IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

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We all look forward to spring. This season's arrival raises hope for the future, no matter how bad the winter has been. For some, such as Federal Reserve Chairman Ben Bernanke, spring seemed to arrive earlier than usual. During a television interview this February, the Chairman mentioned there were "green shoots of recovery." Recent data have raised hopes that the "worst of the worst" may be over and that the economy is nearing a turning point. But are these green shoots indeed the first signs of a sustained recovery or are they early blooms that will fall victim to the next economic chill? The economists at IHS Global Insight have gleaned the recent economic data to determine whether conditions are ripe for a bumper season of economic activity or whether a short crop spoils the year. Their findings are summarized in this issue of the *Idaho Outlook.*

While it is still too early to declare that the end of the recession is nigh, there is some room for hope. First, the mere fact that not all the data look like they are falling off a cliff is a good sign. It is quite common for the "noise-to-signal" ratio in the data to increase when the economy is in the proximity of a turning point. Another way of saying this is: mixed signals on the economy—some data moving up while others are moving down—are often leading indicators of a turning point. Second, even for the data that are still falling, the rate of descent for many has diminished. This too can be a leading indicator of a turning point. Nonetheless, a closer look at the data of the past few weeks suggests that while some parts of the economy may be approaching bottom, others are a long way off.

Recent data for retail sales, consumer spending, housing starts and permits (especially the latter), home sales, financial risk spreads, and commodity prices suggest the economy is thawing. In each of these cases, however, it would be premature to assume it is at its trough. For example, after registering positive growth in the first quarter, consumer spending will probably falter in the second quarter, before beginning a sustained recovery in the third. Similarly, housing starts will probably bottom out in the current quarter and begin to increase sometime over the summer. At the same time, while some financial spreads are at levels last seen before the September collapse of Lehman Brothers (the TED spread and commercial paper spreads), other indicators of financial distress have not eased much, especially corporate bond spreads for companies with less than stellar credit ratings. Similarly, while prices of some commodities such as energy and nonferrous metals have clearly bottomed out, others such as steel have more downside risks.

Other data provide stronger evidence that the economy has not yet hit bottom. While the 663,000 drop in March payrolls was huge, ironically it was not as bad as many had expected. Nevertheless, employment always lags the recovery. So, even though IHS Global Insight predicts that economic growth will turn positive by the fourth quarter of this year, it does not expect employment growth to rebound until the second quarter of 2010. In other words, there will be more bad news on the jobs front for the next few months. Exports are also likely to lag the recovery because the upturns in Europe and Japan are expected to begin a quarter or two later than in the United States. Thanks to massive fiscal and monetary stimulus, the Chinese and American economies will be first to emerge from this downturn. Finally, business spending on structures will continue to contract at double-digit rates through the second quarter of 2010, because of excess capacity, the credit crunch and (in the case of drilling) low energy prices.

There is a tendency in the depths of a recession to fall into the trap of fearing that the bad times will last for a long time. It should be noted, however, the business cycle is alive and well, and powerful forces work both on the downside and the upside. One of the most powerful forces that fuel a recovery is pent-up demand. At the bottom of every cycle many households still have the means to buy new homes, cars, and other big-ticket items. They do not make the purchases because they are worried about hits to their income (mostly because of job losses) and wealth. Typically, the longer the downturn, the more the pent-up demand—more cars need replacement, more young families want to buy a home, and so forth. This pent-up demand is eventually released when households sense that the worst news on the economy, house prices, and the stock market is over. A similar pattern is also evident among businesses, many of which have the financial resources to hire workers and to make investments, but are reluctant to do so until they are convinced that the recovery has "legs."

During this cycle, there are at least three triggers that will—most likely sooner rather than later—be the catalysts for the release of pent-up demand: lower commodity prices, lower interest rates, and fiscal stimulus. Not surprisingly, the parts of the economy that will benefit first are the interest-sensitive sectors and those being targeted by the fiscal-stimulus package—especially consumer spending and housing. It is hoped these triggers will soon release pent-up demand so it can help nurture the "green shoots of the recovery" into growth that fulfills the promise of spring.

Idaho General Fund Update

As of March 31, 2009

	$ Millions		
Revenue Source	FY 2009 Executive Estimate[3]	DFM Predicted to Date	Actual Accrued to Date
Individual Income Tax	1,222.6	787.8	763.4
Corporate Income Tax	156.5	88.0	86.1
Sales Tax	1,041.6	791.5	788.2
Product Taxes[1]	29.7	22.5	22.9
Miscellaneous	110.1	52.6	63.8
TOTAL GENERAL FUND[2]	**2,560.4**	**1,742.5**	**1,724.5**

1 Product Taxes include beer, wine, liquor, tobacco and cigarette taxes

2 May not total due to rounding

3 Revised Estimate as of March 2009

March brought much needed relief to the General Fund revenue stream, in the form of stronger-than-expected individual income tax receipts. Overall the General Fund was ahead by $7.8 million for the month, bringing the fiscal year-to-date shortfall down to $18.0 million.

The individual income tax broke a string of three straight negative months, coming in $15 million above the target for the month of March. Unfortunately, this still leaves the category $24.4 million behind the target for the fiscal year to date. Both the product taxes and miscellaneous revenues came in ahead of target for the month (and are ahead on a fiscal year-to-date basis). The corporate income tax and sales tax both came in below target for March (and are both down on a fiscal year-to-date basis).

The individual income tax was ahead of expectations by $15 million in March on a combination of stronger-than-expected filing collections ($7.9 million) and lower-than-expected refund payments ($7.8 million). Weaker-than-expected withholding collections in March offset a small amount of the gain, coming in $1.9 million lower than predicted for the month. On a fiscal year-to-date basis all three components contributed to the $24.4 million shortfall. Filing collections are short by $14.1 million, but this is substantially down from the $24.6 million gap as of the end of January. Withholding collections are short by $7.3 million, which is up only slightly from the $5.1 million shortage at the end of January. And finally, refund payments are high by $3.7 million for the fiscal year to date.

The corporate income tax took a $6.9 million hit in March, swinging it from $5.0 million ahead of expectations as of the end of February to $1.9 million below expectations as of the end of March. Almost half of March's weakness was due to an unusual $3.4 million refund of a mistaken payment (it went to the wrong state) received last October. Absent that payout, corporate income tax refunds would have actually been $1.0 million below expectations in March.

The sales tax had another weak month in March, coming in $2.3 million short of expectations—this is the same amount as February's shortfall. Sales tax is now $3.3 million low on a fiscal year-to-date basis. The weakness in this revenue category is nothing short of stunning. The predicted decline through March (based on the current forecast and the monthly collection pattern over 40 years) is 8.9%, but the actual decline is 9.3%. In all the years going back to FY 1967 there has only been one year in which the first nine months of the fiscal year declined—a 1.9% decline in FY 1987. Interestingly, FY 1987 ended down a more modest 1.2%. The current forecast has FY 2009 ending down 8.7%.

The product tax and miscellaneous revenue both came in above their respective targets for the month of March—$0.1 million in the case of product taxes and $2.0 million in the case of miscellaneous revenue. The positive result for miscellaneous revenue was a combination of $3.9 million more than expected in interest earnings and $1.6 million less than expected in insurance premium tax collections.