Utah League of Cities and Towns
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Key Driver:
Construction will dampen 2007 and 2008 taxable sales

Utah Construction Permit Values
In millions of dollars
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 12.7% relative to the same period a year earlier. These receipts represented taxable sales from May through July. September distribution receipts, representing July’s taxable sales, were also down 12.7%. Notably, July and August’s -10% and -15% respective declines were on top of -2% and -9% declines for the same months in 2008. Expect October distribution to decrease only 5 to 8% because of the cash for clunkers program. November and December could be closer to 10% declines before consumer spending improves relative to last year.

The succeeding charts explain how leading and coincident economic indicators have worsened in 16 of the past 17 months spelling a serious economic downturn and resulting in a declines for Utah cities’ major revenue source – sales taxes.
1% Local Option Sales Taxes, seasonally adjusted

In order to comprehend more fully how the latest monthly distributions compare to each other and
to levels in prior years it is useful to examine them without any monthly seasonal variation. We
have calculated monthly seasonal factors and have divided these factors into each month’s
distribution revenue. For example, the factor for February’s distribution, representing December
sales, is 1.218, or 21.8% higher than average.

The result indicates how far Utah cities’ number one revenue source has dropped during this
recession. Indeed, the 1% tax yield has fallen from a high of $42.4 million in May 2007 to a
low of $31.9 million in August and September 2009, a drop of 24.7 percent.
Salient Economic Indicator Charts for Utah Cities

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 (as opposed to the much broadcasted unemployment rate).

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.

By August 2009, Utah employment had fallen 4.4% from a year earlier. After improving somewhat in April and May, Utah’s job machine fell back during this summer. The job decline in Salt Lake County during August was even more severe – down 4.8%. Expect greater employment declines into the 5% range over the next several months, until the job machine recovers.

On a sector-by-sector basis, employment declines were reported in the construction (-17.2%), manufacturing (-10.2%), professional and business services (-7.5%), information (-3.7%), finance (-3.2%), and the leisure and hospitality (-3.5%) sectors during August 2009. In contrast, job gains were reported in the education and health services, (+3.2%), government (+1%), and natural resources (+0.9%) sectors.
Utah Employment Change Relative to California

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 are 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.

In January 2009, unemployment claims exceeded the 10,000 record monthly-levels experienced in the 2001-03 recession to a new peak of 14,934 in April 2009. September’s claims, after adjusting for seasonal changes, rose from the 13,900 to 14,200 level during June, July and August to 14,365, basically the same high level experienced since March. If claims continue to level off, it will be good news for Utah’s employment outlook about six months into the future.

Nevertheless, the huge, unprecedented upswing in unemployment claims over the last year suggests that Utah’s employment outlook will continue to be very soft over the next few 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.

After a sustained four-year boom, construction employment in Utah began to decline in February 2008. By March 2009, it had fallen 23.4% 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 5% worse than data listed on the previous page from Utah’s Department of Workforce Services).

By August 2009, Utah construction employment fell 17.5% from the prior year. March’s 23.4% decline may end up being the low point for this recession as construction employment appears to have stabilized at the 75,000 level (down from a peak of 105,700 in December 2007). Expect it to continue to fall relative to 2008 levels, about 20%, over the next few months, and then expect lower declines later this year.
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.

Before December 2008’s gain of 25 percent, residential construction permit values fell between 40% and 70% per month after late 2007. During the last three months, residential construction values fell only 4.9% compared to a year earlier. July’s 39% decline followed a 47% gain in June. It appears to us that residential construction is trending upwards (at least the declines are lower and there are some months of gains). Hopefully, we are in the final stages of a “bottoming out”. When these declines turn into positive gains, sales taxes will start improving.
Salient Economic Indicator Charts for Utah Cities

**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 financial headwinds we are experiencing 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 0.18% in May and June 2009 due to an international flight to safety. November 2008’s long-term (10 year) rate of 3.53% slipped 111 basis points to 2.42% in December 2008. **Usually, mortgage rates tend to follow the 10-year Treasury bill. Over the past eight months, 10-year notes began an upward trend of 105 basis points (1.05%) to 3.59% in August, as mortgage banks have perceived a long-term increase in their basic cost of funds.**

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**Long vs. Short Term Interest Rates**

10-year Treasury note rose 11 basis points in August 2009

- **Tightened money**
- **Loosened money**
- **Loosening money supply**

**Percent Yield**

- **Tbill 90 day**
- **Tbill 10 year**
Since large shares of economy switched from the federal government spending to consumer spending once the GIs returned from WWII, economists at the University of Michigan have surveyed American households with respect to their propensity to buy appliances and automobiles in the future.

The chart below of U.S. Consumer Sentiment portrays the impact of recent consumers’ concerns with their financial status and ability and desire to purchase large appliances and automobiles. Since mid-2007 sentiment dropped from the 90’s (a good level) down to the mid 50’s late in 2008. Consumer confidence or sentiment in the 50s and 60s create a psychological headwind against spending on durable goods, especially autos and trucks. Since February, American households’ confidence has improved from the mid 50’s to September’s reading of 73.5. **If the job market improves and interest rates and inflation stay low, confidence may continue to improve. This would stimulate car, truck and appliance sales.**

**U.S. Consumer Sentiment Index**

*September's reading of 73.5 was the highest in two years*
**Chart of the Month**

**Personal Savings Rate**

The U.S. personal savings rate, which had moved to the record low of 1% to 2% over the past few years jumped up to 6.2% in May 2009 and then backed down to 3% in August 2009. This implies that consumers had taken 4% to 5% of their incomes off the table in fear of further job losses that would otherwise go to **consumer spending and taxable sales**. Although this is good personal finance policy on an individual basis, on a short-term, macroeconomic basis it hurts demand for goods and services.

![Personal Saving Rate (PSAVERT)](chart.png)

*Source: U.S. Department of Commerce: Bureau of Economic Analysis*

Shaded areas indicate US recessions.

*2009 research.stlouisfed.org*