

Economic and Revenue Outlook

Presented to
WSU & UW Board of Regents

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Pullman, Washington



WASHINGTON STATE
ECONOMIC AND REVENUE FORECAST COUNCIL



Summary

- Revenue collections since our September forecast have come in on target, however
 - Revenues based on economic activity are below target
 - Most of the modest positive variance can be explained by timing and other non-economic factors
- The passage of Initiative 1107 will lower expected revenues by \$281 million
- Additionally, a weaker economic outlook for the next biennium, and the flatter trajectory to it, has lowered revenue collections
- Total General Fund–State revenues will be lower by
 - \$385 million this biennium
 - \$809 million next biennium

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This is the worst recession since WW II

| Recession | Peak-to-trough decline | | Recession Duration |
|----------------|------------------------|----------------|--------------------|
| | Real GDP | Employment | |
| | <i>percent</i> | <i>percent</i> | <i>months</i> |
| 1948-49 | 1.6 | 5.0 | 11 |
| 1953-54 | 2.5 | 3.4 | 10 |
| 1957-58 | 3.1 | 4.2 | 8 |
| 1960-61 | 0.5 | 2.3 | 10 |
| 1969-70 | 0.2 | 1.2 | 11 |
| 1973-75 | 3.2 | 1.9 | 16 |
| 1980 | 2.2 | 2.3 | 6 |
| 1981-82 | 2.6 | 3.1 | 16 |
| 1990-91 | 1.4 | 1.4 | 8 |
| 2001 | 0.7 | 1.7 | 8 |
| Average | 1.8 | 2.6 | 10 |
| 2007-09 | 4.1 | 6.1 | 18 |

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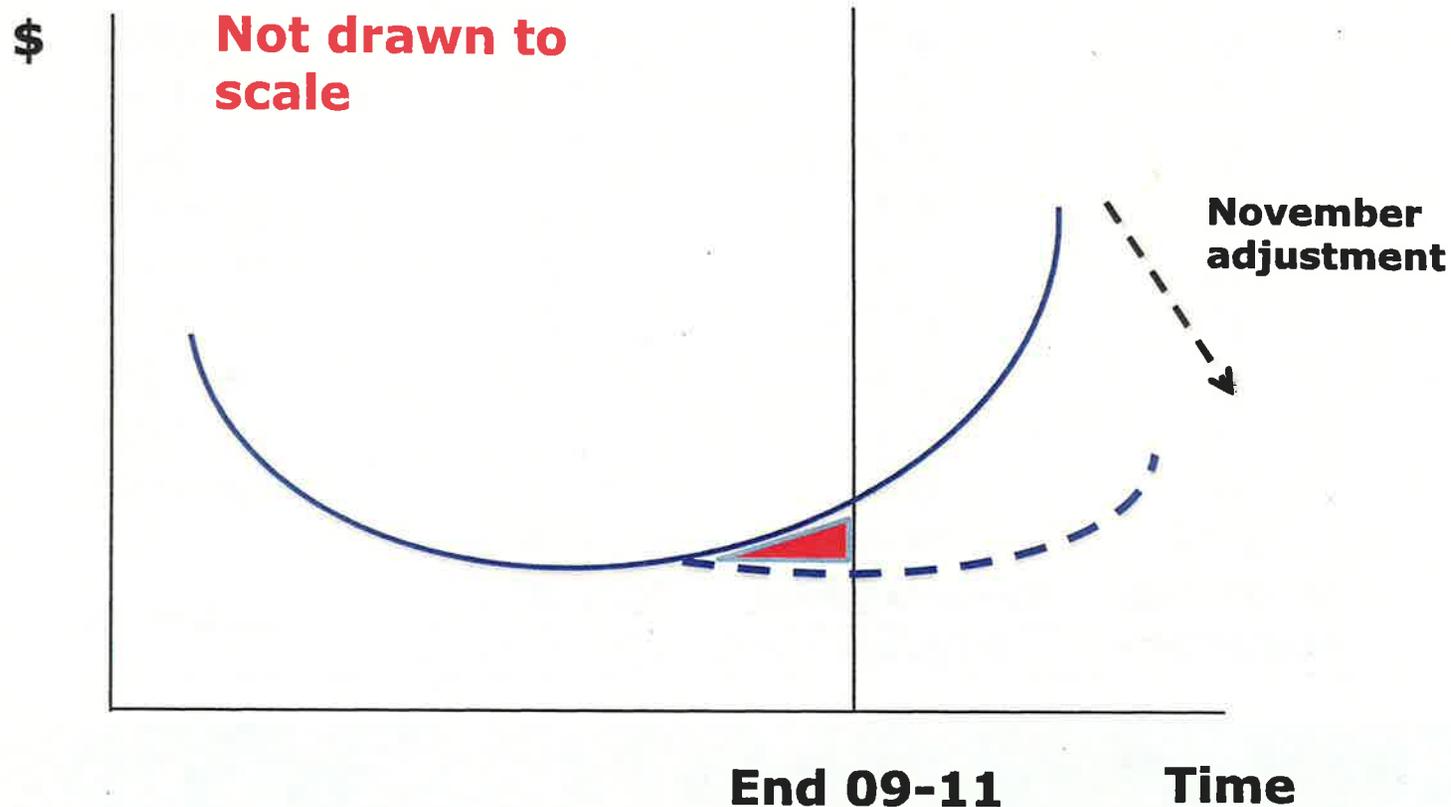
Source: NBER, ERFC

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A reduction in the rate of recovery in activity affects the forecast for this biennium, not just the next one



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Source: ERFC

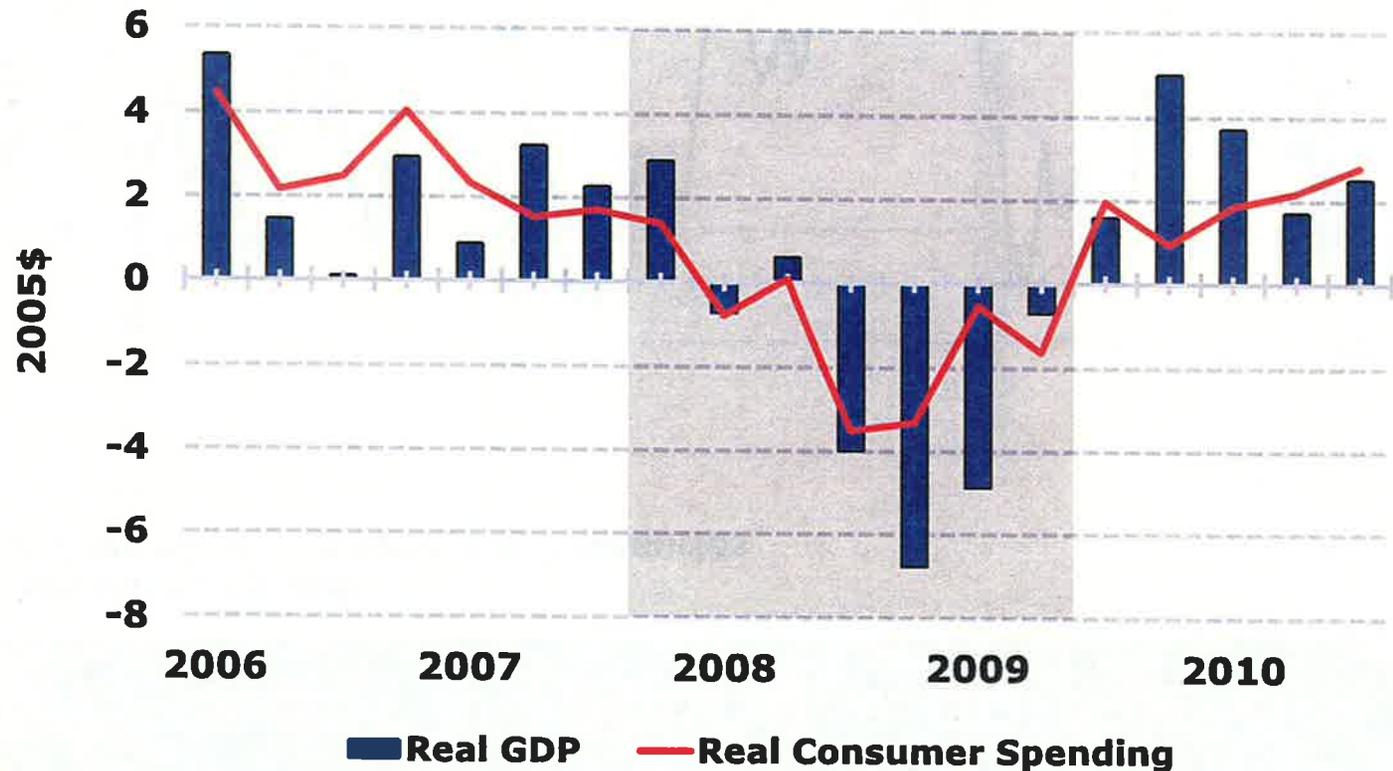
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GDP is growing, but modestly

Percent growth, SAAR



Source: BEA, data through 2010 Q3

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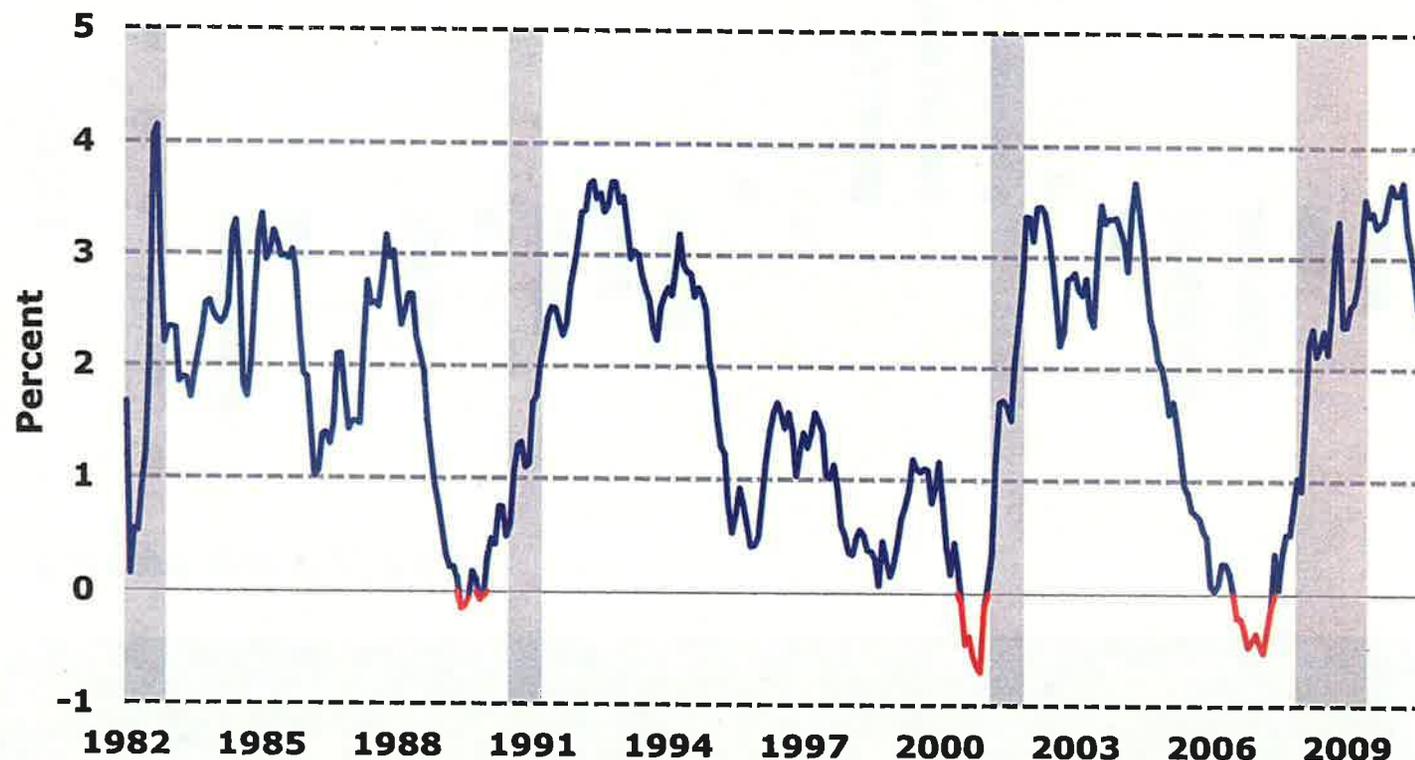
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The yield curve has flattened, but is not signaling a double dip

An inverted yield curve typically precedes a recession while a steepening yield curve signifies a recovery

Yield Curve Spread
10-Year minus 3-Month U.S. Treasuries



Source: Federal Reserve Board, ERFC; data through November 26, 2010

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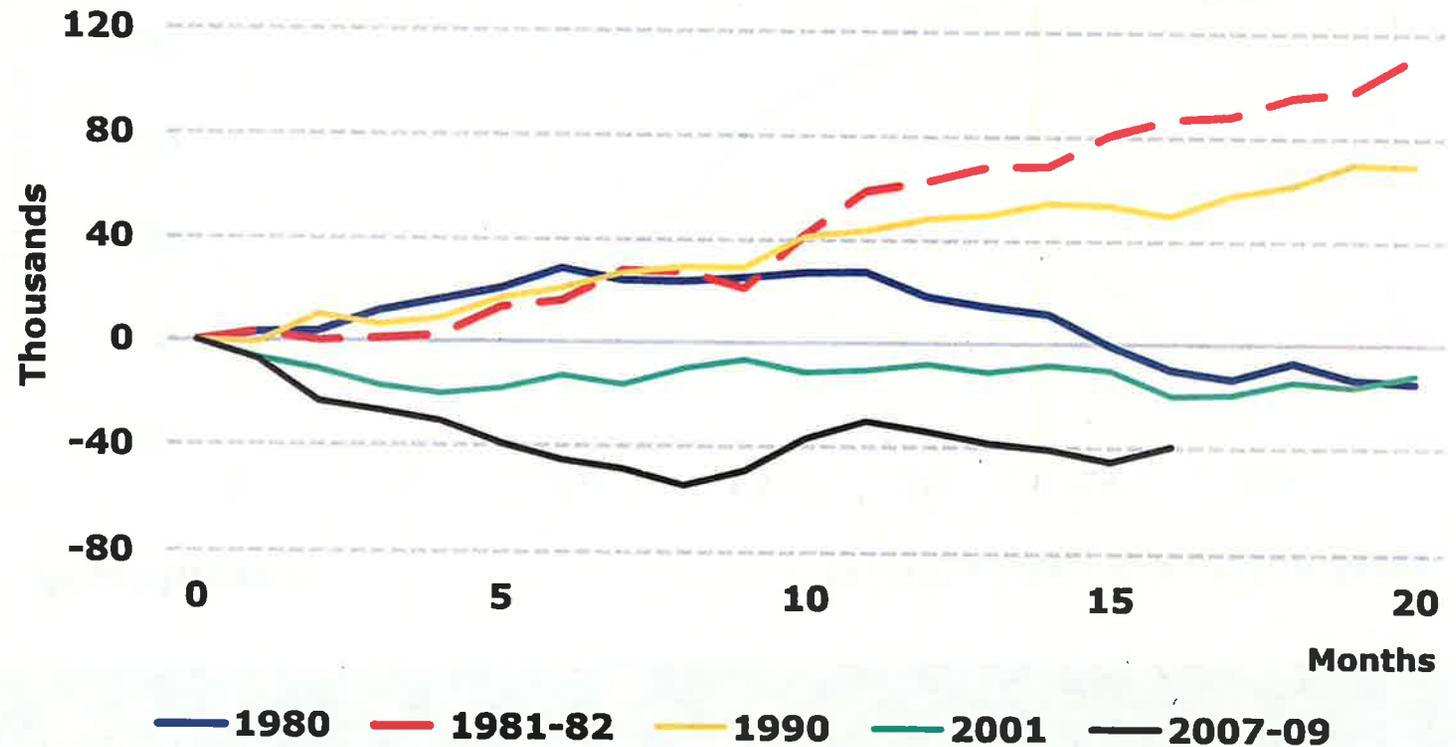
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Employment growth in WA since the trough has been slowest for this recession...

Change in Employment Since Recession Trough



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Source: BLS, WA ESD; data through October 2010

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... and the hole we are in is also the deepest

Peak to trough job losses

1981-82:

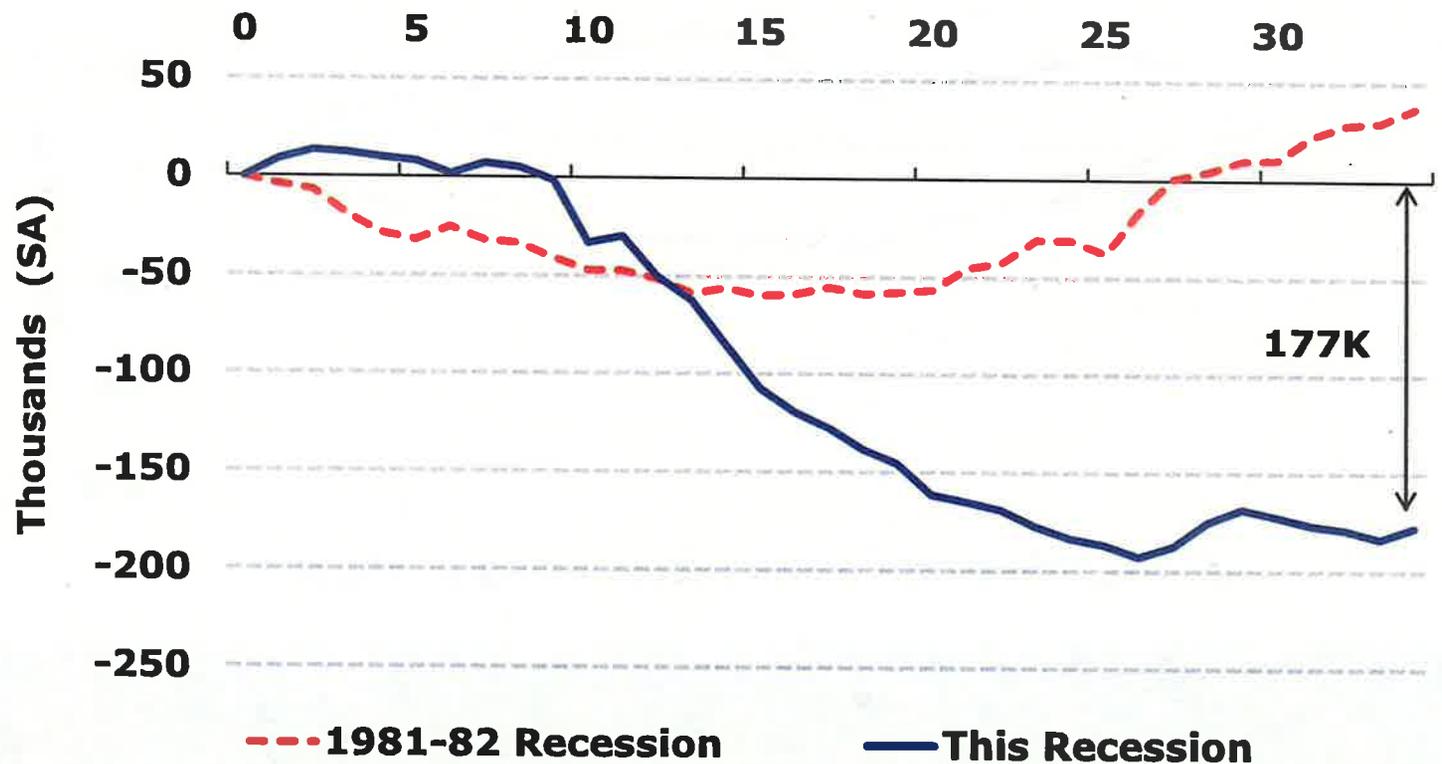
2.9% of labor force

This time:

5.5% of labor force

Washington

Months after Recession Start



Source: WA ESD, ERFC; data through October 2010

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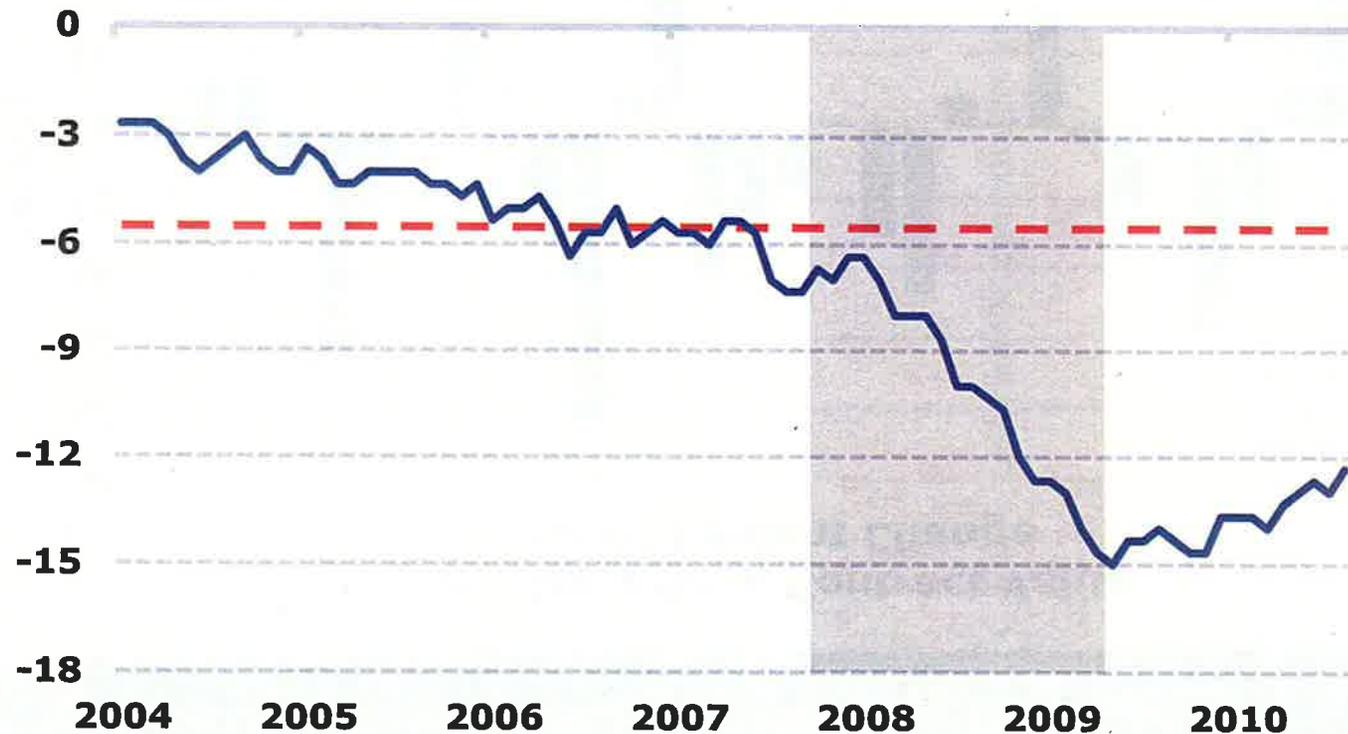
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Credit conditions for small business are improving, but remain tight

**Availability of Loans
Net Percent ("Easier" minus "Harder"), 3mma**



Source: National Federation of Independent Business; data through October 2010

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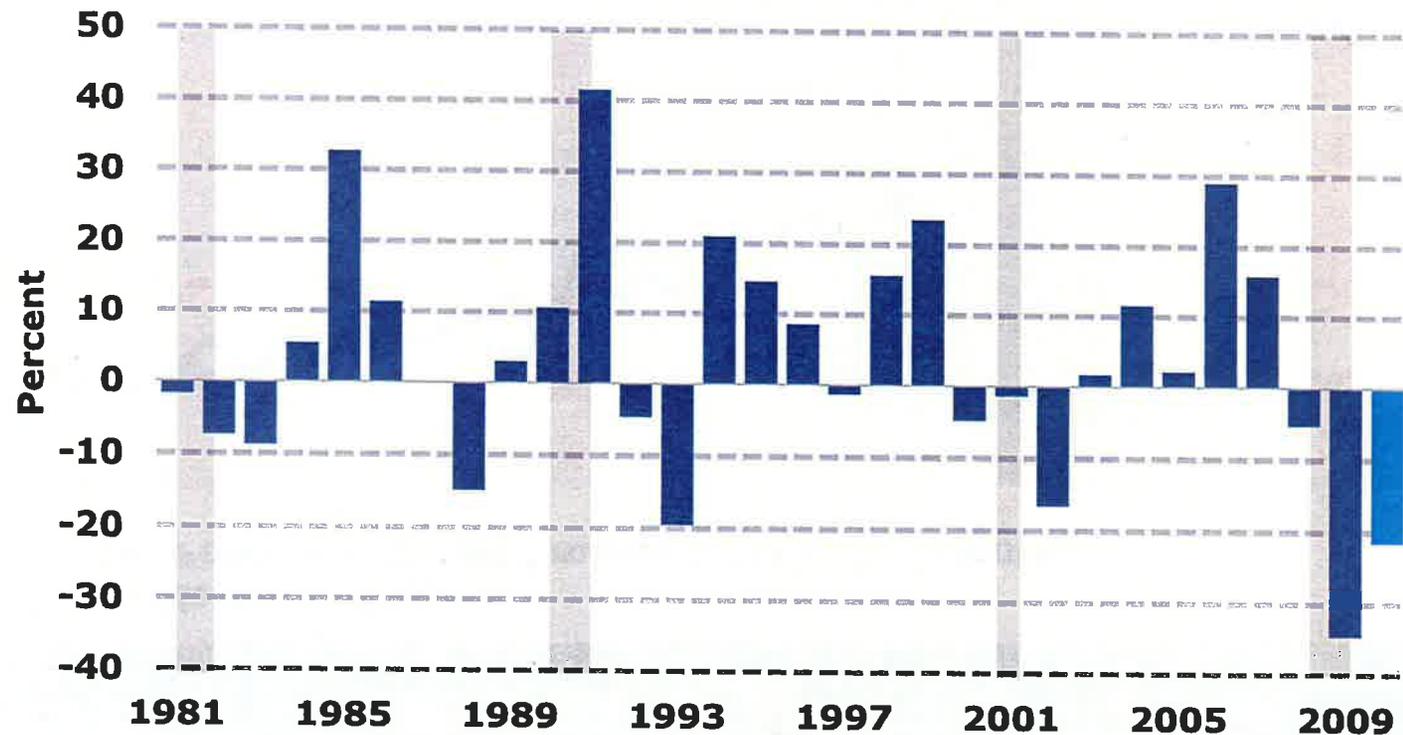
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We do not expect recovery in non-residential construction until 2012

Non-Residential Contract Value Annual Percent Change



Source: McGraw-Hill Construction, data through October 2010

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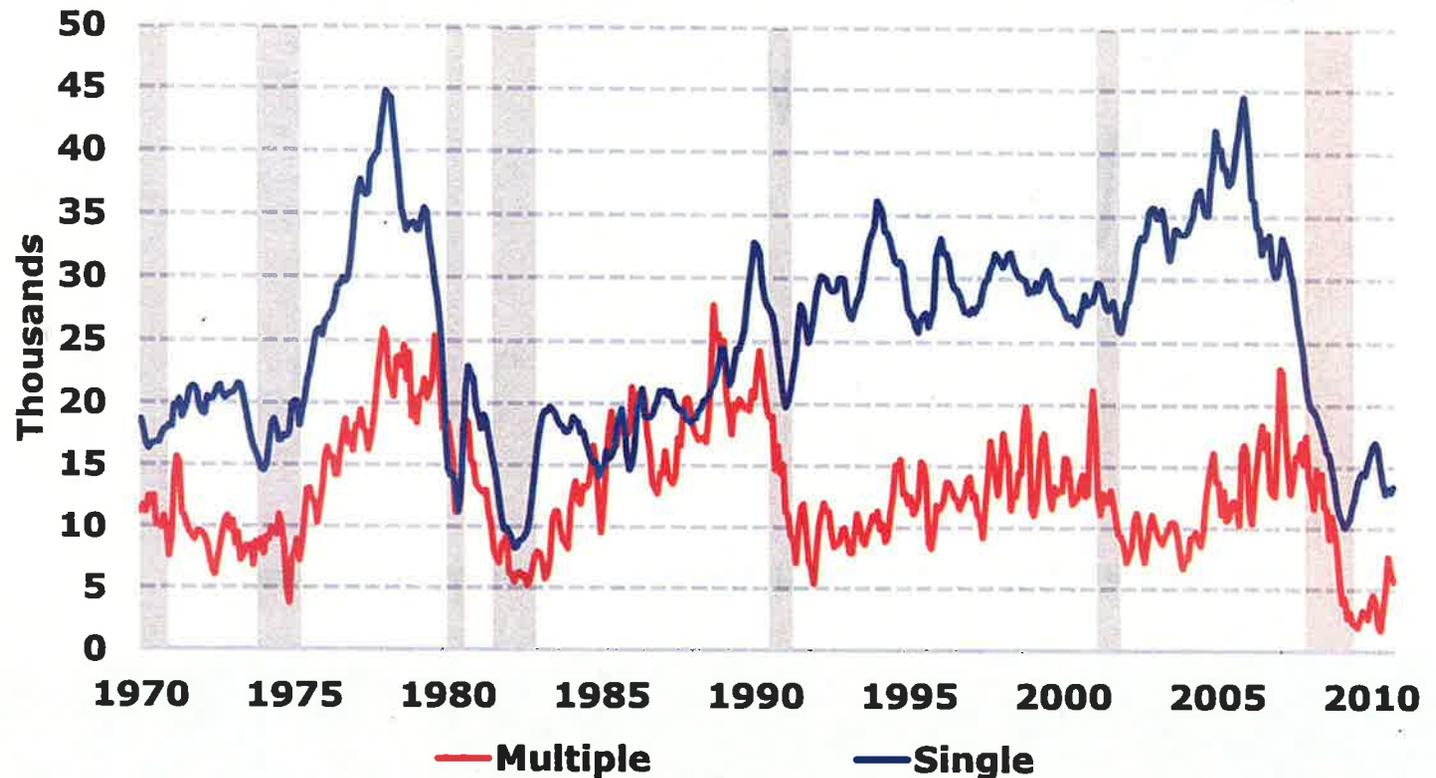
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WA single-family building permits appear to be stabilizing

Washington Housing Units Authorized by Building Permits, 3MMA, SAAR



Source: U.S. Census Bureau; data through October 2010

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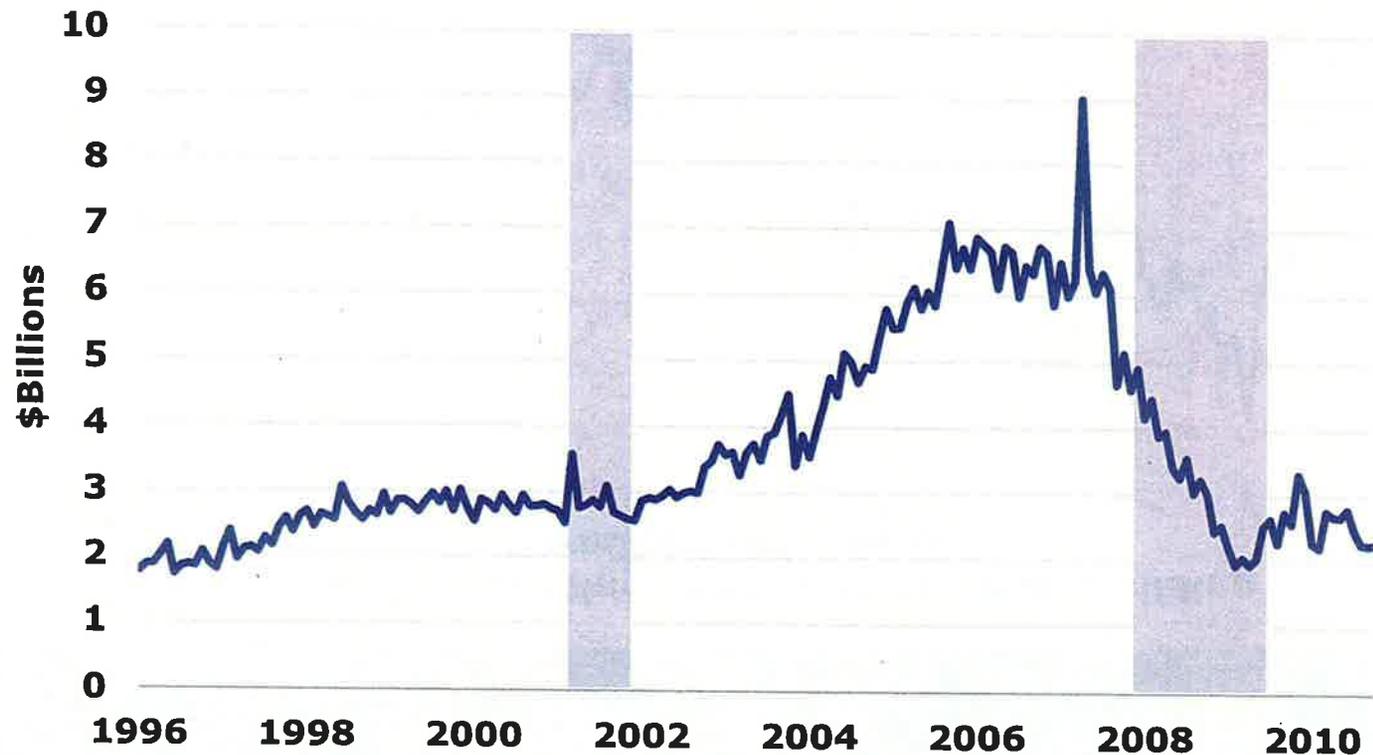
Post-credit drop-off in REET seems to be complete

Seasonally adjusted preliminary October activity was flat after the August-September post-credit drop-off

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Seasonally Adjusted Taxable Real Estate Excise Activity



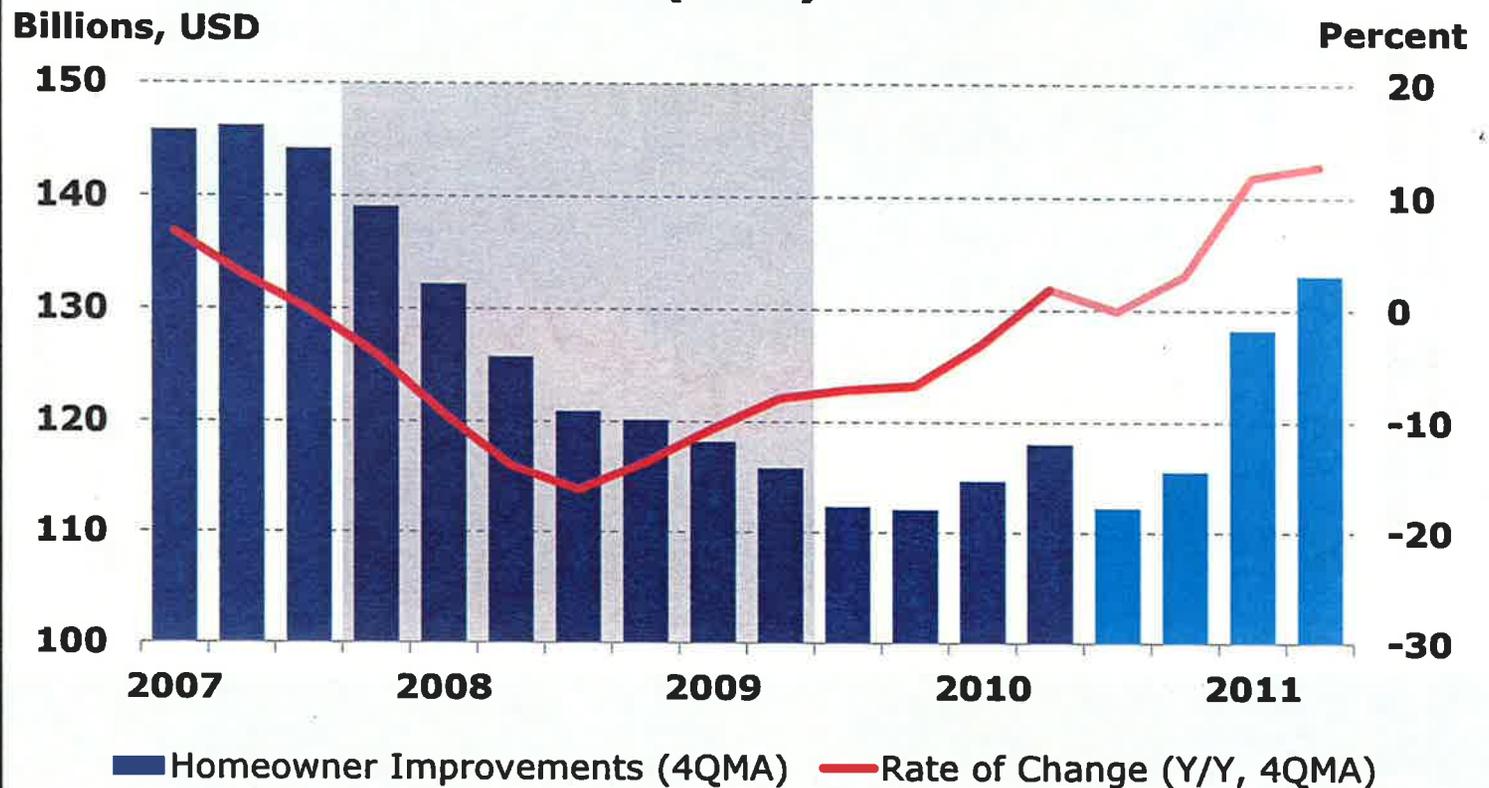
Source: ERFC; monthly data through October 2010

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Leading indicator predicts improvement in remodeling expenditures

The Leading Indicator of Remodeling Activity (LIRA)



Source: Joint Center for Housing Studies of Harvard University, actual data through 2010 Q2

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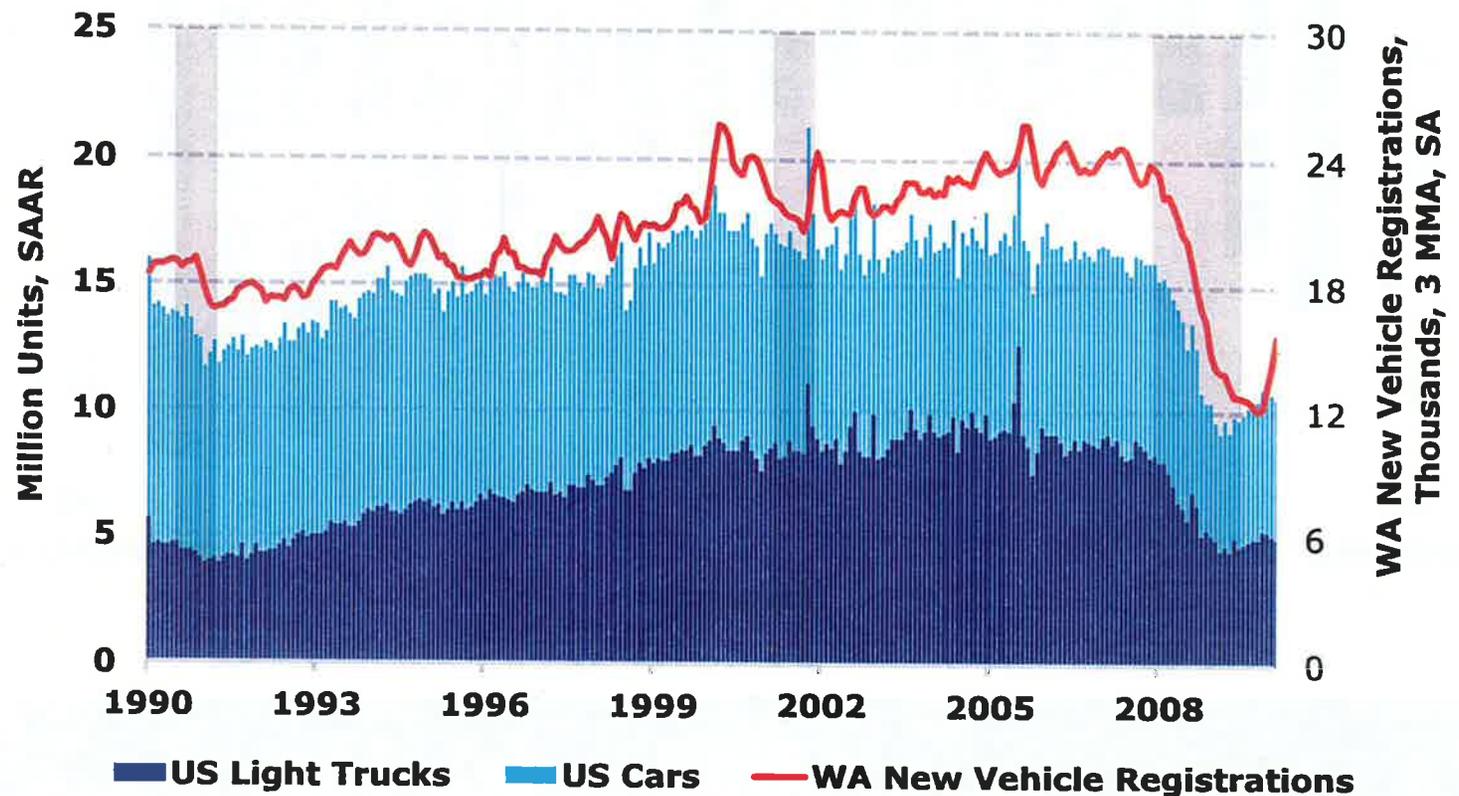
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Automotive sales ticked up in October

Cash for Clunkers effect removed



Source: Autodata Corporation, WA DOL; data through October 2010

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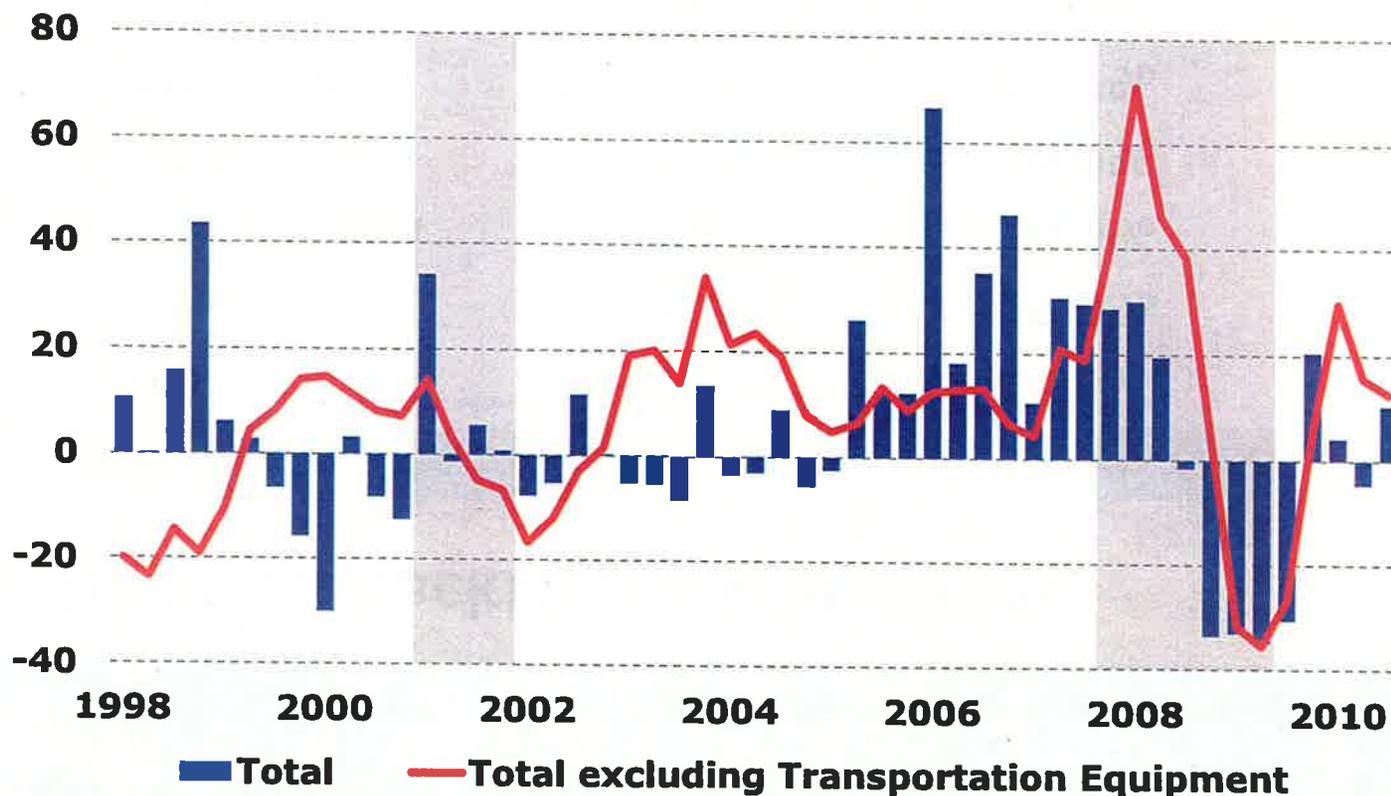
WA export growth is stable, and will help state outperform in the recovery

Total exports were up 10% y/y in Q3

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Exports
Percent Change, year ago



Source: Wisier Trade Data; through 2010 Q3



Boeing has a healthy and geographically diversified order book

- Boeing's backlog: 3,469 planes

| Region | Planes | Share (%) |
|----------------|---------------|------------------|
| Africa | 98 | 2.8% |
| Americas | 1,017 | 29.3% |
| Asia & Oceania | 970 | 28.0% |
| Europe | 658 | 19.0% |
| Middle East | 371 | 10.7% |
| Unidentified | 355 | 10.2% |
| Total | 3,469 | 100% |

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Source: Boeing; data through October, 2010

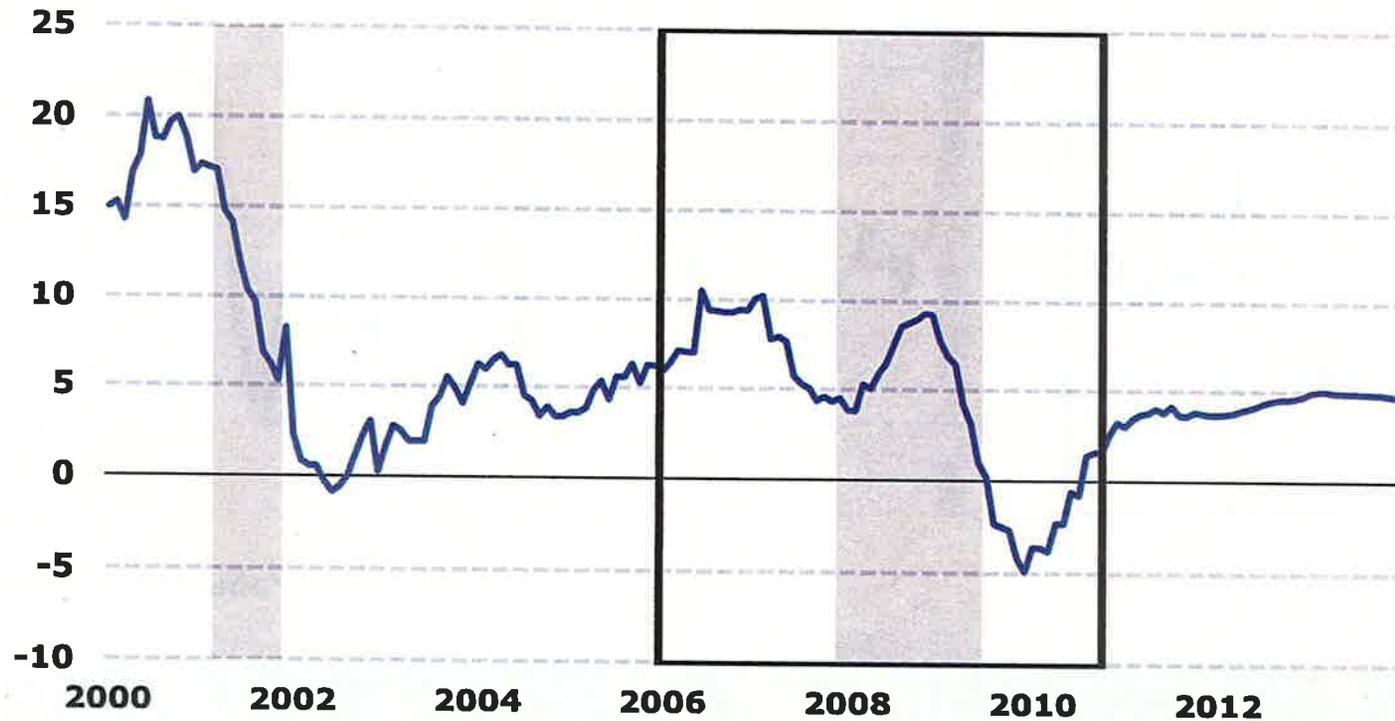
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Software publishing employment is expected to eventually grow at about 5% per year

Percent change, year ago



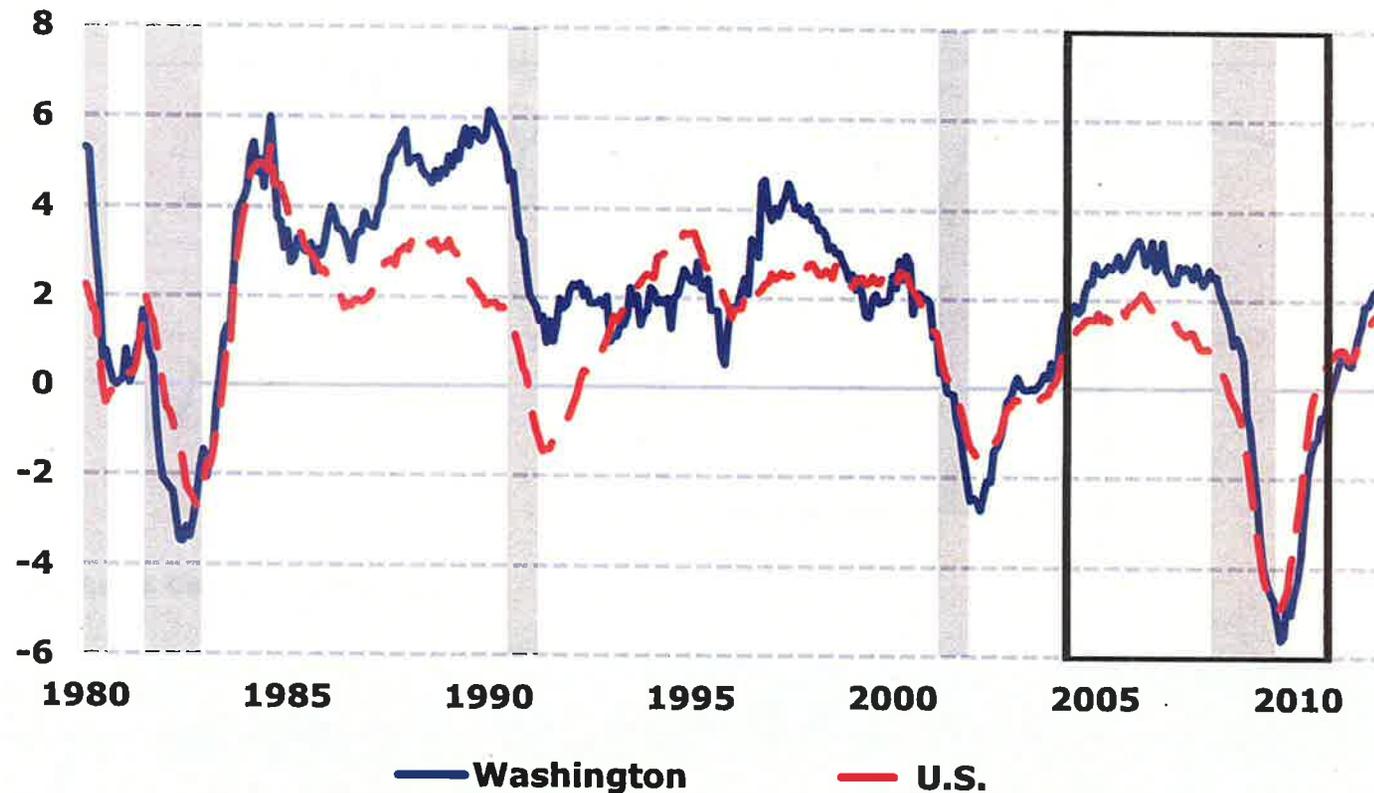
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Source: ERFC November 2010 forecast; actual through October 2010



WA employment lagged the nation in the downturn and will recover at about the same rate as the nation

Percent change, year ago



Source: ERFC November 2010 forecast; actual through October 2010

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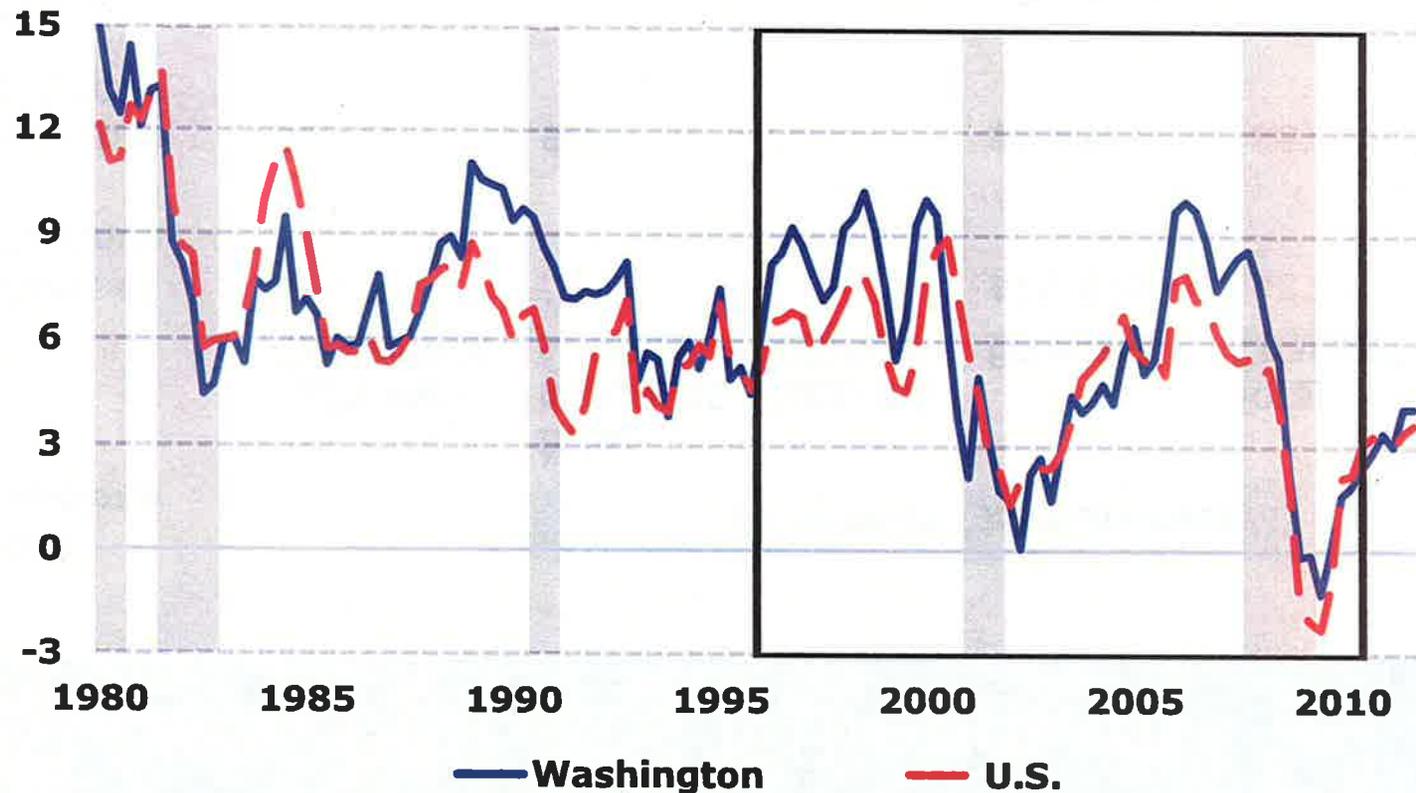
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The recovery in WA personal income growth, however is expected to be better than the nation's

Percent change, year ago



Source: ERFC November 2010 forecast; actual data through 2010Q3

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Forecast changes: General Fund State, 2009-2011 Biennium

September Forecast:

\$28,512 million

USD millions

November '10 Forecast

| | <u>Collection Experience</u> | <u>Non-economic Change</u> | <u>Forecast Change</u> | <u>Forecast</u> | <u>Total Change*</u> |
|--------------------|------------------------------|----------------------------|------------------------|-----------------|----------------------|
| Dept. of Revenue | \$21 | (\$63) | (\$337) | \$26,676 | (\$379) |
| All other agencies | \$0 | \$0 | (\$6) | \$1,451 | (\$6) |
| Total GF-S | \$21 | (\$63) | (\$343) | \$28,127 | (\$385) |

* Detail may not add to total due to rounding

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Forecast changes: General Fund State, 2011-2013 Biennium

| USD millions | November '10 Forecast | | | | |
|--------------------|-------------------------------|-------------------------------------|----------------------------|-----------------|--------------------------|
| | <u>Sept 2010 Forecast</u> | <u>Non- economic Change</u> | <u>Forecast Change</u> | <u>Forecast</u> | <u>Total Change*</u> |
| Dept. of Revenue | \$31,812 | (\$218) | (\$584) | \$31,010 | (\$802) |
| All other agencies | \$1,602 | \$0 | (\$7) | \$1,595 | (\$7) |
| Total GF-S | \$33,414 | (\$218) | (\$591) | \$32,605 | (\$809) |

* Detail may not add to total due to rounding

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General Fund* forecast by fiscal year

* General Fund & Related Funds for FY 07, 08, and 09

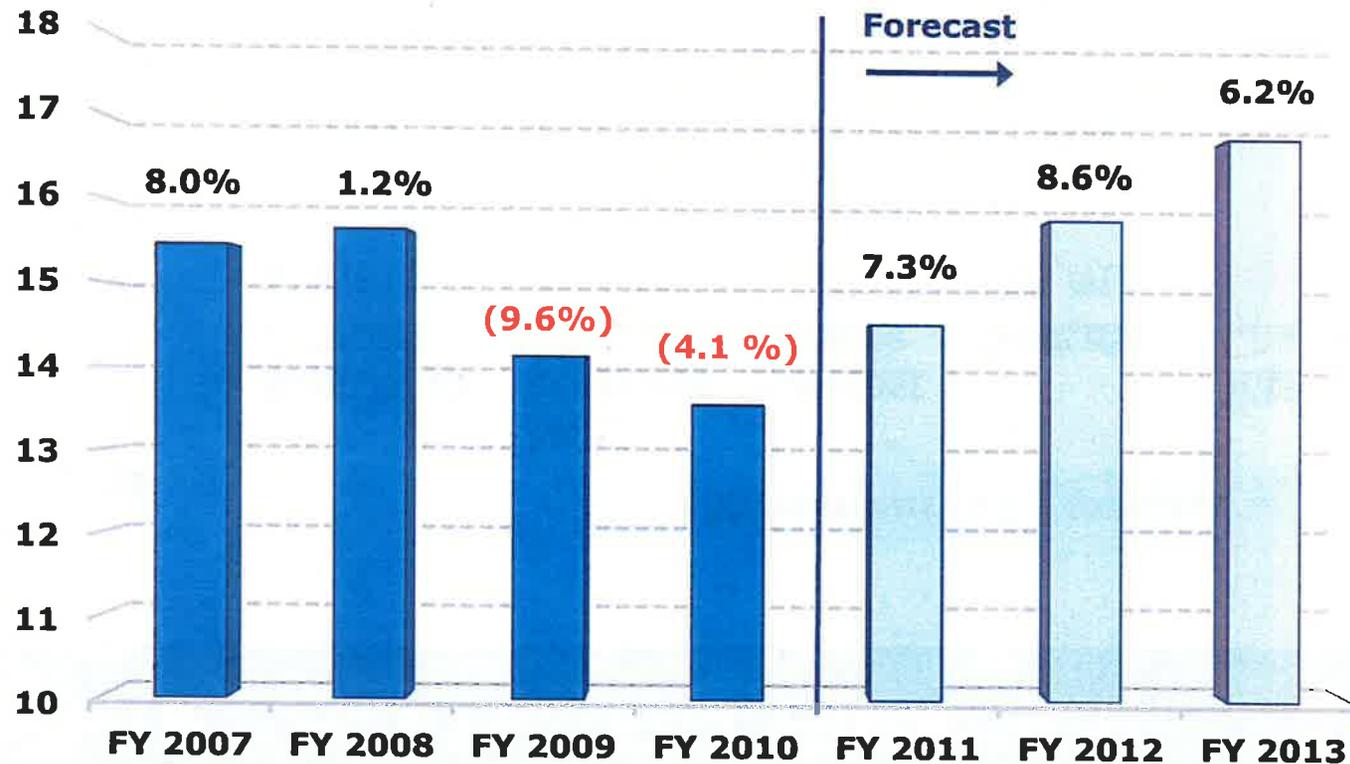
General Fund – new definition, for FY 10-13

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USD billions

GF-State



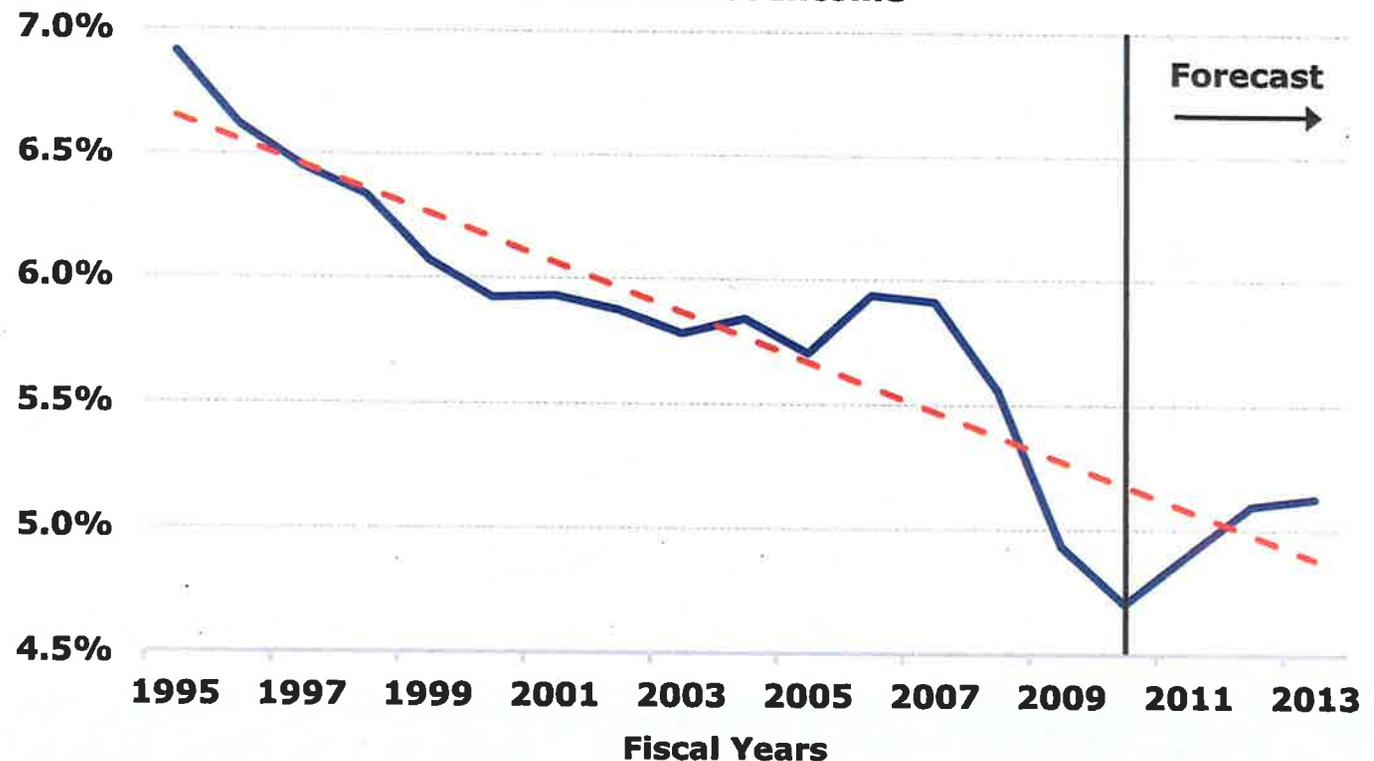
Source: ERFC forecast, November 2010; includes impact of legislative changes

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GF-S revenues as a share of personal income are well below trend

Total General Fund-State Revenue as Percentage of State Personal Income



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*Current definition of Revenue Act

Source: ERFC; data through FY 2010, November 2010 forecast

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Conclusion

- The forecast for the 2009-11 Biennium is \$385 million lower, due economic and non-economic reasons
- The forecast for the 2011-13 Biennium is \$809 million lower for the same reasons
- The economic recovery is ongoing, but at a slower than anticipated pace
- The level of uncertainty in the baseline is still significantly high, but we have recognized part of the downside in this forecast
- Downside risks still remain higher than upside risks

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