

Economic Update

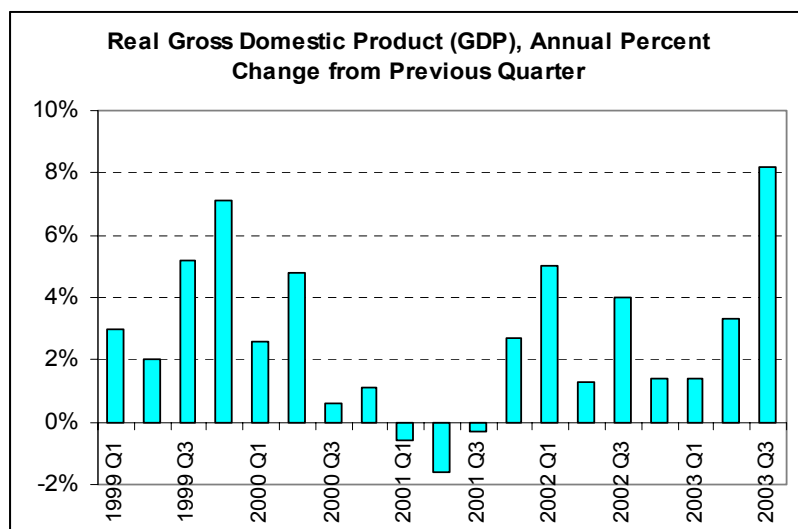
Update on economic issues affecting Seattle's tax revenue performance

DECEMBER 2003

ECONOMY

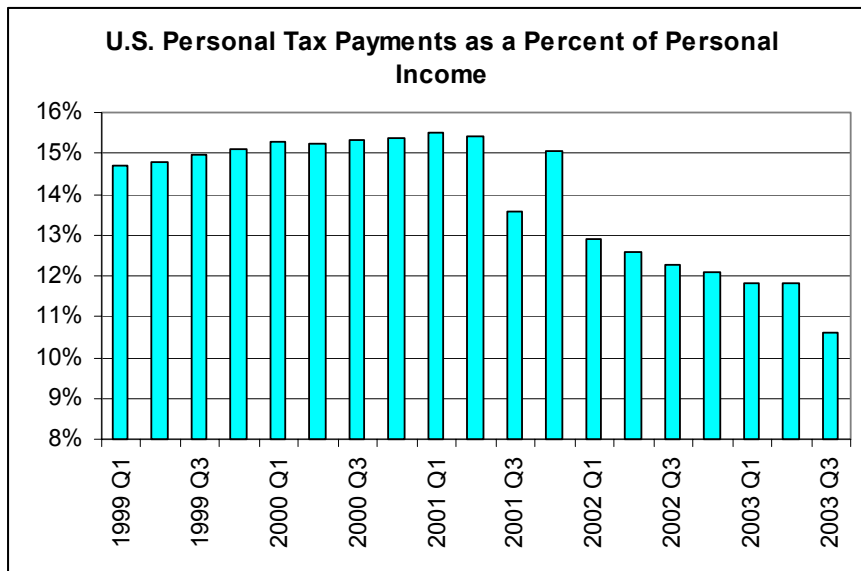
U.S. Economy. The recovery from the 2001 recession, which has been weak and uneven, stalled in the early months of 2003. However, after the conventional phase of the Iraq War ended in early May, the national economy began to pick-up. Industrial production has steadily improved after hitting a low in June, and the stock market has been rising since March. Productivity grew at a rapid pace in both the 2nd and 3rd quarters, and employment has grown at a modest pace in each of the past four months (August – November).

The improving economy was reflected in a remarkably robust 8.2% growth rate for real gross domestic product (GDP) in 3rd quarter 2003. The strongest components of GDP growth were consumer spending, investment in equipment and software, and residential investment (i.e., housing construction).



The strong growth of recent months has been driven in large part by very aggressive fiscal and monetary stimulus. On the fiscal side, a combination of a weak economy, very large tax cuts, and rising federal spending have caused the federal budget to move from a surplus of 2.4% of GDP in 2000 to a deficit of 3.7% of GDP in 2003, a shift of 6.1%. Three successive rounds of federal tax cuts have resulted in a sharp decline in personal tax payments, as illustrated in the figure below.¹ The most recent round of tax cuts went into effect in July of this year, providing stimulus for consumer spending in the third quarter.

¹ The tax payment data presented in the graph come from the GDP accounts. The data do not include sales and real estate taxes; consequently, federal and state income taxes account for a majority of the payments.

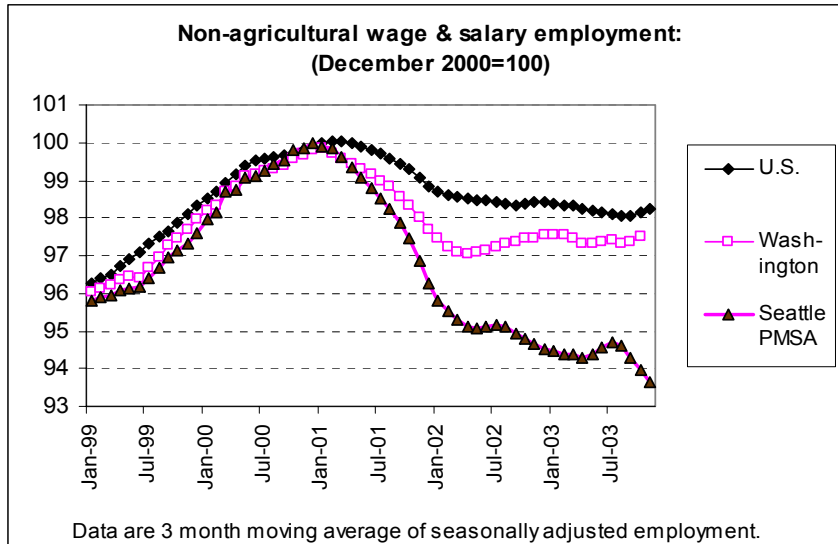


On the monetary side, Federal Reserve policies have pushed interest rates to their lowest level in over 40 years. Low mortgage rates have supported the housing market and home refinancing activity, and low interest rates have bolstered auto sales. The first half of 2003 saw a surge of home mortgage re-financings, which helped to spur consumer spending in the second and third quarters. Economy.com estimates that more than half of the increase in 3rd quarter GDP was due to temporary factors related to either federal government fiscal and monetary policy or the cycle of information technology equipment replacement.

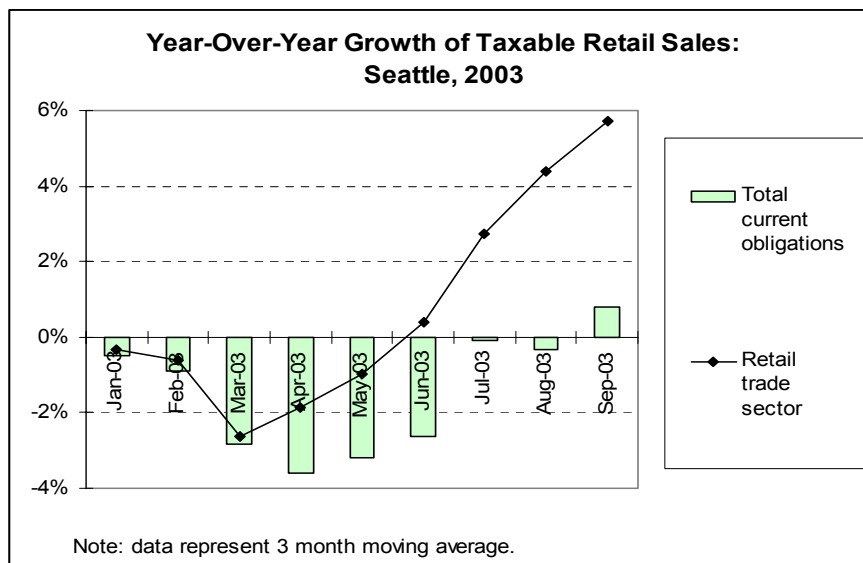
Looking forward to 2004, the key question is whether the recent economic revival can be sustained. Most economists are optimistic that a healthy recovery is now in place and will be sustained in the coming years. Key to sustained growth is a continued employment growth, which is needed to support the economy after the effects of the tax cuts and refinancing boom fade. The economy needs to produce 150,000 jobs per month to keep pace with the growth of the labor force. Also important to the recovery is continued growth in business investment.

Although there is more optimism about the economy's future now than at any time during the recovery, some economists fear that the expansion will be much weaker than anticipated. One reason for concern is that low interest rates have encouraged people to purchase homes and autos earlier than they would have otherwise. This reduces future demand for homes and autos, and increases the risk that demand will fall when interest rates rise. Other factors which could hinder the recovery include high household debt levels, and the nation's trade and federal budget deficits.

Puget Sound Region Economy. While the national economy accelerated in the third quarter, results for the region were mixed, based on the limited information that's available. The region's employment grew modestly in the spring, but then resumed its downward trend in August (see figure below). Since reaching a pre-recession peak at the end of 2000, the region has lost more than 90,000 jobs, approximately six-and-a-half percent of its employment base. During the same period, the nation's employment has fallen by two percent, and the state's by two-and-a-half percent.



Seattle sales tax data provide evidence that although employment continues to fall, consumer spending has picked-up locally as it has nationally. Despite the weakness of the local economy, the region's residents appear to be responding to the stimulus of federal tax cuts and low interest rates. As shown in the figure below, total taxable sales for current obligations² weakened early in 2003, but have recovered in recent months, with year-over-year growth turning slightly positive in September. For the retail trade sector alone, which encompasses the majority of consumer spending, growth has accelerated sharply in recent months, reaching nearly 6 percent on a year-over-year basis in September. Weakness in non-consumer industries, including construction, manufacturing, wholesale trade, and business services is holding back the growth of the overall sales tax base.



² Current obligations exclude payments for previous periods that are associated with refunds, audits, late payments, and payments of past due taxes.

Employment trends at the city level. Employment data, which is readily available for counties and metropolitan areas, is scarce for cities and other sub-county areas. Fortunately, the Puget Sound Regional Council develops small area employment estimates of covered employment³ for the region. Data are available only for the month of March for 1995, 2000, 2001, and 2002. Fortunately, these time periods allow us to look at the boom period of the late 1990s as well as the recent recession. The great majority of the recession's job losses occurred during the period March 2001 – March 2002.

Between March 1995 and March 2000, the 4 county Puget Sound Region added 264,951 jobs, an increase of 18.9% (see figure below). Growth was strongest in King County, particularly in cities located east of Lake Washington, where much of the region's high technology business is concentrated. Seattle added 82,289 jobs, a 19.2% increase, with growth particularly strong in construction, and a variety of business and professional services, including software related businesses.

Change in Covered Employment: Late 90s Boom and Recession*				
	<u>Number of Jobs</u>		<u>Percent Change</u>	
	<u>1995-00</u>	<u>2001-02</u>	<u>1995-00</u>	<u>2001-02</u>
<u>4 County Region</u>	264,951	-69,688	18.9%	-4.2%
King Co.	210,331	-61,112	22.4%	-5.3%
Kitsap Co.	3,097	1,986	4.5%	2.7%
Pierce Co.	25,368	-3,968	12.1%	-1.7%
Snohomish Co.	26,155	-6,594	14.3%	-3.1%
<u>Selected Cities</u>				
Seattle	82,289	-23,149	19.2%	-4.6%
Tacoma	5,541	-327	5.8%	-0.3%
Everett	6,500	-3,326	9.8%	-4.5%
Bellevue	25,360	-10,278	26.7%	-8.4%
Kirkland	10,555	-2,795	37.3%	-8.1%
Redmond	20,490	-1,275	43.4%	-1.6%
Kent	4,146	-1,335	7.4%	-2.2%
Renton	12,314	-4,185	28.8%	-7.5%
Tukwila	4,114	-8,448	9.4%	-19.2%

*Employment figures are for March of each year.

Between March 2001 and March 2002, a period which captures most of the recent recession's job loss, covered employment fell by 69,688 jobs, or 4.2%, in the four county region (see figure above). The pattern of growth among counties was reversed during the downturn. King County experienced the largest percentage job loss, followed by Snohomish. King and Snohomish are the counties with the greatest concentration of high-tech and aerospace businesses, which were hard hit by the recession.

In terms of percentage job loss, Seattle, with a decline of 4.6%, was near the region average. Among the region's large cities, Tacoma and Redmond had limited job loss, while Bellevue was

³ Covered employment includes all jobs subject to unemployment compensation taxes. It comprises more than 90% of total jobs.

on the high side at -8.4%. Job loss was high in Renton and Tukwila, both of which are home to Boeing Company facilities, but low in Redmond, home of Microsoft, and Kent.

Looking more closely at Seattle reveals that, unlike most cities in the region, Seattle also lost jobs between March 2000 and March 2001. Over the two year period March 2000 – March 2002, Seattle lost 31,082 of its covered employment, a decline of 6.1%. The percentage loss was greatest in construction and wholesale trade, communications, and utilities. Interestingly, although both the region and the nation have experienced significant job loss in manufacturing since the beginning of the 2001, Seattle's manufacturing employment remained essentially unchanged from March 2000 through March 2002.

Boeing will build the 7E7 in Everett. On December 16, Boeing announced that it would build the new 7E7 jetliner, and that assembly of the plane would take place in Everett. Boeing had been considering a number of potential locations in the U.S. for 7E7 assembly. Although the number of new jobs associated with 7E7 assembly is modest – in the 800 -1,200 range – the decision to build the new plane in Everett significantly increases the likelihood that Boeing employment will remain stable or increase in the future rather than decline. Had Boeing decided to build the 7E7 elsewhere, it could have been the first step in the gradual movement of commercial airline activity out of the state.

Monthly Cash Update

Comparing year-to-date revenues for general fund taxes and other major revenues with revised forecast.

Year-to-date through November: The following describes how actual 2003 collections for the most important general subfund revenues, through November, compare to the forecast reflected in the 2004 Adopted Budget. Overall, the actual collections exceed the forecast by \$4.5 million, with a big chunk due to better-than-expected B&O returns and property tax revenue. The following describes the notable differences in fuller detail.

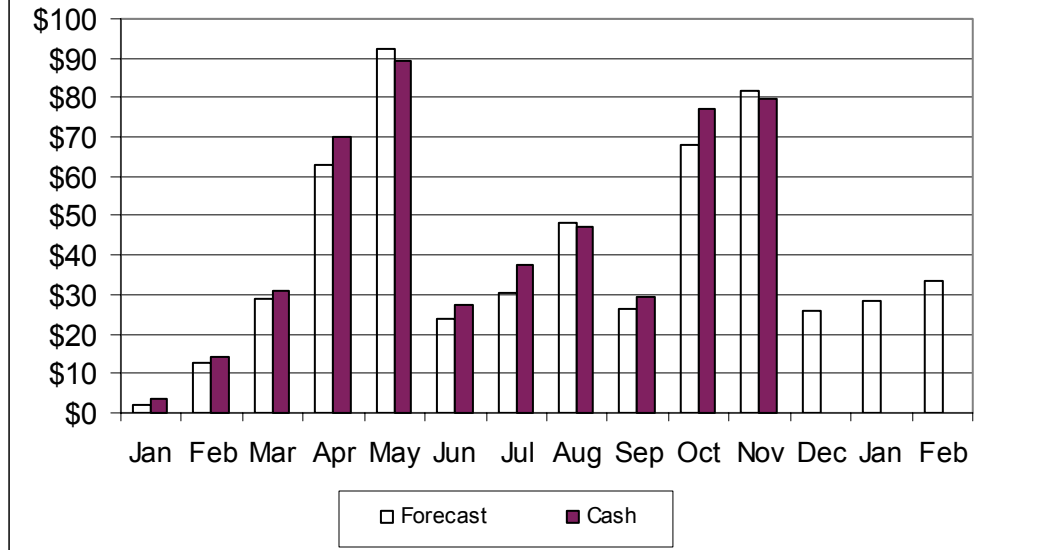
B&O tax: Through November, B&O tax revenue is \$1.3 million above the forecast. B&O receipts have been particularly healthy for service businesses, including hospitals. In addition, receipts from retail trade businesses have improved with the growth of consumer spending in recent months.

Property tax: Actual receipts for property tax are significantly higher than forecast. These gains, however, are likely to be offset by lower-than-anticipated revenues in the remainder of the year as Seattle's share of tax refund and delinquency payments are tallied by King County staff, who administer the property tax.

Admission tax: Collections to date are 9% over forecast and 30% greater than collections in 2002. The strong performance this year is due to larger than expected payments from general entertainment venues such as movie theatres and concerts. The strong year-over-year growth results from the rescission, in 2003, of City policy to allocate 20% of revenues from this tax (excluding revenue from pro sports teams) to the Arts Account.

Interest Earnings: Both cash balances and interest in November fell short of expectations. As a result, interest revenues were down by \$100,000 for the month.

2003 General Fund Forecast vs. Actual Cash Receipts
in millions of dollars



2003 CASH UPDATE THROUGH NOVEMBER

	YEAR TO DATE				COMPARISON TO 2002		
	Cumulative Forecast	Actual	Difference	Percent	Cumulative 2002	Yr/Yr Difference	Yr/Yr Cumulative
PROPERTY TAXES							
General + EMS	174,503,000	176,302,000	1,799,000	1.0%	170,476,000	5,826,000	3.4%
Leasehold Excise Tax	2,904,000	2,932,000	28,000	1.0%	2,850,000	82,000	2.9%
RETAIL SALES TAX							
General	82,754,000	82,823,000	69,000	0.1%	84,219,000	-1,396,000	-1.7%
Criminal Justice	7,838,000	7,963,000	125,000	1.6%	7,968,000	-5,000	-0.1%
BUSINESS TAXES AND OTHER							
Business and Occupation	86,083,000	87,365,000	1,282,000	1.5%	86,046,000	1,319,000	1.5%
Utilities - City Light	24,917,000	24,889,000	-28,000	-0.1%	25,669,000	-780,000	-3.0%
Utilities - City Water	6,904,000	6,976,000	72,000	1.0%	5,997,000	979,000	16.3%
Utilities - City Drainage/Waste Water	11,089,000	11,096,000	7,000	0.1%	10,661,000	435,000	4.1%
Utilities - City Solid Waste & Garbage	6,296,000	6,482,000	186,000	3.0%	6,321,000	161,000	2.5%
Utilities - Cable Television	6,753,000	6,739,000	-14,000	-0.2%	6,451,000	288,000	4.5%
Utilities - Telephone	24,938,000	25,158,000	220,000	0.9%	24,809,000	349,000	1.4%
Utilities - Private Energy	6,412,000	6,595,000	183,000	2.9%	8,457,000	-1,862,000	-22.0%
Admission Tax	5,041,000	5,488,000	447,000	8.9%	4,183,000	1,305,000	31.2%
Court Fines and Forfeitures	14,421,000	14,556,000	135,000	0.9%	13,039,000	1,517,000	11.6%
Interest Income	1,628,000	1,462,000	-166,000	-10.2%	2,720,000	-1,258,000	-46.3%
Parking Meters	8,776,000	8,905,000	129,000	1.5%	8,734,000	171,000	2.0%
Misc. Revenues	5,191,000	5,185,000	-6,000	-0.1%	4,756,000	429,000	9.0%
TOTAL	476,448,000	480,916,000	4,468,000	0.9%	473,356,000	7,560,000	1.6%
Real estate excise tax	25,676,000	25,856,000	180,000	0.7%	20,612,000	5,244,000	25.4%