LFA
Legislative Fiscal Analyst

UTAH LEGISLATURE JUNE 2016

REVENUE UPDATE

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PART A: TAX COLLECTIONS

Utah's revenue is expected to grow by 3.0 percent between FY 2015 and FY 2016. We anticipate collections will be very close to the established target. However, there is some downside risk to the forecast: corporate tax is weak and income tax refunds have been more than anticipated, drawing down income tax revenue. Severance tax remains sluggish. Sales tax is growing moderately in light of the relatively stronger employment picture.

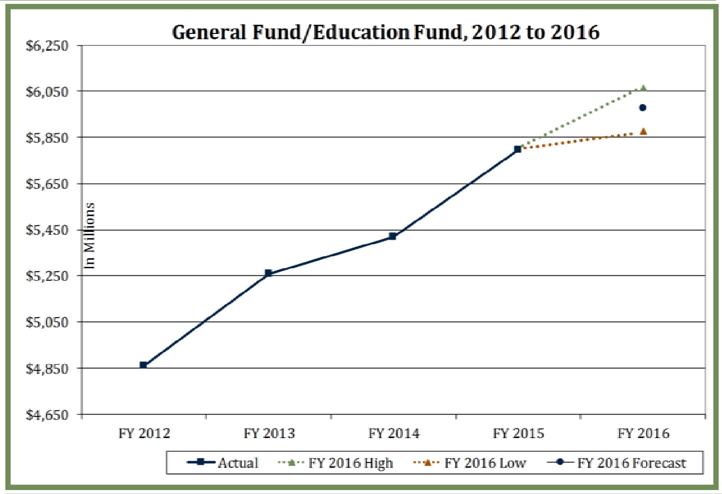
Given current collections and consensus indicators developed by the Revenue Assumptions Working Group, we anticipate FY 2016 General and Education Fund revenues will be in the range of $100.0 million below to $85.0 million above May Executive Appropriations targets. We expect the Transportation Fund to be $5.0 million below to $15.0 million above the May target.

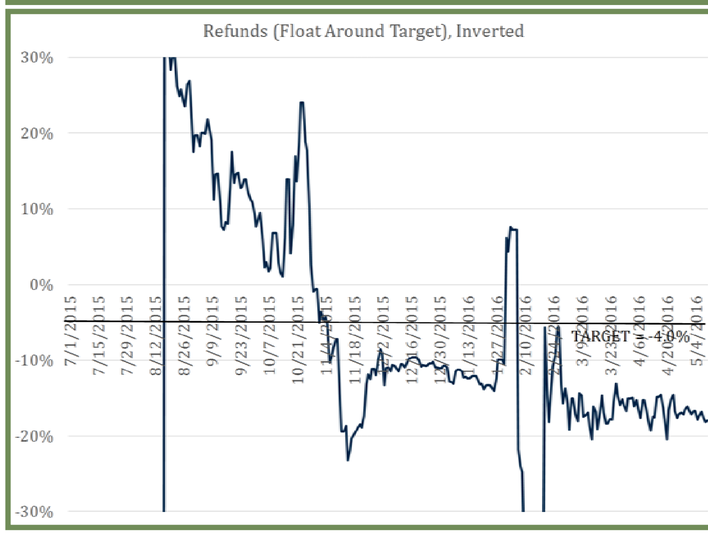
The current forecast assumes moderately strong growth in several key areas such as employment, wages, construction, and taxable sales. Factors that may influence the direction and magnitude of economic growth in the coming quarters include business investment, household formation, wage growth, commodity prices, interest rates, growth in China and other emerging market economies, equity markets, business and consumer confidence, and other unforeseen events. At the same time, current collections are not keeping pace with expectations.

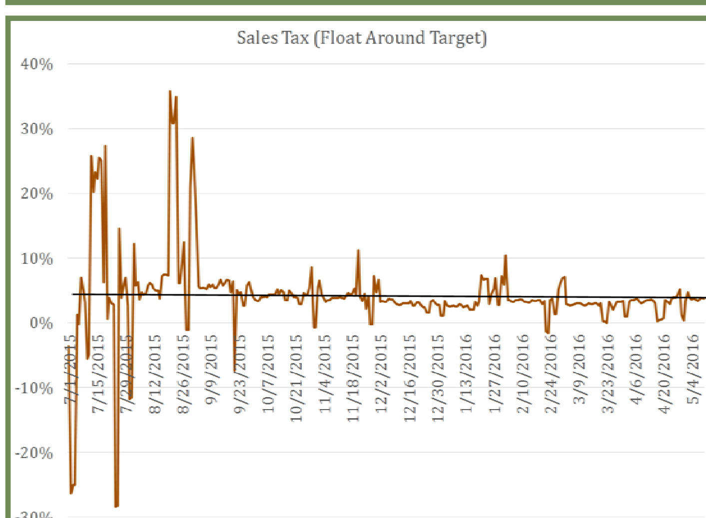
Through the first half of FY 2016, income tax refunds were running well behind the prior fiscal year. That changed when the October filings started showing up with higher than normal refunds. Refunds have continued on this path for the remainder of the fiscal year, currently floating at around 17.0 percent more than last year's amount. The jump in growth is not anticipated to occur again in the coming year, although refunds are anticipated to come in above their current level. Corporate income tax is also down. The weak corporate profits picture stems from the national corporate earnings recession in the past few quarters. In 2016, corporate profits are anticipated to be down 3.0 percent.

On sales tax, although online sales have been a continued focus, it is not one of the largest factors behind the current moderately positive growth picture. The largest drivers behind sales tax growth moderation are low inflation ($38.0 million), abnormally weak business investment ($35.0 million), and relatively subdued wage growth ($32.0 million). Growth in online sales comes in after these three at $16.0 million for FY 2016. Looking towards the 2016 calendar year, taxable sales are expected be up 5.0 percent.

Severance taxes are also quite weak, as the oil and natural gas recession works its way into revenues. Behind the decline in oil and gas severance taxes is the depressed prices and production of oil and natural gas for most of FY 2016. We anticipate further weakness through 2016 of -13.0 percent (oil) and –18.0 percent (natural gas).







A1

General Fund

A2

Education Fund

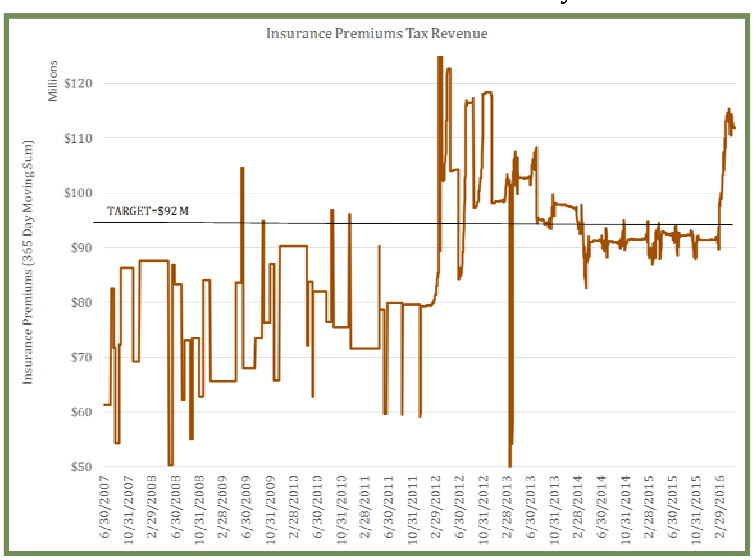
The General Fund is expected to end FY 2016 between $35.0 million below to $50.0 million above the latest revenue target.

The downside risk to the General Fund forecast is largely due to sales tax and severance taxes. Revenue from oil and gas severance taxes and sales taxes depend upon the price of oil, natural gas, and inflation in general. When prices are high, nominal revenue is higher. However, because prices were low for most of FY 2016, revenue growth has been sluggish.

Sales tax is experiencing only moderately strong growth for at least four reasons. First, compared to high points of prior two economic expansions, consumer inflation is about 1.5 percent low for this point of the economic cycle. The 1.5 percent equates to about $38.0 million in forgone sales tax revenue. Second, business investment is abnormally weak. The weakness equates to $35.0 million in missing sales tax revenue. Third, wage growth is also slow for this point in the economic cycle. The 1.2 percent wage sluggishness equates to about $32.0 million in forgone sales tax revenue. Fourth, the growth in online sales may forgo about $16.0 million in sales tax revenue in 2016.

Unfavorable factors to sales tax revenue growth	
Low inflation	$38 M
Weak business investment	$35 M
Weak wage growth	$32 M
Growth in online sales	$16 M

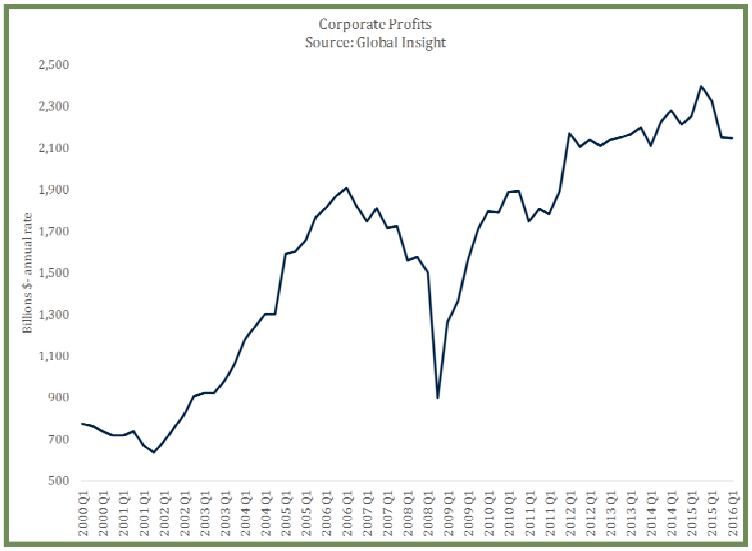
On the up side, insurance premiums appear to be growing well above targets and based on current trends could come in $10.0 million to $20.0 million above estimates. Although as the economy grows premiums tend to grow because they are based in most cases on total sales volume, this year's over-performance also stems from prior year and current year reclassification of certain deposits due to tax software changes. Early indications are that the reclassification will probably only slightly reduce the allocation to the General Fund in the current year.

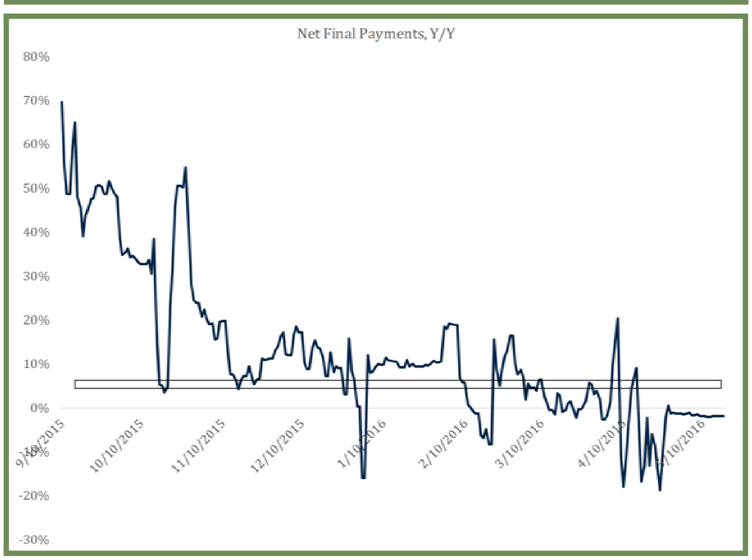


The Education Fund is expected to end FY 2016 within a range of $65.0 million below to $35.0 million above the May target.

Every year there are two revenue bumps in April's gross final payments, one from individual income tax payments and the second from corporate income tax payments. This year indications prior to April looked strong on the individual tax side. However, when revenues were calculated in April after the time most final payments typically get posted, the revenue picture came in weaker than expected. Overall, gross final payments and withholding came in moderately strong. The largest factor behind the income tax weakness is refunds. Rather than growing moderately like they had been in previous fiscal years (around $400.0 million), refunds will likely end the fiscal year with growth between 15.0 percent and 20.0 percent, decreasing individual income tax revenue by around $60.0 million.

Corporate profits are also weaker than anticipated as a stronger dollar and diminished revenue growth soured the past few quarters' corporate profits.





A3 Transportation Fund

The Transportation Fund is anticipated to end FY 2016 from $5.0 million below target to $15.0 million above target.

Overall, revenue growth is fairly strong, largely due to increased miles traveled aided in part by lower gas prices. The two charts below present the relatively strong picture. The two major sources of revenue to the Transportation Fund are motor fuel tax and special fuel tax. Both are above the growth rate target (horizontal bar on each chart).

On January 1, 2016 the gas tax was increased by 4.9 cents per gallon. Revenue from the gas tax increase started showing up in March. Early indications are that revenue from the gas tax increase is coming in about on-target, with the over performance largely due to induced-traveling from the low gasoline and diesel prices.

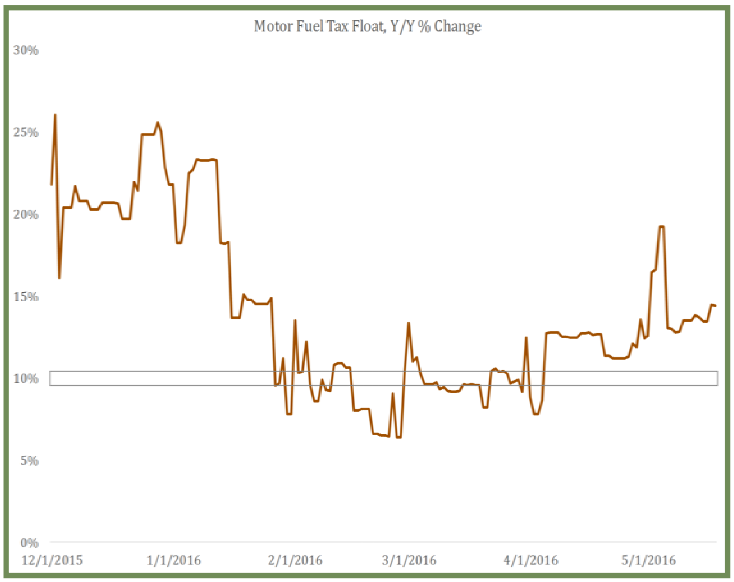
On the recent rise in gas prices, the downward effect on consumer travel and overall gasoline purchases has yet to show up in revenue.

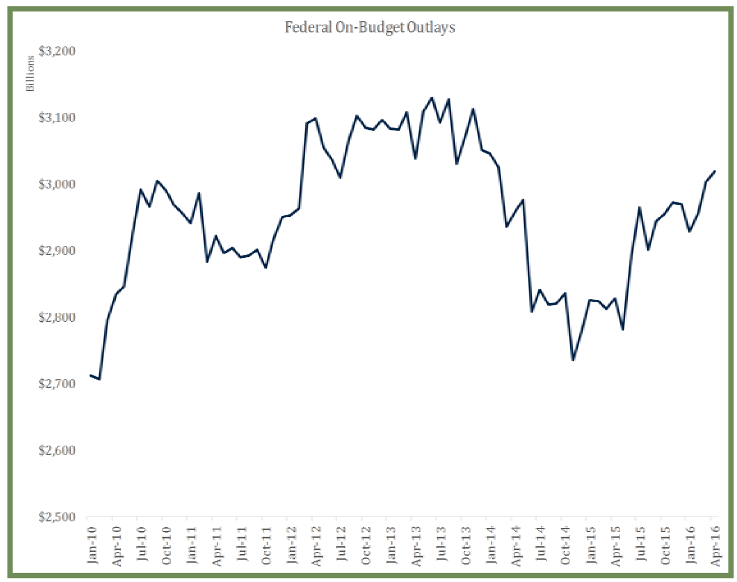
A4 Federal Funds

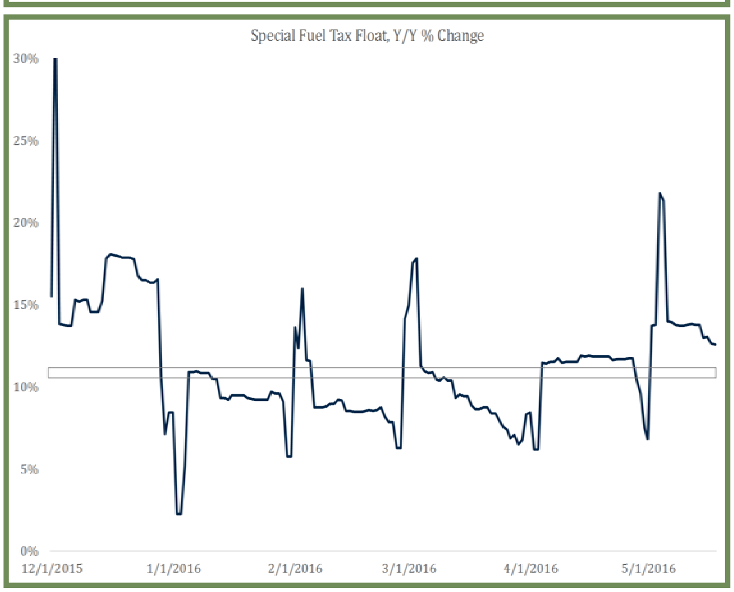
Similar to net individual income and corporate tax receipts in Utah, for April, the U.S. Treasury reported weak tax receipts, largely driven by weaker than anticipated individual and corporate income tax. Because of the ability to deficit finance, the weak receipts have had no effect on the expenditure trends at the federal level.

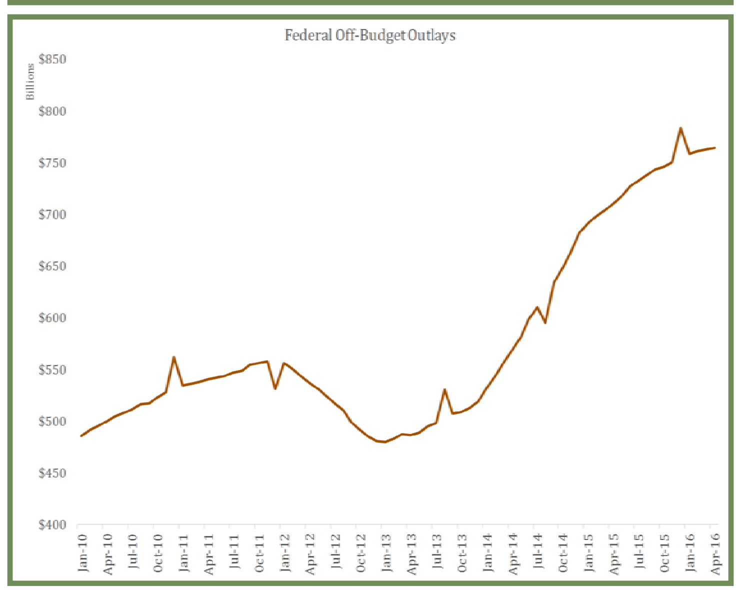
On federal expenditures, both on-budget and off-budget outlays are now increasing since bottoming in late 2014 (on-budget) or early 2013 (off-budget). The growth in the two since their respective bottoms is quite different. Off-budget spending is up around 59.0 percent since its 2013 bottom, while on-budget spending is up 10.0 percent since its 2014 bottom. The spending growth rates differential stems from the driving forces. Off-budget spending includes Social Security, the Post Office, and Fannie Mae/Freddie Mac.

At the State level, early indications are that federal funds including mineral lease will be close to flat.







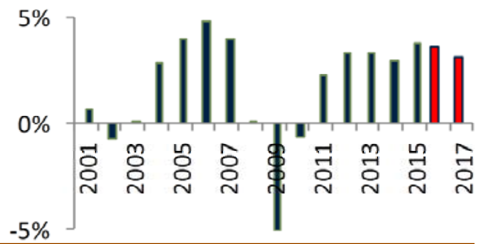


B1

REVIEW OF THE ECONOMIC INDICATORS

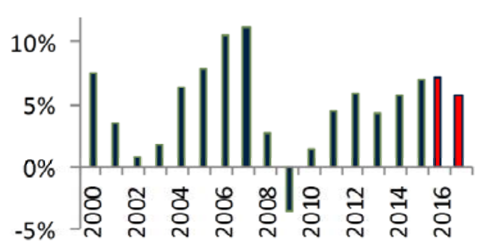
Nonagricultural Employment

Employment growth in Utah remains one of the strongest in the nation. Current estimates show employment growth at 3.6 percent for 2016, moderating to 3.1 percent for 2017. The labor market in Utah consistently registers in the nation's top 10 for lowest unemployment rate and highest employment growth.



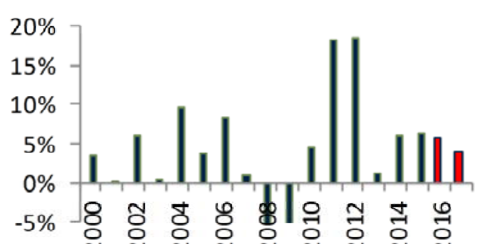
Nonagricultural Wages

The average annual wage in the State is estimated at $45,019 in 2016, a projected increase of 3.5 percent over the prior year. Wage growth is expected to remain moderate at 2.5 percent in 2017. This translates to an average annual wage increase of $1,502 in 2016 and $1,147 in 2017. Total wage growth is expected to be 7.2 percent for 2016 and 5.8 percent for 2017.



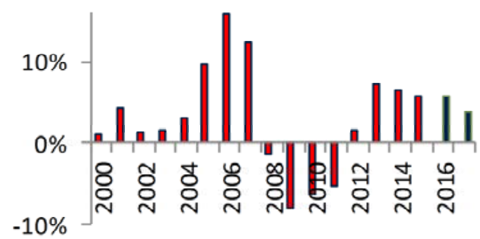
New Automobiles and Truck Sales

Sales of new automobiles and trucks remains strong in 2016. The new automobile and truck market is anticipated to grow by 5.7 percent and 4.0 percent in 2016 and 2017, respectively.



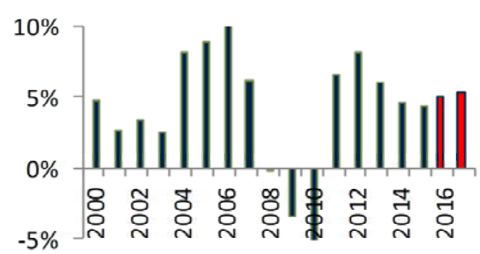
Housing Prices

Housing prices continue to improve with expected growth for 2016 and 2017 at 5.8 percent and 3.7 percent respectively. The housing prices forecasts are sensitive to interest rates and income expectations. If interest rates rise faster than expected, housing prices could come in lower than expected. Because of the growth in multi-family units the overall price of an average housing unit (i.e. not just single-family homes) has dropped slightly in 2016.



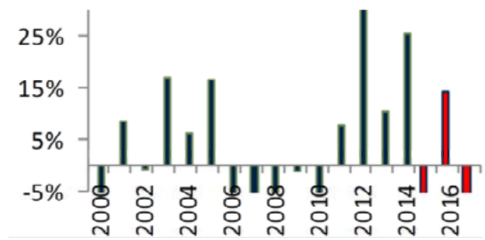
Retail Sales and Total Taxable Sales

Retail sales growth for 2016 is estimated at 5.5 percent . The growth is expected to moderate in 2017 to 5.2 percent. The universe of taxable transactions (all taxable sales) is estimated to grow at 5.0 percent in 2016 and is expected to grow by 5.3 percent in 2017. The difference is largely attributable to business investment, which remains sluggish.



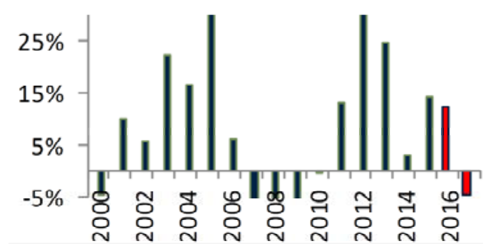
Dwelling Unit Permits

Dwelling unit permits are expected to end 2016 with an additional 20,000 units permitted, an increase of about 14.3 percent over the 17,500 authorized in 2015. Residential permits are anticipated to continue to grow by an additional 18,000 units in 2017.



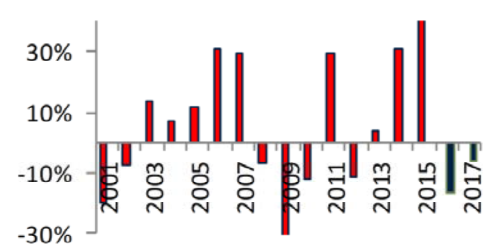
Residential Permit Value

Dwelling unit permits are correlated with residential permit value. Total residential permit value bottomed out at $1.7 billion in 2010. Since then, permit values have grown quickly, with total permit value expected to reach $4.3 billion in 2016 and $4.1 billion in 2017.



Nonresidential Permit Value

Nonresidential construction is strong due to several large projects in 2016. Values for 2016 and 2017 are estimated at $2.0 billion and $1.7 billion.

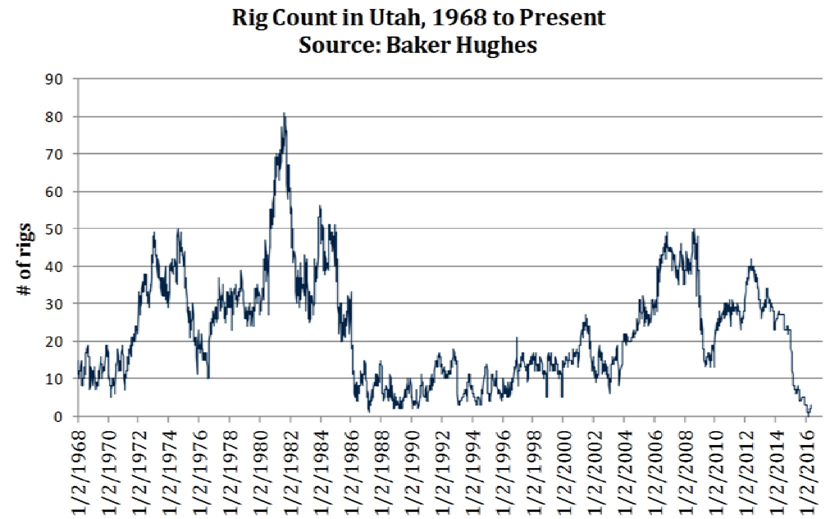


Utah's crude oil price dropped from a high of $100.0 per barrel in 2014 to a low of about $30.0 in late 2015, with prices dipping to $20.0 a barrel in early 2016. As a result, the number of drilling rigs in Utah decreased from about 23 in late 2014, down to three rigs in late 2015, and finally down to zero in early March 2016 and back up to two rigs in April. Since new oil wells are not being drilled, crude oil production in the state decreased nearly 10.0 percent in 2015 and is projected to decrease by 18.9 percent in 2016 and by 10.0 percent in 2017 as rigs remain idle. Similarly, natural gas prices in 2015 were down 43.0 percent and production was down 7.0 percent due to oversupply. The decline is expected to continue through 2016.

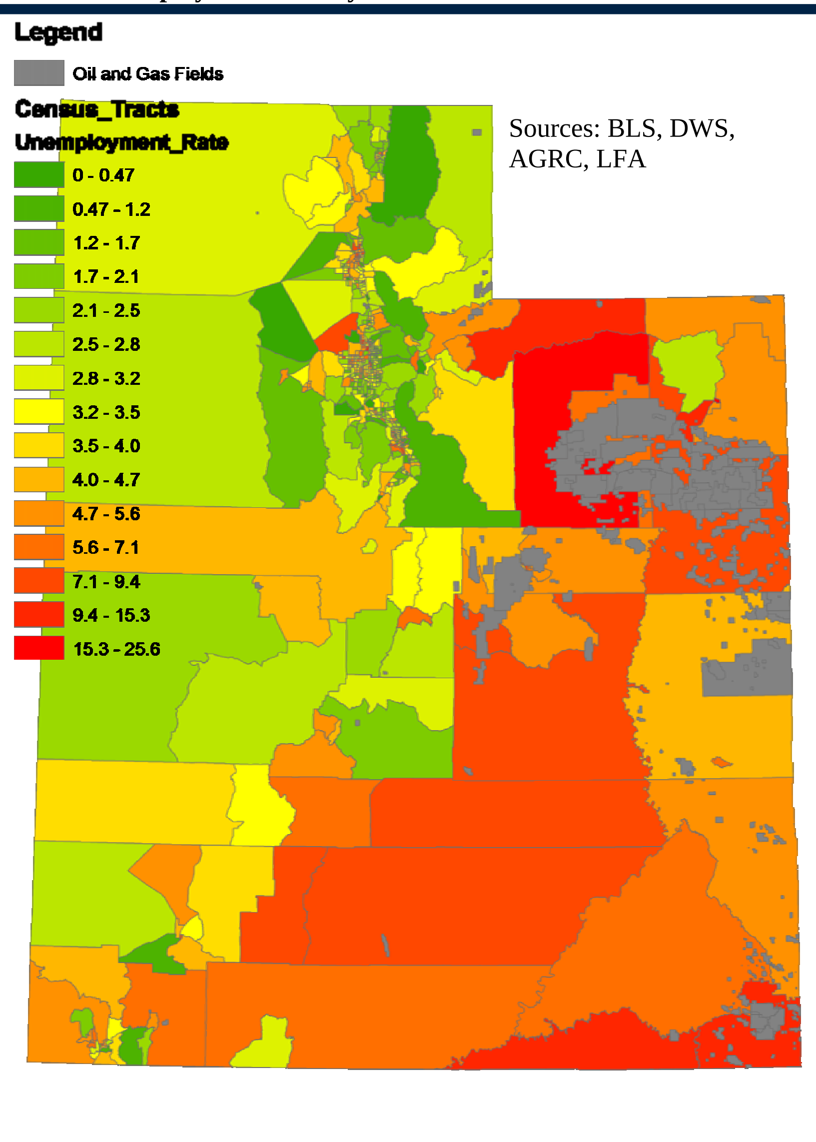
The lower gas price has led to two divergent trends. Drivers are saving significantly from low gas prices, resulting in increased road miles travelled and enhanced motor fuel tax revenues. However, lower gas prices have come at a cost to other parts of the economy. Historically, 70.0 percent of the state's oil and natural gas is produced in the eastern part of the state, which in the past has bolstered the economy and created jobs. The downturn in gas and oil prices has depressed the economies that are reliant on these natural resources.

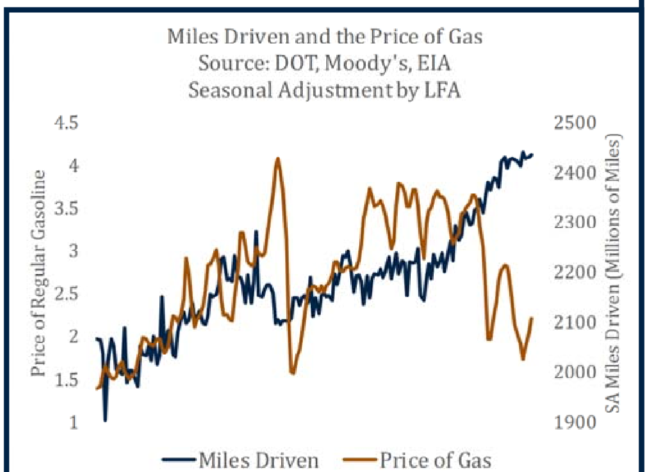
Motorists are saving $641.0 million in 2016 at the pump compared to the prior year and spent $626.0 million less in 2015 compared to 2014. Households are projected to shave between $250.0 million and $375.0 million off expenses due to the low price of gasoline this year.

But lower gas prices means less investment in oil and gas activity, which ultimately has led to cutbacks and layoffs. In FY 2015 while Utah logged a 4.8 percent growth in sales tax revenue in fiscal year 2015 overall, Duchesne County's dropped a significant 6.7 percent, and Uintah County's dropped by 3.2 percent.



Unemployment Rate by Census Tract and Oil/Gas Fields





Construction in Utah continues to be one of the high growth sectors in the economy. Growth has been particularly strong in the following areas: commercial construction, multifamily and transit-oriented development housing, commercial office, industrial, and healthcare.

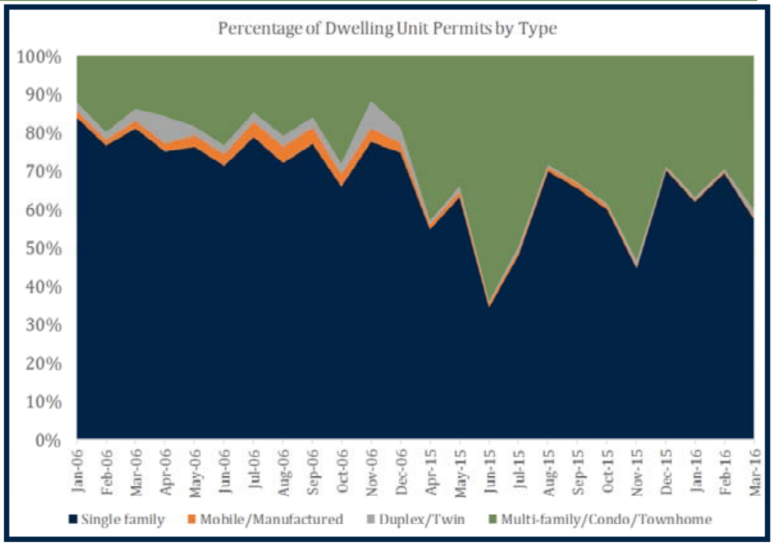
In addition to industry factors driving construction, household formation is also coming back, with Millennials and others starting to create their own households. However, as they purchase homes, Millennials tend to favor multi-family housing units for various reasons. That bias could reverse as more favorable employment opportunities materialize. In the past year multi-family construction has grown by 25.0 percent.

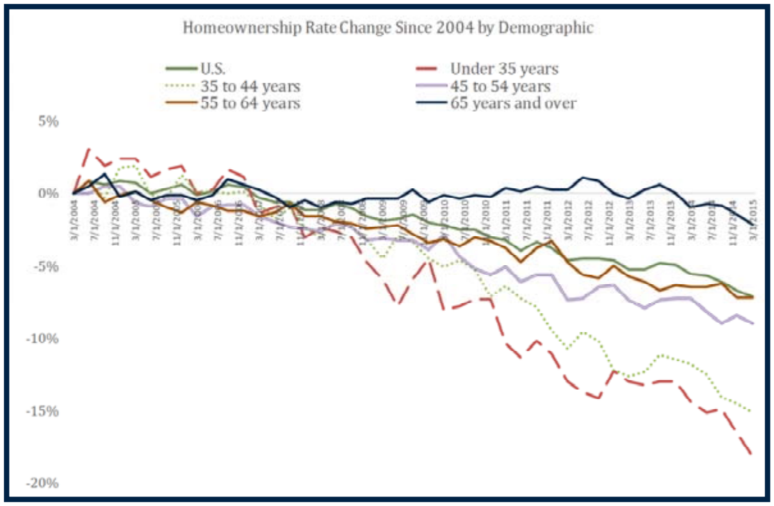
The shift away from single-family households is apparent when looking at Dwelling Unit Permits by City (bottom chart). The left portion is the percentage of total Dwelling Unit Permits in 2006, at the height of the housing market boom. The middle and right panes are the 2015 and 2016 year-to-date figures. In most cases, the percentage of total Dwelling Unit Permits that are single family is down from 2006. For example, Lehi, the fastest growing area for residential permits, is down from 91.0 percent single-family in 2006 to 82.0 percent in 2016.

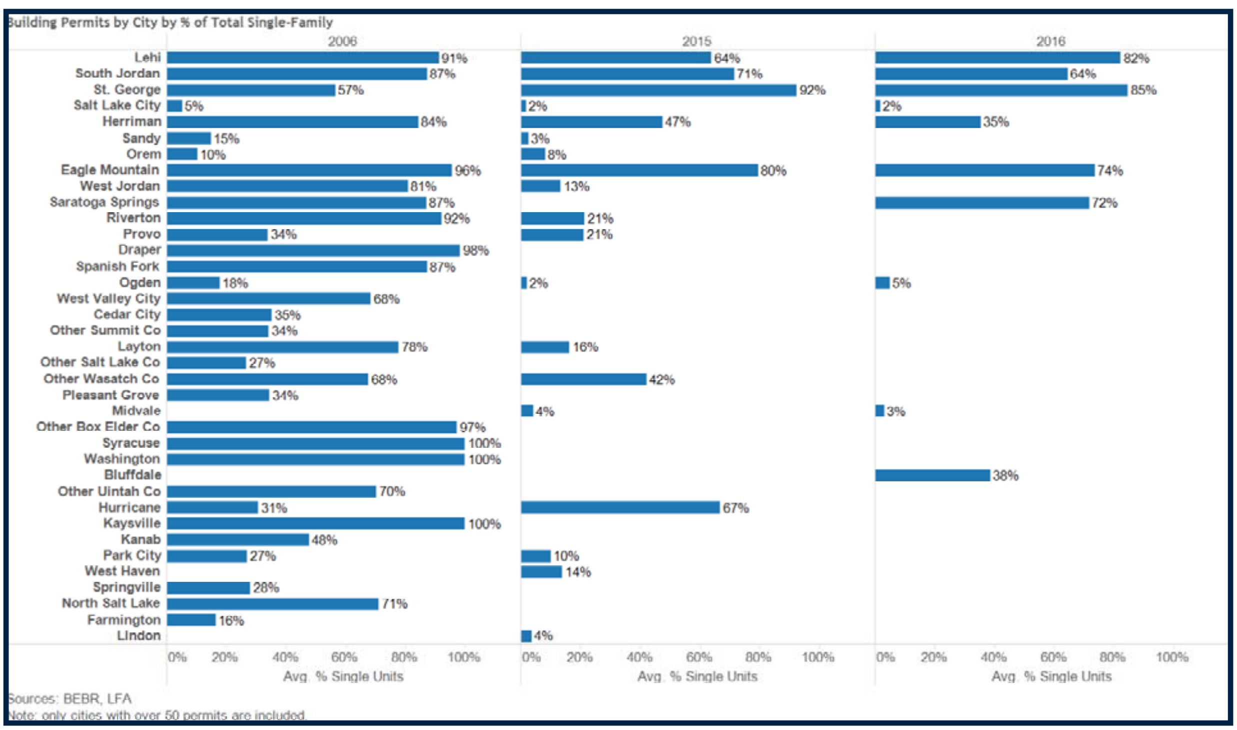
Since 2011, nearly 20,000 new apartment units have received building permits, accounting for 25.0 percent of all new dwelling units in the past five years. The number of first quarter building permits issued for single family units by comparison increased seven percent in 2016.

New single-family home construction in 2016 is concentrated in five cities South Jordan, Herriman, Bluffdale, Lehi, and Saratoga Springs. Growth in these cities is largely the result of the technology industry expansion along the Silicon Slopes in north Utah County and south Salt Lake County.

Non-residential construction is at record levels as a result of several large projects. Historically, nonresidential construction has been about half of the value of residential construction.







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Upside and Downside Risks on the Horizon

The fundamental momentum of business and consumer growth in Utah appears relatively moderate, with the period of strong growth acceleration likely over, and now giving way to cruising speed or decelerating growth. Downside and upside risks are still present, with most of the push largely stemming from external forces.

Upside Risks

Household Formation Re-acceleration
One of the hallmarks of the current economic picture is the demographic shifts that have occurred. In particular, older workers are working much more and younger workers are working much less than prior generations. Should the younger generations (such as Millennials, the largest broad demographic group of the labor market now) gain greater employment opportunities with the broadening economic recovery, they may also begin to demand single family homes typically associated with marriage and family-rearing. An uptick in household formation would almost assuredly provide a broad boost of economic growth.

Business Investment Comes to Life
The past few quarters of business investment have been bluntly weak, in particular spending by businesses connected to or operating in the oil, natural gas, and other commodities businesses. With the recent rise in resource prices, business investment could make a strong comeback, boosting revenues connected with such spending.

In the Near Term, Wage Growth Reignites
The current economic recovery/boom has been quite subdued when it comes to average wage growth. Should labor demand begin to outpace supply, the competition for labor may reignite wage growth.

Commodities Fire Back Up
The question is often asked whether oil prices boost or hinder economic growth. The answer is it depends on location, strength of the price movement, expected duration of the price movement, and level of overall economic growth. In the context of the current economic environment, the rise in commodity prices recently is probably a signal of confidence, something that could strengthen economic growth. Commodity prices also affect employment and revenue in Utah, such as the prices of copper, oil, and natural gas.

Downside Risks

Negative interest rates
Central banks, particularly the European Central Bank and the Bank of Japan, have been experimenting with negative interest rates. These moves, intended to gently force bank business lending and consumer spending, haven't had the intended effects. For example, the Japanese Yen has strengthened rather than weakened. Negative rates could have a contagion effect on conditions in Utah.

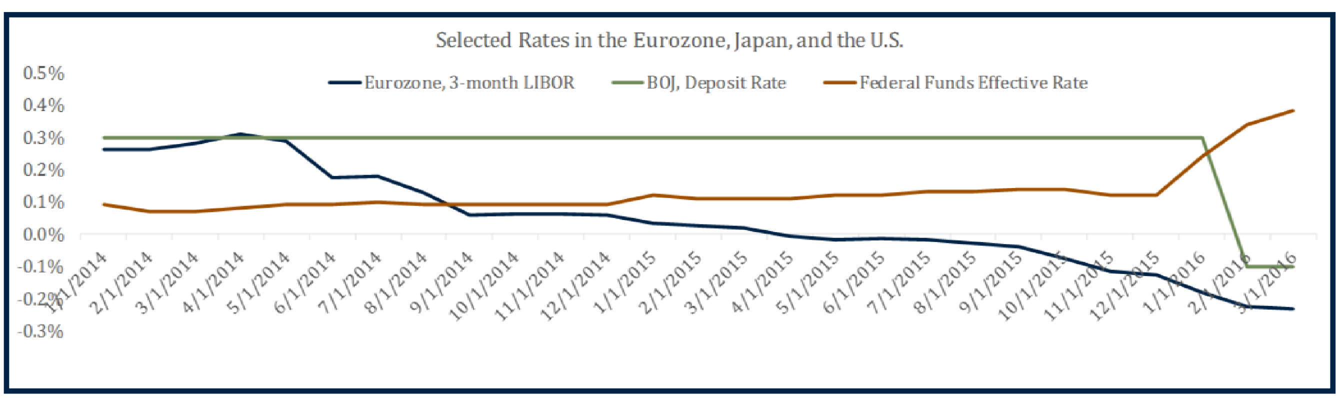
China Experiences a Hard Landing
Recent results out of China are mixed. Because many prices that affect businesses headquartered in Utah are affected by demand out of China, if growth in China decelerates much more, economic growth could weaken in Utah.

A Negative Feedback Loop from Weak Equity Markets Materializes
At times, equity markets respond to perceived weak economic growth prospects negatively, and this weakness has a real effect on actual economic growth. Should a negative feedback loop surface between equity markets and the broader economy, overall business conditions could sour quickly.

Consumers and Businesses Lose Confidence
Consumer confidence is high and has been so for a couple of years. Business confidence is more subdued. Any twitching in these two measures could reduce real economic growth.

Black Swan Events
Black swan events are unexpected or low probability events that have far reaching consequences when they occur. Given the heightened jitteriness of world markets, any large scale black swan event could have an outsized effect on growth.

U.S. Retail and Corporate Profits
At the national level, retail and corporate profits are pre-recessionary. Should the two measures not experience a U-turn, a national recession is likely on the short-term horizon.



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Part C: Revenue Collections

Tax Revenue *(In Millions of Dollars)*	**FY 2015 Final**	**FY 2016 Consensus**	**FY 2016 Consensus Growth Rate**	**FY 2015 Year-to-Date 6/2/2015**	**FY 2016 Year-to-Date 6/2/2016**	**FY 2016 Year-to-Date Growth Rate**
Sales & Use Taxes	$1,714.95	$1,774.60	3.5%	$1,592.55	$1,612.21	1.2%
Individual Income Tax	3,157.67	3,361.28	6.4%	2,892.63	3,017.11	4.3%
Corporate Franchise Tax	373.94	352.40	-5.8%	311.47	271.58	-12.8%
Beer, Cigarette & Tobacco	115.92	114.85	-0.9%	107.68	108.94	1.2%
Insurance Premium Taxes	92.39	91.54	-0.9%	91.88	111.59	21.4%
Severance Taxes	86.03	28.69	-66.7%	88.22	26.08	-70.4%
Other Sources	264.54	255.44	-3.4%	124.35	96.09	-22.7%
Total - General & Education Funds	**$5,805.43**	**$5,978.79**	**3.0%**	**$5,208.78**	**$5,243.59**	**0.7%**
Motor Fuel Tax	$261.74	$289.39	10.6%	235.14	262.66	11.7%
Special Fuel Taxes	100.07	109.74	9.7%	88.47	96.87	9.5%
Other Transportation Fund	85.12	87.39	2.7%	76.63	77.09	0.6%
Total - Transportation Fund	**$446.93**	**$486.52**	**8.9%**	**$400.24**	**$436.62**	**9.1%**

Source: LFA, USTC, DOF