Key Driver:

Construction will dampen 2007 and 2008 taxable sales
1% Local Option Sales Taxes

The 1% city and county option sales tax is one of the major funding sources for Utah cities. Following several years of 9% to 11% growth, city sales taxes have declined in the past six months. The statewide percent change is important to almost all of Utah cities since it determines the growth of the 50% population share of the tax during its distribution by the Tax Commission.

Since growing 6.5% in April 2008, receipts have varied between 0.4% and -8.9%. Two factors may have influenced taxable sales in the past six months. First, the Tax Commission implemented a new sales tax system in the spring (hence the 6.5% bump in April, which may have included more than one month of receipts). Second, the Tax Commission awarded the cities $3 million in local taxes from the counties due to an audit of mobile telephone companies, which incorrectly filed returns to directly to the counties instead of the cities. Thus, actual taxable sales may have been even weaker than is portrayed in the chart below.

During the last three months the 1% local sales tax has fallen 4% relative to the same period in 2007. These receipts represented taxable sales from the summer months of July through September. November distribution receipts, representing sales in September, were down 7%. The succeeding charts explain how leading and coincident economic indicators have worsened over the past nine months spelling a serious economic downturn and resulting in a declines for Utah cities’ major revenue source – sales taxes.
Utah Employment (coincident indicator)

The number of people employed is a critical factor in determining demand for personal consumption and hence, sales taxes. When multiplied by the average wage, Utah wages and salaries becomes the key variable in determining consumer demand and sales tax growth.

Employment in Utah has been falling from the economic expansion 4% to 5% range from 2005 to 2007. Utah employment growth fell from 2% at the beginning of the year to negative 0.2% in October 2008. It still appears to be still heading downward. Declines in employment levels are being reported in the construction (-12.8%), manufacturing (-1.4%), information (-2.1%) and finance (-1.6%) and federal government (-1.5%) sectors.

Given the financial market collapse in October, we expect overall employment growth will turn negative during the next few months and average -1% in 2009. Usually when employment growth turns negative Utah moves into a recession and taxable sales take a dive.
Utah Unemployment Claims (leading indicator)

When unemployment claims start increasing significantly it means that employers are laying off people and not hiring. Unemployment claims tend to lead employment by three to six months and is therefore considered a leading economic indicator. Because monthly claims can be a little volatile, the last three months or quarterly average is considered as the best indicator for to gauge future employment trends.

Unemployment claims jumped up to 11,193 in November, higher than levels experienced in the 2001-03 recession. Utah claims were up 93% in November and up 67% during the last three months (September through November) compared to the same periods in 2007. This suggests that employment will continue to be soft in the next six months.
Utah Construction Employment (leading indicator)

Even though the construction sector represents a relatively small portion of Utah total employment, about 8%, it plays a key role in determining where the economy might turn in the future. Construction purchases are sales taxable. In addition, the economic multiplier for construction purchases is relatively high compared to other sectors.

Construction employment in Utah began to decline relative to 2007 in February 2008. In October it fell in fell 14.1% compared to a year earlier. For the last three months, July through September, construction employment fell 13.7%. Given the 56% drop in residential construction permit values for the year, it seems that employment is holding up fairly well. We expect it to fall further for the next few months, and then begin to improve in early 2009.
Utah Residential Construction Values (leading indicator)

Construction permit values ring through the economy more than twice. Once a project is permitted, purchases of taxable items commence. From the foundation that includes cement, lumber and steel to furnishings, drapes and landscaping most items are taxable for sales tax purposes. In addition, once new residential subdivisions are completed demand for nonresidential retail outlets follow a year or two later.

Since September of 2007 residential construction permit values have been falling in between 40% and 70% per month compared to a year earlier. In the past three months, July through September 2008, residential construction values fell 53%. September’s 38% decline would have been worse but for a large project in Midvale, which drove an 11% gain in Salt Lake County permit values. For 2008, we have decreased our projected decline from -40% to -47%. And, due to recent financial market collapses we have lowered our 2009 forecast from a 15% increase to 3% decline in residential permit values.
Long versus Short Term Interest Rate Spread (leading indicator)

The difference between long- (10-year Treasury note) and short- term (90-day Treasury note) interest rates indicates whether the Federal Reserve Bank is trying to loosen or tighten the money supply. Between 2001 and into late 2006, the spread was loosened dramatically to help move the U.S. economy out of the 2001 recession and past the 9-11 attack. Instead of closing the gap, short-term interest rates were kept extremely low at 1% until the middle of 2004. Because there was a lot of money chasing fewer projects a financial bubble was created, leading to the current finance tightening occurring now.

Late in 2007, the Federal Reserve Bank began lowering short-term rates in a move intended to loosen money supply. However, huge financial losses incurred by residential and hedge fund lenders have constrained lending at present.

In October 2008 the 90-day Treasury bill rate continued to fall from August’s 1.75% to 0.69% due to a international flight to safety. Meanwhile, September’s long-term rate (10 year) rose 12 basis points to 3.81%. The difference between the long- and short-term rates increased to 3.12%, indicating that the market spread loosened by 68 basis points. Despite favorable rate spreads, the most recent monthly Beige Book released by the Federal Reserve Bank indicates that banks are still reluctant to lend to each other and to businesses.
Coined in the stagflation years of the Carter administration, the Misery Index is a rather simple way to determine the pressures on the consumer. When unemployment and inflation rise increase in tandem, the consumer is worse off. The sum of unemployment and inflation create pressure points that can have an impact on consumer spending. It was not by accident the automobile industry funded the first U.S. Misery Index at the University of Michigan in the early 1950s. Strong negative correlations between automobile and truck sales have been found in many personal consumption economic models.

Utah’s Misery Index crossed the 8.0 mark in June 2008 and then peaked in July at 8.8. The Misery Index acts like an inverted confidence index. So, the 8.0 mark signals a downturn in consumer sales, especially for consumer durables like automobiles.

Utah’s unemployment rate has moved from the trough rate of 2.4% in May of 2007 to 3.5% in October 2008. Inflation in the Western U.S., which peaked in July 2008 at 5.3%, has begun to dive recently, recording a 3.3% increase in October. Utah’s Misery Index, which peaked at 8.8% in July, fell to 6.8% (3.3% inflation + 3.5% unemployment rate) in October. This fall in economic “misery” suggests that Utah consumers may start to loosen up on the reins for their spending. However, recent national reports of declines in employment will tend to push up even Utah’s unemployment rate over the next few months.