Economic & Revenue Forecast Tracking

March 2011

Employment and Financial Statement Data through 02/11

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I. EMPLOYMENT FORECAST

A. Macroeconomic Environment

Since mid-February, there has been little change in the US economy. The small change has been positive with better labor hiring news in February. But there have been changes in the rest of the world that could impact the US. The Middle East has seen a wave of political changes and potential for more. The Libya situation could turn into a supply disruption of oil and further the rise in oil prices. Commodity prices appear to be working their way into core inflation. However, with wage inflation still weak, the core inflation’s rise may be muted without a corresponding rise in household income.

Impacts on the US economy from the earthquake in Japan are not fully known at this time. If conditions continue to worsen, the disruption on international trade could lead to a slowdown in global growth.

B. Oregon Employment: Recent Conditions

The February employment report, released March 15th, indicated that Oregon gained 9,800 jobs during the month, following an upwardly revised gain of 6,700 in January. The unemployment rate in February decreased from 10.4 to 10.2 percent. This is the lowest unemployment rate in Oregon since January 2009. The job gain for February is the largest seen since October 1996, and the third largest since the current NAICS-based employment data begins in 1990. Taking a look at the industry-by-industry numbers reveals a very broad based gain across nearly all sectors, which is the type of gain one likes to see. Only Educational and Health Services declined month-over-month, however, this industry has performed better than most others over the course of the business cycle. Overall, no one sector is leading the economy out of the recession, with most benefiting from the overall economic recovery. Over the past five months, employment gains in Oregon have averaged 5,900 per month. Over the past year, employment has increased by 32,300 jobs or 2.03 percent. This marks the first time that the year-over-year employment gains have been at least 2.0 percent since March 2007. The graph below illustrates the employment gains by sector over the past year.
C. Oregon Employment: Forecast Tracking

Currently, employment is substantially above our office’s most recent forecast. The reasons for this are threefold, with the first two being technical in nature. First, the December employment numbers, which were preliminary at the time of our last forecast, were revised upward once a more complete data sample was in place. The preliminary December estimate indicated 1,800 jobs were lost during the month, while the revised figures show a gain of 4,000. Second, the annual benchmark revision for 2010 employment was also positive, meaning all of the original monthly estimates released throughout the year for 2010 were lower than the actual number of jobs in the state. The May employment forecast will incorporate these revisions and will therefore begin from a higher base than did the March outlook. Third, and most importantly, the Oregon economy is simply generating a larger number of new jobs than our office was forecasting last month. This is good news for the state economy as it translates directly into a higher level of aggregate wages and additional consumer spending.

Although the news in recent months has been positive, with the state’s employment picture having improved substantially, the labor market is still a long distance from being healthy. The graph below illustrates the job loss and recovery in Oregon across post-World War II recessions. Oregon lost 148,100 jobs during the most recent recession and still remains 114,200 jobs (6.6%) below pre-recession levels.

Given that our office’s forecast is a quarterly forecast, month-to-month comparisons and analysis can be somewhat problematic. The latest forecast called for about 2,400 jobs per month for the current quarter or a 1.8 percent increase at an annualized rate. Currently actual jobs are coming in much stronger, at a 3.8 percent annualized rate through the first two months of the quarter.
The upward benchmark revision together with the strong job gains in recent months have also improved Oregon’s relative ranking among all states. During the depths of the recession, Oregon was consistently in the bottom five states in terms of job growth. As of January, Oregon’s employment growth ranked 15th best across states. Following the strong February employment report, Oregon’s ranking has no doubt improved further this month.¹

II. PERSONAL INCOME TAX REVENUE FORECAST

A. Recent Collections

The recovery in personal income tax collections is progressing in step with the improvement seen in labor market conditions. After employment bottomed out at the end of 2009, growth in personal income tax collections accelerated noticeably. Revenue growth then stalled along with job gains as the economy entered into a soft patch during the summer of 2010. Improvement in revenue growth returned along with hiring early in 2011, with growth rates now consistent with what has been seen during previous periods of economic expansion.

¹ For more detailed information on the annual benchmark and how Oregon compares to other states, see our recent blog posts at: [http://oregoneconomicanalysis.wordpress.com](http://oregoneconomicanalysis.wordpress.com).
B. March 2011 Forecast Tracking

In the average fiscal year, 64.1% of all personal income tax revenues are collected by February. According to the March 2011 forecast, collections are running somewhat behind this pace, with only 59.5% having been received to date. Even so, no revisions to the outlook are called for at this time.

The fact that the share of collections received through February appears to be below its historical average is not surprising. With economic conditions having improved, and revenue growth having accelerated as the fiscal year progressed, it can be expected that year-end collections will be relatively large. The outlook for the last few months of the fiscal year looks very much like what was seen after turning points in recent business cycles (e.g. fiscal years 2005-07).

In addition to the acceleration of growth during the fiscal year, filing delays also suggest that we can expect a relatively strong year’s end for tax collections. Due to uncertainty surrounding whether Oregon would be connected to recent federal tax law changes, affected taxpayers were advised to delay filing their tax returns until the Legislature took action. Although policymakers have recently resolved the issue, the number of personal income tax returns received by the Oregon Department of Revenue through February was down 2% relative to last year.
C. Tracking the 2009 Close of Session Forecast

For the fourth quarter of 2010, personal income tax collections came in $30 million below what was assumed in the 2009 Close of Session forecast. As such, the cumulative error over the biennium as a whole has increased to $724 million. Most of this overall error arose when year-end returns for 2009 were filed, with tax payments reflecting the large income losses that households had incurred in housing and equity markets. Recent forecasts now reflect the altered landscape, and are not expected to change much in the May update. However, the Close of Session forecast will continue to overestimate revenue at the end of the biennium, since it is based on outdated income assumptions from two years ago.

D. Looking Ahead to 2011-13

This spring’s collections of final tax payments and refunds are important not only for the 2009-11 biennium’s revenue outlook, but also help to shed light on the outlook for the upcoming 2011-13 budget period.

Getting a good handle on year-end tax payments helps guide the outlook for the upcoming biennium in three primary ways. First, revenues in the current year form the starting point for the next biennium’s forecast. Errors in the current year forecast will typically shift estimates in future years up or down.

Second, the returns of taxpayers who file extensions (usually in October) often show growth similar to returns that are filed on time. While most of the revenue from extended returns is still paid by
April in order to avoid penalties, extension filers have historically played a large role during transition periods in the business cycle similar to what we are going through now. Extension filers include many of the wealthiest taxpayers (with complicated returns) who can move the needle by themselves in Oregon.

Finally, today’s final payments are the best indicator of next year’s quarterly estimated tax payments, since estimated tax payments tend to be very backward-looking. Many taxpayers take advantage of “safe harbor” rules that allow them to make minimum tax payments based on liability from the previous year without incurring penalties. Such filers often wait until the end of the year to calculate their true liability and settle up their bill.

Based on the tracking of revenues and near term economic outlook, there is not a compelling reason to change the revenue outlook for the rest of this biennium. For the 2011-13 biennium, we have new risks from the Middle East turmoil and the Japan earthquake on the downside and a strong February job report for Oregon on the upside. If the positive economic factors outweigh the negative, this may lead to raising the revenue outlook for 2011-13. Essentially, the recovery that is already in the forecast may turn out stronger. At this time, this can only be a qualitative statement and we truly have to wait for the April payments data before laying down numbers. As forecasters, the recent data indicates a more optimistic outlook for 2011-13.

We will continue to monitor both economic and revenue data. Our next update is scheduled for April 13, 2011.