Utah's Economy

What's Happened and Where Do We Go From Here?

OLRGC
OFFICE OF LEGISLATIVE RESEARCH AND GENERAL COUNSEL

HIGHLIGHTS

- After a period of extraordinary economic growth, the recent national recession has also led to a historic slowdown in Utah's economy. Evidence of the dramatic slowdown appears across multiple indicators, including employment, housing, and taxable sales data.
- Various indicators suggest that the nation's economy is now growing rather than contracting, although the pace of growth may be subdued for some time. For example, it remains to be seen how quickly U.S. and Utah employment growth will resume.
- Utah's internal population growth is likely to support continued growth in the size of Utah's economy over time.

Utah's Economy Has Slowed Dramatically

After a period of extraordinary economic growth, the nation has fallen into a serious recession. Utah has not been insulated from this historic economic decline. Evidence of the dramatic slowdown appears across multiple indicators, including employment, housing, and taxable sales data. This briefing paper provides some historical context to the slowdown.

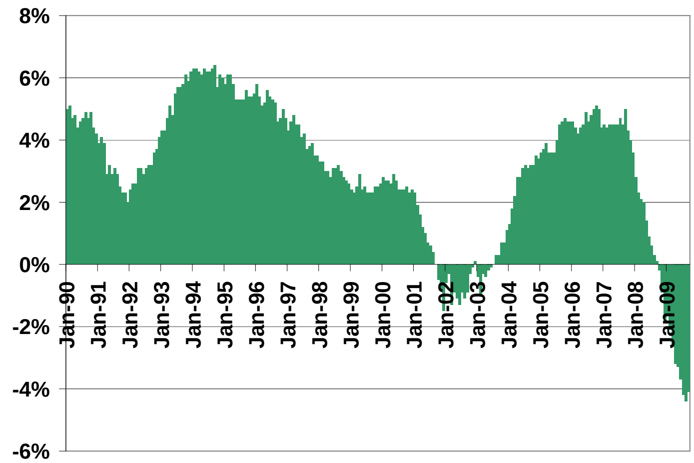
EMPLOYMENT

Significant Job Losses

Between January 2005 and January 2008, the Utah economy created approximately 140,000 new jobs. However, as the nation's economy slowed so did Utah's. Between September 2008 and September 2009, Utah lost an estimated 51,500 jobs – a 4.1% drop in total employment.

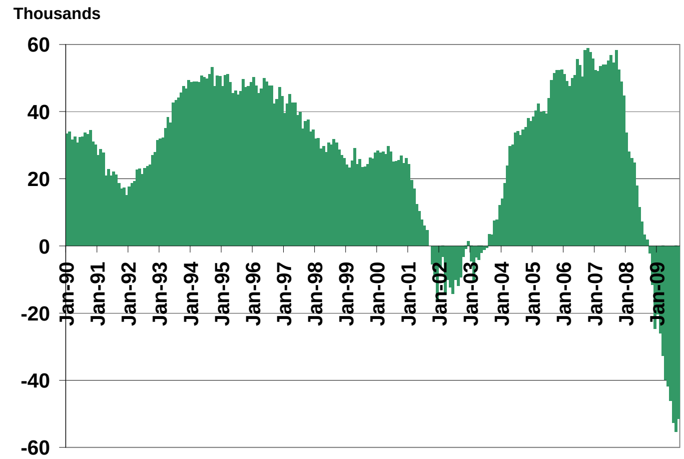
As shown in Chart 1, in October 2008 Utah began shedding jobs on a year-over basis. The number of jobs has steadily declined since then. Not since the early 1950s has the Utah economy lost as large a percentage of jobs. Chart 2 shows the year-over change in the number of jobs since 1990 and Chart 3 displays the annual percent change in jobs from 1950 to 2008. As Chart 3 notes, over the past 60 years the number of jobs in Utah has grown by an average of 3.3% annually. Although 2009 is not complete, the 4.1% loss in jobs over the last 12 months stands in sharp contrast to the job-creating growth the state has enjoyed for most of the post WWII period, with the exception of the 2001-2002 recession.

Chart 1
Utah Employment Year-over Growth Rate by Month
January 1990 – September 2009



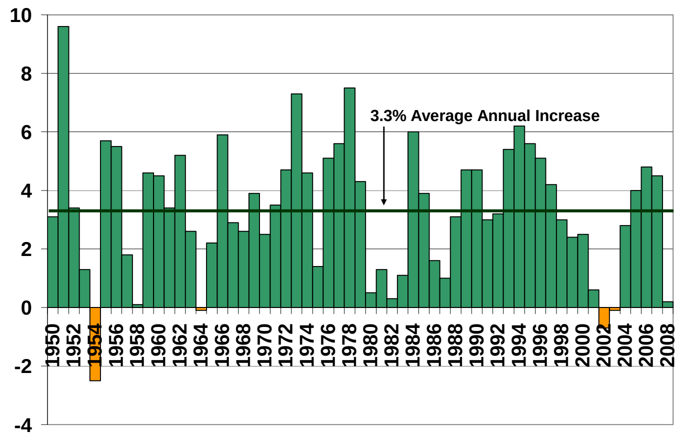
Source: Department of Workforce Services

Chart 2
Utah Employment Year-over Change by Month
January 1990 – September 2009



Source: Department of Workforce Services

Chart 3
Utah Non-agricultural Employment % Change
1950 – 2008

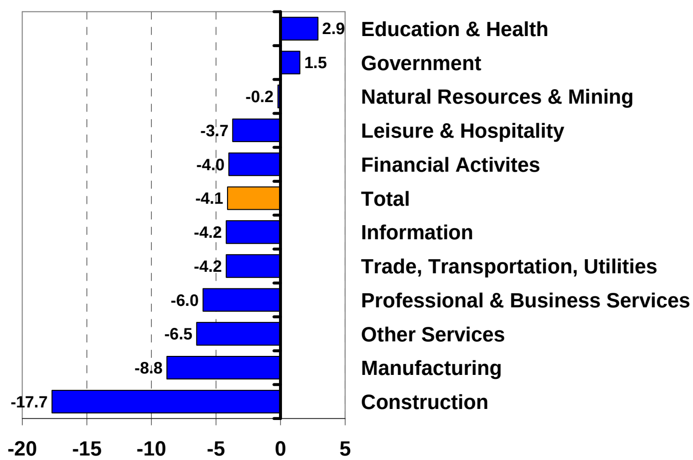


Source: Governor's Office of Planning and Budget

Employment Changes by Sector

Job losses have occurred in nearly all sectors of the economy, as displayed in Chart 4. Only the private education & health and government sectors have seen increases over the past twelve months.

Chart 4
Utah Employment Growth Rate by Sector
September 2008 to September 2009



Source: Department of Workforce Services

Job losses have been particularly severe in the construction and manufacturing sectors, with construction employment falling 17.7% since September 2008. The loss of construction jobs is notably hard on males with no post high school education. As noted in a recent *Wall Street Journal* article, "In recent years, men without college degrees, who found it difficult to get the factory jobs that sustained their counterparts in decades past, have turned to construction work to climb into the American middle class. Now they are falling from it."[1]

The manufacturing sector has also been hard hit by job losses over the last 12 months. While job losses are found in all areas of the manufacturing sector, losses have been particularly acute in durable goods manufacturing, which has experienced a drop of 11.3% over the past 12 months.

The trade, transportation, and utilities sector employs the largest number of Utahns. Retail trade, which includes department stores, grocery stores, and auto dealers, is the largest component of this sector. It has experienced a 4.2% reduction in employment during the last 12 months.

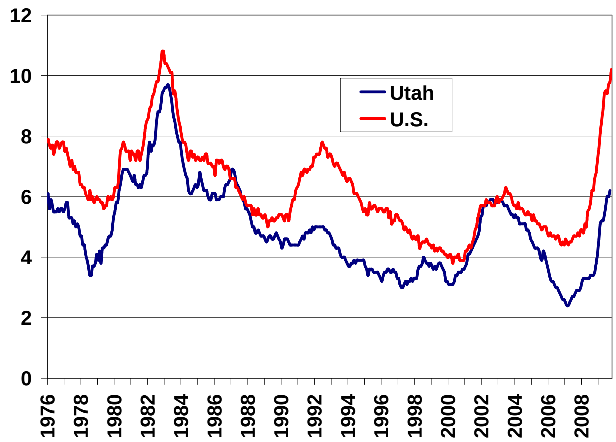
The government sector grew by 1.5% overall, although the growth was not equally distributed. During the past 12 months, federal government employment grew by 3.3%, while local government employment (which includes public schools) grew by 2.3%. State government school employment (which includes higher education) decreased by 0.2%. All other state government employment shrank the most, with a 1.9% decrease.

However, employment losses may be slowing. The September year-over employment change (-4.1%) was not as severe as August's year-over decline (-4.5%). Citing this slowing rate of decline, the Department of Workforce Services' latest employment report suggests that, "Utah may have just passed through an inflection point within the business cycle – [that] the low point has been reached and the trend forward will now be back up."[2]

Unemployment Rate

Utah's current unemployment rate of 6.2%, although up significantly from its historic lows in recent years, remains far below the U.S. unemployment rate of 10.2%. For most of the post WWII period, Utah has consistently enjoyed an unemployment rate lower than the U.S. rate. This has been especially true since 1990. Since then, the Utah unemployment rate has been lower than the U.S. rate except for after the 2002 Olympic Winter Games, when construction and other related employment declined sharply. As shown in Chart 5, in recent months Utah's unemployment rate has been as much as four percentage points lower than the U.S. rate.

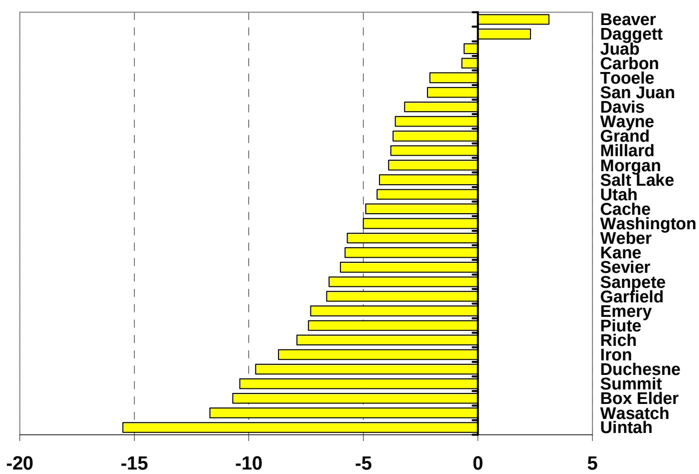
Chart 5
Utah and U.S. Monthly Unemployment Rate
Monthly, 1976 – 2009



Source: U.S. Bureau of Labor Statistics

Utah's job losses are geographically widespread, as shown in Chart 6, with 27 of Utah's 29 counties experiencing job losses over the last 12 months. All four Wasatch Front counties (Utah, Salt Lake, Davis, and Weber) experienced job losses over 3%, with the highest Wasatch Front job loss rate in Weber County (5.7%).

Chart 6
Utah Unemployment Growth Rate by County
September 2008 to September 2009



Source: Department of Workforce Services

Recent wind power and geothermal development has helped Beaver County to enjoy a 3.1 percent gain in the number of jobs. Daggett County also experienced an increase.

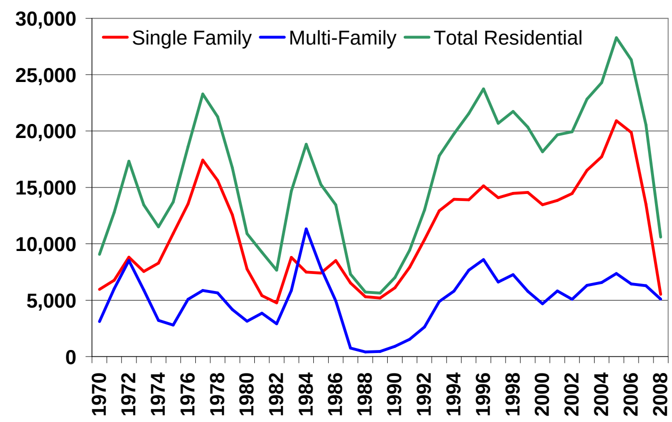
HOUSING

Construction

Utah's housing markets have been severely hit by the national economic slowdown. Construction activity slowed dramatically in 2008, with residential construction falling precipitously. This slowing trend has continued in 2009. Charts 7 and 8 show the historic trends for construction permits and permit values from 1970 through 2008. Chart 9 shows a year-over comparison through September 2009, the latest month for which data is available.

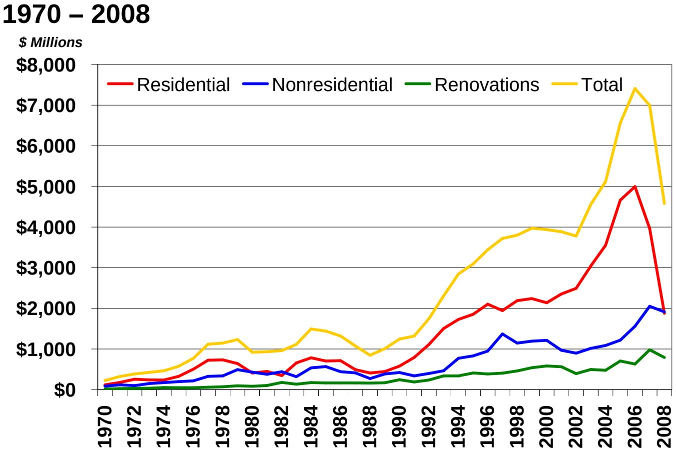
Several factors have contributed to the slowdown, including a significant run-up in both prices and the number of housing units constructed prior to the recession, significant tightening of credit availability, employment losses, increases in foreclosures, and caution on the part of consumers.

Chart 7
Utah Residential Construction Permits by Type
1970 – 2008



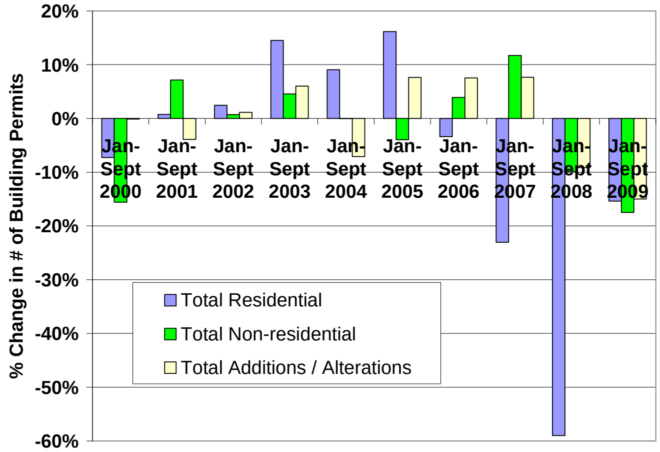
Source: U of U Bureau of Economic & Business Research

Chart 8
Utah Construction Permit Values by Type
1970 – 2008



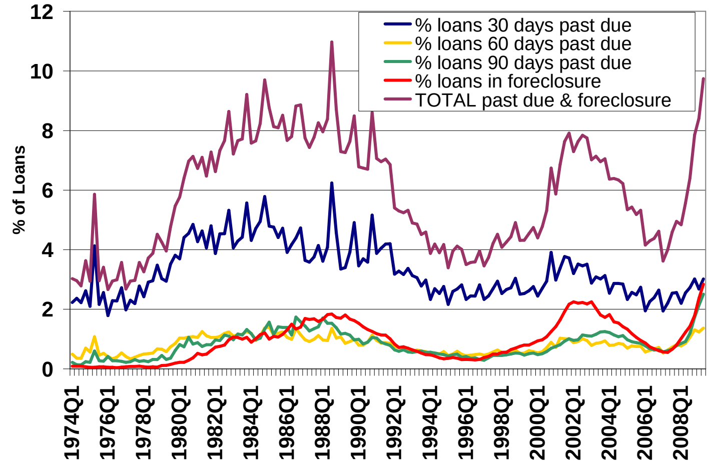
Source: U of U Bureau of Economic & Business Research

Chart 9
Year-over Percent Change in Permits
January to September, 2000 – 2009



Source: U of U Bureau of Economic & Business Research

Chart 11
Utah Delinquency and Foreclosure Rates
1974Q1 – 2009Q2

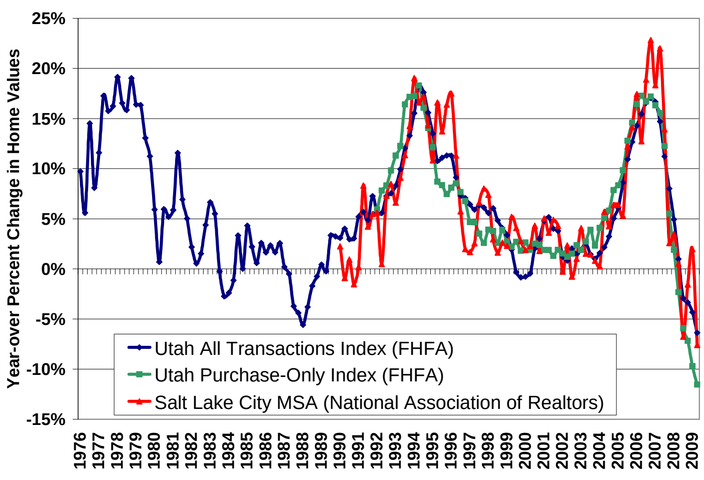


Source: Mortgage Bankers Association

Home Values

As a result of these and other factors, home prices in the state have declined. Chart 10 shows three different measures of home values over time. All measures show a decline in home values, although Utah's declines to date have not been as dramatic as the declines in some other regions of the country.

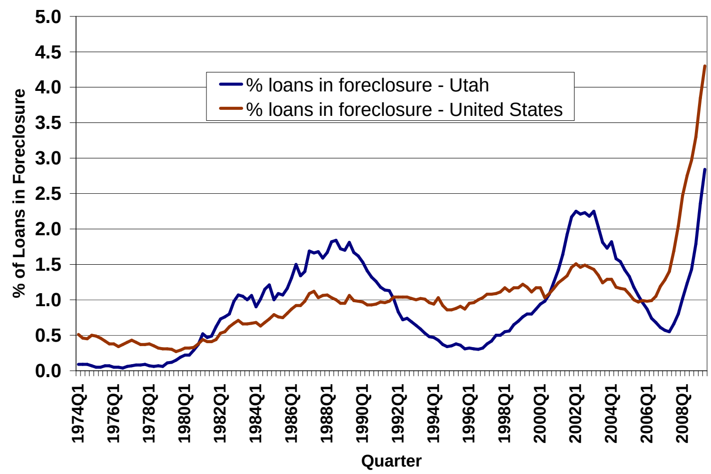
Chart 10
Year-over Change in Quarterly Home Prices
1976Q1 – 2009Q2



Mortgage Delinquencies

Mortgage delinquencies and foreclosures in the state increased dramatically in 2009, as shown in Chart 11. In 2009, 90-day delinquencies and foreclosures reached their highest point in the last 35 years. However, Utah foreclosure rates through the second quarter of 2009 remain below the overall U.S. foreclosure rate, as shown in Chart 12.

Chart 12
Utah and U.S. Foreclosure Rates
1974Q1 – 2009Q2



Source: Mortgage Bankers Association

Mortgage Interest Rates and Affordability

Although housing markets have been in significant turmoil, positive aspects do exist. Mortgage interest rates are extremely low by historical standards (roughly 5% for a 30-year fixed rate loan), which provides a sizable long-term benefit in the form of lower interest payments for those who purchase or refinance with a long-term loan. Lower interest payments free up funds for other consumption or investment uses. In addition, housing affordability has improved substantially due to low interest rates coupled with lower housing prices.

TAX REVENUES

Revenues

As a result of the slowdown in the state's economy, not surprisingly, tax revenues in the state have dropped significantly.

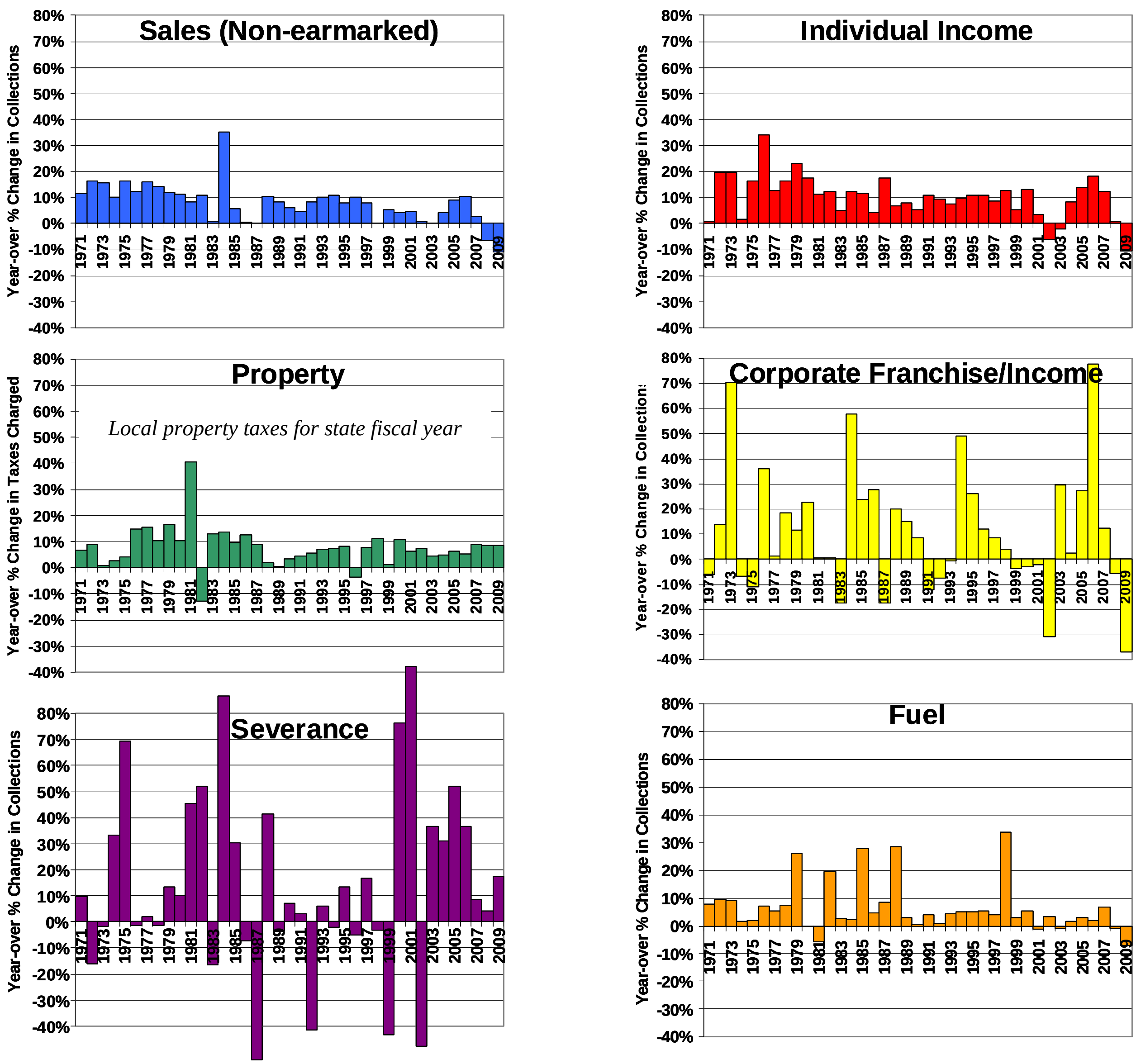
Education Fund tax revenues fell from $3 billion in FY 2008 to $2.6 billion in FY 2009, a year-over decline of nearly 14%. Individual income taxes dropped from a high of $2.6 billion in FY 2008 to $2.3 billion in FY 2009, a decline of about 11%. Corporate franchise and income tax and gross receipts tax revenues dropped an even more dramatic 37%, from about $405 million in FY 2008 to about $255 million in FY 2009.

General Fund tax revenues dropped from $2 billion in FY 2008 to $1.8 billion in FY 2009, a decline of nearly 10%. The state sales and use tax, by far the largest General Fund revenue source, accounted for nearly all of this decline, falling from $1.74 billion in FY 2008 to $1.55 billion in FY 2009.

Chart 13 provides some historical context for the recent revenue declines by tracking the year-over percentage change in different revenue sources over three decades. As the charts indicate, the recent revenue declines in the state's major revenue sources (sales tax and individual income tax) are unprecedented in that period. The charts also illustrate the differences in volatility among the different state and local revenue sources over time.

Chart 13
Year-over Percent Change in Tax Revenues
FY 1971 – 2009

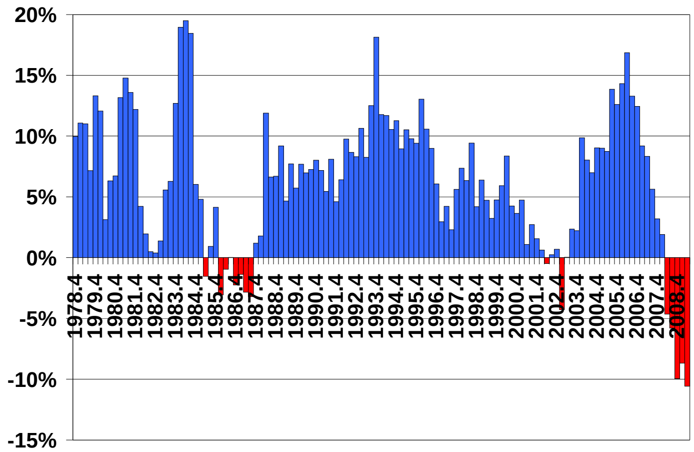
Source: Utah State Tax Commission



So why have tax revenues fallen so dramatically? Revenue changes are driven by both changes in the economy and in tax policy.

The economic slowdown has clearly impacted state revenues of all types. For example, Chart 14 shows the year-over change in quarterly taxable sales – the sales tax base. As the chart shows, each of the five quarters from 2008Q2 through 2009Q2 have exceeded any year-over decline in taxable sales in the past three decades.

Chart 14
Year-over Change in Quarterly Taxable Sales
FY 1978Q4 – 2009Q2



Source: Utah State Tax Commission

Chart 15 shows the year-over change in taxable sales in selected major sales tax sectors. As the chart demonstrates, although general merchandise sales have actually increased by about 5% over the prior fiscal year, many of the other larger sectors have decreased by over 20%, including motor vehicle, durable goods, furniture, and building and garden. These sales numbers have implications not only for the sales tax, but also for other taxes such as the income tax as the slowdown's effects carry through to employment and business profits.

In addition to economic changes, such as consumption pattern changes that show up in taxable sales data, part of the year-over decline in revenues over the past several years is due to tax reductions that were recently enacted.

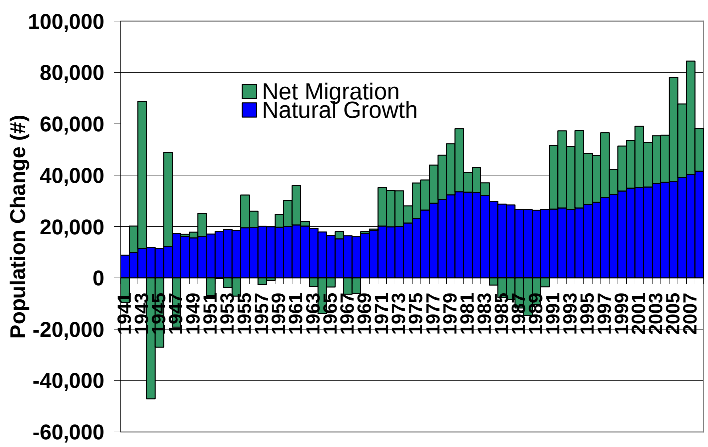
For example, SB 223 from the 2007 General Session was enacted when continued revenue growth was projected. The bill made major changes to the state's individual income tax system, reduced the state sales tax on food from 2.75% to 1.75%, and reduced the general sales tax rate from 4.75% to 4.65%[1], along with various other changes. The Office of the Legislative Fiscal Analyst's fiscal note estimated the bill's total tax reductions at $73 million in FY 2008 and $219 million in FY 2009. That is, an estimated $145 million of the year-over revenue difference between FY 2008 and FY 2009 was due to a tax policy decision to reduce revenues.

POPULATION

One important factor affecting the economy is population change. Population change is often categorized into two types: (1) natural increase and (2) net migration. Natural increase is internally-generated population increase – that is, the number of births minus the number of deaths. Net migration is the number of people moving into the state less those moving out of the state.

As shown in Chart 16, because of its comparatively high birthrate, Utah has a fairly predictable natural increase level which leads to overall population growth. Over the past several years, this natural increase alone has been about 40,000 annually – the equivalent of a city roughly the size of Bountiful.

Chart 16
Population Change
1941 – 2008

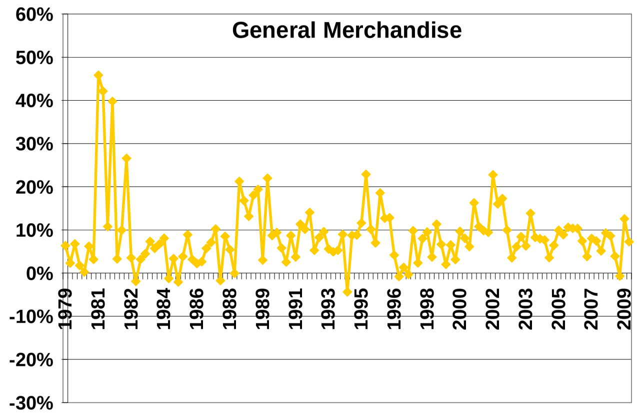


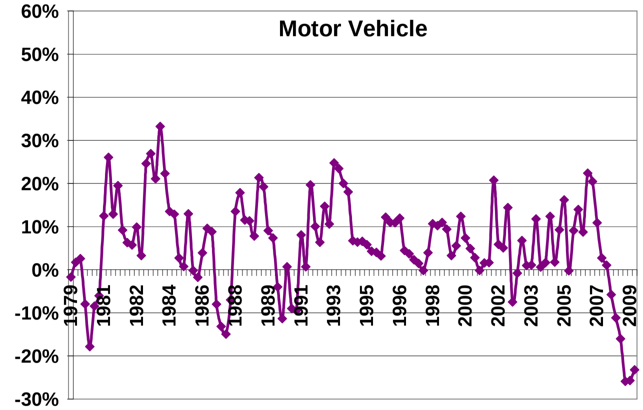
Source: Governor's Office of Planning and Budget

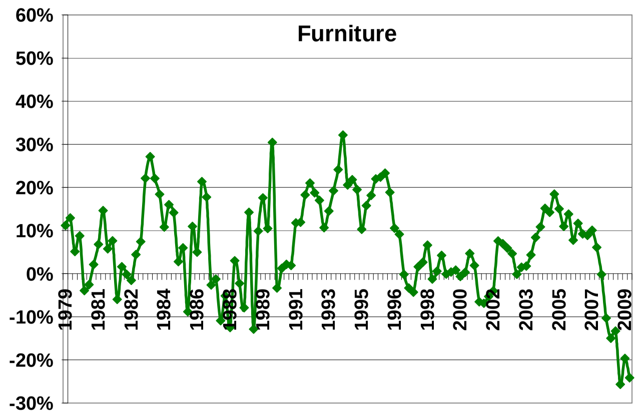
Unlike natural increase, net migration tends to be volatile. Utah has generally experienced positive net migration over the past 40 years. The state's last period of out-migration occurred between 1984 and

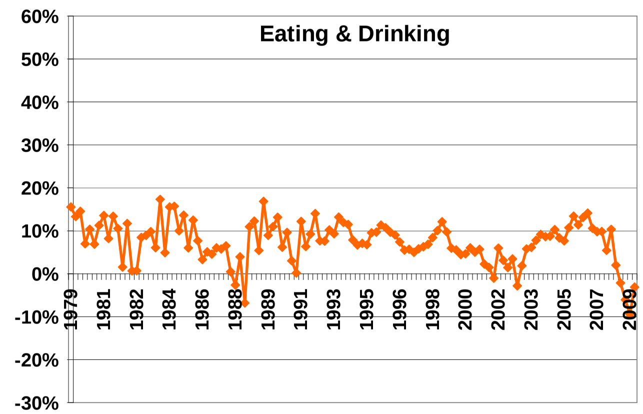
Chart 15
Year-over Taxable Sales Change, Selected Sectors
FY 1979 – 2009

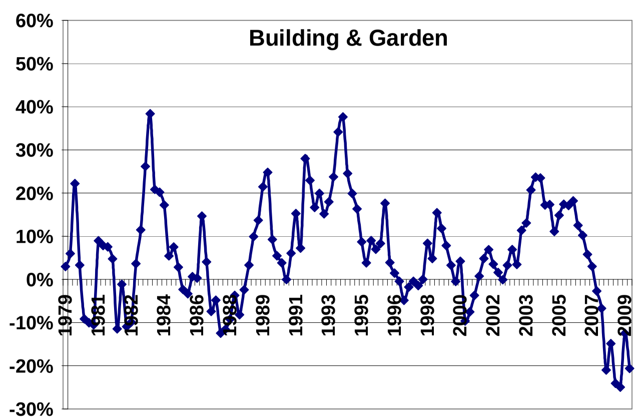
Source: Utah State Tax Commission

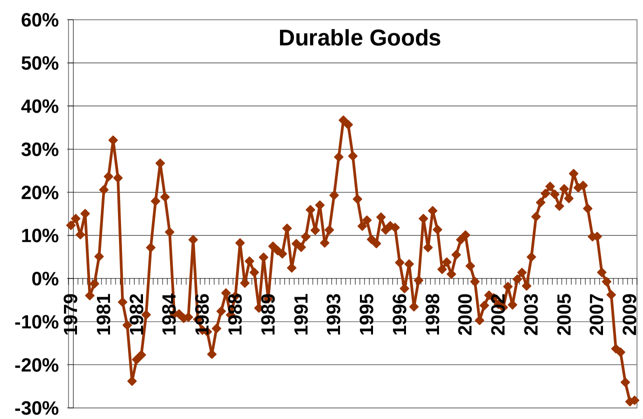


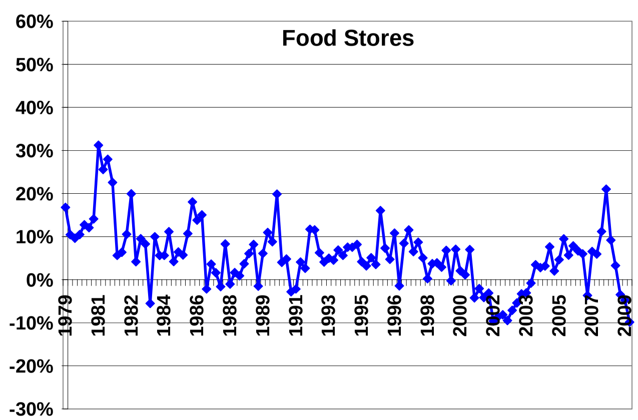


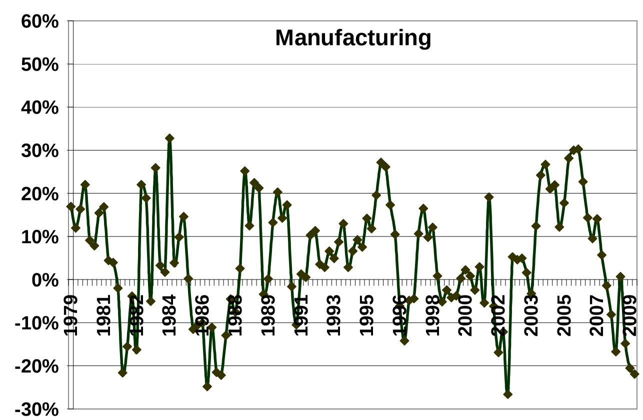












1990. But even in these years, the state's natural increase led to an overall population increase. In several recent years (2005 and 2007), net migration was so strong it actually exceeded natural increase. However, this net migration slowed dramatically as the recent recession began, from about 44,300 (2007) to about 16,600 (2008). It is projected to decline further in 2009.

Because of the strong natural increase accompanied with positive net migration, the Census Bureau reports that Utah was the nation's fastest growth state in 2008, with a population growth rate of 2.5%. For many decades, Utah has consistently ranked as one of the 10 fastest growing states and is often one of the top 5.

Population is an important economic indicator because population growth generally leads to greater demand for goods and services, thereby increasing total economic activity. Over time, population growth tends to have a positive impact on tax revenues as more people purchase food, clothing, housewares, housing, transportation, and other items. At the same time, this population growth also generally increases demand for government services, such as education, transportation, and municipal services.

OUTLOOK

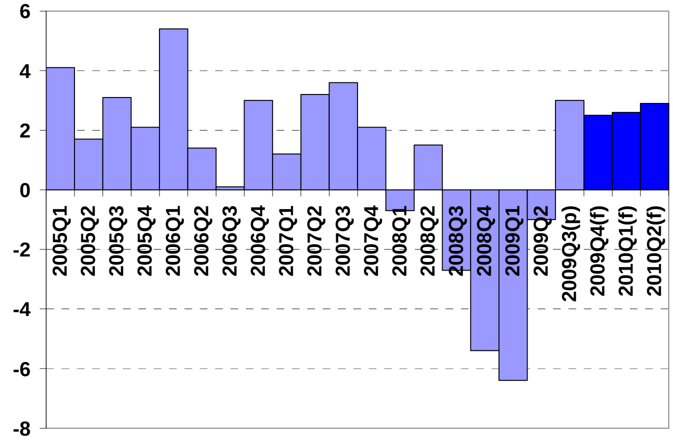
So when will the "Great Recession" end? Or at least stop getting worse? While economists differ in their forecasts of future economic activity, most agree that the national economy is now growing, albeit slowly, and that the worst of the recent economic downturn is behind us. However, this beginning of a national recovery does not mean that all economic indicators will be positive going forward, either for the nation or for Utah.

National Economy

The National Bureau of Economic Research, a private research organization that studies the economy, says that the United States entered into a recession in December of 2007, after 73 months of economic expansion. Chart 17 shows the percentage change by quarter in real gross domestic product (GDP) – the value of all goods and services produced in the country during a given period of time – since 2005 and forecasts through the first half of 2010.

Although only a rough rule of thumb, the nation is said to be in a recession if there are two consecutive quarters of decline in real GDP. While the U.S. economy shrank nearly every quarter between the first quarter of 2008 and the second quarter of 2009, a first look at GDP growth in third quarter of 2009 shows an increase of 3.5%. However, much of that growth was fueled by one-time government support, including incentives for car and home purchases.

Chart 17
Percent Change in Real GDP by Quarter
2005Q1 – 2010Q2(f)



Source: U.S. Bureau of Economic Analysis

The following are a few examples that suggest stabilization in the national economy:

- Most economists recently surveyed by the *Wall Street Journal* think that the economy is now expanding modestly and will continue to do so for the next year. However, those same economists believe the nation's unemployment rate will remain above nine percent during all of 2010. This means that though they believe there will be economic growth, job growth will not quickly follow.[4]
- Another recent survey of economic activity, conducted by the 12 regional banks of the Federal Reserve System, found that "economic activity is stabilizing or improving in the vast majority of the country." [5]
- Utah economist Jeff Thredgold writes: "The American economy returned to growth during 2009's third quarter, a welcome departure from an extended period of painful economic contraction. While the return to growth is obviously a positive development, it does not suggest that problems

with housing, commercial real estate, rising unemployment and continuing job losses are behind us."[6]

- With increases in eight of ten leading indicators, the Conference Board Leading Economic Index increased for the sixth consecutive month in September. "These numbers strongly suggest that a recovery is developing. However, the intensity of that recovery will depend on how much, and how soon, demand picks up."[7]

While "Wall Street" has been doing better the last few months, widespread optimism is yet to be felt on "Main Street." Consumer spending makes up about 70% of the nation's economic activity and there are few signs that consumers, still battered by weak home prices, declines in retirement accounts, credit restrictions, and worries about employment, are ready to propel economic expansion through consumption increases. Real household wealth has declined by trillions of dollars since 2007 and consumers are likely to continue their frugal ways.

This sudden frugality that hampers economic growth is sometimes referred to as the "paradox of thrift." At the very time when the economy needs consumers to spend more freely, contrary economic conditions persuade consumers to be cautious and save rather than consume. Although savings and investment are generally beneficial to the economy in the long term, in the short term this sudden replacement of consumption with savings lowers economic output.

Utah Economy

So what about the Utah economy? Although solid national GDP growth is clearly an encouraging sign, this does not necessarily translate to immediate improvement in all economic indicators, either nationally or in Utah.

Creighton University's Utah Business Conditions Index, based on a survey of the state's supply managers, showed an increase above the preceding months and suggests an expansionary economy over the next three to six months. However, their economist cautions that, "While our survey indicates the pace of job losses will diminish, I expect the region to continue to lose jobs."[8]

Employment tends to lag changes in other economic indicators. So the recent national 3rd quarter GDP growth is not likely to lead to rapid job creation in Utah. In many economic sectors, existing workers are working at less than full capacity due to furloughs or other working hour reductions. Prior to hiring new employees, employers are likely to give existing employees more hours. So even though job losses may be moderating, significant job growth seems unlikely to occur in the near term. This is important for the state because it will be employment growth that impacts tax revenue growth.

The state's two largest revenue sources are the sales tax and individual income tax; both are closely tied to employment. State tax revenues will not improve significantly until employment numbers improve.

In summary, while near-term economic conditions are less than positive, as employment losses moderate and housing markets improve over time, other sectors of the economy will also begin to improve. However, this is likely to take some time. So the recovery looks to be slow and moderate over the next few years.

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1. "Slump Removes Hard Hats Ladder to Prosperity." *The Wall Street Journal*. October 1, 2009.

2. "Utah's Employment Summary: September 2009." State of Utah, Department of Workforce Services. October 15, 2009.

3. The rate was later increased to 4.70% by HB 359 of the 2008 General Session.

4. "Economic Confidence Rebounds." *The Wall Street Journal*. September 11, 2009.

5. "Fed survey shows U.S. recession may be over." Yahoo Finance. URL: http://news.yahoo.com/s/ap/20090909/ap_on_bi_ge/us_economy. Viewed October 1, 2009.

6. "U.S. Economic Growth!" *Tea Leaf*. Thredgold Economic Associates. www.thredgold.com. October 29, 2009.

7. "The Conference Board Leading Economic Index (LEI) for the U.S. Improves Again; Sixth Consecutive Increase." www.conference-board.org. October 22, 2009.

8. "Utah Financial Outlook on an Upswing." *Deseret News.* November 2, 2009.