

IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

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Economic forecasting is a great business for those with a talent for being wrong. It is rare (and probably coincidental) when an economic forecast is exactly correct. They are either too high or too low. Indeed, most economists are content when their forecasts come close. To achieve this goal, they sift through mountains of data points, weighing each one's impact on the economy's future path. One risk economists face is letting current conditions overly influence their predictions about the future. During the current economic calamity, there's a risk the forecast will be worse than the recession will actually be.

We do not mean to understate the seriousness of the recession; it will be bad by historical standards. It is expected to last almost two years and real output is projected to decline 2.6%. In addition, the recovery will be gradual, with real GDP growing below its potential of three percent until the middle of next year. The number of jobs are not expected to regain their pre-recession peak until a year later. As bad as

this outlook is, it is far from being the most dire forecast. Rarely a day goes by without an economist or a commentator equating the current recession to the Great Depression. We addressed this issue last November. Now, as then, we believe such comparisons are unrealistic, and reflect current hard times causing exaggerated pessimism about the future.

There are several factors suggesting the future may not be as dark as some have portrayed. Among all the gloomy news has been a smattering of positive news. Nationally, real GDP growth in the fourth quarter of 2008 was stronger than most economists had predicted. They were also surprised that retail sales actually rose in January. There has been anecdotal evidence that housing sales have improved in some areas. The forecasts of the national economy are also stabilizing. In the early months of the current recession, forecasters were constantly lowering their forecasts as new data became available. Recently, the month-to-month changes in the forecasts have been

much smaller, suggesting economists are becoming satisfied things are not growing worse.

In Idaho newly released data show that the accelerating year-over-year decline in total non-farm employment may be stabilizing. Before this week, the rates of decline were -1.9% in October, -3.0% in November, and -4.3% in December. Clearly, a bad situation getting worse. Between recent benchmarking and newly released data for January 2009, the numbers are now -1.4% in October, -2.7% in November, -4.0% in December, and -3.6% in January. Clearly, October-December were not as bad as originally estimated and January marked a stabilizing in the rate of descent.

Another wildcard is how consumers and businesses will react to the federal stimulus package. Most forecasts assume a rather subdued response. However, we could be surprised by higher spending and investment.

Idaho General Fund Update

General Fund revenue results for January 2009 were disappointing to say the least. It is quite rare for a single month to come in as much as \$33.0 million lower than the predicted amount. When added to December's under performance of \$10.5 million, this brings the cumulative General Fund revenue shortfall to \$43.5 million for the fiscal year to date. Bad as this is, it would be a mistake to extrapolate this underperformance into the remaining five months of the fiscal year.

Once again, the vast majority of January's weakness was from the individual income tax. Overall this category accounts for \$32.1 million of the month's shortfall, with well over half (\$17.3 million) due to weakness in the filing component. When added to the \$7.8 million shortage from December, filing collections are \$25.5 million lower than predicted based on

historical collection patterns. Fortunately, the historical collection pattern may not be a valid indicator of how this year's filing collection pattern will look. Specifically, in this case there is reason to believe the incentive to voluntarily pay state income tax by December 31st (which shows up as late December/early January filing collections) has weakened, meaning that weakness in these two months may not signal how the full fiscal year will turn out. At this point there is no reason to think the current forecast of a 24% decline in FY 2009 individual income tax filing collections is invalid.

The other major source of weakness in the individual income tax in January was withholding collections that were \$12.8 million lower than expected for the month. This is almost \$10 million more than the \$2.9 million shortfall in December. While this is worrisome, it may be an exaggeration of the extent of the problem faced for the rest of the fiscal year. The reason for tempering the pessimism inherent in the January result

is that a particularly dismal holiday shopping season, and its lack of normal seasonal retail hiring, may be making the withholding situation look worse than it actually is. Nonetheless, based on both revenue data through January and economic data released since the current revenue forecast was produced in early December 2008, it is prudent to acknowledge that the most likely outcome for withholding collections for the full fiscal year is in the range of \$25-35 million less than the current forecast.

The corporate income tax fell into a see-saw pattern in January, with the month short by \$2.5 million after December's gain of \$3.5 million over the current forecast. That leaves the fiscal year-to-date result \$1.0 million ahead of expectations. The see-saw comes from the fact that in November 2008 the corporate income tax fell \$1.7 million short of expectations. At this point there is no reason to think the current forecast of corporate income tax is invalid.

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Idaho General Fund Update

As of January 31, 2009

\$ Millions			
Revenue Source	FY 2009 Executive Estimate ³	DFM Predicted to Date	Actual Accrued to Date
Individual Income Tax	1,268.0	747.8	704.1
Corporate Income Tax	157.1	75.1	76.1
Sales Tax	1,068.9	658.9	651.9
Product Taxes ¹	29.7	18.0	18.2
Miscellaneous	110.1	47.5	53.4
TOTAL GENERAL FUND²	2,633.8	1,547.3	1,503.7

1 Product Taxes include beer, wine, liquor, tobacco and cigarette taxes
2 May not total due to rounding
3 Revised Estimate as of January 2009

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Surprisingly, sales tax revenue improved dramatically in January, coming in a mere \$1.3 million below the predicted amount. This is a substantial improvement relative to the prior month, when sales tax revenue fell \$5.7 million below expectations for the month of December. Keep in mind that revenue is collected in the month after the economic activity occurs, meaning that January's improvement reflects December retail sales. In spite of this positive development, it is now likely that sales tax revenue for all of FY 2009 will undershoot the current forecast. Sales tax gross receipts through January 2009 were expected to be down 7.7% relative to the same period a year earlier, but are actually down by 8.6%. At this point it is prudent to scale back expectations for full FY 2009 General Fund revenue by an amount of approximately \$10 million. This implies the full fiscal year revenue decline goes from 6.4% (the current forecast) to 7.1%. To put this into perspective, in the past 40 years there has NEVER been a year in which July-January gross sales tax receipts (normalized for rate

changes) have declined from the same period the prior year. There have been two fiscal years in the past 40 where the full year's collections have declined—last year (FY 2008) was down 1.2% and FY 1987 was down by an identical 1.2%. There is now no doubt the decline for all FY 2009 will set a modern record, the only question is how steep that decline will be.

Product taxes were \$0.1 million lower than expected in January, based on lower than expected tobacco tax, beer tax, and wine tax collections. That still leaves this revenue category \$0.2 million ahead on a fiscal year-to-date basis. Miscellaneous revenue was \$3.0 million above expectations, with \$2.7 million of this due to higher than expected Treasurer's interest earnings. The miscellaneous revenue category is now \$5.9 million ahead of expectations on a fiscal year-to-date basis.

In summary, the net effect of revenue performance through January 2009 is an estimate that FY 2009 revenue will fall approximately \$40 million short of the current forecast of \$2,633.8 million

(\$30 million less income tax withholding, \$10 million less sales tax revenue). There remains much uncertainty surrounding what will happen with individual income tax filing collections (particularly in April), but receipts to date do not suggest the current forecast of a 24% decline in filing collections in FY 2009 should be changed.

One major factor that has not been incorporated into this assessment is the effect of the federal fiscal stimulus legislation that now appears to be on the verge of enactment. If this becomes law, it will have impacts on the state's economic forecast, General Fund revenue outlook, and the amount of federal funds available for state and local spending in Idaho. Assessing these impacts will take time, because they will be a function not only of the specific provisions in the federal legislation, but also how Idaho policy makers respond to those provisions. In particular, there may be federal stimulus dollars that are allocated to Idaho but have strings attached that are unacceptable to Idaho policy makers. It will take a currently unknown amount of time to sort through these issues.

