Salient Economic Indicators for Utah Cities

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Key Driver:
Construction will dampen 2007 and 2008 taxable sales

Utah Construction Permit Values  
In millions of dollars
- Residential
- Nonresidential
- Remodels

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 9.6% relative to the same period a year earlier. These receipts represented taxable sales from the months from November through January. March distribution receipts, representing January taxable sales, were down 5.7%. Following December sales decline of 13.8%, does the January loss of less than 6% signal an end to the double-digit drops? Maybe.

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 near 2% gains at the beginning of 2008 to negative 1.5% by December 2008. It still appears to be still heading downward.

February’s 2.1 percent decline indicates a further deterioration in Utah’s job market is probably in the cards over the next few months. It may be important to note that the economists that create this data recently revised ‘upwards’ the declines since last October. **Still, job declines portends declines in taxable sales over the near term.**

Declines in employment levels were reported in the construction (-15.6%), manufacturing (-7.8%), leisure and hospitality (-4.1), information (-3.4%) and finance (-3.1%) and the professional and business service (-1.2%) sectors during February 2009.

The chart below shows Utah employment growth from January 2001 through December 2008.
Over the past 24 months, Utah’s employment declines have tended to follow California’s declines.

(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.
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**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 January 2009 it fell 20.3% compared to a year earlier (the source of this data is from the U.S. Bureau of Labor Statistics through the St. Louis Federal Reserve Bank website and appears slightly more negative than data listed on the previous page from Utah’s Department of Workforce Services). For the last three months, November through January, construction employment fell 19%. Given the 55% drop in residential construction permit values during 2008, the only question is why hasn’t this leading indicator fallen faster. Expect it to fall further for the next few months, and then perhaps we will see improvements by the fall of 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, residential construction values fell 28%. January’s 33% decline, following December’s 25% serendipitous gain, may be leading to a less-severe string of declines compared to late 2007 and early 2008. Hopefully, we are in the early stages of a “bottoming out”. If that is the case, it bodes well for sales taxes.
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**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.

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. Similarly, November’s long-term (10 year) rate of 3.53% slipped 101 basis points to 2.52% in January, but edged up to 2.87% in February 2009. 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, this week there were rumbles in the bond markets as a London sale closed due to lack of interest and the Chinese are indicating they want to rely less on U.S. bonds.
Utah Misery Index – (coincident indicator)

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 5.1% in February 2009. 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 2009, edging back up to 0.3% in February. A Misery Index falling from 8.8% in July 2008 to 5.4% (5.1% + 0.3%) in February 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.