Idaho Economic Outlook and Revenue Assessment Committee

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Chairmen and members of the Economic Outlook and Revenue Assessment Committee, thank you for this opportunity to present the national and Idaho economic forecasts. I will first review the national outlook then cover the Idaho forecast. The national economic forecast was prepared and released by IHS Global Insight in November 2013. IHS Global Insight is a world leader in economic forecasting and consulting. The data from the national forecast was then input into a computer-based model of the Idaho economy that is maintained and operated by the Division of Financial Management. Nathaniel Clayville is the person in our bureau that does most of the hands-on computer work. Once the data are available, Mr. Clayville and I work together to produce a forecast of Idaho's economy. Some of the outputs from the Idaho Economic Model, such as personal income, are then used to develop our General Fund revenue forecast that I will be discussing next week.

The Great Recession officially ended in the summer of 2009. However, it took about a year to see the first notable signs of a turnaround. After a slow start, the economy did begin to warm, but it was tepid compared to past recoveries. However, with time the economy is expected to slowly heat up.

Let's start our review of the national forecast with Real Gross Domestic Product. Real GDP is the inflation-adjusted value of all the goods and services produced in the US in a given fiscal year. The chart illustrates how it has grown and is expected to grow over the next few years. From this slide the Great Recession clearly had its biggest impact in FY2009 when real GDP shrank over 2.5%. It was flat in FY 2010. Real GDP growth recovered the next fiscal year and hovered near 2.0% over the next few years. These increases were welcome, but they were low for a recovery. The chart shows real GDP is forecast to grow by 2.0% again in FY 2014. However, growth is anticipated to speed up after that year.

Much of the projected real GDP acceleration depends on recovering consumer spending. This should come as no surprise, as consumer spending accounts for about two-thirds of the nation's economic activity. The current chart shows consumer spending retreated by nearly 2% in FY 2009, which coincided with the drop in real GDP. Over the next few years consumer spending is expected to revive, and this will boost real GDP growth. With so much riding on the recovery of consumer spending, I'd like to share a few slides on why spending is likely to improve.

We think that after several years, consumers will be in the mood to spend again. This can be seen in the current slide that shows the historical and predicted University of Michigan Consumer Sentiment Index. Notice how the index was at its lowest point during the recent recession. The chart also shows that after an initial rise to about 70 in FY 2010, consumer sentiment did not budge for three years. It finally moved above that level in FY 2013, and it is expected to improve further, rising to 90 in FY 2016.

One of the factors lifting consumers' moods is rising personal income. Higher personal income will not only improve consumer sentiment, but it will provide the means to increase spending. Spending should also be enhanced by pent up demand. Consumers postponed major purchases during and immediately after the Great Recession. A good example of this is automobile purchases. Car sales fell to under 5.5 million units in FY 2009. However, they have been growing since then and should top 8.3 million units in FY 2016.

The improving labor market is a major reason real personal income is expected to rise over the next few years. Wage and salary payments are the largest component of personal income. The two following graphs illustrate how the labor market is recovering since the Great Recession. The first chart shows nonfarm jobs. It can be seen that the US economy suffered net job losses in both fiscal years 2009 and 2010, and barely added jobs in FY 2011. This is one of the reasons the recovery did not feel like much of a recovery. Job growth grew by more than 1.0% in FY 2012 and should gradually speed up over the forecast period.

The next chart shows the US civilian unemployment rate. Thanks to the growing number of jobs, the number of persons employed is forecast to increase, and this will lower the unemployment rate. However, it should be pointed out that this improvement will be gradual. There are a couple reasons for this. First, job growth, while improving, is not robust. Second, as job prospects improve, persons that gave up looking for work will reenter the labor force. When they were not looking for work, they were not counted as unemployed. However, once they do start looking for work they will be counted as unemployed until they find a job. The improving labor market will boost consumers' moods.

Improving household finances should also lift consumers' spirits. As the chart shows, average household new net worth was about $68,000 in FY 2007, but dropped below this threshold in FY 2008 and remained under it through in FY 2012. It is estimated to have hit about $72,000 in FY 2013. It should continue rising after that and top $80,000 in FY 2016. The stronger household balance sheets will facilitate future spending.

Rising home prices is one of the factors fueling the increase in household net worth. The recent history and forecast of the Federal Housing Finance Agency national housing price index for purchased homes are charted in this slide. The index has a base of 100 in the first quarter of 1991. Thus, the index value of 225 in FY 2007 means the average home price in that year was 2.25 times what it was in the beginning of 1991. The price index fell steadily from FY 2007 to 184 in FY 2011. It rose above 200 in FY 2014 and should average about 220 in fiscal years 2015 and 2016. Keep in mind, however, that even after this growth the index is still less than what it was in FY 2006.

There are concerns that these home price increases and rising mortgage interest rates may stall the housing recovery by making homes unaffordable. However, rising income should help sustain the housing recovery. The National Association of Realtors' Single-Family Home Affordability Index measures how much family income is available compared to the amount needed to qualify for a mortgage for a median priced home. For example, an index of one means there is just enough income to qualify for a mortgage. An index of two means family income is two times higher than the qualifying amount. The current chart shows that affordability peaked in FY 2013, but should remain well above its FY 2007 trough for the foreseeable future.

Housing starts will also benefit from the increased number of household formations. Many people delayed starting households (getting married, moving out of family homes, moving back in with family, etc.) in recent years. In FY 2010, less than 300,000 new households were formed, which was more than one million fewer than in FY 2007. As the economy improves, so should the number of household formations, which will raise the demand for housing.

The combination of housing affordability and household formations will boost the demand for housing, and this will raise national housing starts. This is a welcome turnaround. One of the reasons the economy did not recover faster is the housing sector did not lead the economy out of the recession as it traditionally does. Finally, an important piece of the economic recovery is in place. Keep in mind, however, housing starts are not forecast to return to its bubble peak of more than two million units.

One concern with the recovering economy is the resurgence of inflation. As the first chart shows, has shown some spikes in recent years. These spikes are caused by temporary factors. For example, the FY 2008 spike was driven by soaring energy prices and strong food prices. Note that by the next year inflation had dropped significantly as these prices receded. Absent these temporary events, inflation should remain tame over the forecast period.

The major determinant of inflation will be labor costs. For most businesses personnel is their largest cost. These costs are built into their prices. A major reason consumer inflation is expected to stay low is the labor costs are projected to rise slowly. In a previous chart we showed the national unemployment rate gradually dropping over time. In fact, while it is headed in the right direction, the unemployment rate is not anticipated to drop below the rate consistent (about 5%) with full employment over the forecast period. Thus, employment cost pressures should rise slowly.

It's now time to shift our focus to the Idaho economy. The first chart shows the Gem State's nominal personal income. This is measure is the amount of income Idahoans have to spend. Its largest component is wages and salaries.

Personal income growth is forecast to have slowed to 3.7% in FY 2013 from 4.3% in the previous year. This slower growth reflects the expiration of the federal payroll tax cut. Farm proprietors' income is expected to have hit a record of $1.9 billion in this year.

Wage and salary payments are projected to grow 4.4% in FY 2014. However, some of these gains will be offset by farm proprietors' income is that is forecast to decline from the record of $1.9 billion in FY 2013 to $1.4 billion in FY 2014. As a result, Idaho nominal personal income should rise 3.5% that year. However, personal income should advance over 5% in both fiscal years 2015 and 2016, as wages and salary payments grow by more than 6% in each year.

The faster wage and salary payments pace mirrors the improved Idaho jobs outlook. In fact, nonfarm employment growth should increase gradually over the next few years. Specifically, the number of jobs is expected to increase 2.6% in FY 2014, 3.1% in FY 2015, and 3.3% in FY 2016. But this growth should be put in perspective; it will not match the pace it enjoyed during the middle of the last decade. And the level of employment is not projected to top its FY 2008 peak until FY 2015. The sectors adding the most jobs during the forecast period are: Professional and business services (12,500). Health care and private education (10,300 jobs). Retail trade (7,900). Construction (7,900). Leisure and hospitality (5,000 jobs).

My last slide covers Idaho housing sector. The good news here is that housing starts finally began improving in the FY2012 and are expected to gradually increase over the forecast period. I think it is important to stress the word "gradually." There are predicted to be about 14,400 housing starts by FY 2016. While this is about 10,000 more units that were built in FY 2011, it is about 8,000 fewer units than were built in FY 2006.