Key Driver:

Construction will dampen 2007 and 2008 taxable sales
Salient Economic Indicator Charts for Utah Cities

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.

During the last three months revenues from the 1% local sales tax declined 9.3% relative to the same period in 2007. These receipts represented taxable sales from the months from October through December (fourth quarter). February distribution receipts, representing December taxable sales, were down a disturbing 13.8%.

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.

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**Statewide 1% Local Sales Taxes**

![Statewide 1% Local Sales Taxes Chart]

2/27/09
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 2% in December 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 -2% to -3% in 2009. Usually when employment growth turns negative Utah moves into a recession and taxable sales take a dive. There is no exception to that rule in 2008, especially following the financial turmoil in the fall, which succeeded the residential construction collapse.

The chart below shows Utah employment growth from January 2001 through December 2008.
In the past two months, Utah’s decline in employment has exceeded California’s’s
(Source: St. Louis Federal Reserve Bank)
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 have now risen past the 10,000-level experienced in the 2001-03 recession to a 12,000 peak. Utah claims were up 105% in February 2009 and up 84% during the last three months compared to the same periods in 2007.

The unemployment claims data suggests that employment will continue to be soft in the next six months. The chart below demonstrate how unemployment claims and employment growth tend to mirror each other.
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 December 2008 it fell 22% compared to a year earlier. For the last three months, October through December, construction employment fell 18.4%. Given the 55% drop in residential construction permit values for the year, it is no wonder that construction employment is finally declining sharply. We expect it to fall further for the next few months, and then begin to improve in mid-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.

Until December’s 25% jump, residential construction permit values fell between 40% and 70% per month since late 2007. In the past three months, October through December 2008, residential construction values fell 33%. December’s 25% gain was partially due to permits for the significant City Creek retail/condo project in downtown Salt Lake City. This project will be under construction for at least another year and more, albeit smaller, permits are expected in 2009. For 2009, we are projecting another decline, approximately -10% to -25%. But this decline should be significantly less than 2008’s 52.7% drop. So, sales tax growth should be somewhat less negative.
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ong 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.

Since August 2008 the 90-day Treasury bill rate has steadily declined from 1.75% down to 0.13% in January due to an international flight to safety. Meanwhile, November’s long-term (10 year) rate of 3.53% slipped 101 basis points to 2.52% in January. Usually, mortgage rates tend to follow the 10-year Treasury bill. If mortgage banks perceive a long-term drop in their basic cost of funds, eventually mortgage rates may come down another 1 percent. This would help jump-start the construction market later this year. However, there may be resistance from investors when the Fed starts borrowing funds to pay for the bailouts.

Long vs. Short Term Interest Rates
10-year Treasury note rose slightly to 2.52% in January 2009
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 signaled a downturn in consumer sales, especially for consumer durables like automobiles.

Utah’s unemployment rate has increased from the trough rate of 2.4% in May of 2007 to our estimate of 4.7% in January 2008. The good news is that inflation in the Western U.S., which peaked at 5.3% in July 2008, fell to 0.1% in January. A Misery Index falling from 8.8% in July to 4.8% (4.7% + 0.1%) in January would normally suggest that Utah consumers might loosen up the reins for their spending. However, the drop in employment by 2% will trump the decline in the cost-of-living for consumer decisions to buy durable goods like autos and trucks. Until the job market improves soft retail durable sales are probably in the cards.