IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

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As the old saying goes, "It's not the end of the world, but you can see the end of the world from it." This adage aptly applies to the nation's economic situation a year ago. In summer and fall of 2008, turmoil in world financial markets pushed the U.S. economy from a typical recession towards something far worse. Fortunately, a major calamity was averted. Earlier this month, economists at IHS Global Insight sifted through the financial and economic disorder of the past year and produced a short list of the lessons that have been learned so far from the recent experience. The findings outlined below are those of IHS Global Insight and not the policy of DFM or the State of Idaho.

The good news is that the economic policy mistakes that led to the Great Depression seem to be well understood and the desire not to repeat them seems to have been a large part of the motivation behind the much better policy response this time. This is not to say no mistakes were made, however. But in fairness, policy making during the crises was often akin to repairing the engine of a fast moving car.

Two of the key factors behind the depth of last fall's crisis were the size and extreme risks taken by large banks in the U.S. and Europe. Given their influence on the economy, these institutions were deemed "too big to fail." Unfortunately, this problem has become worse. One of the remedies for the industry, consolidation through distressed mergers and acquisitions, in the wake of events a year ago has made the concentration in the banking industry even greater. This, along with the potential moral hazard engendered by the large bailouts in the last couple of years, could set the stage for future bank crises. (Moral hazard occurs when an entity is either partly or totally sheltered from the consequences of its risky behavior.)

One of the most controversial policy actions was the Federal Reserve and the U.S. Treasury allowing Lehman Brothers to fail. Many rationales have been used to defend the decision. One of the most compelling was the fear of moral hazard. While this is a valid fear, some have argued that the middle of a crisis is the worst possible time to take action against it. It is better to deal with moral hazard between crises. Another controversial policy was the Troubled Asset Relief Program (TARP). Many people felt it was inappropriate to bail out private banks with public money. But not all the $700 million of TARP funds was used to shore up banks; less than half was used for this purpose. The rest went to Fannie Mae, Freddie Mac, the Federal Housing Administration, and the Federal Deposit Insurance Corporation. Even more important, the collapse of Lehman Brothers, the response to the subsequent fallout, and the "atmospherics" around the passage of the TARP shattered the confidence in the ability of the U.S. government to deal with the crisis, locked up global financial markets, and increased the severity of the recession.

The recent turmoil has caused a rethinking of conventional wisdom. Both during the high-tech bubble of the 1990s and the housing bubble of the 2000s, Federal Reserve policy was not to deflate bubbles, but to clean up the mess after they burst on their own. One of the big policy changes likely to occur in monetary policy operating procedures at the Federal Reserve and other central banks is much greater attention being given to asset prices, with the possibility of pre-emptive tightening during periods of rapid asset price inflation. This change reflects the fact that the cost of cleaning up the current crises is huge and most likely many times greater than the economic and financial damage that would have resulted from raising interest rates earlier.

Another concern is the U.S. will suffer a "lost decade" like Japan did during the 1990s. According to IHS Global Insight, this is not likely. First, the recent banking crisis is much smaller than Japan's. For example, the direct fiscal cost in the U.S. is about 5% of GDP, compared with 24% in Japan. Second, the policy response in the U.S. was much swifter and bigger than in Japan. Third, American banks and corporations are financially much healthier than was the case in Japan in the 1990s.

While a U.S. recession was probably unavoidable, past policy mistakes increased its severity. Fortunately, actions taken in the U.S. prevented an unthinkable calamity, and may prevent a Japan-style period of extended sluggish growth in the U.S. As a result, the U.S. economy is further from the end of the world than it was last year.

Idaho General Fund Update

As of September 30, 2009

	$ Millions		
Revenue Source	FY 2010 Executive Estimate[3]	DFM Predicted to Date	Actual Accrued to Date
Individual Income Tax	1,137.1	247.8	262.8
Corporate Income Tax	132.1	29.5	23.4
Sales Tax	963.3	261.2	261.0
Product Taxes[1]	40.7	11.7	12.0
Miscellaneous	104.0	30.5	30.6
TOTAL GENERAL FUND[2]	**2,377.2**	**580.6**	**589.9**

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

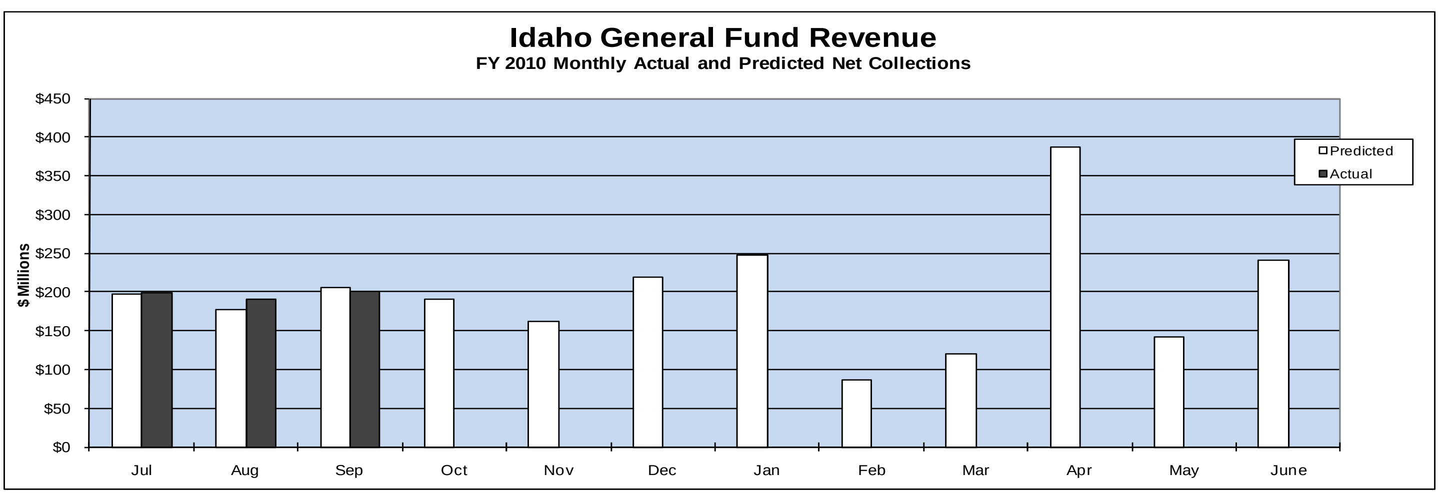
September brought with it the first overall weakness in FY 2010 General Fund revenue collections. Revenues for the month were $4.5 million lower than expected. However, because of the cushion that developed in July and August, cumulative General Fund revenue remains in excess to the tune of $9.3 million. September's weakness was confined to the corporate income tax and the sales tax. The other three revenue categories (individual income tax, product taxes, and miscellaneous revenue) all came in ahead of expectations for the month, and they remain ahead on a fiscal year-to-date basis.

Individual income tax collections came in $2.0 million higher than expected for the month, and now stand $15.0 million ahead of expectations for the fiscal year to date. The month of September's strength was spread over a combination of stronger-than-expected filing and withholding collections, and lower-than-expected refund payouts. The fiscal year-to-date excess is primarily due to filing payments (ahead by $9.0 million), with additional support coming from refunds that are $3.6 million lower than expected and withholding collections that are $1.6 million ahead of target.

Corporate income tax was $6.0 million below expectations for September, and is now $6.0 million low for the fiscal year to date. In September filing payments were $1.1 million lower than expected, quarterly estimated payments were $3.4 million lower than expected, and refunds were $1.5 million higher than expected.

Sales tax revenue was low by $1.6 million in September, and when combined with August's more modest weakness, brings the fiscal year-to-date balance low by $0.1 million. The year-over-year decline in September was actually 11.6% versus 9.7% that was expected. The cumulative year-to-date decline is actually 13.2%, which is much closer to the expected decline of 12.9%.

Product tax revenue was slightly ($0.2 million) ahead of target for the month, on strong liquor surcharge collections. Product tax revenue is now ahead of expectations by $0.4 million through September. Miscellaneous revenue was ahead by $1.1 million for the month, on a combination of stronger-than-expected insurance premium tax collections and unclaimed property receipts. Miscellaneous revenue is now $0.1 million ahead of expectations on a fiscal year-to-date basis.



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