Utah ended FY 2011 with a $107 million General and Education Fund revenue surplus. Given that new, higher base, revenue must grow by an additional 0.6% in FY 2012 to meet targets established last General Session. Our most recent revenue projections show FY 2012 targets are well within range, with slightly more upside than downside risk. We anticipate that FY 2012 General and Education Fund revenue will be between $50 million less and $100 million more than estimated last Spring. We further believe the Transportation Fund may be $10 million below to $5 million above our previous estimate.

Revenue to the General Fund came in $47 million higher than estimated for FY 2011. The Education Fund had a $60 million revenue surplus at FY 2011 year-end. The Division of Finance estimates that, after making statutorily required deposits to Rainy Day and Disaster Recovery funds, and after setting-aside surplus for the Industrial Assistance Fund, policymakers will have $60 million in available one-time revenue. The Transportation Fund ended FY 2011 right on target.

As of now, there is around a 48% chance for a shallow recession and moderate risk (21%) for a deep recession. The key risk factors continue to be the housing market, wage growth, consumer spending, inflation and corporate volatility. The baseline scenario for Utah’s economy continues to be a dull recovery.

Signals on the upside include increased residential permit values, accelerating labor force growth, and retail sales growth.

The coming 255 days of FY 2012 present upside and downside capture risks. The state has greater upside capture risk than most other states, but also has greater downside capture risk. Should the nation’s economy deteriorate from its current slow speed, we would anticipate the state to underperform, whereas should the nation’s growth rate pick up, we would anticipate economic growth in the state to outperform most other states.

The greater connection with the downside is largely a slow movement towards greater correlation with the nation. Over the past four national recoveries and recessions, the State has moved towards a higher upside capture ratio (grow faster than most other states in good times) but also not as good downside ratio (performing not as well in bad times).
In summing all sources, we expect the General Fund to end FY 2012 in the range of $20 million below target to $40 million above the EAC adopted April consensus.

**Sales Tax**
Sales tax ended FY 2011 about $45 million above target. Although early, sales tax is coming in under target for FY 2012. The map below represents the performance of sales tax by zip code through 2010. The generally poor performance of sales tax for the prior years was due to Wasatch Front taxable sales declines. One of the factors to watch for at this time of year is the performance of the equity indices. When stocks perform well, 4th quarter retail sales tend to do well, and vice versa.

**Beer, Cigarette, & Tobacco Taxes**
Beer, cigarette, and tobacco taxes ended FY 2011 $15 million above target. Revenue from cigarette and tobacco taxes came in above target because the gain from the tax increase is greater than the decline in consumption. Cigarette consumption declined by about 10 million packs — about 23% of the demand decline is attributable to a shift of purchases to out-of-state companies, with Idaho, Nevada, Wyoming, and Colorado experiencing shifting from Utah. The rest of the consumption decline is due to individuals either quitting, cutting back, or purchasing cigarettes in a non-taxed manner.

**Severance Taxes**
Revenue from oil, gas, and mining taxes ended FY 2011 about $10 million below target. This was largely the result of underperformance in the severance tax on oil and gas. We expect oil and natural gas severance tax to come in under target in FY 2012 as well. The price of oil and natural gas have dampened recently, and we anticipate only narrow growth in the prices of both of these commodities in the next two years.

**Insurance Premiums**
Insurance premiums ended FY 2011 $3.4 million below target. We anticipate underperformance in FY 2012 as well.

**Liquor Profits**
Liquor profits transferred to the General Fund represent revenue less costs. Through roughly the first three months of FY 2012, purchases at state liquor stores are up 8.8%, with the largest increases happening in Utah County (20.1%). On the cost side, outlays excluding the costs of goods sold are flat.
Education Fund revenue is expected to end FY 2012 $30 below to $60 million above the April EAC FY 2012 consensus.

**Individual Income Tax**

One of the shifts we’re seeing that affects income tax collections is a shift in income demographics. Younger generation individuals, (15-17 year olds), lost as a group in 2009, about 50% of the wages they had earned over the prior two years. Expanding the younger generation to 18-30 year olds shows that the age demographic lost about 40% of the wages they had made over the prior two years. In contrast, 56-65 year olds gained about 31% in 2009 of the wages they gained over the three years covered. The oldest age group, over 66, gained about 34% of their wage income in 2009 when compared with the previous two years. This matters for revenue in that recessions can have lifetime generational effects on actual and expected income and wealth.

The shift in wages earned is also apparent in labor force participation. Individuals 16-19 years old have decreased their labor force participation (LFPR) by 31% since 2001, 20-24 year olds have decreased their LFPR by 3%, 25-34 year olds by 2%, 35-44 year olds by 8%, and 45-54 year olds by 3%. In contrast, 55-64 year olds have increased their LFPR by 10% and 65 and over have increased their LFPR by 23%. These income tax demographics are not indicative of strong future growth.

**Corporate Tax**

At best, corporate income tax is coming in flat. Payments for the third quarter of 2011 (FY 2012) came in $15 million below third quarter payments of 2010 (FY 2011). Although worldwide corporate profits are at an all-time high, corporate tax revenue to the state is still $153 million below its all-time high in FY 2007 of $414 million.

The common perception is that corporations responded to the recession at the expense of labor. This was the case for some corporations. It appears, though, that the all-time high in corporate income tax revenue was the result of strong top of the line revenue in conjunction with limiting labor costs (see 2006 in chart). When the downturn began to materialize in 2007, corporations continued adding wages. This happened even though top of the line gross revenue was declining.

The story of 2007 holds for 2008, only in greater magnitude. In contrast, corporations responded to their revenue problem in 2009 by decreasing labor costs. This varies by industry also. Overall, corporations continue to exhibit concerns about expanding their balance sheets.
Utah’s economic indicators are generally improving. This section is a review of some major indicators. We also address the downside risk associated with these indicators.

**Nonagricultural Employment**

The Revenue Assumptions Committee (RAC) has as a baseline nonagricultural employment growing by 2.3% in 2011, 2.7% in 2012, and 3.1% in 2013. Of the 39,000 new nonagricultural jobs expected in 2013, about 14,000 have a 50/50 chance of not materializing.

**Nonagricultural Wages**

RAC has as its baseline average annual pay growing by 2.9% in 2011, 3.2% in 2012, and 3.5% in 2013. The forecast for 2013 contains about a 50/50 chance that $600 million in wages will not materialize.

**Retail Sales**

The retail sales baseline is growth of 4.8% in 2011, 5.9% in 2012, and 4.2% in 2013. Of the $27.8 billion in anticipated 2012 taxable retail sales, about $0.7 billion has a 50/50 chance of not materializing. For 2013, $1.0 billion of the $29.0 billion in anticipated retail sales has a 50/50 chance of not materializing. Translating to sales tax, there’s a 50/50 chance of about $74 million not materializing in 2012 and 2013.

**New Auto & Truck Sales**

RAC anticipates new auto and truck sales to grow by 10.2% in 2011, 12.9% in 2012, and 11.0% in 2013. The double digit growth rates are somewhat misleading as future purchases may be accelerated into the current forecast.

**Dwelling Unit Permits and Residential Permit Value**

Dwelling unit permits are still performing slowly. More than likely less than 10,000 permits will be issued for single family homes. These levels are reminiscent of the 1960s. As housing permits slow, rental units increase. From 2000 to 2010 rental housing units increased 2.65%, compared to owner housing units, which increased 2.11%.

**Nonresidential Permit Value**

RAC expects nonresidential permit value to stay at $1.1 billion in 2011 and 2012 and to grow to $1.3 billion in 2013. By the past decade’s standards, 2012 and 2013 are weak. Should business gain greater confidence in the market, nonresidential construction contains at least another $0.5 billion in upside potential for 2013. Of course, business expectations are volatile, and signs of weakness could deteriorate demand for nonresidential construction.

**Consumer Prices**

The baseline for consumer price appreciation is for 3.0% in 2011, 1.3% in 2012, and 1.9% in 2013. Current consensus expectations have no downside risk (price disinflation or price depreciation) — there’s about 60% chance of above 3% inflation in 2012 and 2013. In terms of revenue, consumers can generally expect price appreciation to put downward pressure on disposable income purchases.
Interstate Comparisons

Nonagricultural employment in Utah bottomed in February 2010 at 1,173,000. The peak was in December 2007 at 1,264,000, representing a drop from peak to trough of 91,000 nonagricultural jobs. Since hitting the low in February 2010, job growth has been steadily climbing—gaining back almost half of the jobs lost. As of August 2011 total nonagricultural employment was back to 1,218,000 — up 45,000 from the February 2010 lows. Gains in Education and Health Services, Professional and Business Services, and Leisure and Hospitality have led the way. Job growth is expected to continue into 2012 and 2013 at close to a 3% growth rate.

Compared to many of the Western States, Utah is doing well. Using the Philadelphia Fed’s coincident index for the 2nd quarter of 2011 as a measure of growth Utah ranks 3rd fastest of the eight western states shown.

In the real estate market, the State has also done well. Using the purchase only home price index released by Federal housing Finance Agency (FHFA) through first quarter of 2011 Utah has the second lowest peak to trough decline in housing prices of the eight states shown.

As mentioned in the overview, the State’s business cycle has moved over the past 30 years to more closely resemble the nation’s downside, while capturing a larger portion of the upside. During the 1981 to 2001 national growth and recession cycles, Utah had a downside capture ratio that was strong enough to withstand some hiccups in the national economy.

In contrast, over the past ten years, the state has moved towards a position where it is more affected by national economic parameters. In fact, the state captured about 104% of the employment downside during the 2008-2010 recession. With 100% being the United States as a whole, this means that Utah’s employment recession was deeper in scope than the nation as a whole.

On the upside, the state has moved towards outperforming most other states when the national economy is performing well. In the 1980-1991 timeframe, Utah captured about 130% of the upside, whereas currently it is capturing about 200% of the nation’s upside. This means that employment growth in the state is about twice as high as the nation as a whole. We expect the upside trend to continue over the 2012 and 2013 time frame.
Expiring Stimulus
We are concerned about the effect expiring stimulus dollars may have on economic growth. Expiring stimulus programs include, among others, the payroll tax reduction of 2%, the unemployment insurance program expansion, accelerated depreciation, state and local transfers, and infrastructure & other spending. The Council of Economic Advisors (CEA) released a report prior to passage of the American Rehabilitation and Re- construction Act (ARRA), estimating that the unemployment rate would generally be 1 to 2 percentage points lower than what otherwise would be the case. The anticipated results didn’t materialize, and we think it’s largely because the multiplier effects of the stimulus programs were lower than anticipated. Because the stimulus had, at best, subdued effects on the upside, we continue to watch for downside effects as adjustments are made.

Expiring Tax Changes & Tax Uncertainty
Adding to consumer concern is tax uncertainty. Over the past four years, federal tax changes have affected state revenue. Some of the effects have been direct, such as the bonus depreciation and expensing allowances. Others have been indirect, such as the sales tax not lost because of the 2% payroll tax reduction (the average individual can expect an increase of $850 in withholding). Also, federal income tax rates on wages, dividends, capital gains, and other income are set to increase in 2013. For single individuals, the tax rate changes means an increase in tax liability of $210 million. For married individuals, $920 million. All of these issues will affect future consumption, but, the possibility also affects current consumption.

Debt
Government and, to a lesser extent, consumer debt continue to hang over the head of this dull recovery. We anticipate debt to be a continual issue for a while.

Business & Consumer Expectations
General business conditions have improved. The concern is that small businesses, where a good portion of job growth takes place, continue to signal mediocre business conditions. The next page contains the Michigan Consumer Sentiment Index. Overall, the index is up from its lows. When looking at the longer horizon, though, the index is generally in a downward trend. This matters in that consumer expectations affect sales tax.
Macro Conditions

World and national conditions have improved from a year ago, albeit at a dull pace. The data are giving mixed signals regarding whether the national economy will deteriorate or continue to improve.

- Growth in output and demand as measured by the Gross Domestic Product (GDP) or retail sales improved over the past few years, but the positive growth rates of both have been slow and contain at least a 40% chance of deterioration in 2012.

- The national employment picture is improving, but not at a pace that would bring the unemployment rate to its natural level of around 4%. To improve the unemployment rate, jobs in the U.S. would need to grow by 200,000 a month. The most recent estimate for September was job growth of 103,000.

- Institute for Supply Management (ISM) surveys on new orders and manufacturing production have hooked down in recent months or fallen below levels indicative of future growth.

- Consumer prices are ticking up, raising the risk of the economy entering a situation of stagflation (high inflation and high unemployment). Also on the downside consumer spending is struggling to keep up with inflation rates. Consumer spending adjusted for inflation has dropped 6.7 percent from June 2009 to June 2011.

- Consumer confidence has been consistently weak.

- Business Investment has ticked up recently, indicating businesses are making fixed investments, albeit at a weak pace.

- The housing market, as measured by new and existing home sales, continues to perform poorly.

- Interest rates remain at historically low levels, indicating investor concern over growth prospects.

- The Economic Cycle Research Institute’s (ECRI) weekly leading index has been deteriorating in recent weeks. The indicator is generally accurate at predicting economic activity, and the shift into recession territory is a sign of concern.

Overall, the national economy has improved over the past year, but continues to be under pressure to perform well enough for enough people to be considered healthy.
### Tax Revenue (In Millions of Dollars)

<table>
<thead>
<tr>
<th>Tax Revenue</th>
<th>FY 2011 Final</th>
<th>FY 2012 Consensus</th>
<th>FY 2012 Growth Rate</th>
<th>FY 2011 Year-to-Date (10/13/2010)</th>
<th>FY 2012 Year-to-Date (10/13/2011)</th>
<th>FY 2012 Year-to-Date Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales &amp; Use Taxes</td>
<td>$1,601.40</td>
<td>$1,521.39</td>
<td>-5.0%</td>
<td>$411.89</td>
<td>$393.32</td>
<td>-4.5%</td>
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<tr>
<td>Individual Income Tax</td>
<td>2,298.18</td>
<td>2,394.21</td>
<td>4.2%</td>
<td>486.47</td>
<td>537.93</td>
<td>10.6%</td>
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<tr>
<td>Corporate Franchise Tax</td>
<td>260.74</td>
<td>273.36</td>
<td>4.8%</td>
<td>76.55</td>
<td>61.32</td>
<td>-19.9%</td>
</tr>
<tr>
<td>Beer, Cigarette &amp; Tobacco</td>
<td>125.52</td>
<td>111.48</td>
<td>-11.2%</td>
<td>23.90</td>
<td>32.10</td>
<td>34.3%</td>
</tr>
<tr>
<td>Insurance Premium Taxes</td>
<td>78.39</td>
<td>82.50</td>
<td>8.7%</td>
<td>19.61</td>
<td>19.68</td>
<td>0.4%</td>
</tr>
<tr>
<td>Severance Taxes</td>
<td>86.97</td>
<td>101.37</td>
<td>16.6%</td>
<td>19.52</td>
<td>24.55</td>
<td>25.8%</td>
</tr>
<tr>
<td>Other Sources</td>
<td>210.30</td>
<td>201.15</td>
<td>-4.4%</td>
<td>36.01</td>
<td>32.47</td>
<td>-9.8%</td>
</tr>
<tr>
<td><strong>Total - General &amp; Education Funds</strong></td>
<td><strong>$4,658.99</strong></td>
<td><strong>$4,685.46</strong></td>
<td><strong>0.6%</strong></td>
<td><strong>$1,073.95</strong></td>
<td><strong>$1,101.37</strong></td>
<td><strong>2.6%</strong></td>
</tr>
<tr>
<td>Motor Fuel Tax</td>
<td>$252.50</td>
<td>$254.94</td>
<td>1.0%</td>
<td>62.71</td>
<td>62.20</td>
<td>-0.8%</td>
</tr>
<tr>
<td>Special Fuel Taxes</td>
<td>102.61</td>
<td>114.81</td>
<td>11.9%</td>
<td>31.09</td>
<td>26.47</td>
<td>-14.9%</td>
</tr>
<tr>
<td>Other Transportation Fund</td>
<td>80.73</td>
<td>78.10</td>
<td>-3.3%</td>
<td>19.06</td>
<td>18.62</td>
<td>-2.3%</td>
</tr>
<tr>
<td><strong>Total - Transportation Fund</strong></td>
<td><strong>$435.84</strong></td>
<td><strong>$447.85</strong></td>
<td><strong>2.8%</strong></td>
<td><strong>$112.86</strong></td>
<td><strong>$107.29</strong></td>
<td><strong>-4.9%</strong></td>
</tr>
</tbody>
</table>

Source: LFA, USTC, DOF