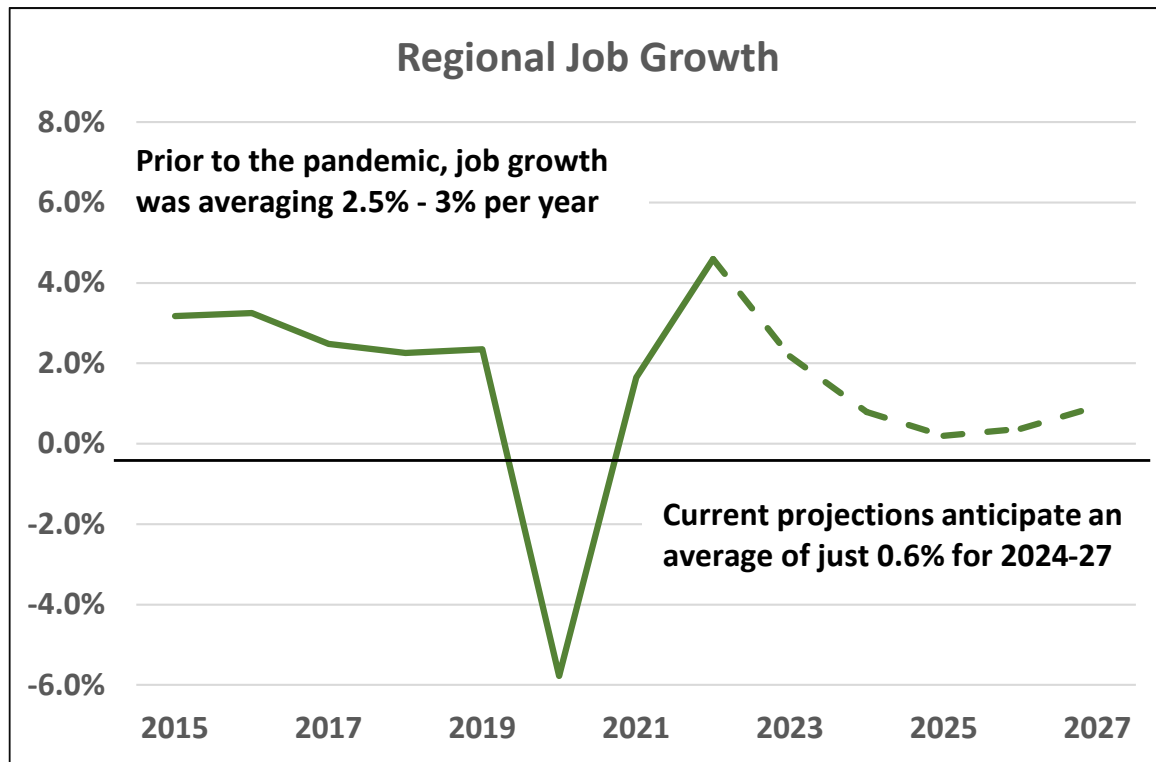


- Revised employment data show that regional job growth was slower in the 2nd half of 2022 than originally thought.
- The revised forecast model predicts that lower regional employment will persist until late this year and then “catch up” during 2024.



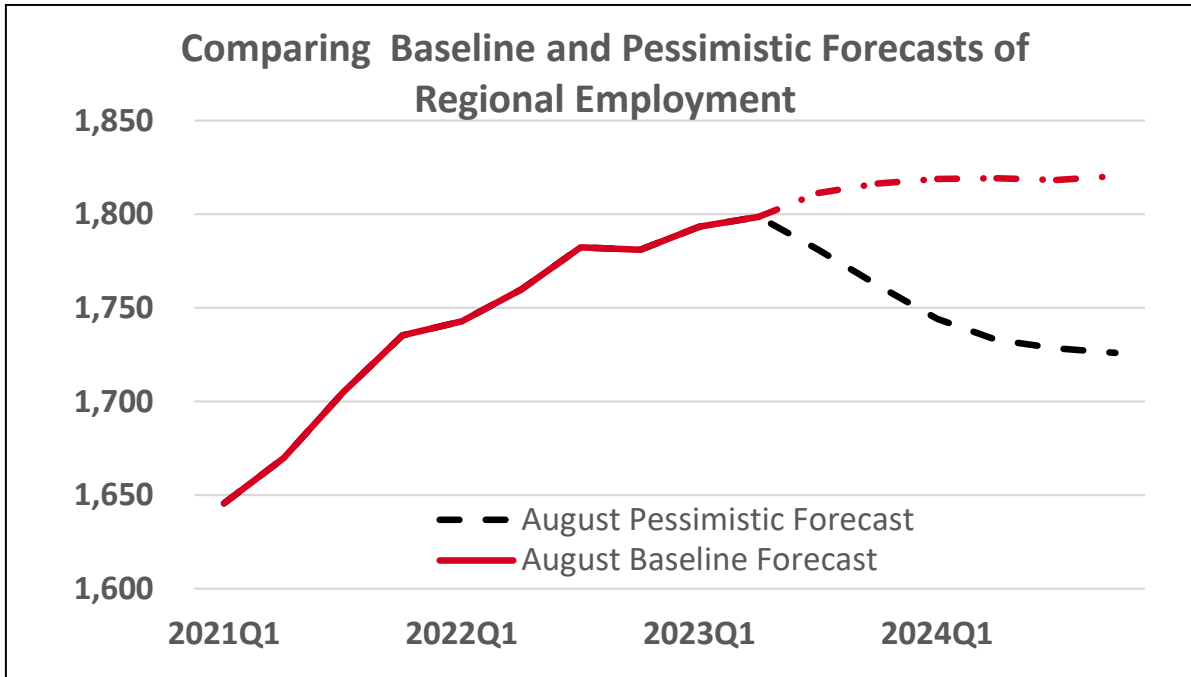
- Inflation cooled more quickly in the first half of the year than projected in April, but the forecast has not changed significantly.
- The updated forecast assumes that inflation will continue to fall, and the quarterly estimates for 2024 are now about 0.3% lower than in April. Beyond 2024, the previous and current forecast converge on a path toward the target rate of ~2.0-2.5%

But the Underlying Forecast Still Calls for Significantly Slower Regional Growth Than Experienced Pre-Pandemic

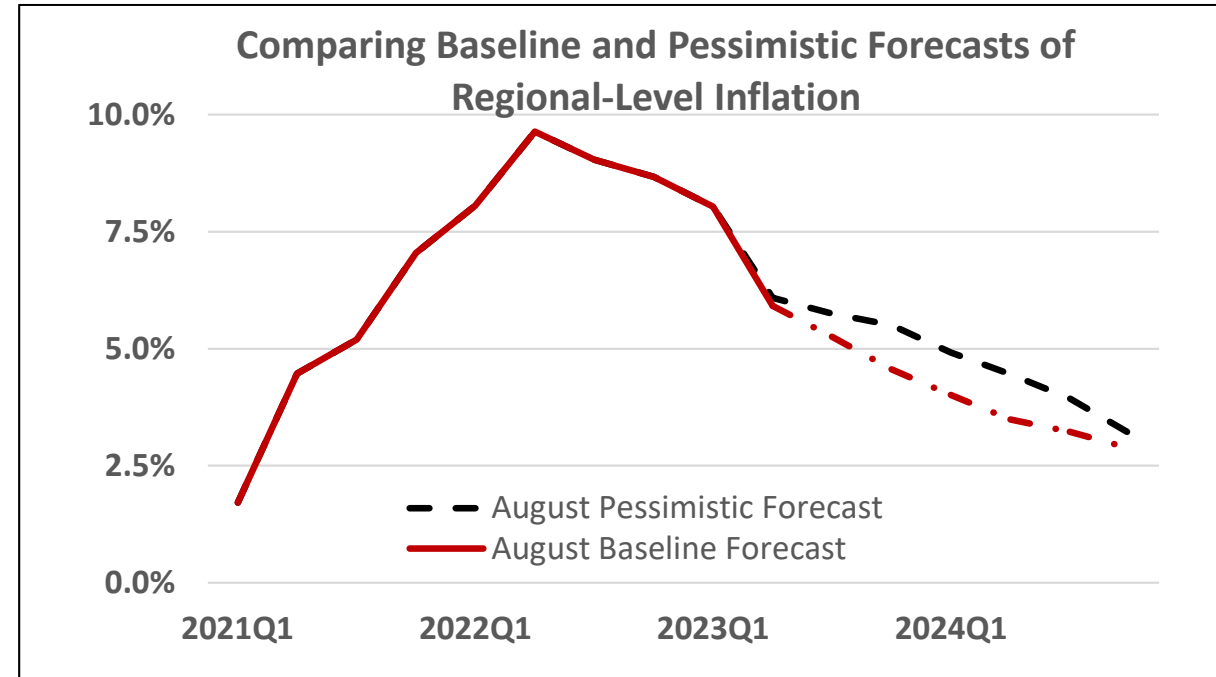


- While largely unchanged since April, it is important to understand that the current projections anticipate a sustained period of slow growth.
- Employment will continue to grow, but not at the same rate seen before the pandemic. And growth in overall regional income will be slower both because employment growth will ease, and because job growth will shift away from the high-paying technology sector.
- Pre-pandemic, regional growth was significantly outpacing the nation as the technology sector grew rapidly and drove a boom in local construction. Looking forward, regional growth is likely to more closely track national trends.

What Does the Pessimistic Forecast Look Like Regionally?



- Driven by the implications of S&P Global’s pessimistic forecast, our regional version of the same scenario projects a significant decline in local employment.

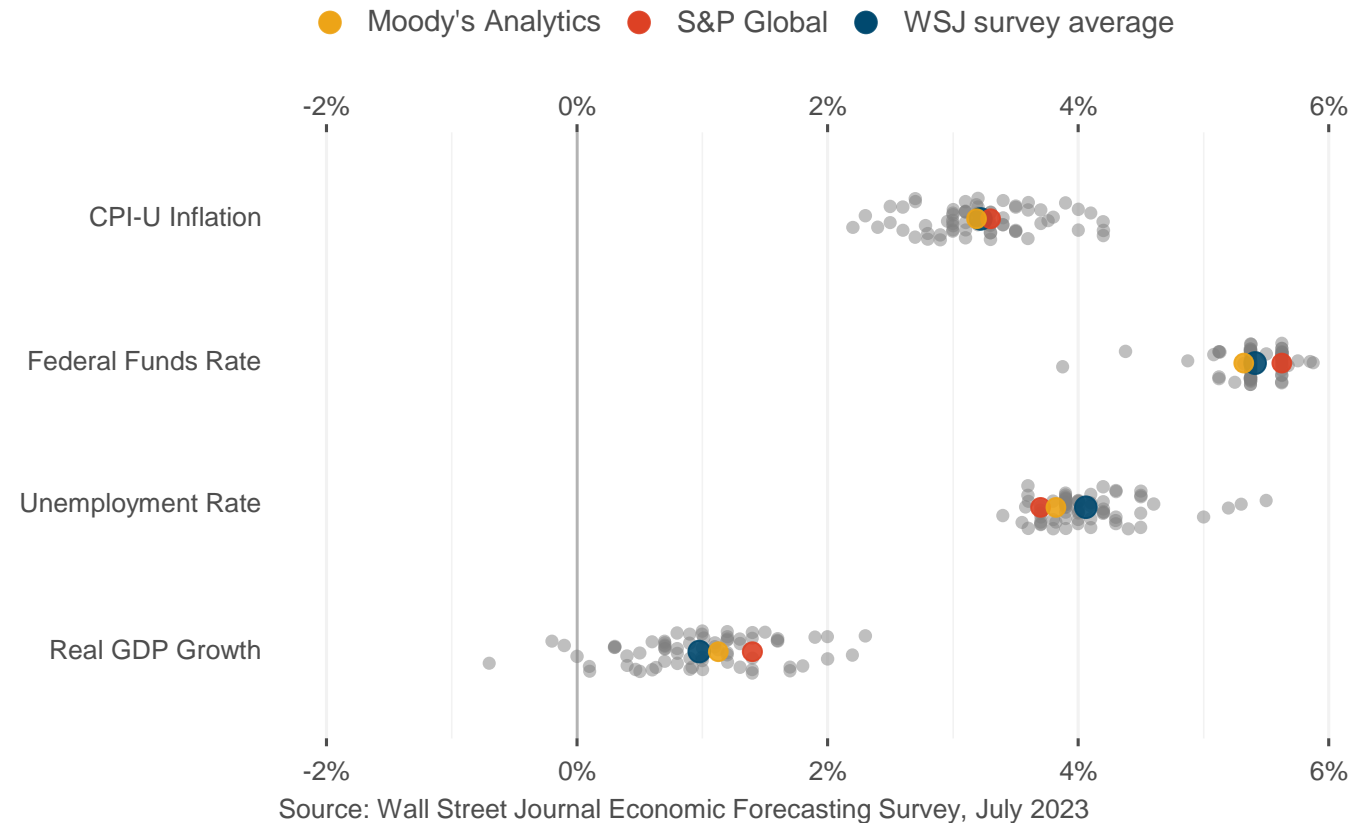


- Under this scenario, escalating energy prices would drive up local inflation, even as other factors such as the softening rental market help contain growth in the local cost of living.

Which Forecast is Most Appropriate?

- We have focused most of our presentation on forecasts that are directly or indirectly linked to S&P Global's "Baseline" forecast. Their Baseline tends to fall within the "middle of the range" of other national forecasters, generally leaning somewhat to the conservative side.
- The Wall Street Journal (WSJ) conducts a quarterly survey of forecasting economists to provide a sense of the relative concurrence or divergence of forecasts. The survey includes 70 business and academic economists.
- This Graphic highlights where S&P Global's forecasts falls with the range of respondents. At present, S&P Global is somewhat more optimistic than the WSJ average for some key economic metrics, but only modestly so.

U.S. economic forecast for year-end 2023



Economic Scenario Recommendation

Context

- There is good reason to believe that the local region is facing stronger economic headwinds than the country as a whole. Our regional dependence on the technology sector was a strength for many years, but that is shifting as the sector cools. In addition, the longer-term implications of work-from-home are expected to ripple through other local sectors, with perhaps the construction sector most directly impacted.
- Our regional forecasting model is designed to capture scenarios such as this, when the local economy is experiencing changes that are materially different from those seen at the national level.
- Consistent with that observation, our updated forecasts for key revenue streams reflect both the near-term impacts of the cooling we are seeing in areas such the real estate market, and the longer-term trends toward slower overall growth.
- S&P Global's pessimistic scenario captures a different set of risks than the those we have identified as being specifically applicable to the local economy, and thus it is not particularly relevant for capturing the potential risks to City revenues.

Conclusion

The Forecast Office recommends using the baseline economic scenario for the August 2023 Revenue Forecast.

Part 3: Revenue Forecast

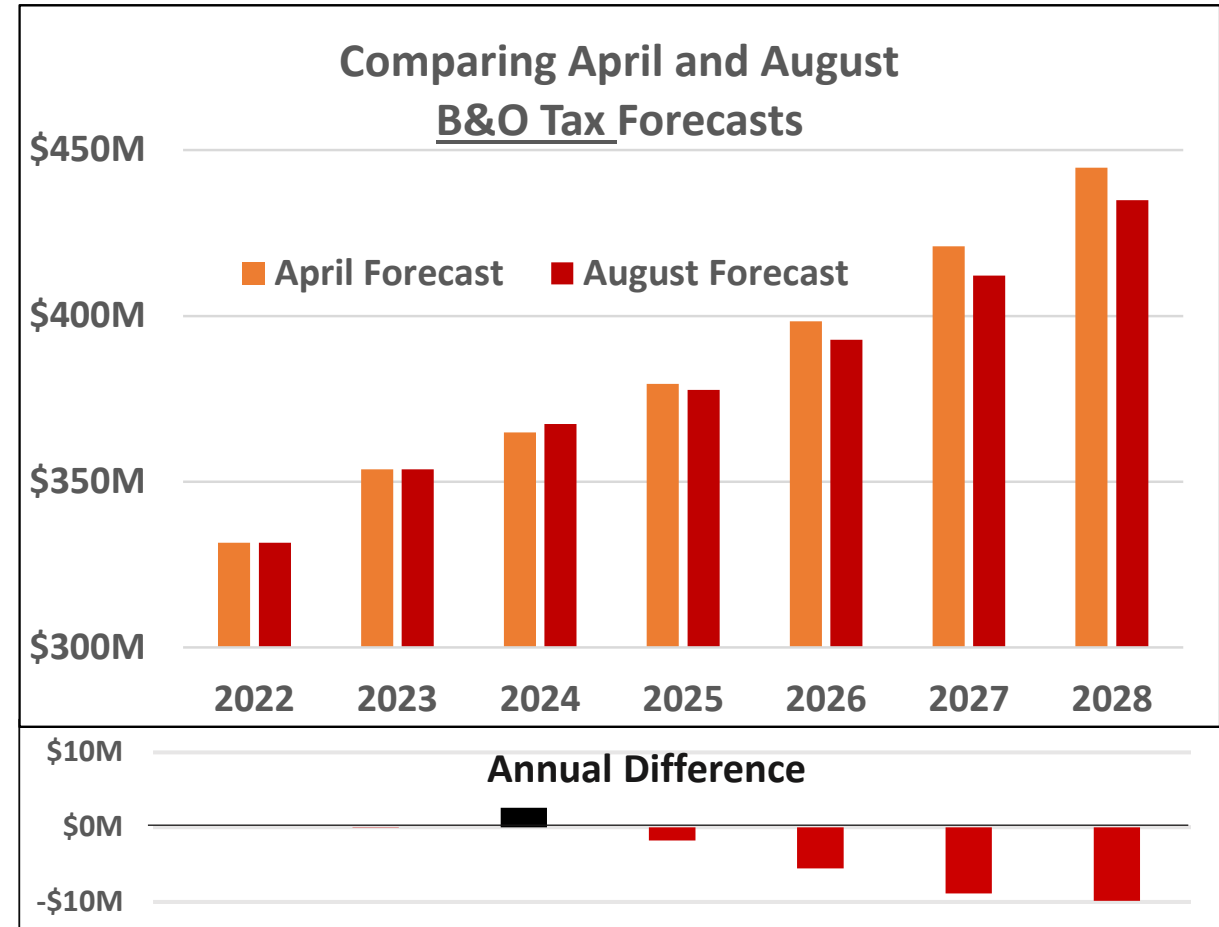
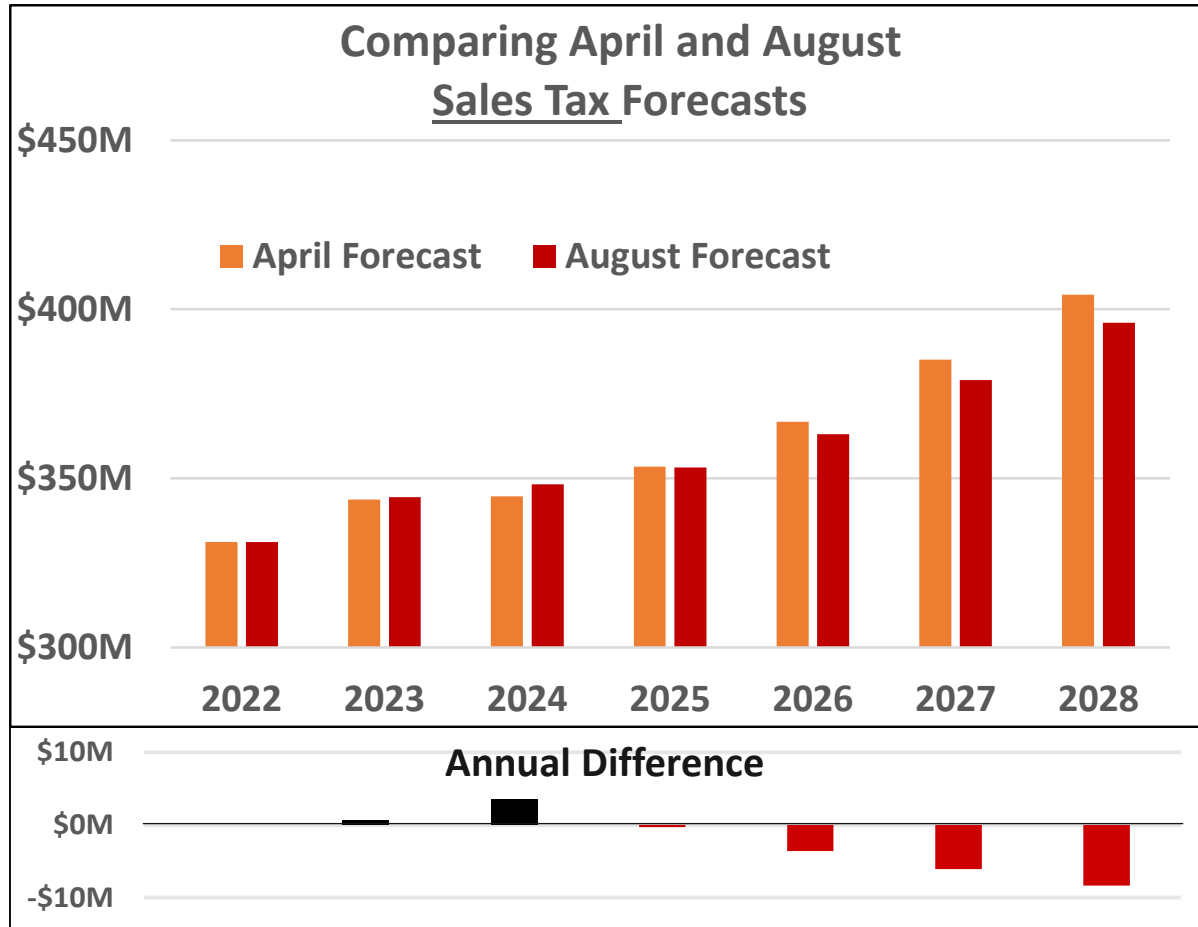


General Fund Revenues - 2023 and 2024 (\$ '000)

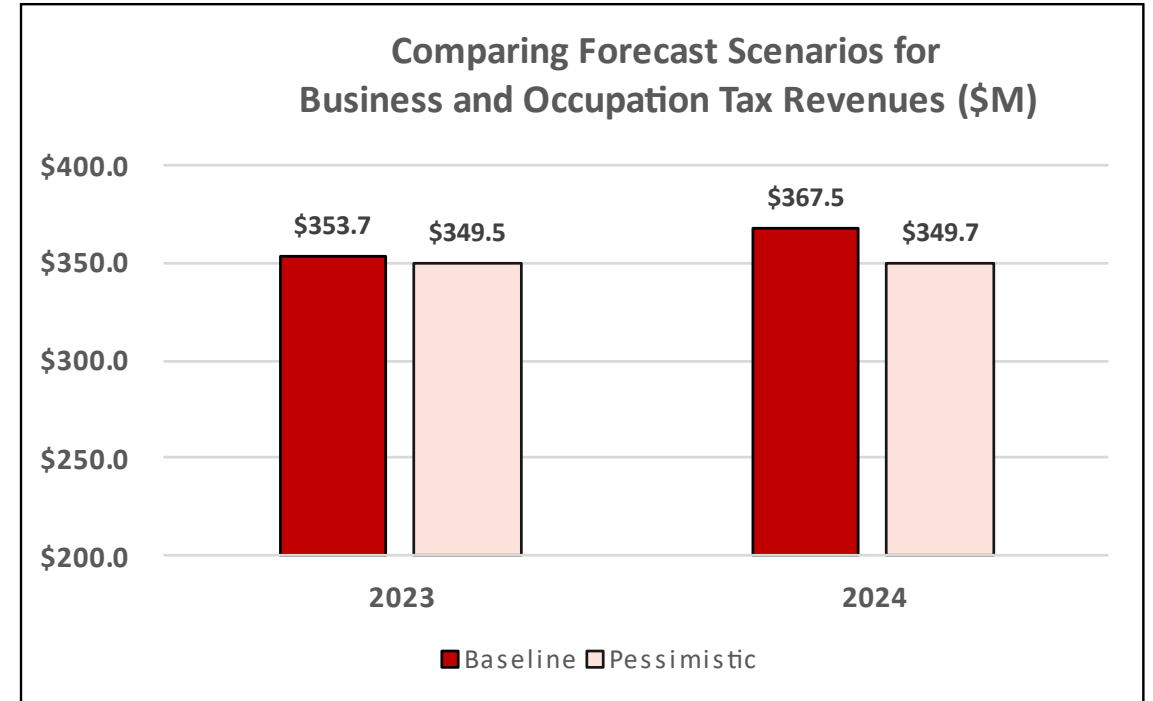
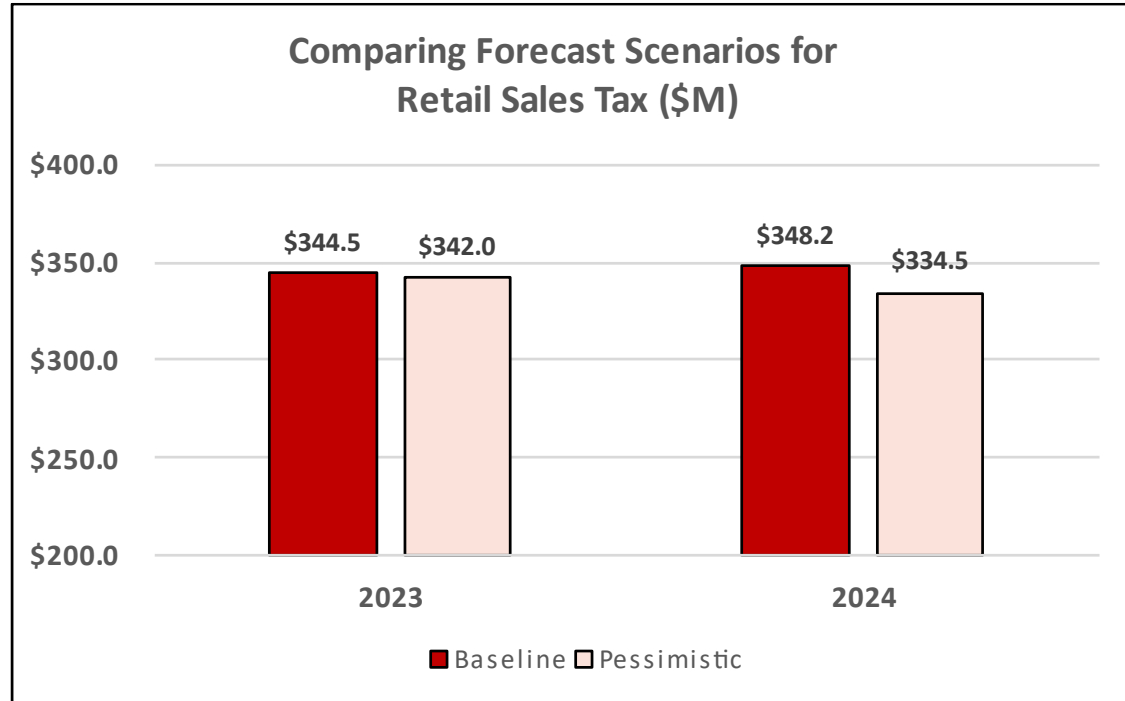
Revenue Source	2022	2023			2024			Total
	2022 Actuals	2023 - April Forecast	2023 - Aug Forecast	Diff: Aug vs. April	2024 - April Forecast	2024 - Aug Forecast	Diff: Aug vs. April	2-Year Total Difference
Property Tax (Including Medic One Levy)	\$371,770	\$378,210	\$379,270	\$1,060	\$383,430	\$385,270	\$1,840	\$2,900
Retail Sales Tax	\$331,220	\$343,790	\$344,460	\$670	\$344,690	\$348,200	\$3,510	\$4,180
Business & Occupation Tax	\$331,580	\$353,740	\$353,730	(\$10)	\$364,890	\$367,460	\$2,570	\$2,560
Utility Tax - Private	\$41,850	\$42,130	\$42,550	\$420	\$39,250	\$38,440	(\$810)	(\$390)
Utility Tax - Public	\$192,850	\$191,910	\$194,630	\$2,720	\$198,420	\$198,790	\$370	\$3,090
Other City Taxes	\$14,540	\$13,660	\$13,900	\$240	\$13,530	\$13,470	(\$60)	\$180
Parking Meters	\$23,860	\$36,930	\$36,650	(\$280)	\$43,340	\$43,870	\$530	\$250
Court Fines	\$13,220	\$14,700	\$21,120	\$6,420	\$16,520	\$18,150	\$1,630	\$8,050
Revenue from Other Public Entities	\$18,640	\$19,490	\$19,690	\$200	\$19,150	\$19,150	\$0	\$200
Grants	\$23,120	\$46,820	\$55,880	\$9,060	\$12,690	\$17,100	\$4,410	\$13,470
Fund Balance Transfers	\$151,010	\$117,260	\$120,000	\$2,740	\$94,700	\$94,700	\$0	\$2,740
Service Charges & Reimbursements	\$132,530	\$69,810	\$72,000	\$2,190	\$70,110	\$73,370	\$3,260	\$5,450
Licenses, Permits, Interest Income and Other	\$50,940	\$67,320	\$73,550	\$6,230	\$59,580	\$63,660	\$4,080	\$10,310
Payroll Tax - Late 2021 Payments	\$44,980	\$2,164	\$2,270	\$106	\$0	\$0	\$0	\$106
Total	\$1,742,110	\$1,697,934	\$1,729,700	\$31,766	\$1,660,300	\$1,681,630	\$21,330	\$53,096
Difference w/o Grants				\$22,706			\$16,920	\$39,626
Annual Growth			(0.7%)			(2.8%)		



Near-Term Revenues Up, But Longer-Term Growth Expected to Slow



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 are more than halfway through 2023, the differences between the two scenarios are more evident in 2024, when the divergences for Retail Sales and B&O exceed \$30M in combination.
- For the GF as a whole, the pessimistic forecast is \$15M lower in 2023 and \$48M lower in 2024, for a biennial total of \$63M less revenue than in the baseline forecast.

Summary of Selected General Government Revenues

Revenue Source	2022	2023			2024			Total
	2022 Actuals	2023 - April Forecast	2023 - Aug Forecast	Diff: Aug vs. April	2024 - April Forecast	2024 - Aug Forecast	Diff: Aug vs. April	2-Year Total Difference
General Government Revenues:								
Payroll Tax^	\$253,060	\$263,260	\$274,590	\$11,330	\$279,740	\$289,860	\$10,120	\$21,450
Admission Tax	\$21,650	\$22,020	\$22,650	\$630	\$22,820	\$23,400	\$580	\$1,210
Sweetened Beverage Tax	\$20,240	\$20,930	\$20,930	\$0	\$21,250	\$21,250	\$0	\$0
Short-Term Rental Tax	\$9,870	\$10,290	\$10,860	\$570	\$11,370	\$11,790	\$420	\$990
REET	\$91,420	\$55,020	\$50,680	(\$4,340)	\$59,960	\$53,920	(\$6,040)	(\$10,380)
Transportation-Specific Revenues:								
Trans. Ben. Dist. - Sales & Use Tax	\$51,950	\$53,780	\$53,900	\$120	\$53,880	\$54,460	\$580	\$700
Trans. Ben. Dist. - Vehicle License Fee	\$15,980	\$18,260	\$18,260	\$0	\$20,610	\$20,610	\$0	\$0
Commercial Parking Tax	\$37,660	\$48,380	\$48,380	\$0	\$47,280	\$50,240	\$2,960	\$2,960
SSTPI - School Zone Speed Enforcement	\$8,470	\$11,270	\$13,240	\$1,970	\$11,050	\$11,560	\$510	\$2,480

^ Excludes late 2021 payments deposited into GF in 2022

JumpStart Payroll Expense Tax Forecast

Background

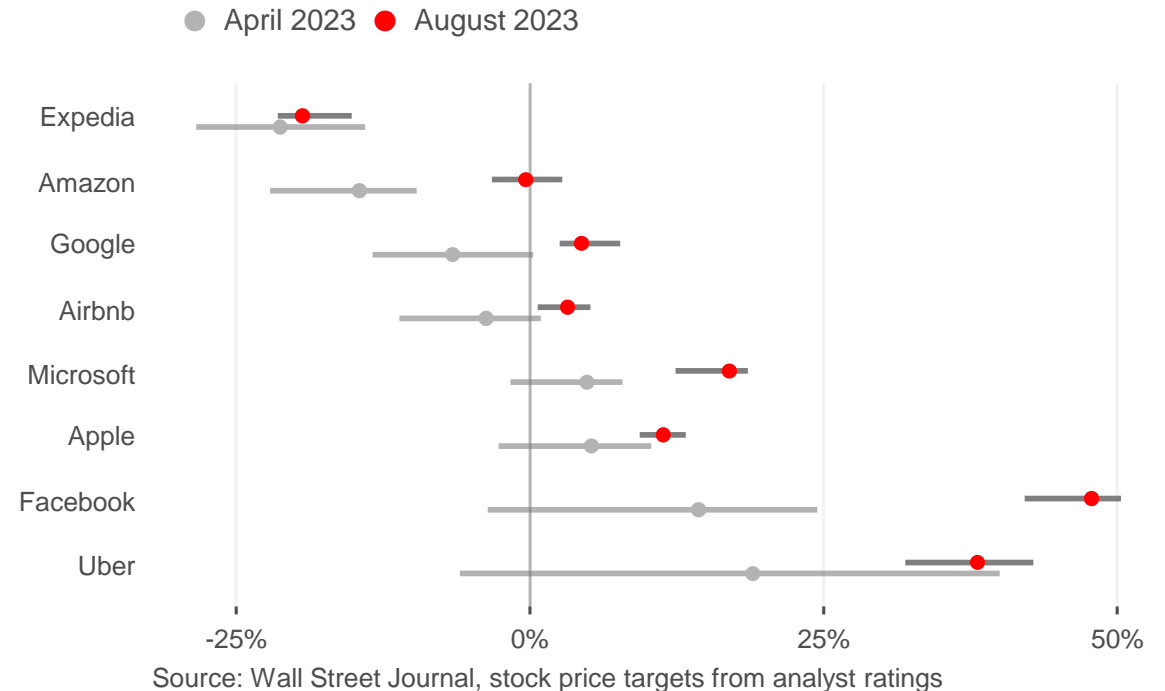
- A significant share of revenues are generated from relatively few taxpayers, many of whom operate in the technology sector.
- The revenue stream has proven to be very volatile. Tax obligations fell from ~\$295M in 2021 to \$253M in 2022.
- Firms must make estimated quarterly payments, but total tax obligation depends on annual compensation expenses and cannot be determined until year-end.
- The Forecast Office has found that both higher stock values and increased in-office attendance are correlated with increased payments.

Forecast Update

- Many taxpayers have made estimated quarterly payments equal to 25% of last year's annual obligation, with an intent to true-up at year-end. This makes sense but means that YTD payments do not reveal much.
- Stock values in the tech sector have been rebounded this year and have a more positive outlook, and "return-to-office" trends have generally met our expectations. In combination, this had led to a modest (~4%) upgrade in JumpStart Payroll Expense Tax Forecast.

Expected year-over-year stock price changes, 2023 over 2022

Low, average, and high estimates



Questions?

