

Economic and Revenue Update

Presented to
Business Advisory Council

Steve Lerch
Executive Director

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WASHINGTON STATE
ECONOMIC AND REVENUE FORECAST COUNCIL



Forecasting during turbulent times

The impacts of the COVID pandemic have been difficult to predict

- Massive government spending to offset COVID impacts
- Changing consumer spending patterns to address social distancing, work from home
- Supply chain, logistics issues have created shortages of some goods
- Labor market disruptions

February forecast completed before Russian invasion of Ukraine

- Commodity prices, inflation likely understated

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Summary

- Inflation, oil prices and interest rates are higher than in the November forecast
- The Federal Reserve is assumed to start raising interest rates in March
- The WA economy is expected to outperform the national economy in both employment and personal income growth for 2022 – 2025
- The forecast of funds subject to the budget outlook is increased by \$1,453 million for 2021-23 biennium



Between the November and February forecasts...

The economic forecast incorporates Nov. 2021 and Dec. 2021 employment data for WA; Nov. 2021, Dec. 2021 and Jan. 2022 for the U.S.

Positives:

- U.S. employment has increased by 1,624,000 jobs
- WA employment has increased by 11,900 jobs
- New COVID cases appear to be declining
- WA retail sales and residential real estate transactions remain strong

Negatives:

- Inflation is higher
- Workers absent due to illness at all-time high
- Supply chain and logistics bottlenecks continue to hamper production and sales



Forecast risks

Upside

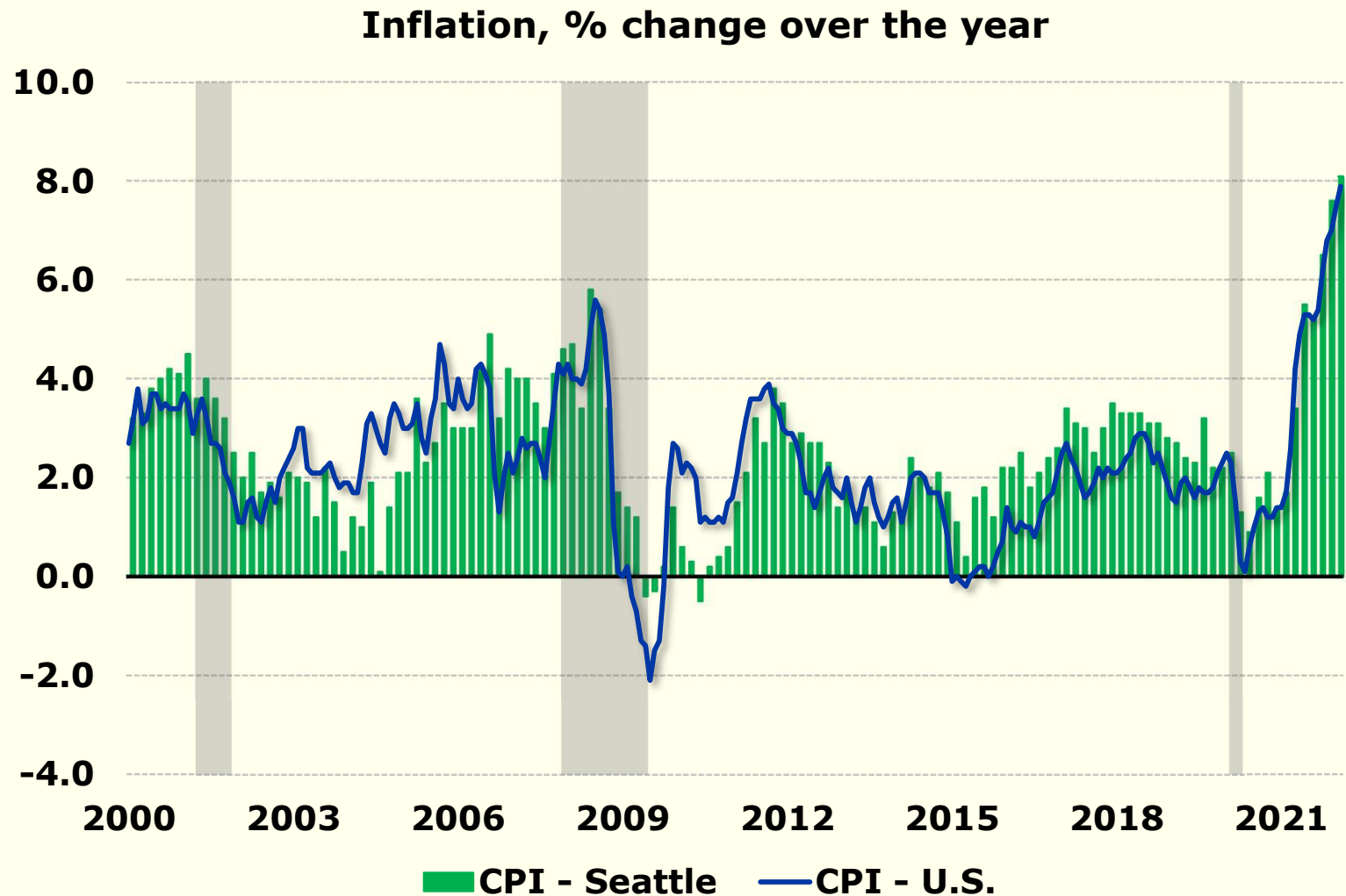
- COVID cases continue to decline, no further variants detected
- The impact of the Infrastructure Investment and Jobs Act is more robust than expected

Downside

- New COVID variants lead to increased cases and hospitalizations, slowing pace of recovery
- Inflation remains elevated
- Geopolitical risks



In February, prices rose at fastest rate since January 1982





U.S. retail trade sales increased 3.8% in January

Sectors with largest sales increases in December:

Nonstore retail: +14.5%

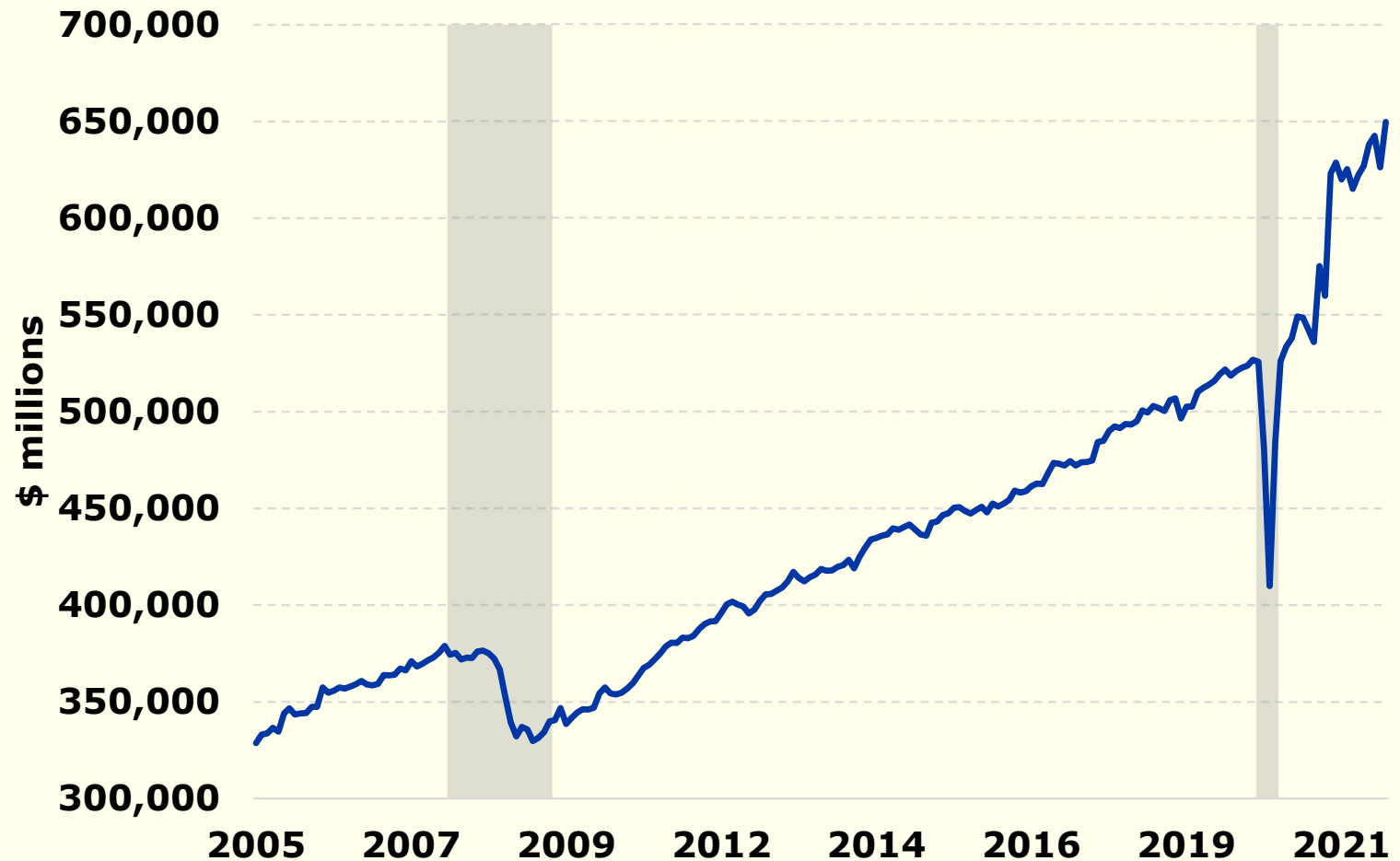
Furniture & home furnishings: +7.2%

Auto, other motor vehicles: +5.9%

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U.S. retail trade & food service sales, SA

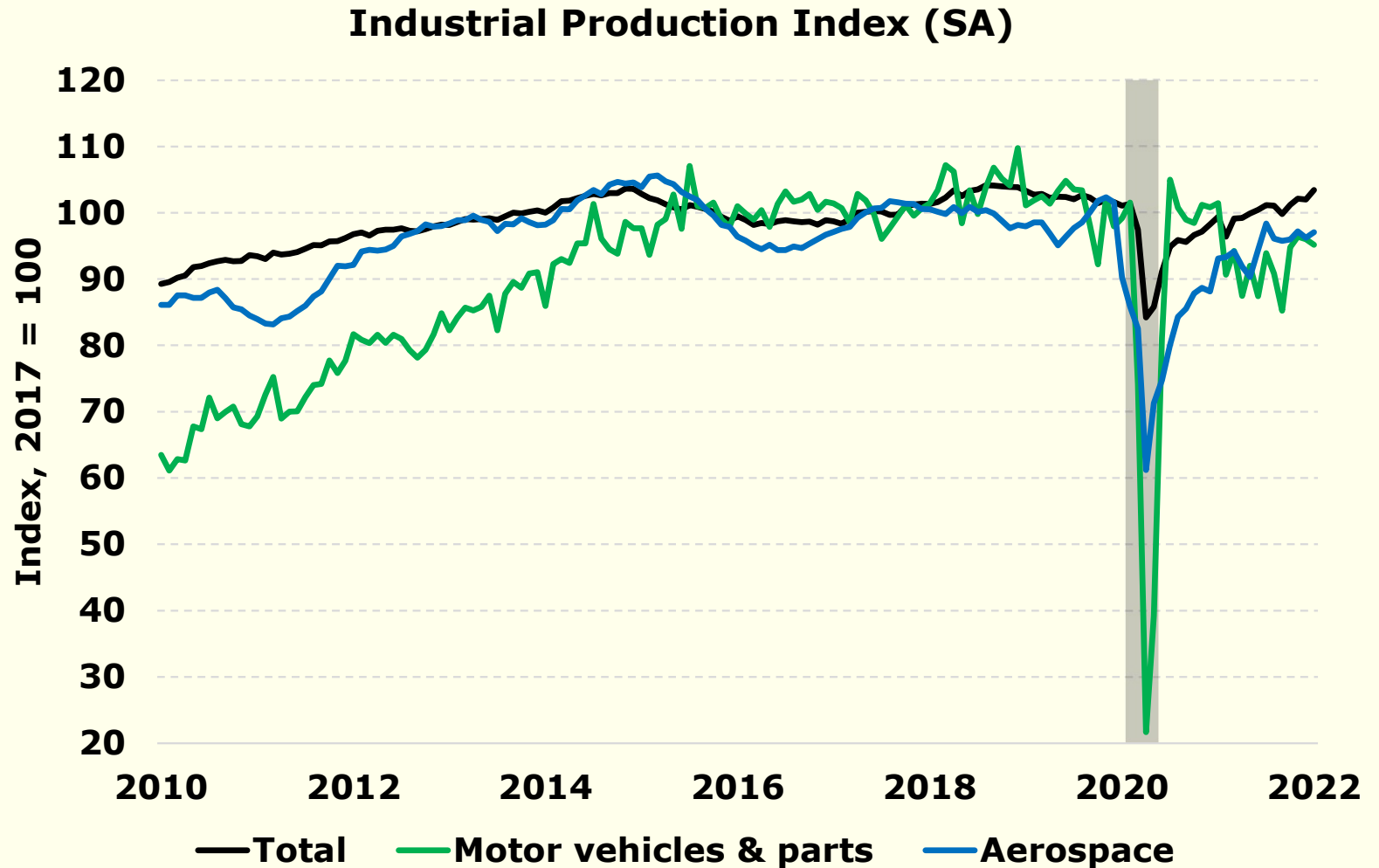


Source: U.S. Census Bureau; data through advanced January 2022

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Although total U.S. industrial production is above pre-pandemic levels, it is not for all sectors

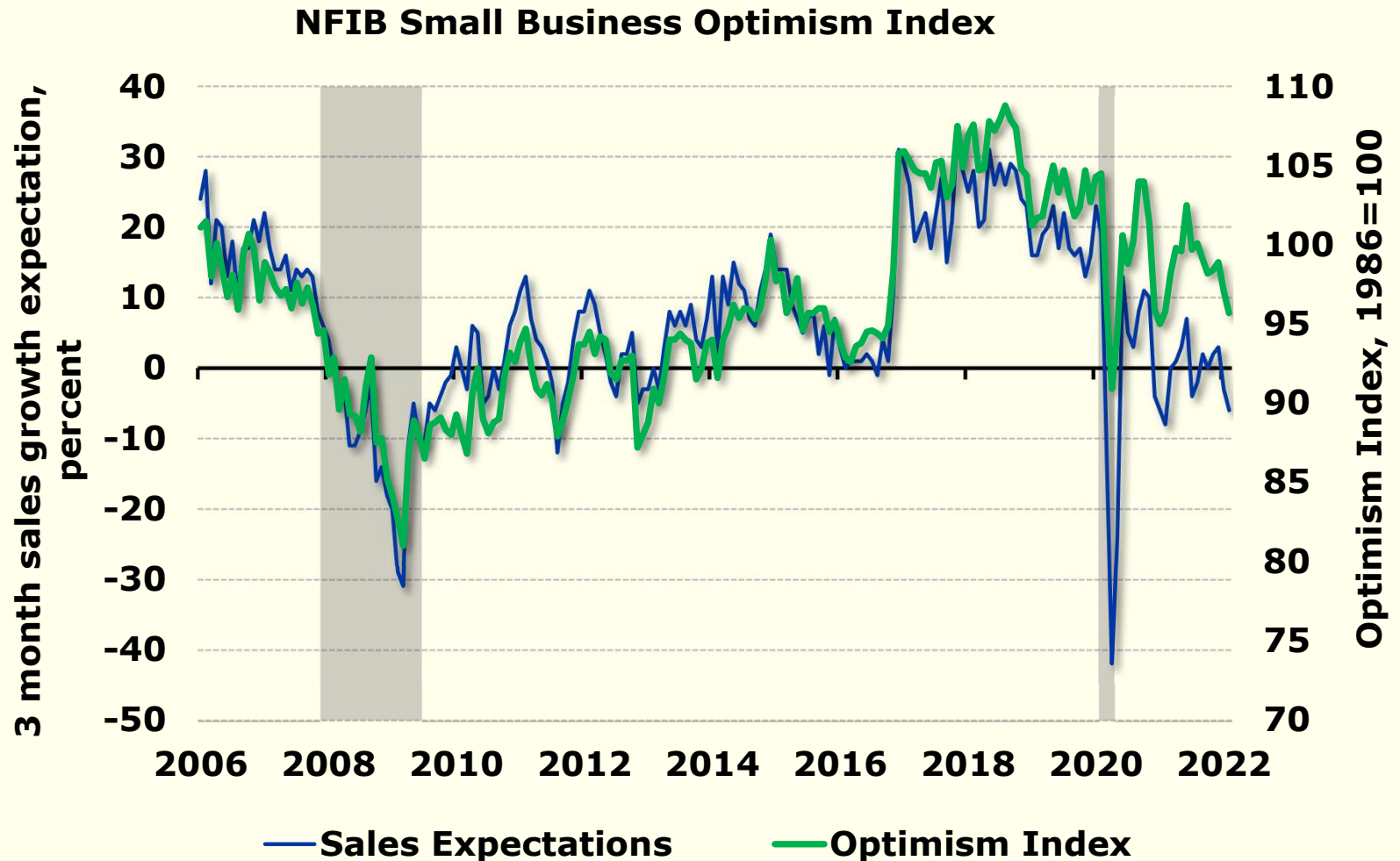


Source: Federal Reserve Board; data through January 2022

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Optimism, sales expectations weaken as small businesses address inflation, unfilled jobs, supply chain issues

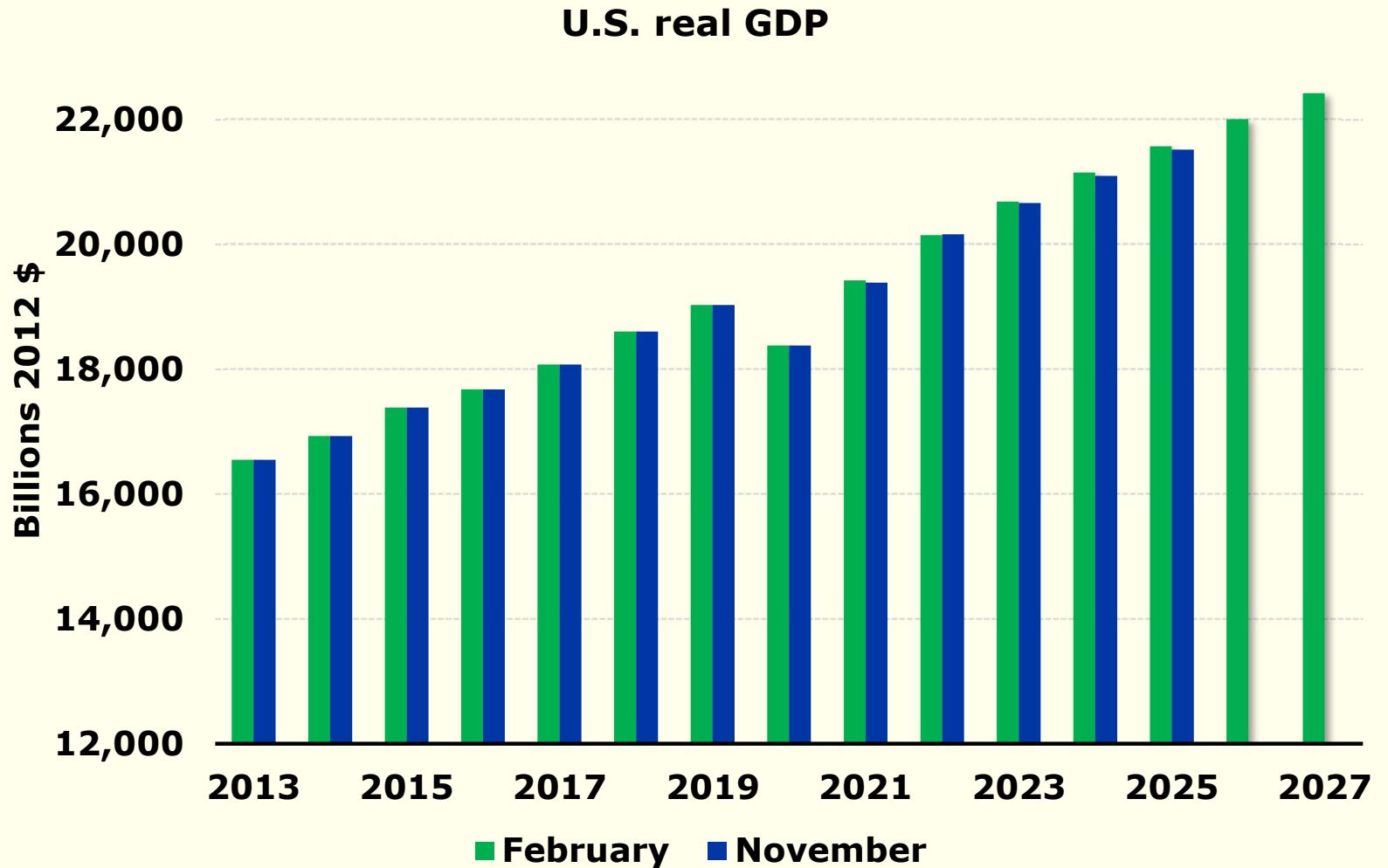


Source: National Federation of Independent Business; data through February 2022

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GDP is very similar to the November forecast



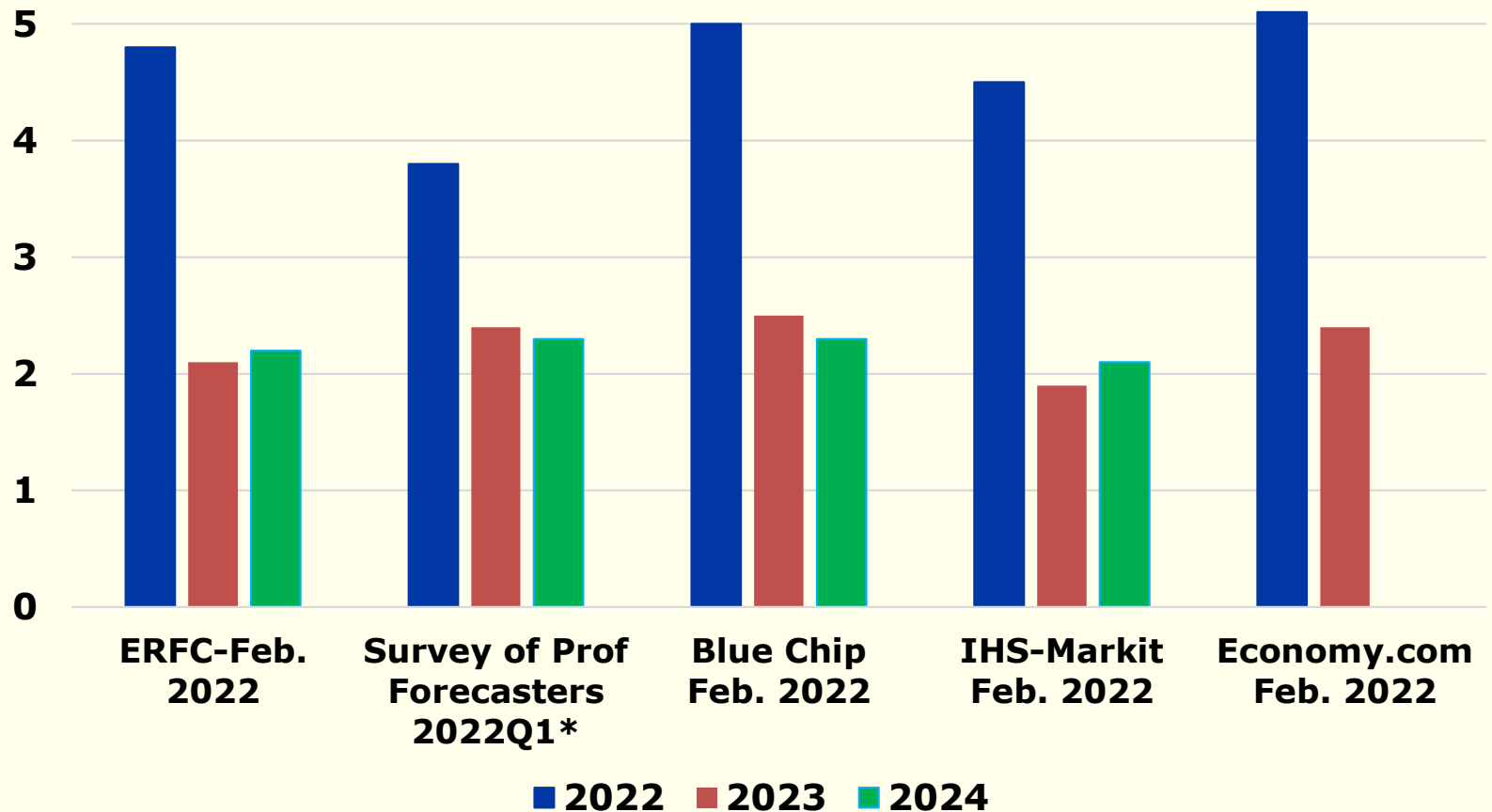
Source: ERFC February 2022 forecast; historical data through 2021



Forecasters generally expect inflation to decrease after this year

The Consumer Price Index increased by 4.7% in 2021

Consumer Price Index, annual % change

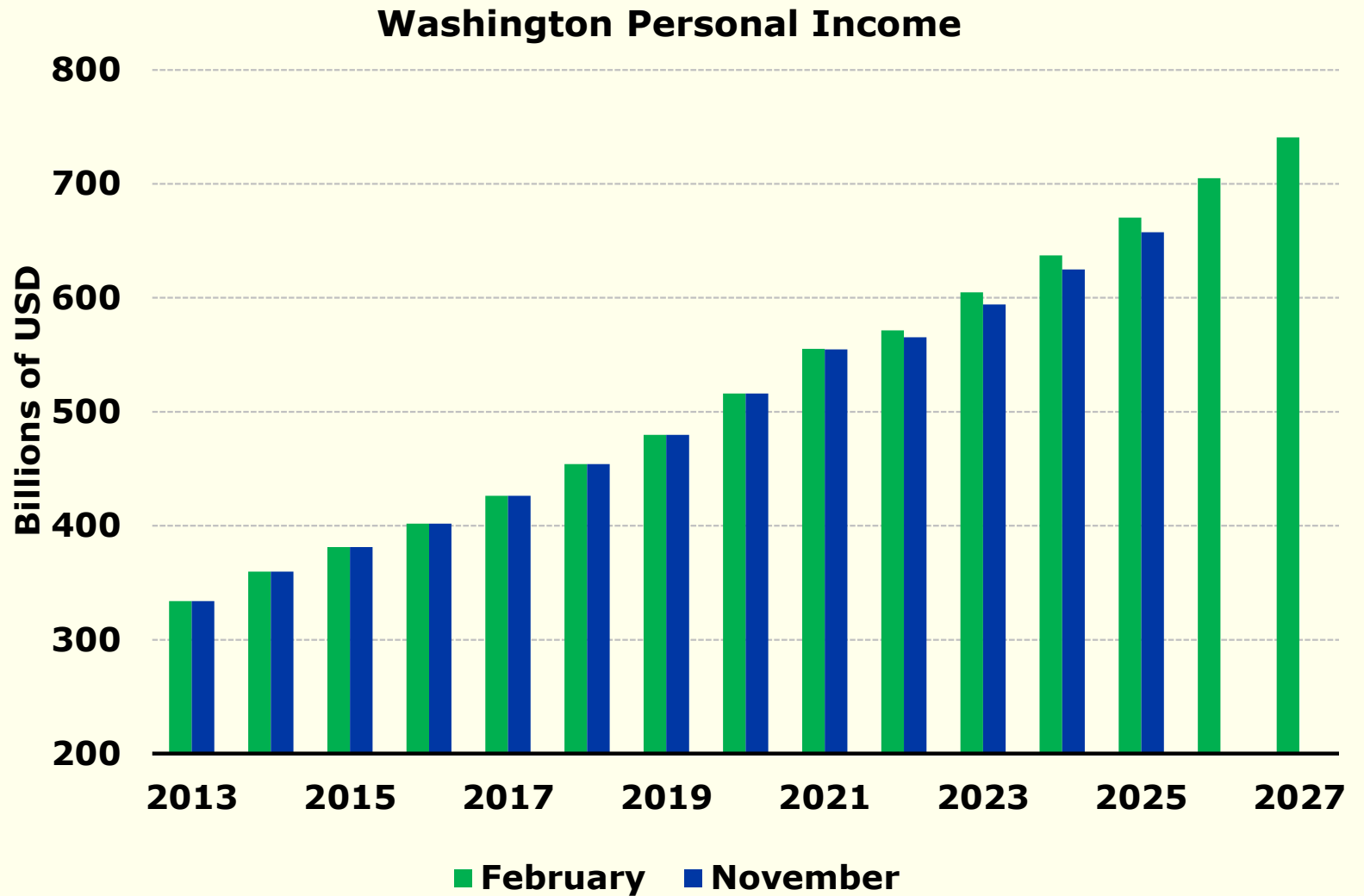


Source: Survey of Prof Forecasters: Q4 over Q4 average; all others annual averages

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WA personal income is slightly higher compared to the November forecast



Source: ERFC February 2022 forecast; historical data through 2020

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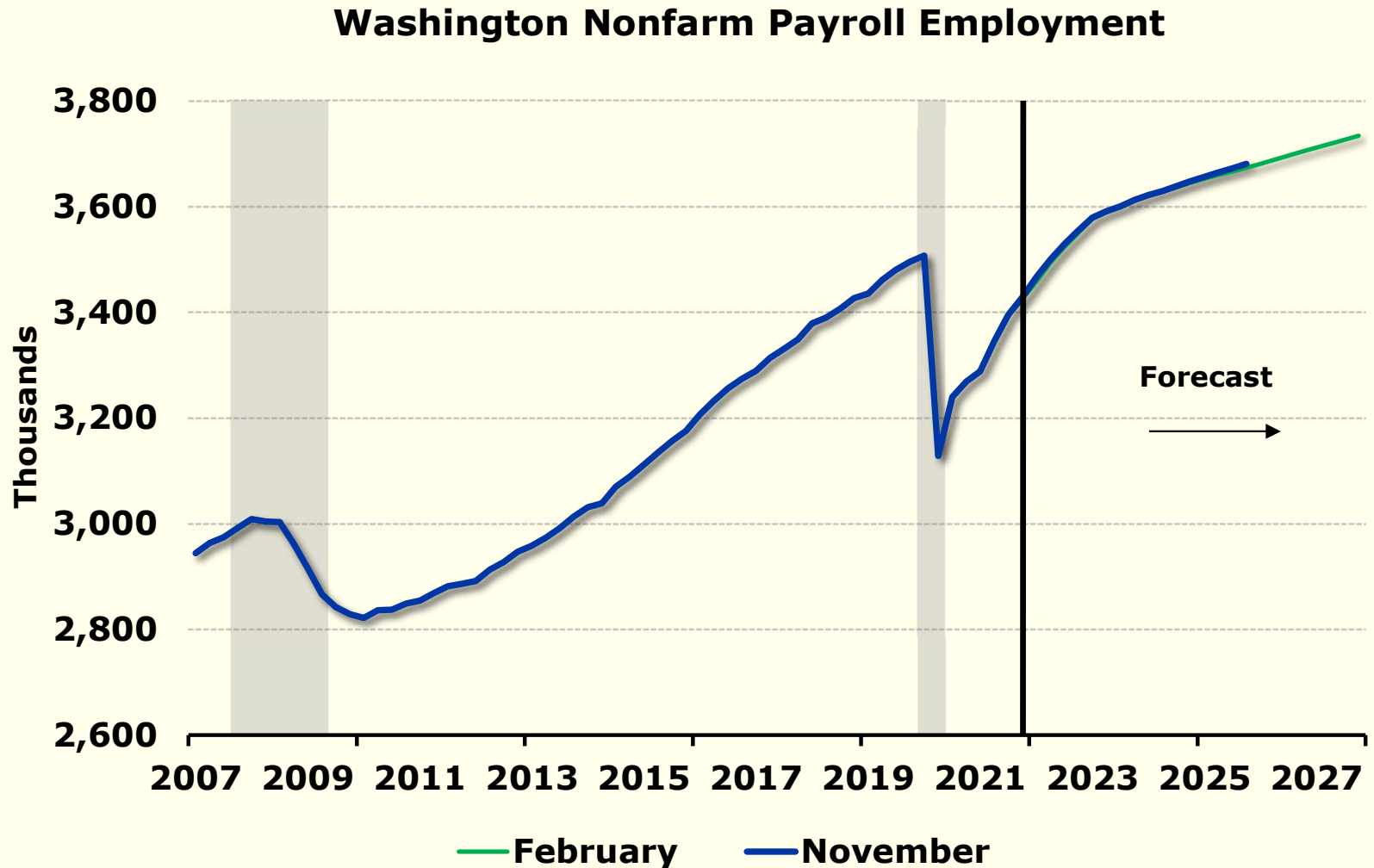


WA employment forecast is essentially unchanged from November

Average annual employment growth, 2022 to 2025:

U.S. = 1.6%

WA = 2.2%



Source: ERFC February 2022 forecast; historical data through Q4 2021

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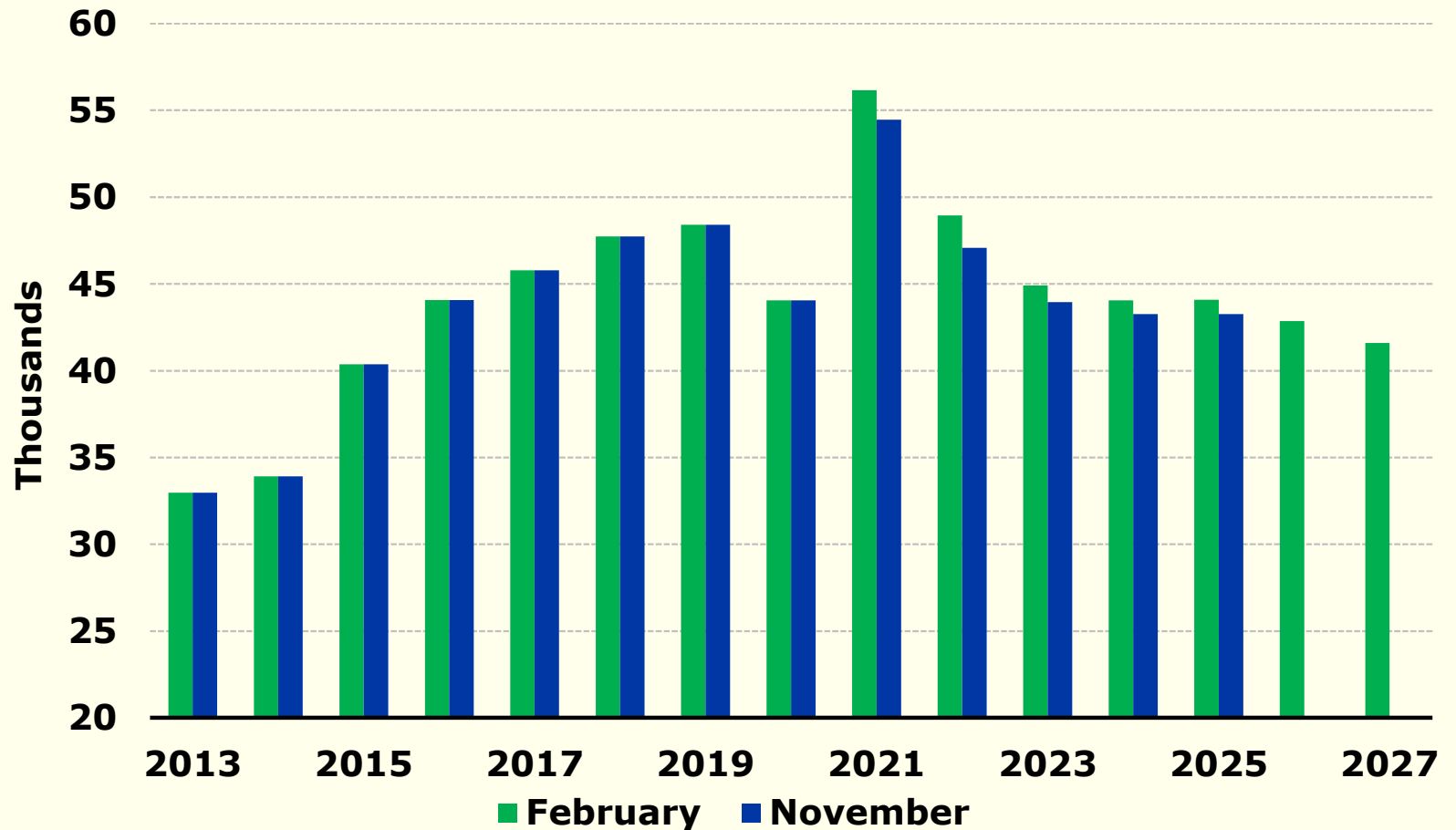
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WA housing permits average 1,100 units higher in 2022 – 2025 compared to November

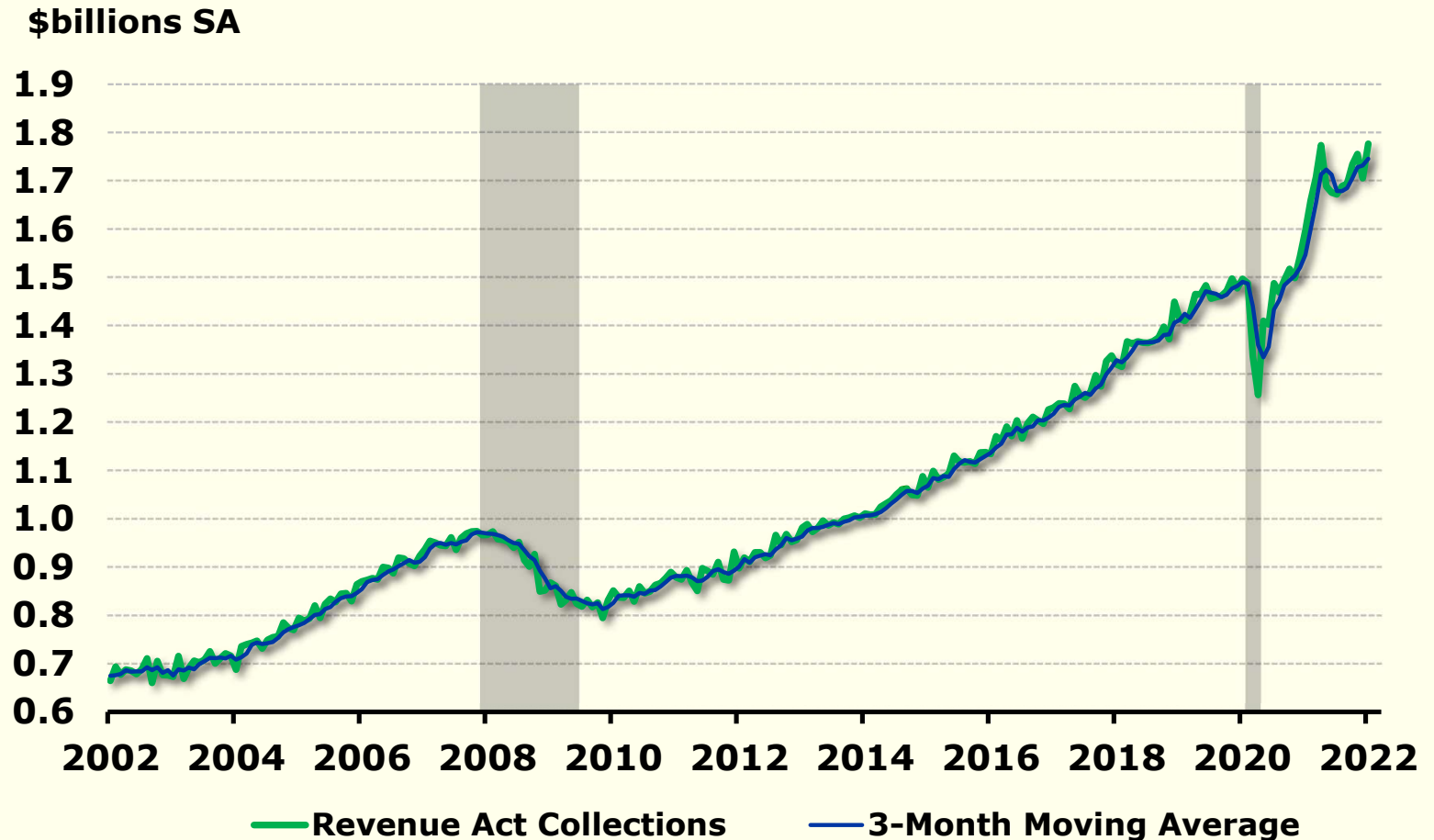
Washington Housing Permits



Source: ERFC February 2022 forecast; historical data through 2021



Revenue Act collections remain strong; year over year growth 9.9% for January activity



* Adjusted for large one-time transactions, amnesty payments, reporting frequency change and deferred 2020 payments, current definition of Revenue Act

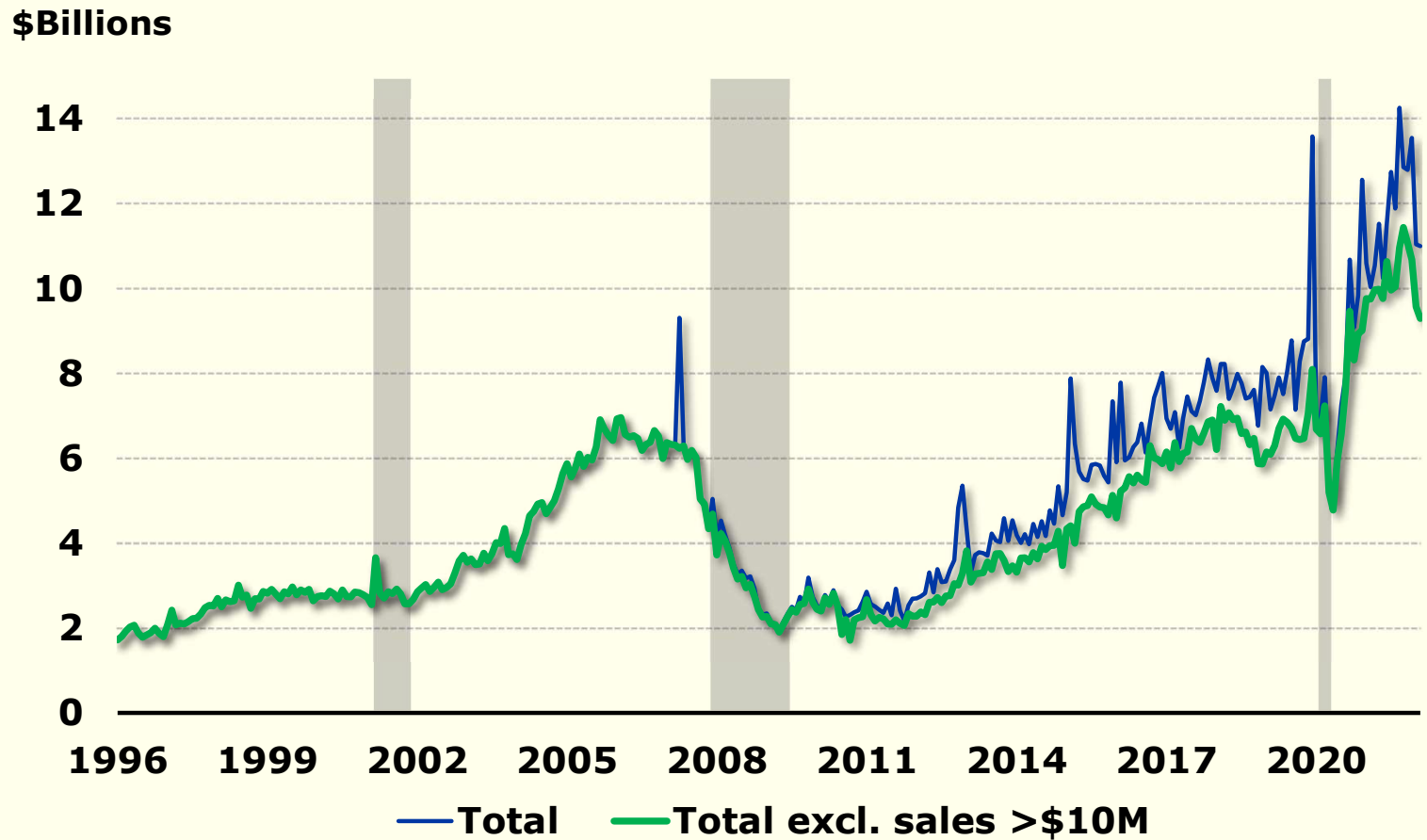
Source: DOR and ERFC; monthly data through January 2022 activity



Seasonally adjusted taxable REET activity in February almost unchanged from January

Large commercial transactions in February totaled \$1.7 B, up from \$1.5 B in January; excluding large sales, SA activity decreased slightly.

Seasonally Adjusted Taxable Real Estate Excise Activity



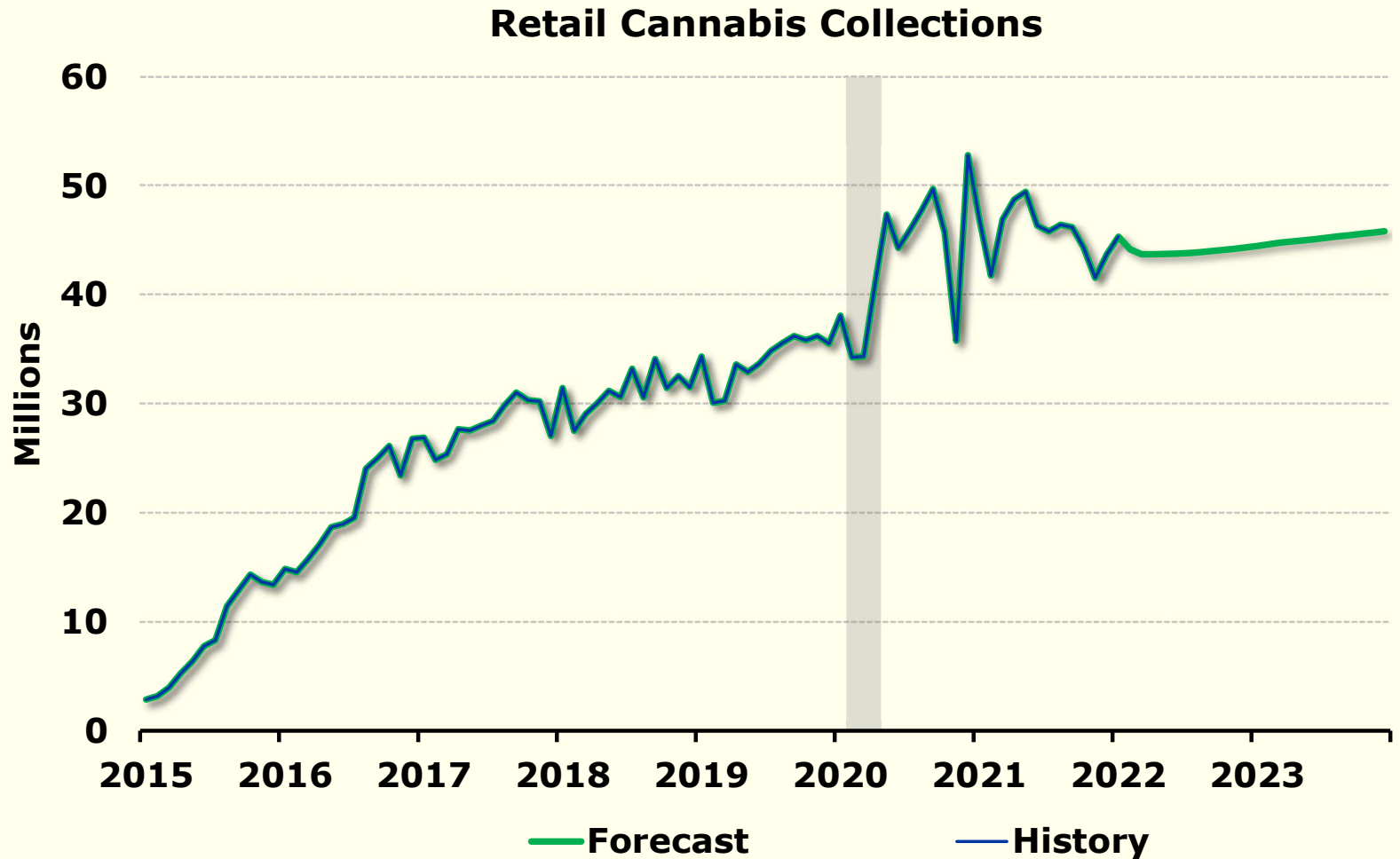
Source: ERFC; Monthly data through February 2022 estimate

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Cannabis revenues appear to be moderating

Collections came in 0.7% below the November forecast



Source: ERFC February 2022 forecast; historical data through January 2022



Forecast changes: all funds, 2021-23 biennium, cash basis

\$Millions	<u>Nov 2021 Forecast</u>	<u>Non-economic Change</u>	<u>Forecast Change</u>	<u>Feb 2022 Forecast</u>	<u>Total Change[#]</u>
General Fund-State	\$57,519	n/a	\$1,400	\$58,919	\$1,400
Education Legacy Trust Account	\$1,687	n/a	\$56	\$1,687	\$56
WA Opportunity Pathways Account	\$354	n/a	(\$10)	\$345	(\$10)
Workforce Education Investment Account	\$678	n/a	\$6	\$684	\$6
Total	\$60,238	n/a	\$1,453	\$61,691	\$1,453

Detail may not add to total due to rounding



Forecast changes, all funds: 2023-2025 biennium, cash basis

\$Millions	<u>Nov 2021 Forecast</u>	<u>Non-economic Change</u>	<u>Forecast Change</u>	<u>Feb 2022 Forecast</u>	<u>Total Change#</u>
General Fund-State	\$60,864	n/a	\$1,311	\$62,175	\$1,311
Education Legacy Trust Account	\$2,082	n/a	\$2	\$2,084	\$2
WA Opportunity Pathways Account	\$355	n/a	\$2	\$356	\$2
Workforce Education Investment Account	\$748	n/a	\$5	\$753	\$5
Total	\$64,047	n/a	\$1,320	\$65,368	\$1,320

Detail may not add to total due to rounding



What are the major factors that drove the revenue forecast increase?

- Collections variance of \$452 million since November forecast
- Higher inflation
- Slightly stronger personal income
- Stronger residential construction and construction employment
- Continued stronger-than-expected growth in retail sales, real estate transactions



2021-23 Biennium alternative General Fund-State forecasts

\$Millions (cash basis)	2021-23 Biennium	Difference From the baseline#
February 2022 Baseline (50%)	\$58,919	
<u>February 2022 Alternative Forecasts</u>		
Optimistic (20%)	\$61,453	\$2,534
Pessimistic (30%)	\$56,606	(\$2,314)
Probability Weighted Average	\$58,732	(\$187)
GCEA*	\$59,014	\$95

*Based on the Governor's Council of Economic Advisors' economic assumptions

#May not add to total due to rounding



2023-25 Biennium alternative General Fund-State forecasts

\$Millions (cash basis)	2023-25 Biennium	Difference From the baseline[#]
February 2022 Baseline (50%)	\$62,175	
<u>February 2022 Alternative Forecasts</u>		
Optimistic (20%)	\$67,721	\$5,546
Pessimistic (30%)	\$56,953	(\$5,222)
Probability Weighted Average	\$61,717	(\$457)
GCEA*	\$62,537	\$362

*Based on the Governor's Council of Economic Advisors' economic assumptions

#May not add to total due to rounding



New data since February forecast

Employment, oil prices, inflation all above February forecast levels; situation in Ukraine, COVID, data revisions will impact how well forecast tracks reality

U.S.

- February employment: 687,000 new jobs
- February unemployment rate: 3.8%
- February CPI: prices increased 7.9% compared to February 2021
- Oil spot prices have mostly been above \$100/barrel since March 1st

Washington

- January & February employment: 36,300 new jobs
- February unemployment rate: 4.3%



Conclusion

- U.S. GDP, employment forecasts similar to November; inflation, oil prices higher in 2022 - 2025
- WA personal income growth forecast slightly higher than Nov. forecast; residential construction forecast revised up
- COVID, inflation, geopolitics pose forecast risks
- Total state revenues are expected to grow 16.1% between the 2019-21 and 2021-23 biennia and 6.0% between the 2021-23 and 2023-25 biennia



Questions



**Economic & Revenue Forecast Council
PO BOX 40912
Olympia WA 98504-0912**

**www.erfc.wa.gov
360-534-1560**