Economic Update

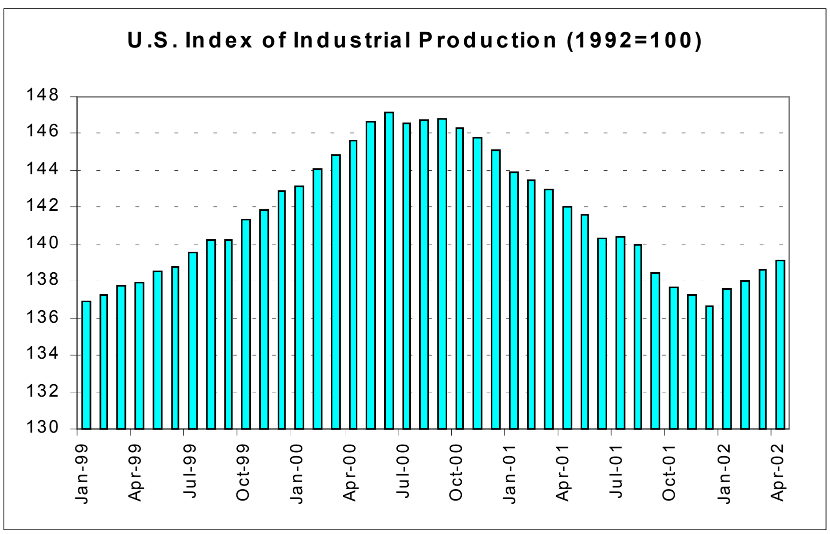
Monthly update on economic issues affecting Seattle's tax revenue performance

May 2002

U.S. Economy. The national economy continues its recovery from last year's recession, but the pace of recovery has slowed since first quarter 2002. This slowing is reflected in the daily economic data releases, which while mostly positive, contain a mix of good and bad news. This type of behavior is consistent with the consensus view that the recovery will be sluggish.

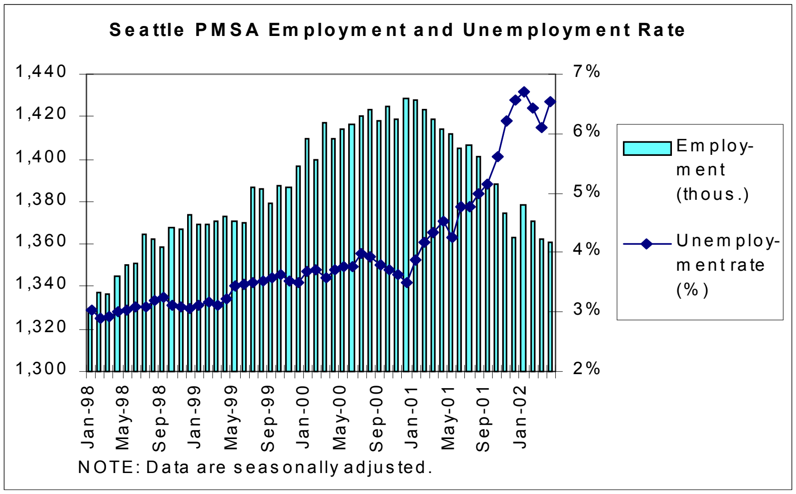
According to the latest labor market report, the U.S. unemployment rate rose to 6.0% in April, the highest level in 8 years. On the positive side, there was a modest employment increase of 43,000 jobs in April, the first gain in 9 months. Manufacturing continues its steady improvement after hitting bottom in December (see chart below), productivity growth has been remarkable, and non-residential construction is declining as office and factory vacancy rates rise.

The nation's gross domestic product (GDP) registered a strong 5.8% gain in first quarter 2002. Much of the gain (3.1% of the 5.8%) was due to a slowdown in the rate of inventory reduction - relative to fourth quarter 2001. The most positive news was the healthy 2.6% growth of final sales. Consumer spending rose by 3.5%, and government consumption increased by 7.9% as federal defense spending surged.



With the economy still fragile, there is some risk that the recovery could stall and the economy could slip back into recession. Risk factors include energy prices, the possibility that weak profits will restrain business investment, and the chance that consumer spending will slow if labor markets remain weak and mortgage rates rise.

Puget Sound Region economy. Unlike the nation, the Puget Sound economy has yet to begin recovering from the recession. However, there are signs that the economy may have reached bottom. For example, after rising steadily during 2001, the region's unemployment rate has more-or-less stabilized in recent months (see chart below).



As the chart indicates, the region's economy peaked in December 2000. Since that time, the unemployment rate has risen from 3.5% to 6.5%, and the Seattle PMSA (King, Snohomish, and Island Counties) has lost 65,100 jobs (on a seasonally adjusted basis), a drop of 4.6%. With layoffs at Boeing expected to continue through at least the middle of this year, the economy is forecast to remain relatively flat during the rest of 2002, and then begin to grow in 2003.

Monthly Cash Update

Comparing year-to-date revenues for general fund taxes and other major revenues with adopted forecast.

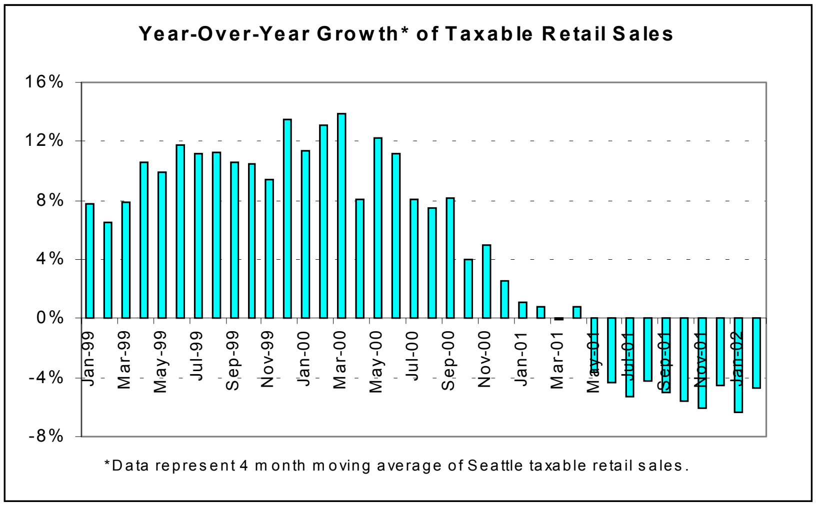
CITY REVENUE

Year-to-date through April: The following describes how actual 2002 collections for the most important general subfund revenues compare to the forecast that was prepared in November 2001 for the adopted budget.

Overall, actual revenue is lagging the forecast by 2.2%, although there is considerable variability among individual revenues, particularly sales tax, the private and public utilities, and courts, fines, and forfeitures.

Retail sales tax. Because sales tax revenue is accrued by 2 months, we have booked only 2 months of revenue for 2002. For those 2 months, revenue is down $2.0 million, or 10.5%, from the same months in 2001. Roughly half of that drop is due to variability in the end-of-year processing of tax payments.

Recent trends in sales tax revenue growth are depicted in the top figure to the right. The figure portrays year-over-year growth rates for monthly revenue that have been smoothed by creating a 4 month moving average series (i.e., the growth rate for a given month reflects the average growth for the most recent 4 months). Growth rates have been in the –5% range for nearly a year, which represents a huge drop from most of 1999 and early 2000, when monthly growth averaged over 10%.



2002 Major General Fund Revenues through April, including REET, compared to adopted budget

	YEAR TO DATE				COMPARISON TO 2001		
	Cumulative Forecast	Actual	Difference	Percent	Cumulative 2001	Yr/Yr Difference	Yr/Yr Cumulative
PROPERTY TAXES							
General + EMS	42,653,000	42,722,000	69,000	0.2%	34,061,000	8,661,000	25.4%
Leasehold Excise Tax	788,000	734,000	-54,000	-6.9%	769,000	-35,000	-4.6%
REET	6,500,000	6,469,000	-31,000	-0.5%	6,420,000	49,000	0.8%
RETAIL SALES TAX							
General	17,546,000	16,677,000	-869,000	-5.0%	18,635,000	-1,958,000	-10.5%
Criminal Justice	1,698,000	1,563,000	-135,000	-8.0%	1,777,000	-214,000	-12.0%
BUSINESS TAXES AND OTHER							
Business and Occupation	5,216,000	5,357,000	141,000	2.7%	7,855,000	-2,498,000	-31.8%
Utilities - City Light	8,539,000	8,998,000	459,000	5.4%	7,335,000	1,663,000	22.7%
Utilities - City Water	1,472,000	1,258,000	-214,000	-14.5%	1,250,000	8,000	0.6%
Utilities - City Drainage/Waste Water	2,973,000	2,460,000	-513,000	-17.3%	2,536,000	-76,000	-3.0%
Utilities - City Solid Waste & Garbage	2,001,000	1,909,000	-92,000	-4.6%	2,019,000	-110,000	-5.4%
Utilities - Cable Television	1,862,000	1,934,000	72,000	3.9%	2,028,000	-94,000	-4.6%
Utilities - Telephone	8,316,000	7,410,000	-906,000	-10.9%	7,582,000	-172,000	-2.3%
Utilities - Private Energy	3,267,000	4,056,000	789,000	24.2%	3,761,000	295,000	7.8%
Admission Tax	1,320,000	1,477,000	157,000	11.9%	1,739,000	-262,000	-15.1%
Court Fines and Forfeitures	5,858,000	4,827,000	-1,031,000	-17.6%	5,150,000	-323,000	-6.3%
Interest Income	877,000	752,000	-125,000	-14.3%	919,000	-167,000	-18.2%
Parking Meters	3,194,000	3,083,000	-111,000	-3.5%	3,170,000	-87,000	-2.7%
Misc. Revenues	1,711,000	1,513,000	-198,000	-11.6%	1,683,000	-170,000	-10.1%
TOTAL, Selected Non-Tax Rev.	115,791,000	113,199,000	-2,592,000	-2.2%	108,689,000	4,510,000	4.1%

Recessions – Past and Present

How does the latest recession compare to other recent recessions?

SPECIAL TOPIC: RECESSIONS

A recession is a significant and broad-based decline in economic activity. More precisely, a recession is a period of significant decline in total output, income, employment, and trade, usually lasting from 6 months to a year, and marked by widespread contractions in many sectors of the economy. Since the end of World War II, the U.S. economy has experienced 10 recessions; their average length was 11 months.

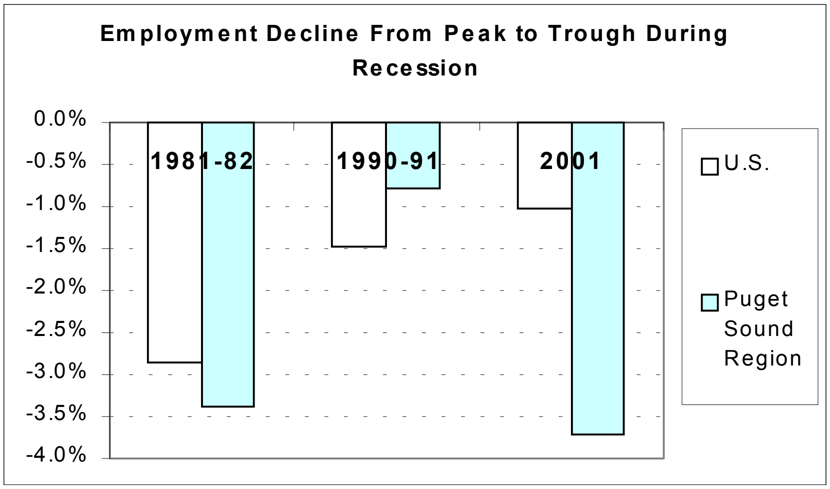
Each recession has its own unique characteristics in terms of its causes, length, severity, and the specific sectors of the economy that see the sharpest decline. The impact of a national recession on the different regions of the country varies depending on the character of the recession. A recession characterized by a steep drop in durable goods manufacturing activity will have a different regional impact than one distinguished by a downturn in the financial sector.

Analysis of the last 3 recessions. The analysis here focuses on the last 3 recessions: the 1981-82, 1990-91 and 2001 recessions. The 1981-82 recession, one of the longest and most severe recessions of the post-war period, was caused in large part by tight money policies implemented by the Federal Reserve Board to bring an end to the high inflation of the 1970s decade. Rising interest rates and the Gulf War helped to precipitate the relatively mild 1990-91 recession. The even more mild recession of 2001 had among its causes the deflation of the late 1990s stock market bubble and a steep fall-off in business investment.

We use two measures to analyze each recession's impact: employment change and the unemployment rate. Employment change is good indicator of the magnitude of the decline in economic activity that occurs during a recession.[1] However, a recession's impact on households and businesses depends not only the size of the economic decline, but also on how bad conditions become during a recession. This is reflected in such measures as the unemployment rate and number of business failures. A key determinant of how bad conditions become during a recession is the health of the economy when the recession begins. If the economy is already weak when the recession starts, impacts will be far worse than if the economy is healthy before it moves into recession.

During the recession of 1981-82, U.S. employment fell by 2.9% and the nation's unemployment rate rose to 10.7%, the highest level of the post-war period. One reason that the 1981-82 recession was so severe is that the economy was already weak when the recession began, because it had not had time to recover from a prior recession in January-July 1980. Conditions in the Puget Sound Region mirrored national conditions, though job loss was somewhat higher here (-3.4%) and the local unemployment rate reached 11.0%.

[1] There is no measure of output (i.e., something that would be comparable to gross domestic product) available at the regional level.



During the mild recession of 1990-91, which saw U.S. employment decline by 1.5%, the Puget Sound Region was relatively untouched. With local employment falling by only 0.7%, many economists argue there was no recession in the region. A key reason for the local economy's strong performance was the fact that Boeing employment remained relatively stable during 1990 and 1991.

Peak Unemployment Rate during Recession

Recession	U.S.	Puget Sound Region
1981-82	10.7%	11.0%
1990-91	7.6%	7.2%
2001	6.0%	6.9%

Although an official end to the 2001 recession has not yet been decreed, the recession appears to have ended sometime toward the end of 2001 or early in 2002. At the national level, the recession was very mild. Employment declined by 1.0% from peak-to-trough, and the unemployment rate is not expected to rise above the April 2002 rate of 6.0%.

Locally, the recession has been far from mild. Characteristics of the national recession included a stock market drop, a slowdown in the technology sector, the collapse of the dotcoms, and a major drop in air travel following the September 11 attacks. All of these factors have hit the Puget Sound Region hard, given the region's specialization in technology industries, including dotcoms, and the fact that it's the home of Boeing's production facilities for commercial airliners.

In the Puget Sound Region (King, Snohomish, Pierce, and Kitsap Counties), peak-to-trough job loss during the current recession is expected to reach –3.7%, with employment hitting bottom during 2nd quarter 2002. This is a steeper decline than that of 1981-82. On the positive side, the unemployment rate is expected to peak at a relatively modest 6.9%. This relatively low unemployment rate reflects the region's very low level of unemployment entering the recession, and the fact that low unemployment elsewhere in the nation enables job seekers to find work outside of the region if they so choose.

How City of Seattle revenue is affected by recessions. City of Seattle revenue is strongly affected by the ups and downs of the business cycle. The retail sales and B&O taxes are dependent upon the value of retail transactions and the gross income of Seattle businesses, respectively. Other taxes, such as utility taxes, are also influenced by economic conditions.

The annual growth of Seattle's taxable retail sales, one of the revenue sources most sensitive to economic conditions, is shown in the graph below. Note that the inflation has been removed from the figures in the graph so that real growth is shown. In addition, the graph shows the latest forecast for 2002-04 revenues. The graph clearly illustrates the severity of the 1981-82 recession, as well as the earlier 1980 recession. Between 1979 and 1982, the City's sales tax base declined by 19.4% in real terms. Although locally the 1990-91 recession was quite mild, its impact on taxable sales was significant. Real taxable sales fell by 4.1% in 1991, and growth remained weakly negative until 1996.

Taxable sales growth during the 2001 recession closely resembles that of 1981-82. Growth in 2001 was slightly weaker than in 1981 (-7.8% vs. –7.3%), and growth in 2002 is forecast to be similar to that in 1982. However, one difference from 1981-82 is that we are not forecasting a strong bounce-back from the current recession. The recovery is expected to be weak, in large part because the national recovery is expected to be subdued.