

Economic and Revenue Update

August 17, 2022

**Office of Economic and Revenue Forecasts
&
City Budget Office**

Presentation Outline

Part I: Current Conditions: Economic Update

Part II: Looking Forward: Revised Economic Forecasts

Part III: Bottomline: Revenue Forecast



Economic Update



Overall Economic Conditions Have Deteriorated Since the April Forecast

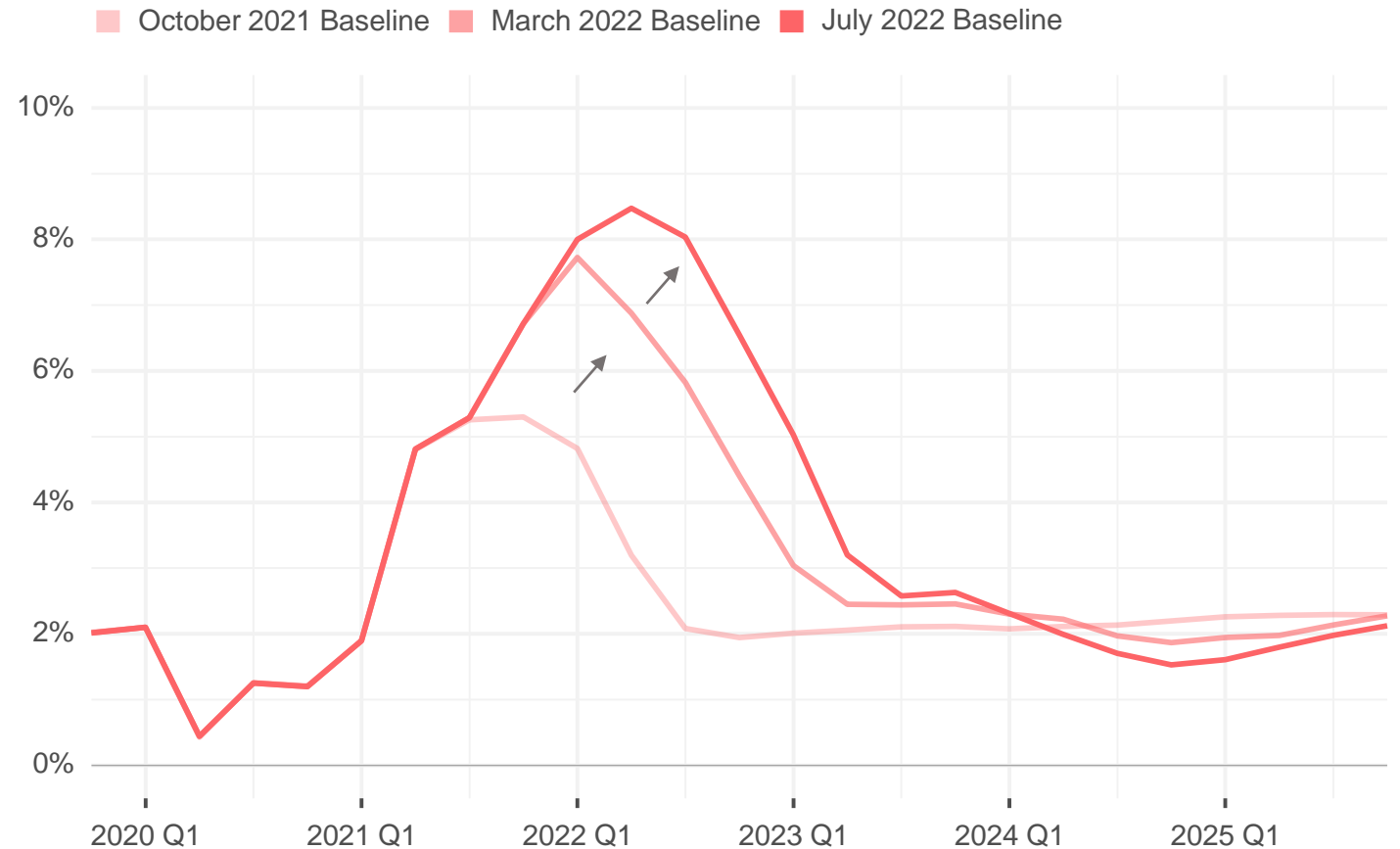
- Inflation and the efforts to contain inflation have become dominant factors in the economy.
- Recent data has revealed that U.S. Gross Domestic Product (GDP) decreased in the first half of the year, although overall employment growth remains strong.
- The Federal Reserve has responded to these mixed signals with an aggressive strategy to increase interest rates and reduce inflation.
- Now, the key question for the economy is whether these steps can reduce inflation without significant impacts to the currently strong labor market. If not, a recession could result.
- Although developed in early July before the latest Fed Rate increase and the GDP announcement, the national forecast upon which we base our work largely anticipated the most recent developments regarding interest rates and GDP.



Inflation Accelerated Quickly and Has Now Reached a 40-Year High

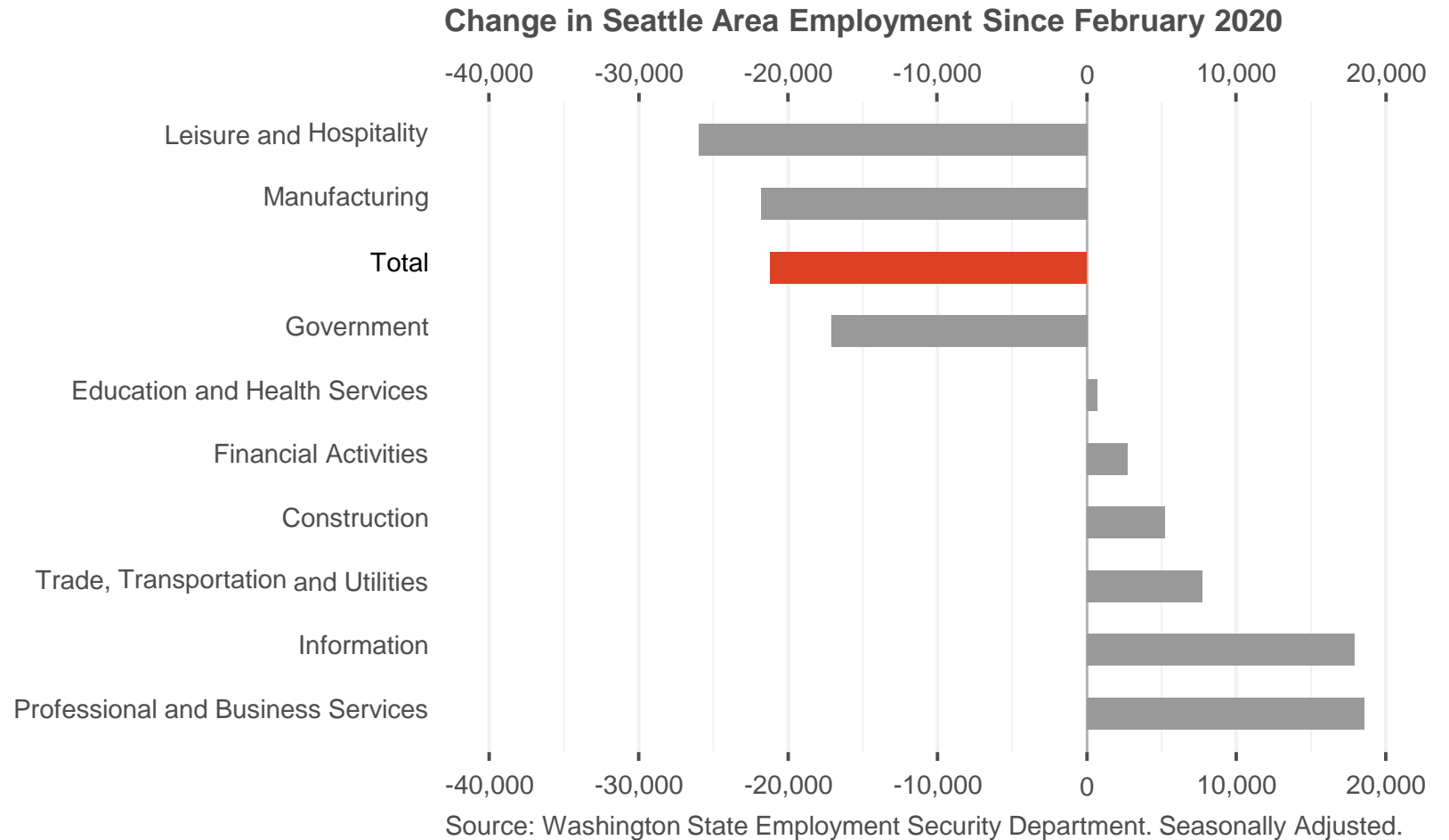
- Since last fall, inflation has nearly doubled, and forecasts now anticipate that relatively high rates will persist into next year.
- As of June, consumer prices at the national level had increased by 9.1% over the previous 12 months. The comparable figure for the Seattle Metropolitan Area is 10.1%.
- Responding to these inflationary pressures, the Fed raised the rate it charges to banks by 0.75% in July. This followed an increase of the same amount in June. Increases of this magnitude and speed have not been seen since the early 1980's. And further increases are still anticipated.
- The long-term forecast, which shows inflation moderating price by mid-2023, is consistent with the Fed's strong commitment to controlling inflation.

IHS Markit U.S. CPI-U Inflation Forecast



Overall Employment Recovery Strong, But Still Slow in Some Sectors

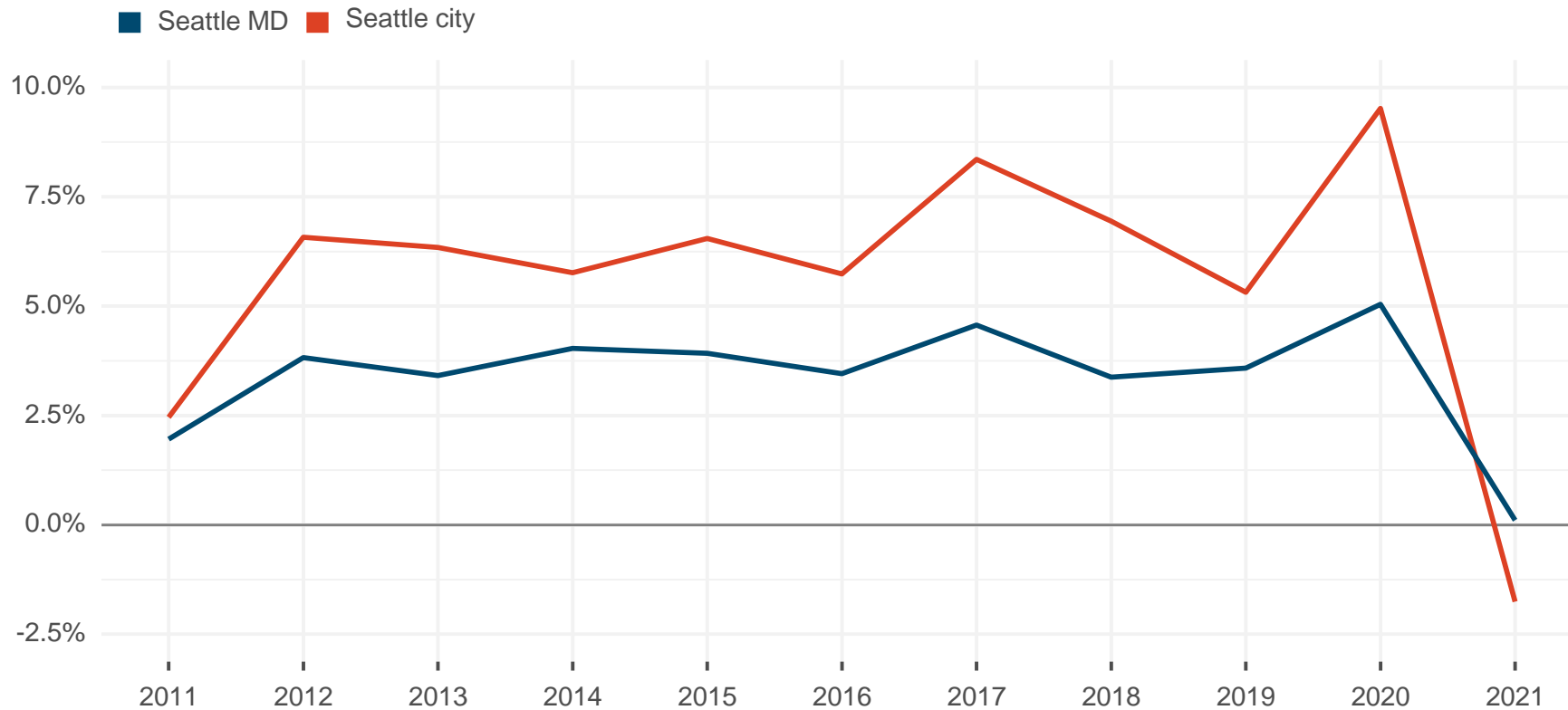
- While inflation has accelerated and GDP has declined over the first half of this year, employment growth remains strong.
- Locally, strong job growth over the past two years has driven total employment to within 1.2% of the levels seen in earlier 2020.
- Nonetheless, the Leisure and Hospitality sector has been slow to recover. Looking forward, the strength of the current summer tourist season should help with continued recovery in this sector.
- By contrast, robust employment growth in the Trade, Information and Professional Services sectors has been a driving force in the region's overall economic recovery.



Job Growth in Technology May be Shifting Away from Seattle

Employment growth for trade, information, professional and business services

March 2011 to March 2021



Source: Puget Sound Regional Council, covered employment in month of March



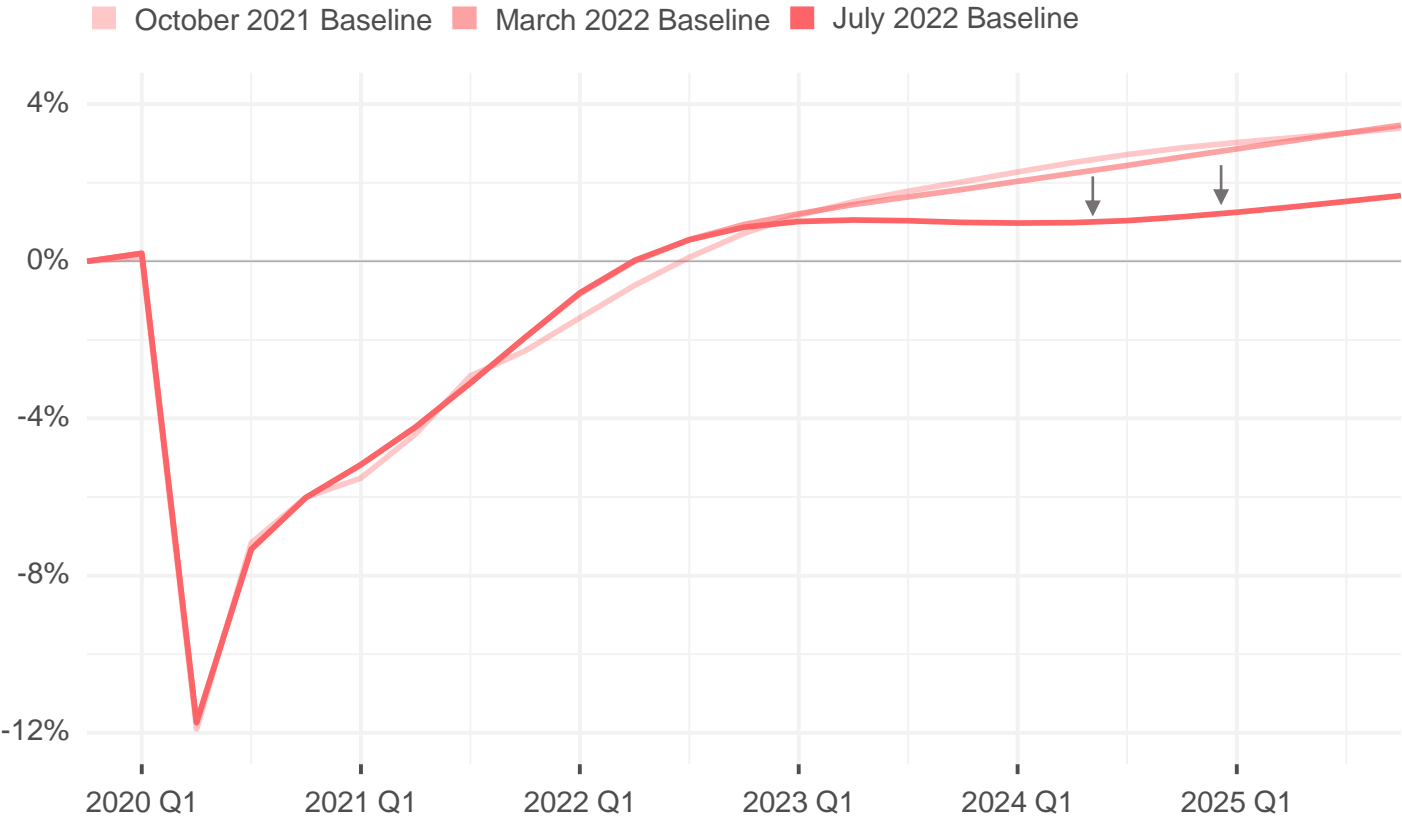
National and Regional Economic Forecasts



Inflation and Fed Response Has Cooled The Overall Economic Outlook

IHS Markit U.S. Employment Forecast

Change from 2019 Q4



- The graph to the left focuses on changes in employment to capture the general trend of the national economy. Other high-level measures of economic activity would show a comparable pattern.
- Between Fall and Spring, there was only a small change in overall economic projections.
- By contrast, the national forecasts produced in July anticipate an extended period of relatively slow growth in employment, and for the overall economy.

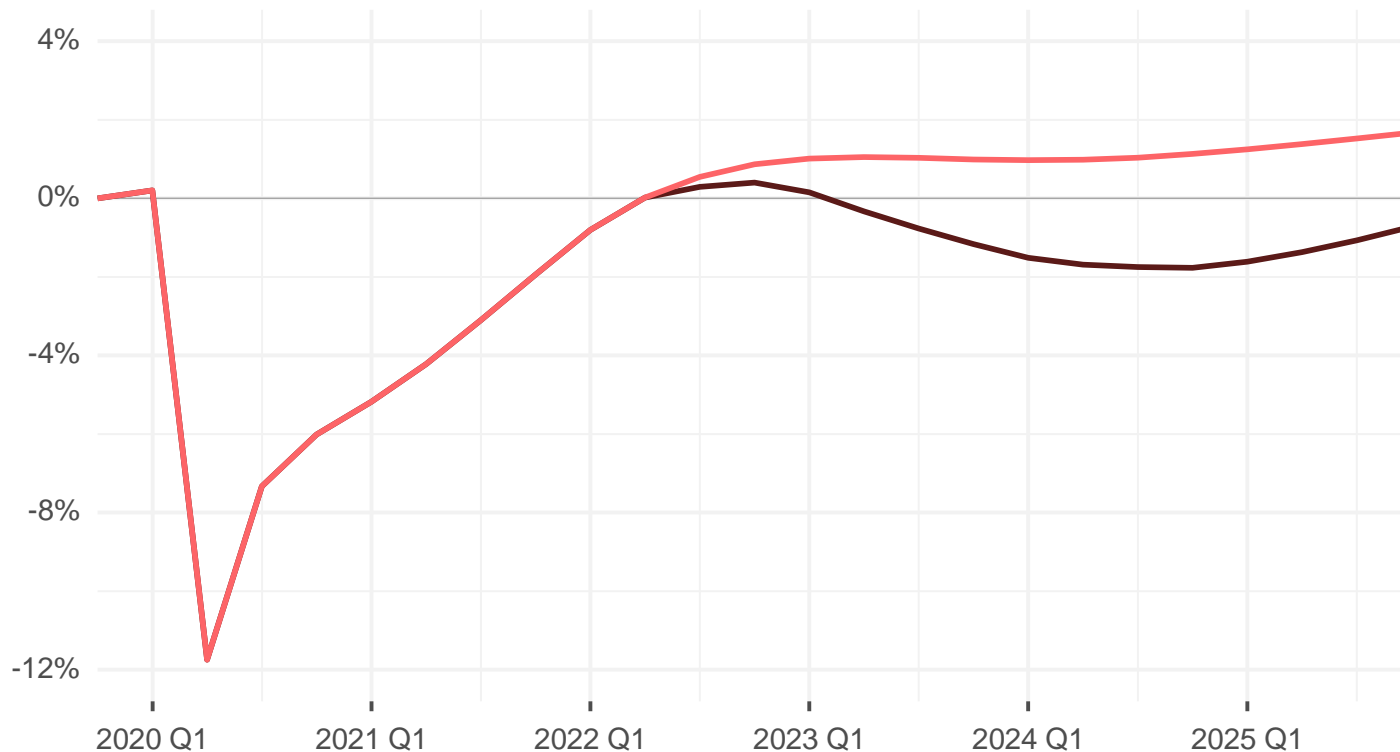


The Revised National Forecast Also Includes Increased Risk of a Recession

IHS Markit U.S. Employment Forecast

Change from 2019 Q4

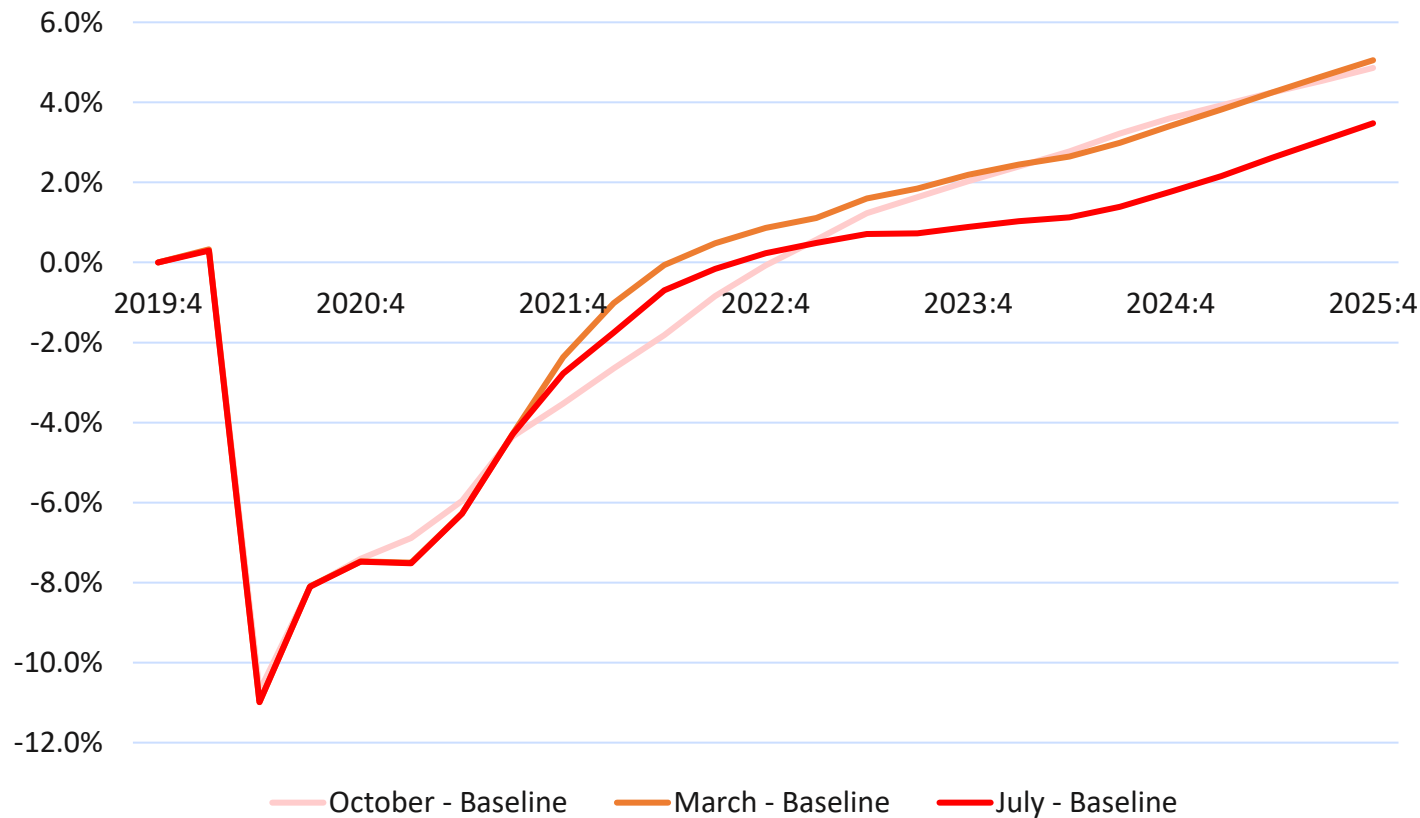
■ July 2022 Baseline ■ July 2022 Pessimistic



- Focusing again on employment as a measure of the overall economy, this graph compares the Baseline and Pessimistic forecast for the national economy.
- The baseline forecast shown here anticipated recent Fed actions and the second quarter GDP decline. Looking forward, the baseline forecast projects a return to GDP growth in the third quarter of this year.
- But the updated pessimistic scenario is consistent with a true recession and would be associated with job losses over the next 2 years. Being notably shallower and shorter, this recession would resemble the 2001 recession more than the Great Recession or the COVID-19 recession.
- The probability assigned to this pessimistic scenario now stands at 45%, compared to 35% in the spring. The probability of the baseline forecast remains at 50%. (And the optimistic scenario at just 5%.)

The Shift in Economic Outlook is Also Seen in the Regional Forecast

**Comparing Regional Employment Forecasts
Change in Employment Since 2019 Q4**



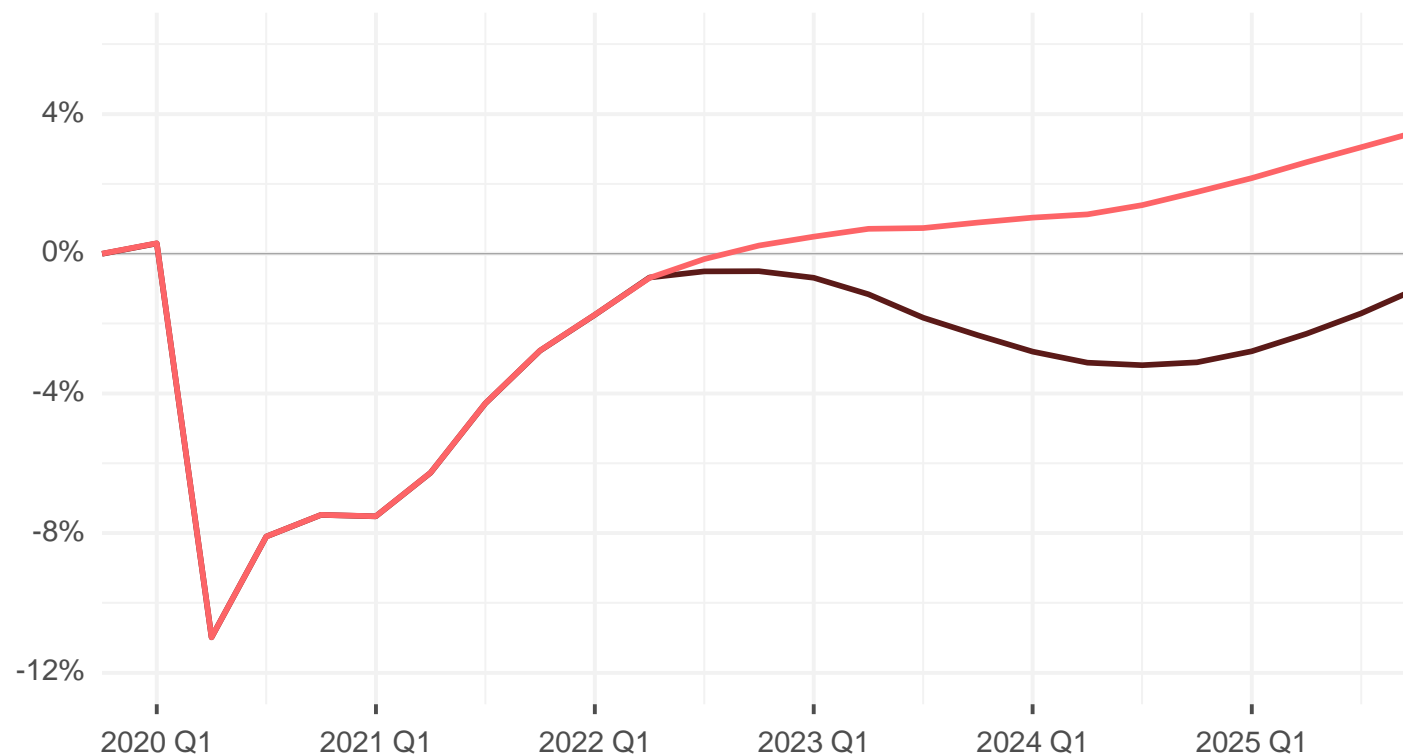
- Focusing again on employment, we can see that the current regional forecast anticipates notably slower job growth than projected in April. And the pattern seen here is also reflected in other measures of regional economic activity.
- Both the general economic uncertainty created by increasing inflation and the Fed's direct steps to control escalating prices are expected to slow the overall level of real economic growth within the region.
- Recent announcements regarding near-term hiring slowdowns at major technology firms are consistent with this expectation.

Pessimistic Forecast Reflects Deeper Decline than Comparable April Projections

Employment Forecast for Seattle MD (King and Snohomish Counties)

Change from 2019 Q4

■ July 2022 Baseline ■ July 2022 Pessimistic



- The revised pessimistic scenario for the regional economy projects a local downturn that would result in significant job losses over the next two years.
- While job growth under the new pessimistic scenario would return in the middle of 2024, the recovery would be slow and current employment levels would not be restored until early 2026.

Economic Scenario Recommendation

- The economy is currently at a delicate balance. Inflation has proven more persistent than initially expected and it is unclear whether prices can be stabilized while the job market remains strong. The increased probability assigned to the pessimistic scenario forecast reflects this uncertainty.
- The Federal Reserve has made reducing inflation its prime policy target and is ready to prioritize controlling long-term price escalation over the potential short-term negative impacts on employment and economic growth.
- That said, the current baseline forecast is consistent with recent economic developments. Prepared before the GDP announcement and Federal Reserve rate increases, the current baseline forecast predicted a second quarter annualized GDP decline of 1.3%. The actual annualized decline was “just” 0.9%. The baseline forecast also correctly anticipated July’s 0.75% increase in the Federal Fund’s rate, and the baseline projection also anticipates further increases going forward.
- The 500,000+ jobs added to the national economy in July demonstrates the continued strength of the labor market. And the just-released inflation data for July shows what may be the first evidence of slowing price escalation.
- The Forecast Office recommended using the baseline economic scenario for the August Forecast, and the Forecast Council concurred with this recommendation at their August 8th meeting. The Forecast Office will continue to closely monitor economic developments and will not wait until the November forecast to raise issues, if conditions should warrant.



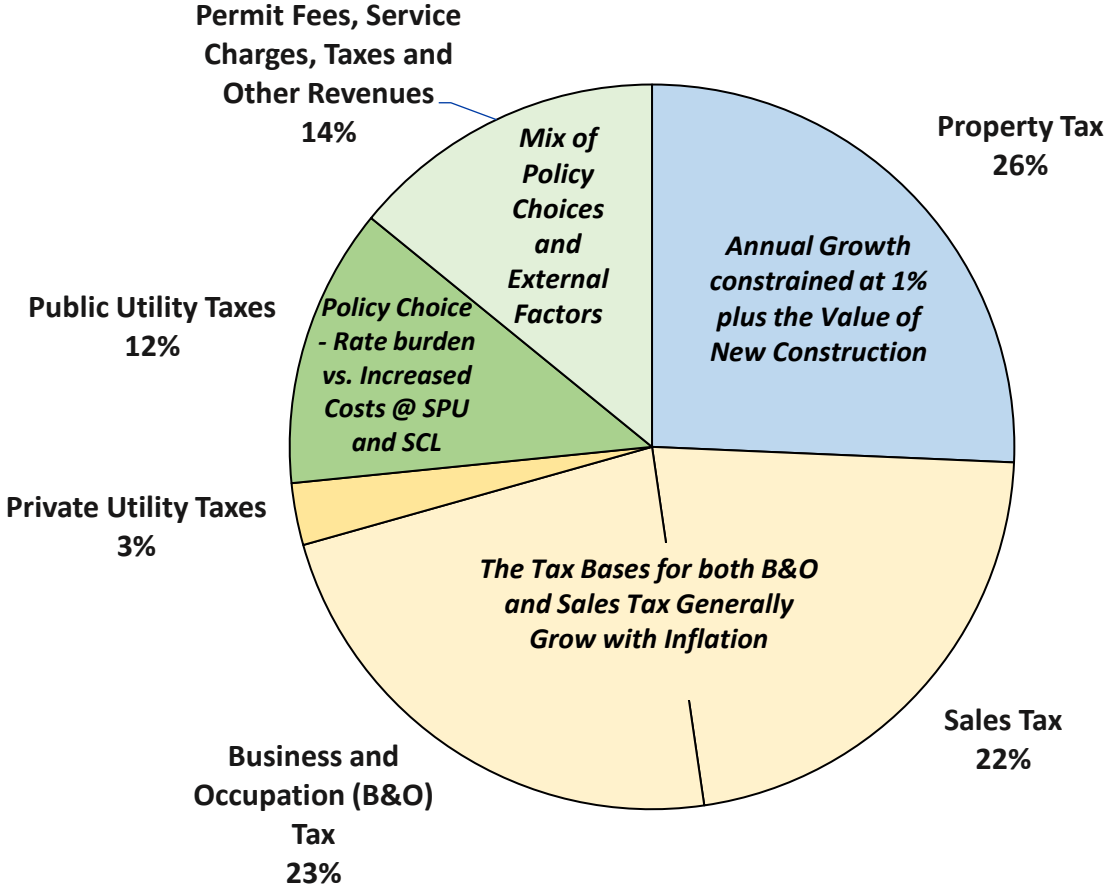
Revenue Update



A High-Inflation Environment Creates Structural Challenges for City Revenues

- Setting aside whether fighting inflation will slow economic growth, the direct impacts of inflation will systematically weaken the purchasing power of General Fund revenues.
- While one might assume that City revenues will generally grow as the prices of goods and services increase, that is not true for all the City’s revenue streams.
- Property tax revenues are statutorily constrained to grow at just 1% plus the value of new construction. They represent 25%+ of total General Fund revenues.
- Furthermore, policy choices about public utility rates and the fees charged for City services could also constrain overall revenue growth.
- And at the same time, inflation will be driving up the costs of all the goods and services the City purchases.

General Fund Revenue and the Impacts of Inflation



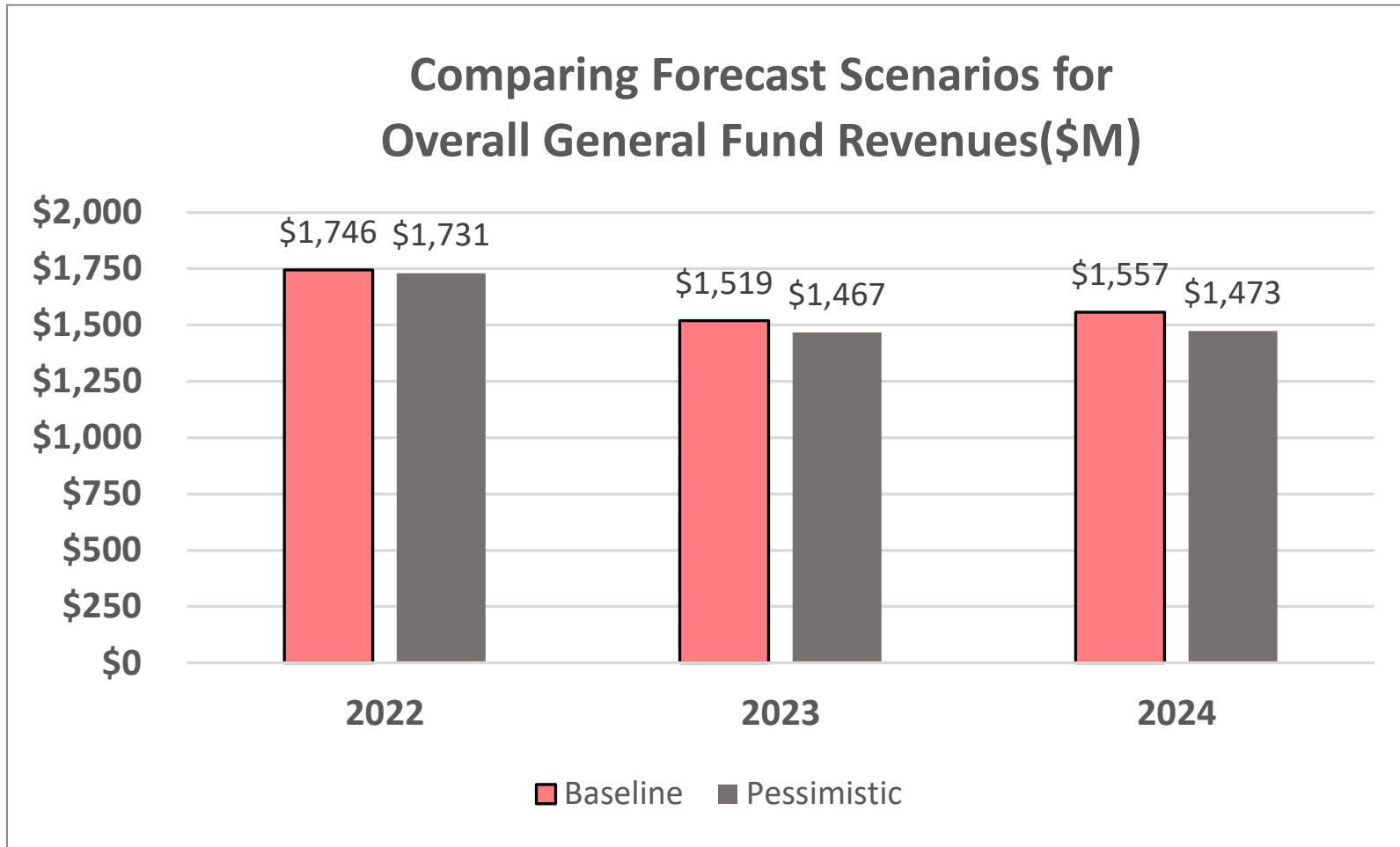
Summary of Revised General Fund Forecast for 2022

Revenue Source	2021 Actuals	2022 - Adopted Budget	2022 - April Forecast	2022 - August Forecast	Diff: August vs. April
Property Tax (Including Medic One Levy)	\$363,690	\$373,770	\$371,600	\$371,630	\$30
Retail Sales Tax	\$299,410	\$303,930	\$318,470	\$326,080	\$7,610
Business & Occupation Tax	\$315,390	\$317,430	\$331,860	\$326,900	(\$4,960)
Utility Tax - Private	\$44,720	\$38,960	\$40,040	\$41,660	\$1,620
Utility Tax - Public	\$169,610	\$178,100	\$180,530	\$179,480	(\$1,050)
Other City Taxes	\$16,880	\$23,380	\$21,230	\$19,240	(\$1,990)
Parking Meters	\$16,510	\$25,600	\$22,330	\$23,850	\$1,520
Court Fines	\$18,610	\$16,090	\$18,430	\$12,810	(\$5,620)
Revenue from Other Public Entities	\$20,880	\$15,550	\$17,050	\$18,360	\$1,310
Grants	\$69,420	\$12,840	\$13,490	\$53,460	\$39,970
Fund Balance Transfers	\$44,680	\$159,590	\$159,590	\$155,230	(\$4,360)
Service Charges & Reimbursements	\$42,840	\$109,810	\$103,350	\$101,630	(\$1,720)
Licenses, Permits, Interest Income and Other	\$72,130	\$70,830	\$73,420	\$73,380	(\$40)
Carry-forward Grants and Legislated Change excluded from April F'cast		\$0	\$40,700	NA	---
Payroll Tax - Late 2021 Payments	N/A	N/A	N/A	\$41,900	\$41,900
Total	\$1,494,770	\$1,645,880	\$1,712,090	\$1,745,610	\$33,520
Annual Growth		10.1%	14.54%	16.8%	

Summary of Revised General Fund Forecasts for 2023 & 2024

Revenue Source	2022 - August Forecast	2023 - April Forecast	2023 - August Forecast	Diff: August vs. April	2024 - April Forecast	2024 - August Forecast	Diff: August vs. April
Property Tax (Including Medic One Levy)	\$371,630	\$382,130	\$381,800	(\$330)	\$387,010	\$388,750	\$1,740
Retail Sales Tax	\$326,080	\$331,740	\$337,480	\$5,740	\$349,720	\$346,230	(\$3,490)
Business & Occupation Tax	\$326,900	\$348,980	\$339,800	(\$9,180)	\$366,980	\$354,110	(\$12,870)
Utility Tax - Private	\$41,660	\$36,050	\$40,750	\$4,700	\$34,110	\$38,050	\$3,940
Utility Tax - Public	\$179,480	\$186,720	\$186,180	(\$540)	\$191,140	\$191,890	\$750
Other City Taxes	\$19,240	\$21,660	\$20,570	(\$1,090)	\$22,640	\$21,530	(\$1,110)
Parking Meters	\$23,850	\$29,460	\$34,630	\$5,170	\$37,220	\$42,120	\$4,900
Court Fines	\$12,810	\$24,080	\$19,760	(\$4,320)	\$28,630	\$24,340	(\$4,290)
Revenue from Other Public Entities	\$18,360	\$18,070	\$18,270	\$200	\$18,210	\$18,540	\$330
Grants	\$53,460	\$28,520	\$22,340	(\$6,180)	\$10,440	\$10,520	\$80
Fund Balance Transfers	\$155,230	\$0	\$2,500	\$2,500	\$0	\$2,500	\$2,500
Service Charges & Reimbursements	\$101,630	\$40,970	\$41,030	\$60	\$43,000	\$42,630	(\$370)
Licenses, Permits, Interest Income & Other	\$73,380	\$77,340	\$74,010	(\$3,330)	\$79,410	\$76,100	(\$3,310)
Payroll Tax - Late 2021 Payments	\$41,900	N/A	N/A	N/A	N/A	N/A	N/A
Total	\$1,745,610	\$1,525,720	\$1,519,120	(\$6,600)	\$1,568,510	\$1,557,310	(\$11,200)
Annual Growth		(10.9%)	(13.0%)		2.8%	2.5%	

Comparing General Fund Totals - Baseline vs. Pessimistic



- The cumulative difference between the Baseline and Pessimistic scenarios over this year and the following biennium (2022,2023, and 2024) is ~\$150 million.

Summary of Selected General Government Revenues for 2022

Revenue Source	2021 Actuals	2022 - Adopted Budget		2022 - April Forecast	2022 - August Forecast	Diff: August vs. April
General Government Revenues:						
Payroll Tax	\$248,100	\$296,250		\$277,490	\$279,640	\$2,150
Admission Tax	\$9,450	\$21,400		\$20,050	\$20,350	\$300
Sweetened Beverage Tax	\$21,240	\$22,860		\$22,190	\$21,770	(\$420)
Short-Term Rental Tax	\$6,050	\$8,370		\$7,920	\$9,050	\$1,130
REET	\$112,180	\$87,810		\$99,720	\$106,600	\$6,880
Transportation-Specific Revenues:						
Trans. Ben. Dist. - Sales & Use Tax	\$37,330	\$49,420		\$49,200	\$51,030	\$1,830
Trans. Ben. Dist. - Vehicle License Fee	\$13,350	\$15,690		\$15,480	\$15,480	\$0
Commercial Parking Tax	\$28,550	\$50,340		\$38,440	\$37,870	(\$570)
SSTPI - Parking Infraction Penalties	\$8,080	\$14,990		\$13,410	\$12,720	(\$690)

Summary of Select General Government Revenue Forecasts for 2023 & 2024

Revenue Source	2022 - August Forecast	2023 - April Forecast	2023 - August Forecast	Diff: August vs. April	2024 - April Forecast	2024 - August Forecast	Diff: August vs. April
General Government Revenues:							
Payroll Tax	\$279,640	\$296,250	\$294,120	(\$2,130)	\$311,970	\$311,470	(\$500)
Admission Tax	\$20,350	\$21,400	\$21,430	\$30	\$22,040	\$22,150	\$110
Sweetened Beverage Tax	\$21,770	\$22,860	\$21,980	(\$880)	\$23,310	\$22,530	(\$780)
Short-Term Rental Tax	\$9,050	\$8,370	\$9,310	\$940	\$8,750	\$9,950	\$1,200
REET	\$106,600	\$87,810	\$94,760	\$6,950	\$82,550	\$94,660	\$12,110
Transportation-Specific Revenues:							
Trans. Ben. Dist. - Sales & Use Tax	\$51,030	\$49,420	\$52,910	\$3,490	\$50,310	\$54,350	\$4,040
Trans. Ben. Dist. - Vehicle License Fee	\$15,480	\$15,690	\$15,690	\$0	\$15,910	\$15,910	\$0
Commercial Parking Tax	\$37,870	\$50,340	\$46,110	(\$4,230)	\$52,620	\$49,130	(\$3,490)
SSTPI - Parking Infraction Penalties	\$12,720	\$14,990	\$14,840	(\$150)	\$14,120	\$14,060	(\$60)



Payroll Expense Tax – What We Know So Far

Who Pays the Tax

- Trade, Information and Professional & Business Services account for more than 88% of the tax receipts for 2021 obligations. This means that revenues are heavily dependent on just three sectors, rather than a diversified tax base.
- For 2021, the tax applied progressively to compensation above \$150,000 paid to employees at businesses with gross receipts of more than \$7 million. In 2022, the comparable figures are \$158,000 and \$7.4 million. The thresholds will increase by 10.1% for next year.
- The measure of the tax is the payroll awarded to employees who work in the City, whether that be from home, or at a Seattle location. Thus, a robust return-to-office would increase the total tax base and we had generally anticipated a faster return.

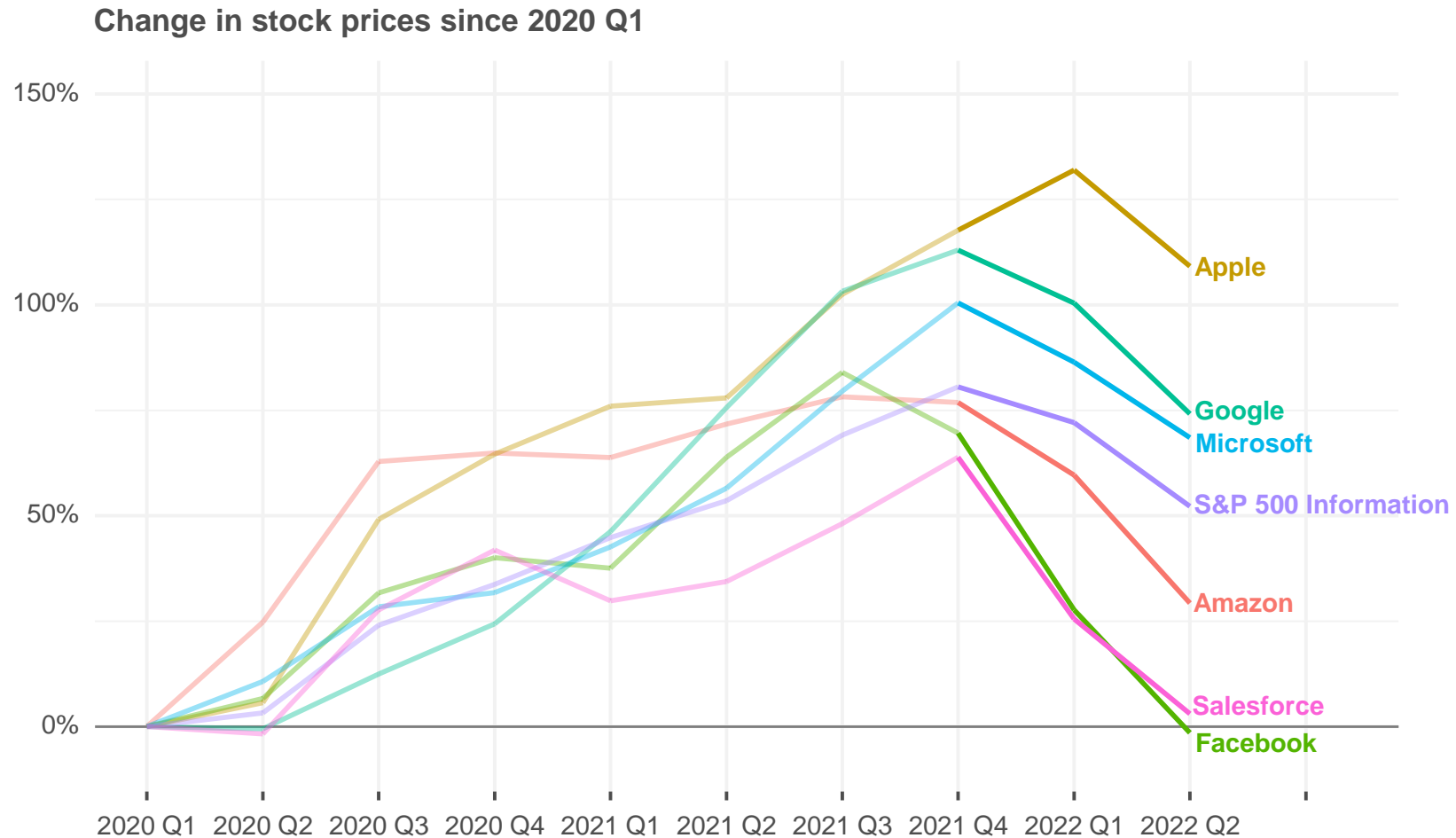
Payments to Date

- Total taxes paid for 2021 are now expected to reach \$290 million. More than \$40 million in delayed 2021 payments have been collected since February of this year.
- For 2021, payments were made one-time, at year end. For 2022, estimated quarterly payments are now required.
- Year-to-date quarterly payments show a pattern of lower estimated tax obligations for many employers. Based on these preliminary second quarter results, some of the larger taxpayers from last year are not on pace to reach their 2021 totals.
- Current payment rates extrapolate to approximately \$260 million in annual revenue, which is below the April 2022 forecast of \$277 million. At the same, historical patterns in payroll data from ESD indicate that more than 50% of total compensation is paid in the second half of the year. Thus, there is good reason to expect that the final total will exceed the a simple “straight-line” extrapolation of current receipts. The final 2022 forecast of just under \$280 million reflects that expectation.
- Looking forward to 2023 and beyond, we are forecasting somewhat slower growth in the coming years anticipating that less of the overall regional job growth in the technology and related sector will be concentrated specifically in the city.



Potential Explanations for Lower Payroll Expense Tax 2022 Payments

- A significant share of compensation at many technology firms comes as stock grants. The Payroll Expense Tax is thus likely to be much more volatile than sale tax or B&O tax.
- Tech stock prices have declined significantly in 2022, after a strong performance in 2021.
- In addition, firms choose one of two methodologies in determining tax obligations: (i) where workers are “primarily assigned”; or (ii) the share of hours worked in Seattle.
- More firms are using the hours worked approach this year, which may reflect expectation that work from home will continue.



Source: Yahoo Finance

Questions?
