Economic and Revenue Update

May 17, 2023

Office of Economic and Revenue Forecasts

&

City Budget Office

Presentation Outline

This presentation is largely an abbreviated version of that provided to the Forecast Council on April 10th.
However, it concludes with some observations about how the economy has evolved over the last 30 days.

Part I: Update on economic developments since the November Forecast – recent and current events

Part II: Revised Economic Forecasts – looking forward to what is expected to come

- National Economy – summary of results from IHS Markit's national economic model
- Regional Economy – summary of results from the Forecast Office's regional economic model

Part III: April Revenue Forecast – General Fund and other major revenue sources

- General Fund Revenues
- Non-GF "General Government" Revenues – including JumpStart Payroll Tax and REET
- Non-GF Transportation Revenues

Part IV: Observations about Recent Economic Developments

Part 1

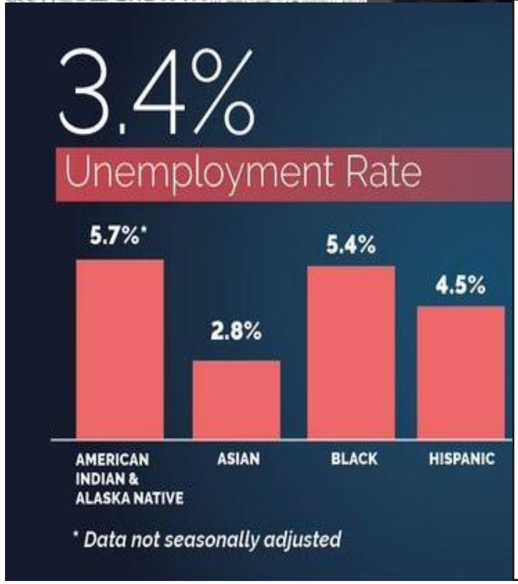
Economic Update – Recent Developments

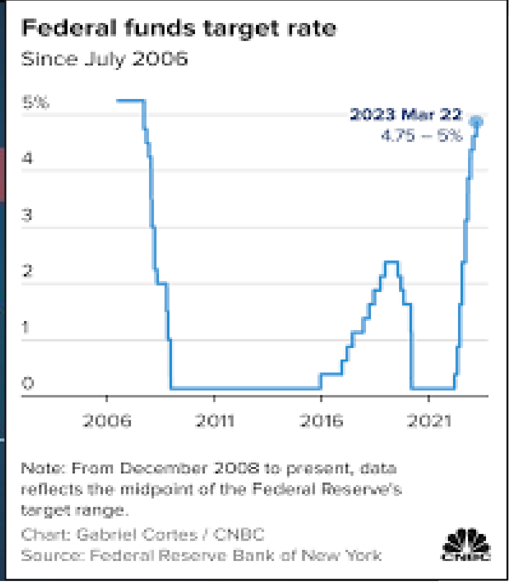
National Outlook Has Improved Since the Last Forecast, But Risks Remain . . .

- Recent job growth has been more modest than in first half of 2022, but still strong. From November through March, national job growth averaged just over 300K per month. The general consensus is that the job growth is currently constrained by the available supply of workers.

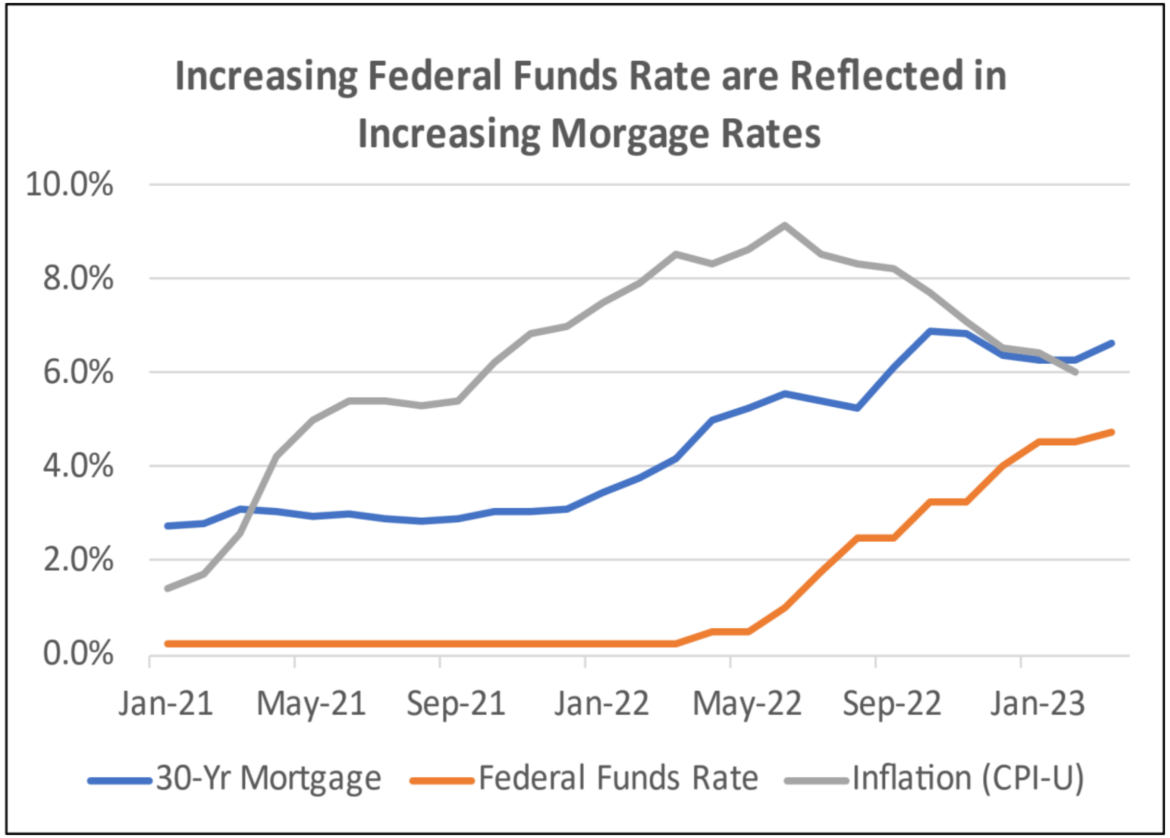
- In October of last year, annual inflation was still running at 7.7%. It had fallen from its peak of 9.1% in June, but was still quite high. As of February, inflation was down to 6.0%. Perhaps more importantly, this marked the eight consecutive month that inflation declined, and the rate is now at its lowest level since September of 2021.

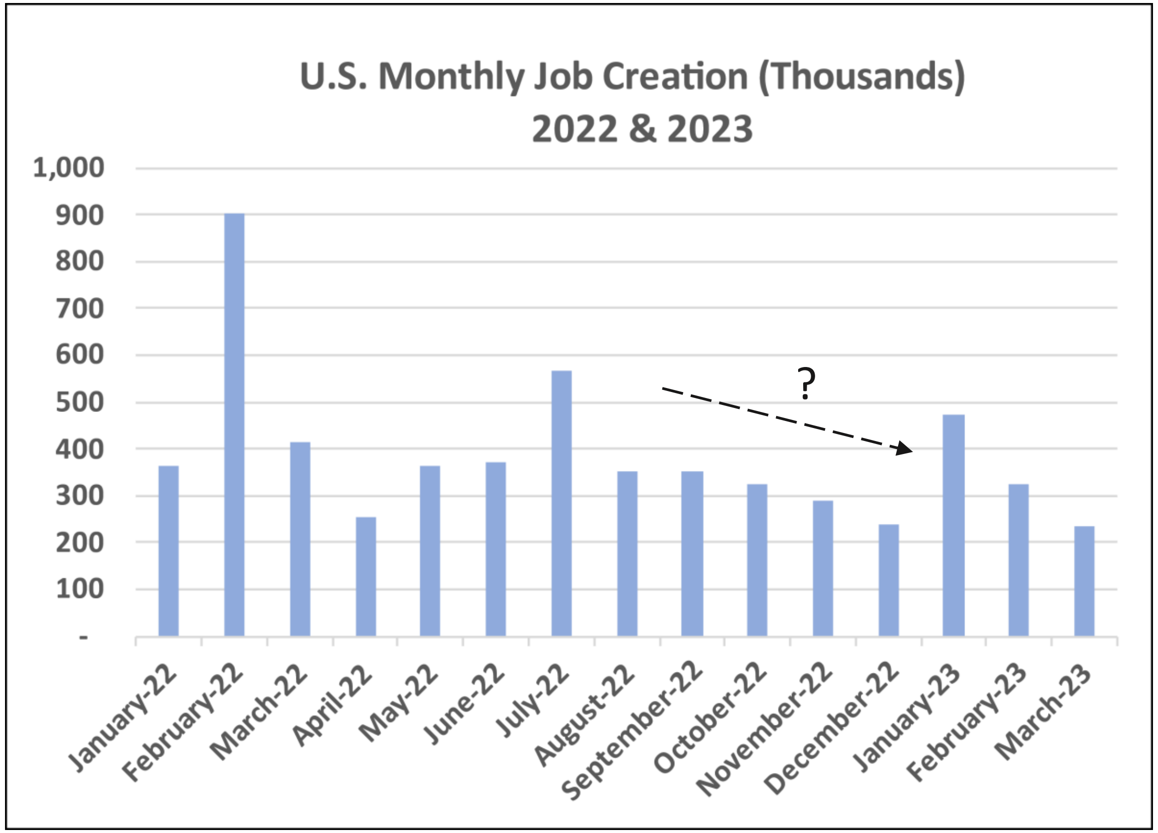
- This all said, risks remain:
  - The failure of SVB and Signature banks have highlighted significant financial stress in the banking system. This could affect access to capital and also reduce overall consumer confidence in the economy.
  - Higher interest rates have dramatically slowed real estate market activity, and tightening will slow business investment as well.
  - The “tight” labor market will continue to put upward pressure on wages, which in turn could drive a longer-term pattern of inflation.
  - Forecasts assume that congress will raise the debt ceiling. If not . . .





Federal Reserve Actions are Having An Impact on the Economy





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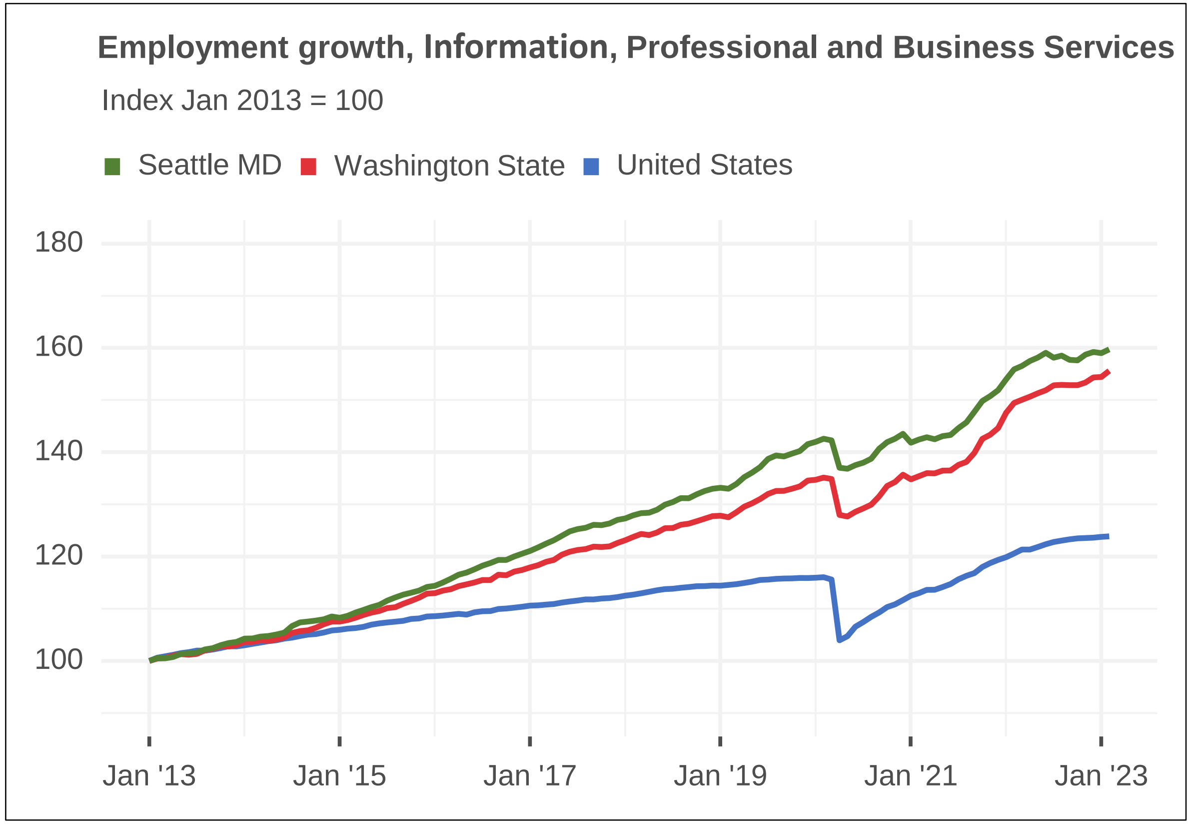
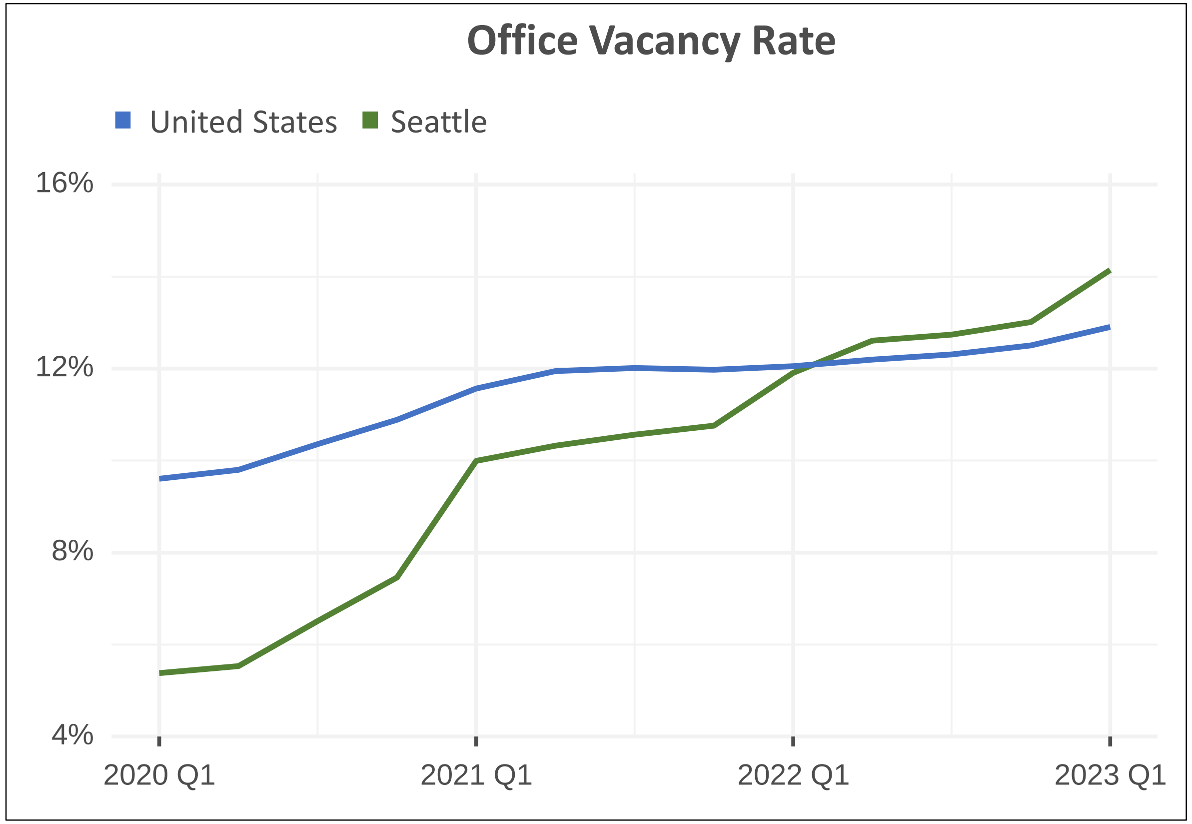
Recent Developments Also Highlight Risks Specific to the Local Economy





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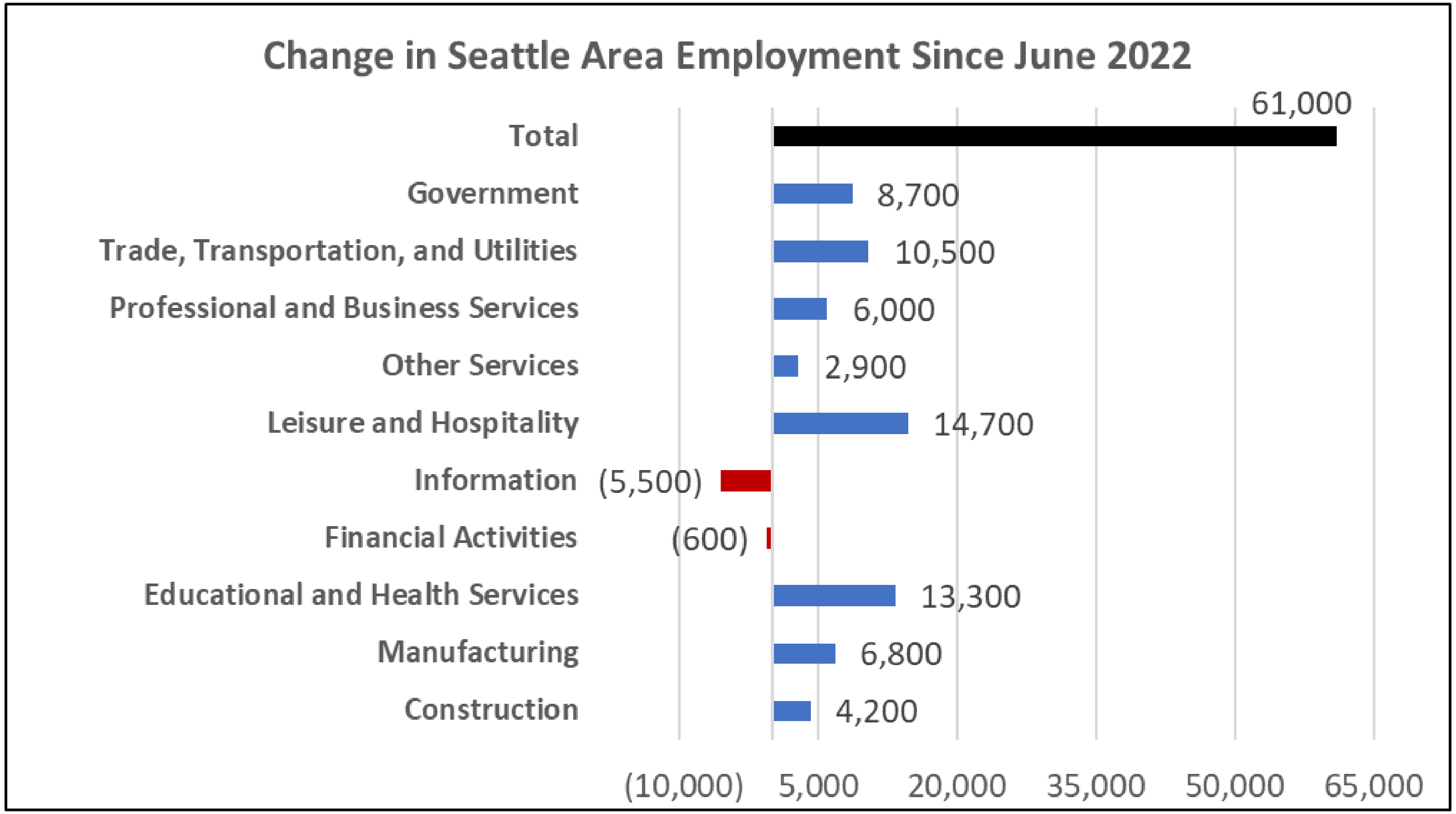
Regional Employment Trends Vary Significantly by Sector

- The regional economy has added almost 61,000 jobs (3.5% growth) since June of last year.
- “Leisure & Hospitality” and “Educational and Health Services” have shown particular strength.
- In contrast, layoffs in the tech sector are reflected in job losses within “Information”, and the relatively smaller contribution of “Professional and Business Services”. These two sectors had driven employment gains over the previous 2 years.
- The impacts of increasing interest rates, and the resulting drop of credit-financed investments, is reflected in the loss of jobs in the “Financial Activities” sector.



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Part 2

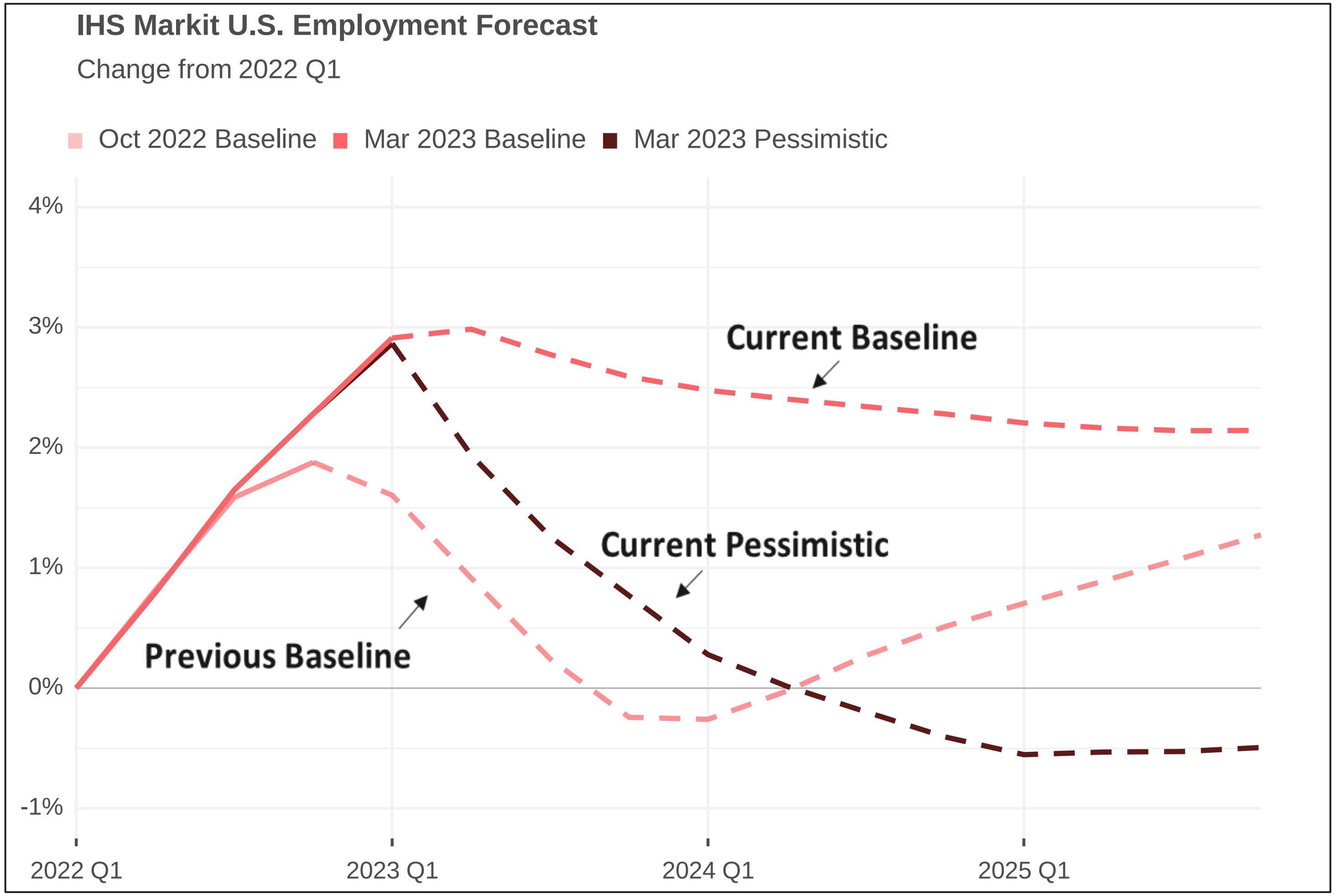
National and Regional Economic Forecasts - Looking Forward

Baseline National Forecast Anticipated a “Soft Landing”

- IHS Markit baseline forecast predicted an extended period of slow growth at the national level, but not a recession. Note that the forecast used for the April update was prepared before the recent banking sector turmoil.

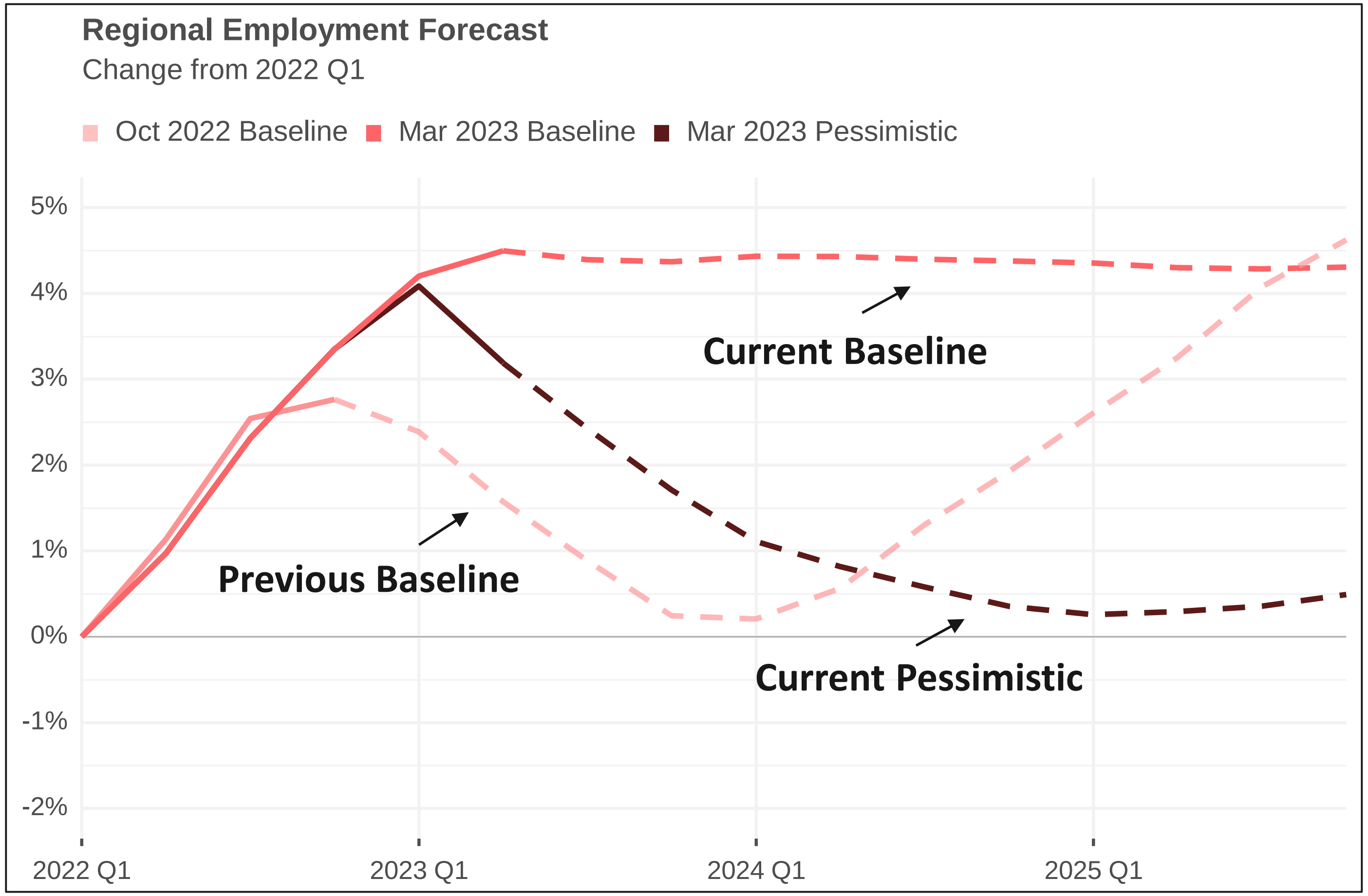
- The phrase “slow-cession” has been used to characterize this forecast. The baseline forecast was consistent with the Fed’s goal of a “soft landing” - cooling the economy w/o causing a recession.

- However, note that the IHS’s pessimistic forecast, to which they assigned a probability of 25%, anticipated a significant employment decline in 2023 employment, and tepid growth in 2024 and beyond. In this scenario, unemployment would peak at 6.1%, compared to 4.5% in the baseline scenario.



Regional Forecast: Stronger Near-Term, Weaker Long-Term

- Consistent with the national forecast, the near-term regional forecast reflects unexpectedly strong job growth in the first quarter of 2023.
- Rather than a short, mild recession as was forecast in November, the current baseline forecast anticipates that employment levels will grow into the 2nd Qrtr of this year before reaching a level that will be sustained for the next 2-3 yrs.
- Looking forward, employment is expected to grow in some sectors, but job reductions in areas such as information and construction will offset these anticipated gains. The net impact will be almost no gain in employment until 2026.
- The pessimistic forecast represents a shift into a short and mild recession that would nevertheless wipe out nearly all of last year's job gains.



Part 3: Revenue Forecast

General Fund Revenues – 2023 and 2024 ($ '000)

	2022	2023			2024			Total
Revenue Source	**2022 Actuals**	**2023 - Adopted Budget**	**2023 - April Forecast**	**Diff: April vs. Adopted**	**2024 - Endorsed Budget**	**2024 - April Forecast**	**Diff: April vs. Endorsed**	**2-Year Total Difference**
Property Tax (Including Medic One Levy)	$371,770	$380,477	$378,210	($2,267)	$386,627	$383,428	($3,199)	**($5,466)**
Retail Sales Tax	$331,220	$332,994	$343,794	$10,800	$339,827	$344,692	$4,865	**$15,665**
Business & Occupation Tax	$331,580	$334,960	$353,735	$18,775	$344,132	$364,886	$20,754	**$39,529**
Utility Tax - Private	$41,850	$40,924	$42,134	$1,210	$38,190	$39,249	$1,059	**$2,269**
Utility Tax - Public	$192,850	$191,149	$191,910	$761	$196,958	$198,416	$1,458	**$2,219**
Other City Taxes	$14,540	$13,959	$13,662	($297)	$14,838	$13,529	($1,309)	**($1,606)**
Parking Meters	$23,860	$37,957	$36,927	($1,030)	$44,463	$43,339	($1,124)	**($2,154)**
Court Fines	$13,220	$19,747	$14,695	($5,052)	$24,330	$16,523	($7,807)	**($12,859)**
Revenue from Other Public Entities	$18,640	$18,494	$19,494	$1,000	$18,761	$19,151	$390	**$1,390**
Grants	$23,120	$23,414	$51,300	$27,886	$10,927	$12,691	$1,764	**$29,650**
Fund Balance Transfers	$151,010	$111,008	$117,260	$6,252	$94,700	$94,700	$0	**$6,252**
Service Charges & Reimbursements	$132,530	$69,778	$69,810	$32	$71,899	$70,106	($1,793)	**($1,761)**
Licenses, Permits, Interest Income and Other	$50,940	$48,588	$62,840	$14,252	$48,858	$59,585	$10,727	**$24,979**
Payroll Tax - Late 2021 Payments	$44,980	$0	$2,164	$2,164	$0	$0	$0	$2,164
Total	**$1,742,110**	**$1,623,449**	**$1,697,935**	**$74,486**	**$1,634,510**	**$1,660,295**	**$25,785**	**$100,271**
Difference w/o Grants				**$46,600**			**$24,021**	**$70,621**

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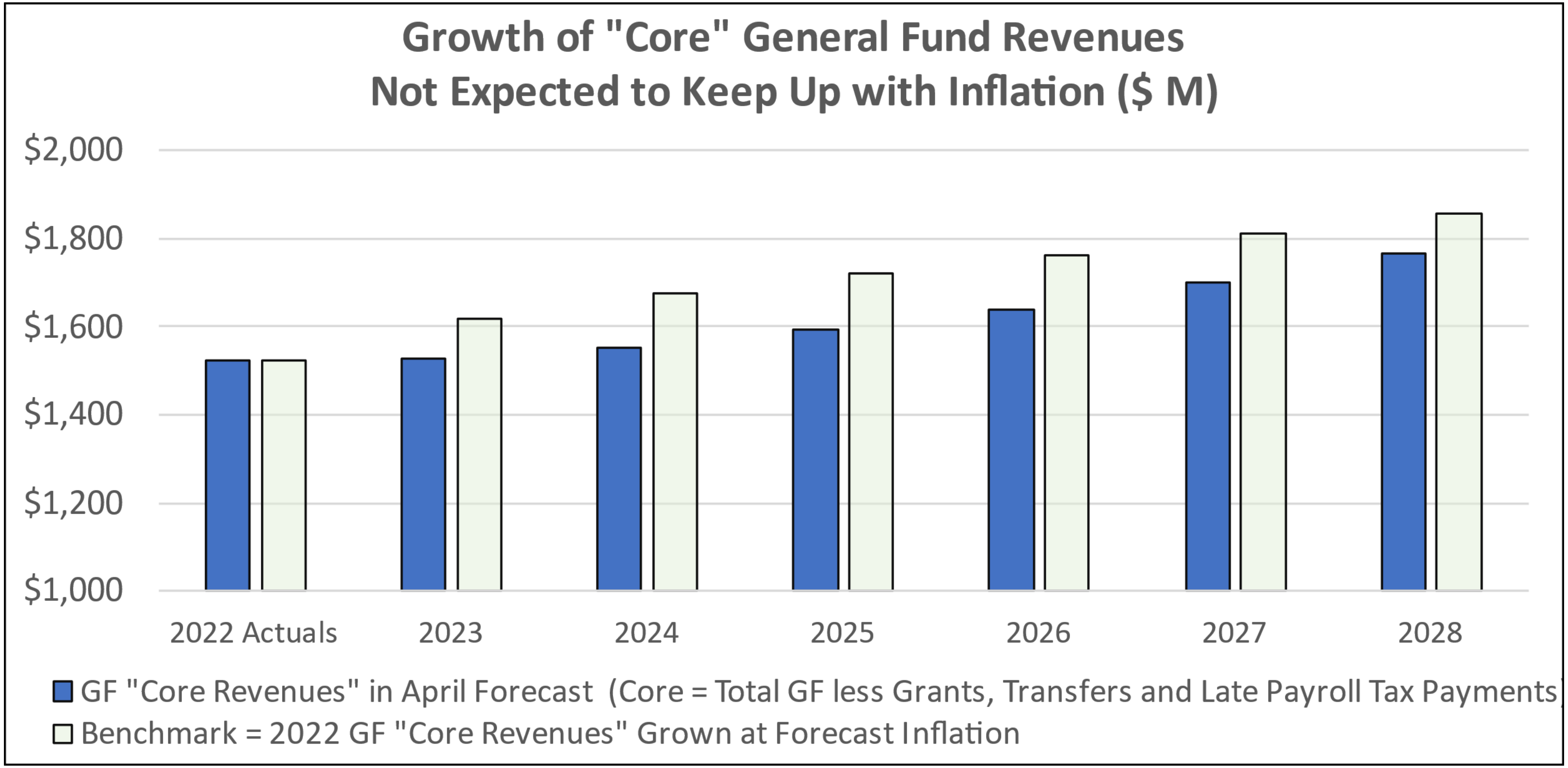
Long-Term Forecast of “Core” General Fund Revenues



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Summary of Selected General Government Revenues

	2022		2023				2024			Total
Revenue Source	**2022 Actuals**		**2023 - Adopted Budget**	**2023 - April Forecast**	**Diff: April vs. Adopted**		**2024 - Endorsed Budget**	**2024 - April Forecast**	**Diff: April vs. Endorsed**	**2-Year Total Difference**
General Government Revenues:										
Payroll Tax^	$253,060		$294,120	$263,260	($30,860)		$311,466	$279,740	($31,726)	**($62,586)**
Admission Tax*	$21,650		$21,430	$22,020	$590		$22,153	$22,820	$667	**$1,257**
Sweetened Beverage Tax	$20,240		$20,390	$20,930	$540		$20,700	$21,247	$547	**$1,087**
Short-Term Rental Tax	$9,870		$9,430	$10,290	$860		$10,077	$11,374	$1,297	**$2,157**
REET	$91,420		$68,060	$55,020	($13,040)		$68,646	$59,962	($8,684)	**($21,724)**
Transportation-Specific Revenues:										
Trans. Ben. Dist. - Sales & Use Tax	$51,950		$52,250	$53,780	$1,530		$53,359	$53,881	$522	**$2,052**
Trans. Ben. Dist. - Vehicle License Fee	$15,980		$17,650	$18,260	$610		$19,890	$20,615	$725	**$1,335**
Commercial Parking Tax	$37,660		$45,030	$48,380	$3,350		$47,051	$47,276	$225	**$3,575**
SSTPI - School Zone Speed Enforcement	$8,470		$14,840	$11,270	($3,570)		$14,061	$11,050	($3,011)	**($6,581)**

^ This represents the total of 2022 tax obligations. And additional $45M of late 2021 payments were deposited in the GF in 2022, per City ordinance which directs all 2021 obligations to the GF.
*A change in share or Ad Tax revenue generated at Climate Pledge Arena, increases the revenue available to the City by ~$900K in 2023 and $1.5M in 2024.

JumpStart Payroll Expense Tax Forecast

Key Observations

- Actual revenues fell from $293M in 2021 to $253M in 2022. The November forecast for 2023 revenues was $294M.
- The majority of revenues are generated from relatively few firms, concentrated in the technology sector. This sector has been significantly affected by the shift to hybrid work, and is also one where a significant share of compensation is tied to stock values.
- Although the available data are limited, an empirical analysis shows a correlation between tax payments and two key factors: (i) changing stock values; and (ii) evolving "work-from-home" practices.
- The Forecast Office continues to work with ESD and Seattle IT to develop a data-sharing agreement that will significantly enhance the econometric tools we can deploy for the JumpStart Payroll Tax forecasts.

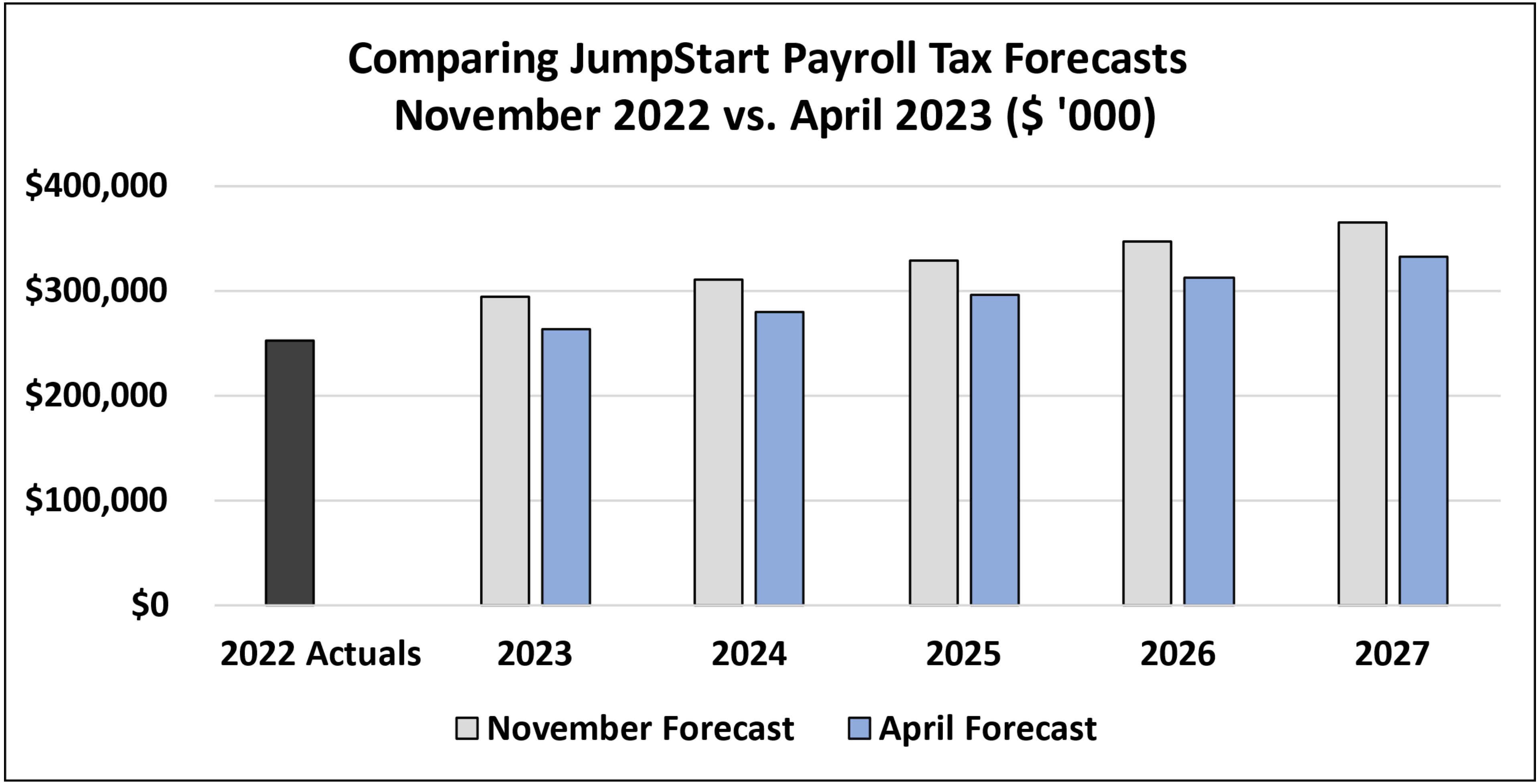
Forecasting Approach

- Estimated a model that formally links revenues to both stock values and in-office head counts.
- Forecasts then require a prediction of both stock value and work-from-home practices. Stock value estimates have been derived from a range of stock analyst forecasts, and office head counts from recently observed behavior.
- These inputs were used to develop the 2023 forecasts. For 2024 and beyond, the 2023 base is predicted to increase at a rate equal to payroll growth in the "Information" and "Business & Professional Services" sectors, as forecast in our regional economic model.

Results

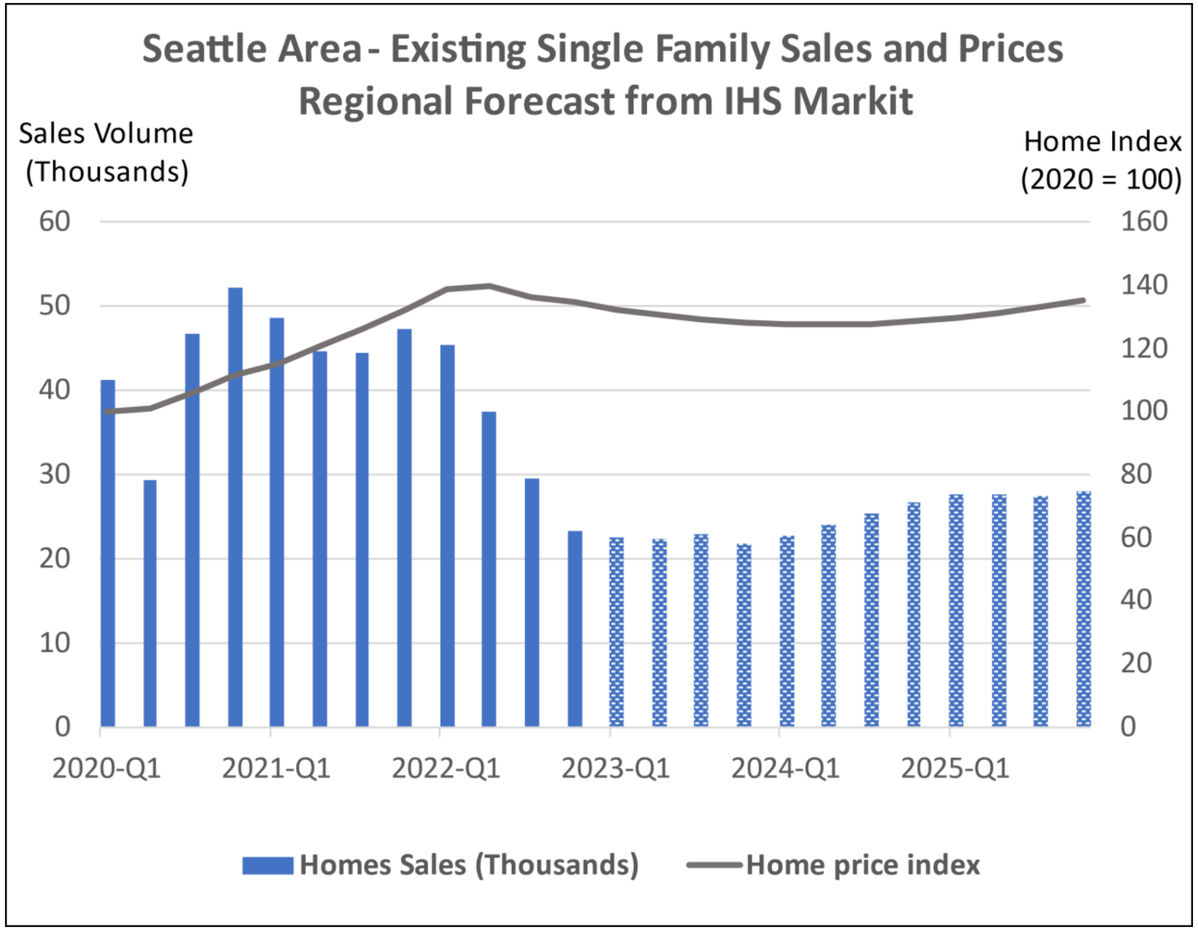
- The revised forecast 2023 forecast is $263M, which is obviously a significant reduction from the $294M previously forecast. The 2024 forecast has been reduced from $311M to $280M.

Long-Term Forecast of JumpStart Payroll Tax Revenues



Understanding the Downward Revision in the REET Forecast

- Increased interest rates have reduced the volume and value of both residential and commercial real estate transactions.
- Commercial transactions have also been affected by uncertainty in the market for office space. No building worth more than $100M has sold since last summer.
- REET revenues fell dramatically in the latter part of last year, leading to a downward revision of the 2023 forecast from $95M to $68M, as part of the November revenue update.
- Per the chart to the right, the volume of residential sales is not expected to rebound significantly within the next three years, even as prices hold relatively steady.
- In addition, the initial results for January, February, and March have fallen short of the revised November forecast.
- Both the State and County revenue updates include significant reductions in their REET forecasts.



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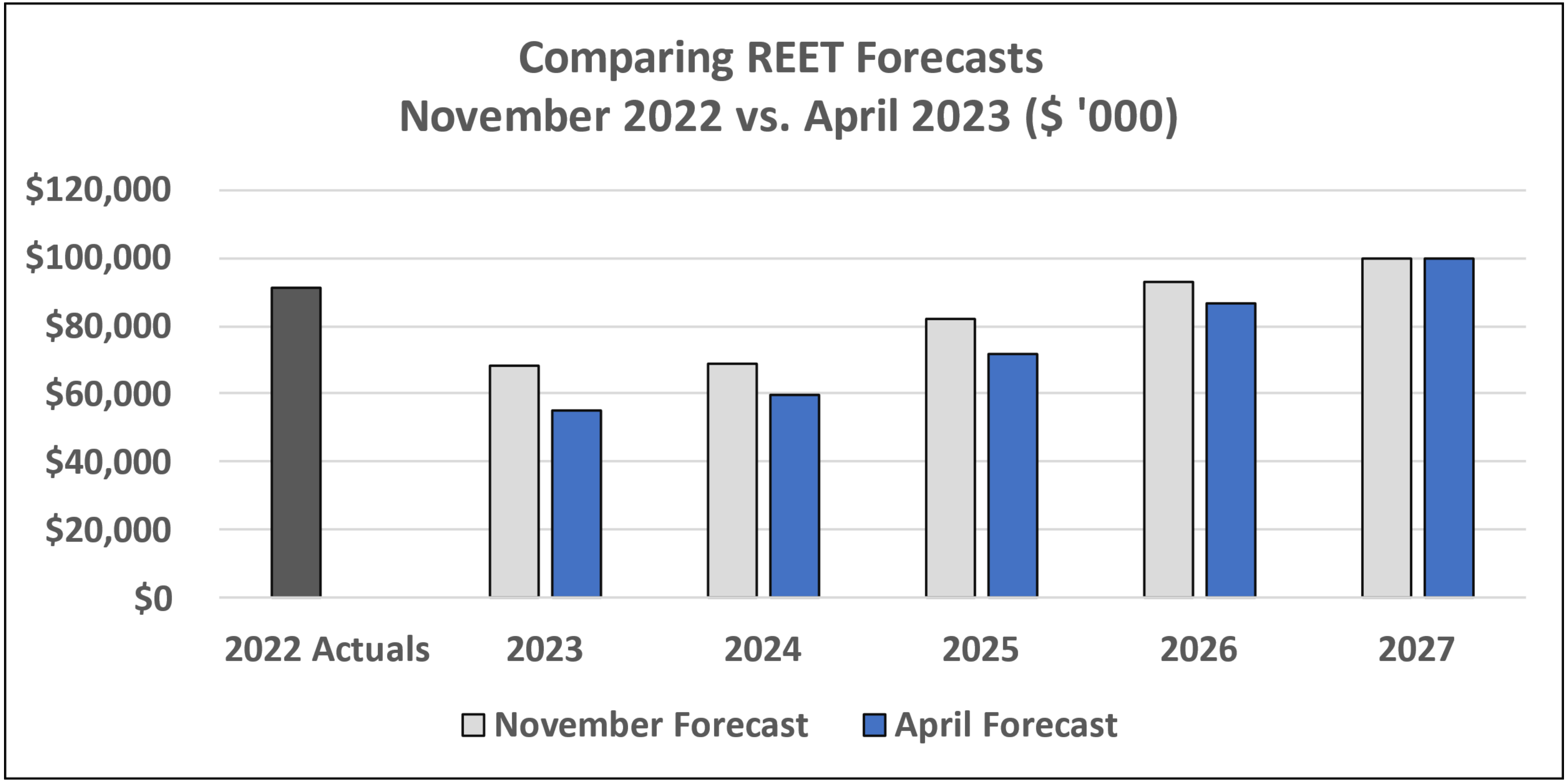
Long-Term Forecast of REET Revenues



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Part IV: Recent Economic Developments

- Turmoil in the banking sector – particularly among “regional” banks – has reignited after being calmed initially. This will likely further limit access to capital (borrowing) and create a further drag on economic growth.

- As anticipated (but not necessarily desired), the Federal Reserve increased in May its benchmark rate by 0.25% to a target range of 5%-5.25%.

- National GDP growth for the first quarter of 2023 was measured at an annualized rate of 1%. This outpaced the forecast decline of 0.4% that underlies the April forecasting models. While not entirely consistent with the forecast, 1% growth does reflect a slowing relative to the 2.1% annual growth seen in 2022.

- The US economy added 253,000 jobs in April, the most since January. This is good news at one level, but further complicates the Fed’s effort to cool inflation while also maintaining stability in the financial markets.

On net, the economy remained strong through the first quarter, but persistent inflation and financial market instability represent significant risks going forward.

Questions?