

IS THIS AS GOOD AS IT GETS? THE 2019 ECONOMIC OUTLOOK

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THE USUAL CAVEATS

Michigan's May Consensus Revenue Estimating Conference is scheduled for May 17th (Friday) and our office's outlook on the economy and revenues may change from the January estimates presented tonight. I will discuss what we've learned since January.

Opinions expressed should be attributed to me alone and may not represent the views of the Department of Treasury or Treasurer Eubanks.

I currently serve as the president of the Board of Education of St. Johns Public Schools, and my opinions should not be considered to represent the Board in any way.

OUTLINE

Overview of Economic Conditions

- U.S.
- Michigan

Transportation Proposal and the Michigan Budget

Economic Outlook

- U.S.
- Michigan

SUMMARY OF CURRENT CONDITIONS

Moderate growth continues

Few signs of excitement or alarm (few, not none)

Consumer spending is growing but the first quarter was not particularly strong

Investment continues to grow with intellectual property leading the way

No significant movement in inflation, exchange rates or interest rates

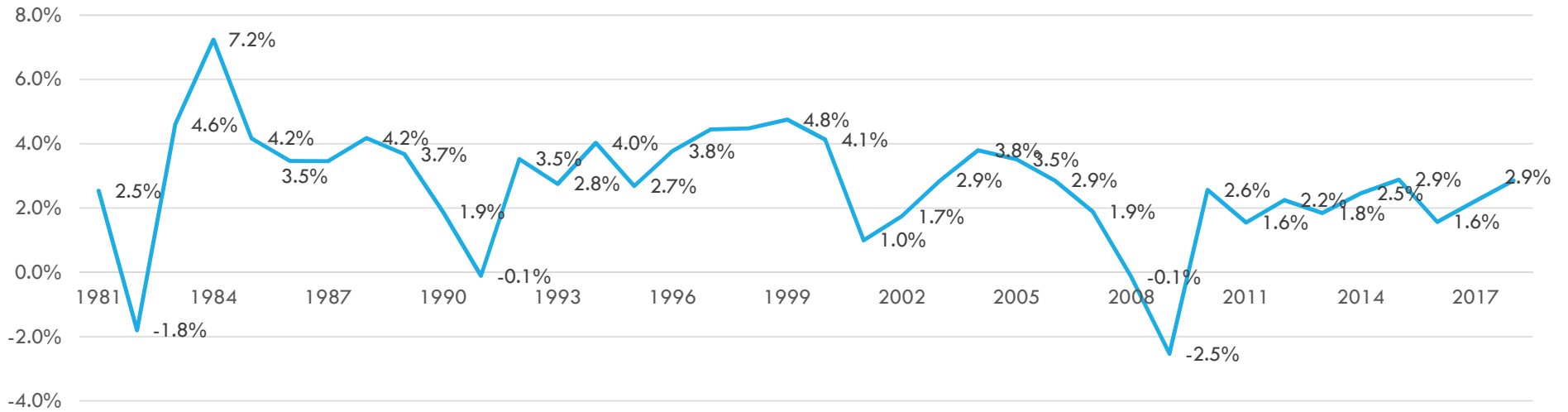
Global growth appears to be slowing, but not sharply

Trade talks are worrisome, but we've been here before

Trade deficit is somewhat larger over the past few years

With a 10-year expansion and coming off a large tax cut we're left wondering, "is this as good as it gets?"

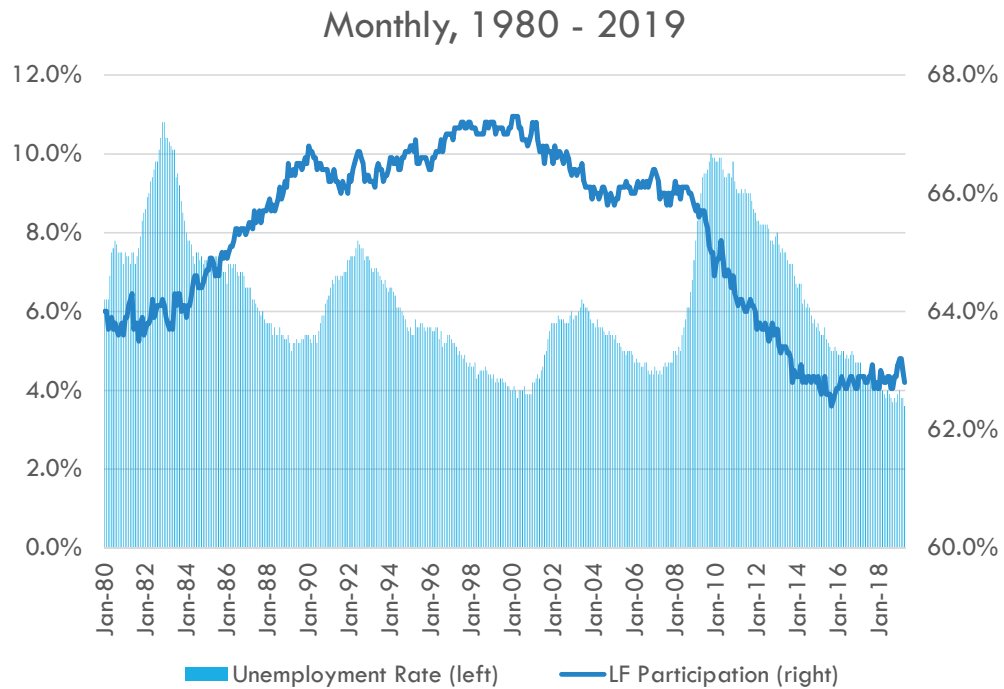
Year-over-Year Growth



Source: BEA.

GROSS DOMESTIC PRODUCT GROWTH 1981-2018

JOB GROWTH AND LOWER PARTICIPATION DRIVE UNEMPLOYMENT RATE TO HISTORIC LOWS



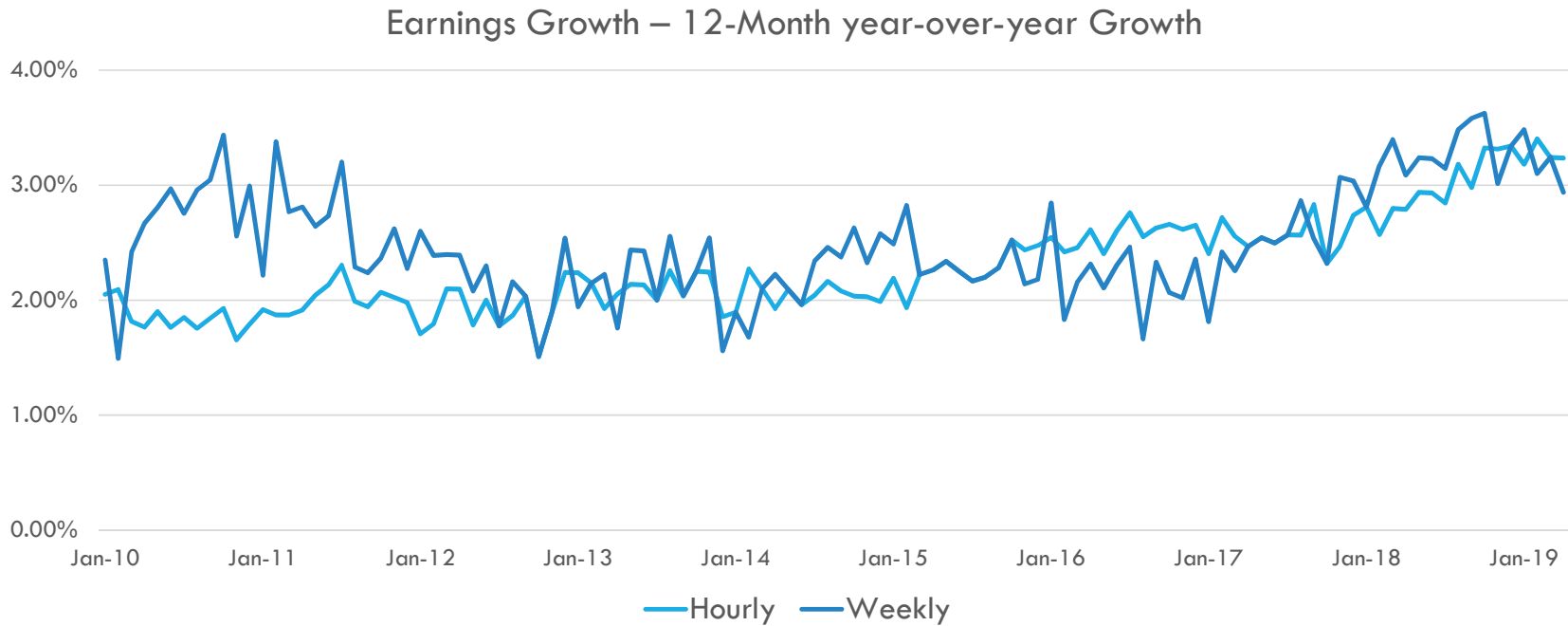
Source: BLS

Population 258.7M

Unemployed 5.8M

1% of Population = 44% of Unemployed

EARNINGS ARE GROWING



Source: BLS

WHO ARE WE, ECONOMICALLY SPEAKING?

Michigan had approximately 3.06% of the U.S. population and 2.71% of U.S. personal income in 2018.

We are a bit older than the U.S. population overall

- Median age 39.8 vs. 38.0
- Percent over age 65 and older 16.7% vs. 15.6%

We are more likely than the U.S. population to have completed high school but less likely to have a Bachelor's degree or higher.

We are more likely to live in owner-occupied housing.

Median household income in 2017 was lower in Michigan (\$52,668) than the national average (\$57,652).

MORE ABOUT US

Michigan's unemployment rate for March was 4.0%, close to the U.S. average of 3.8%.

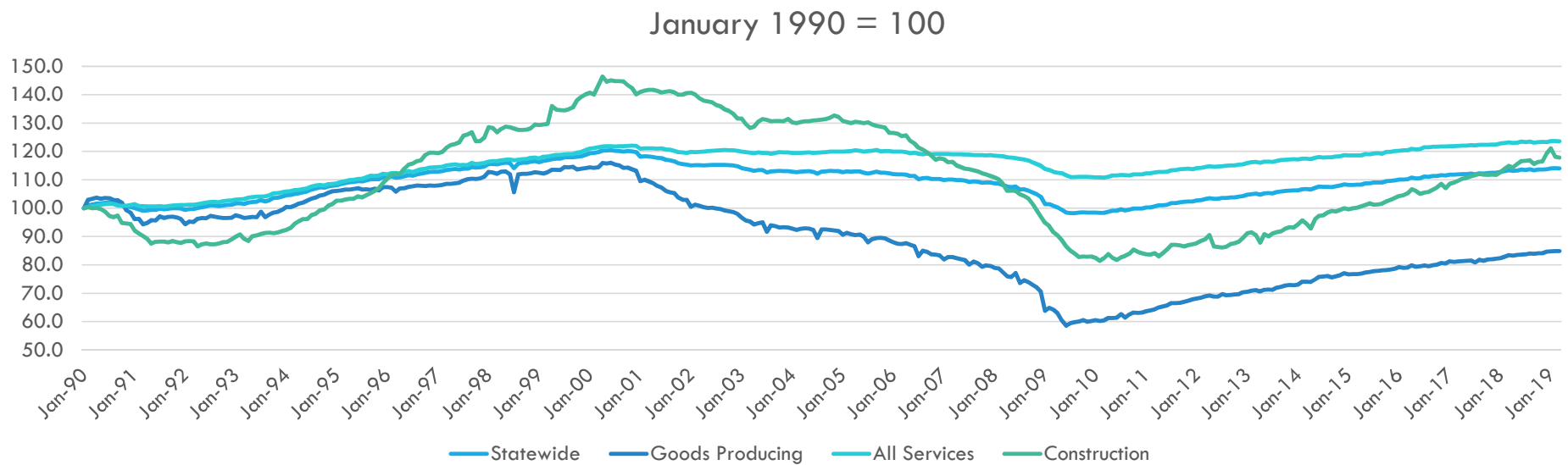
We have fewer adults in the labor force than the U.S. overall, and a higher percentage of people living below the poverty thresholds.

In terms of industry distribution compared to the U.S.:

- More Michigan residents work in manufacturing or professional and business services
- A similar percentage work in trade/transportation/utilities, education/health services, and other services
- A smaller percentage work in construction, information, financial activities, government, or leisure/hospitality

Overall, more than 10% of Michigan employees work in:

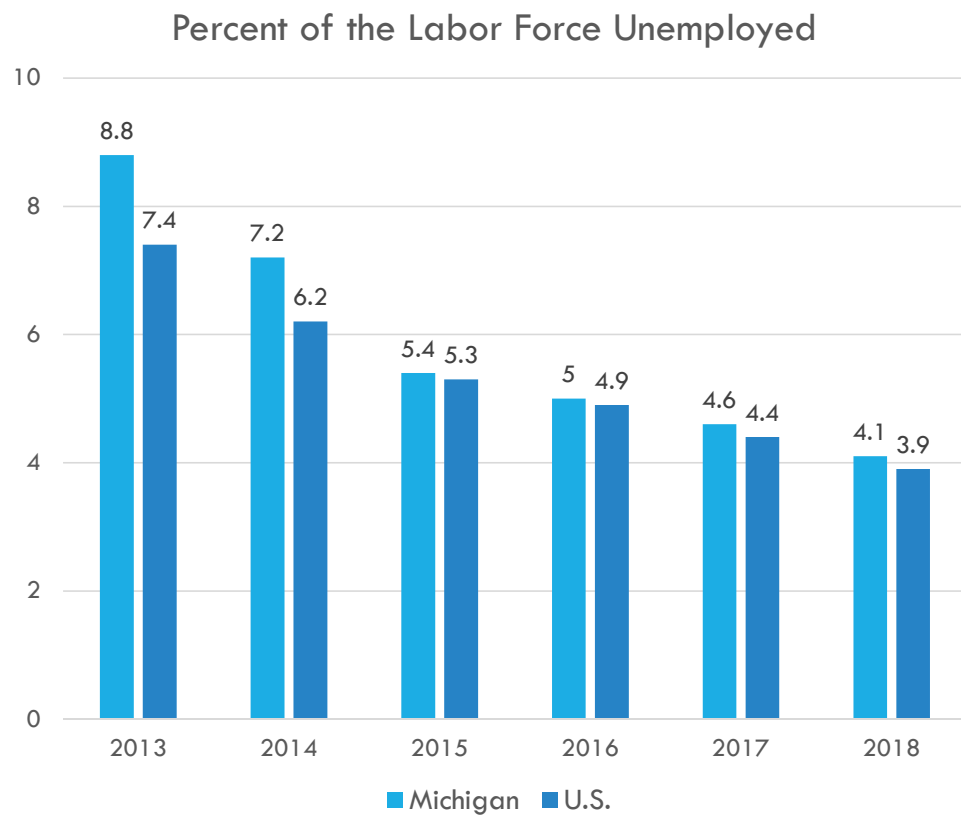
- Trade, Transportation and Utilities (17.9%)
- Education and Health Services (15.4%)
- Professional and Business Services (15.0%)
- Manufacturing (14.3%)
- Government including public education (13.7%)



Source: BLS

MICHIGAN EMPLOYMENT, 1990-2019

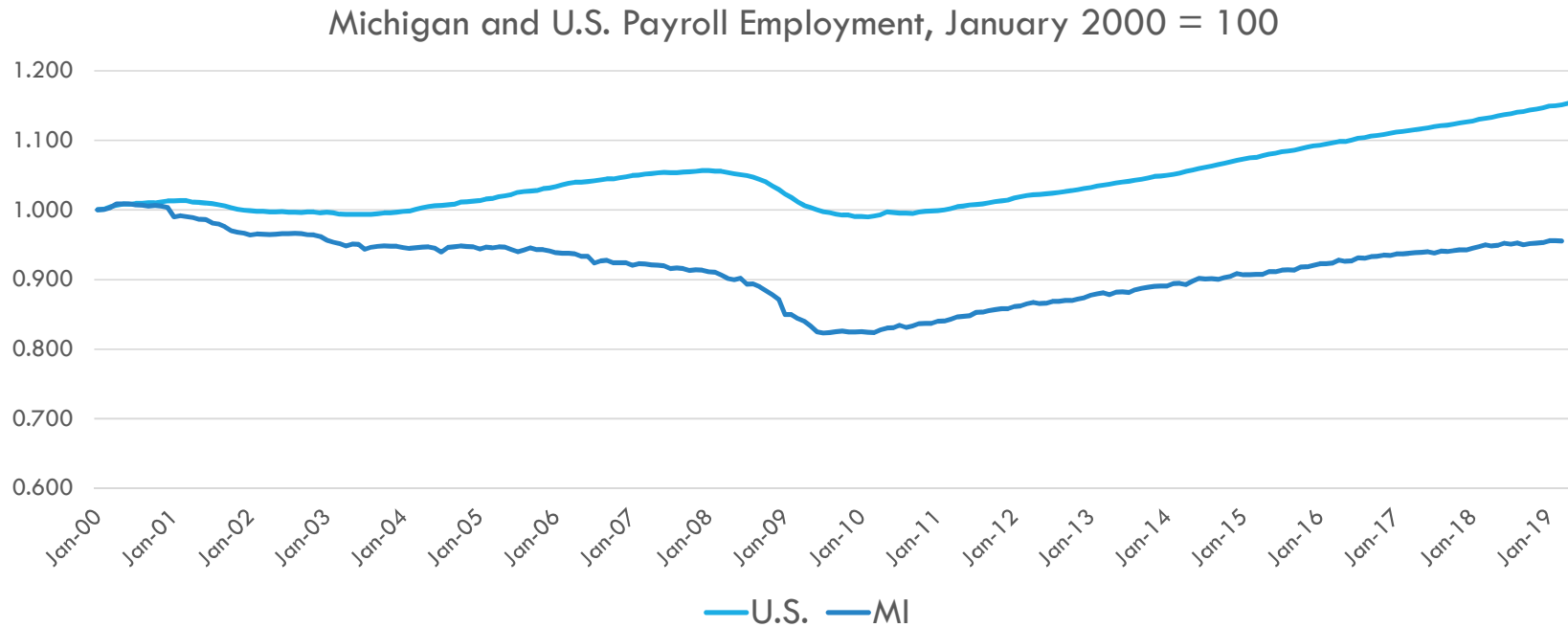
SERVICE EMPLOYMENT GAINS OVER TIME



Source: BLS

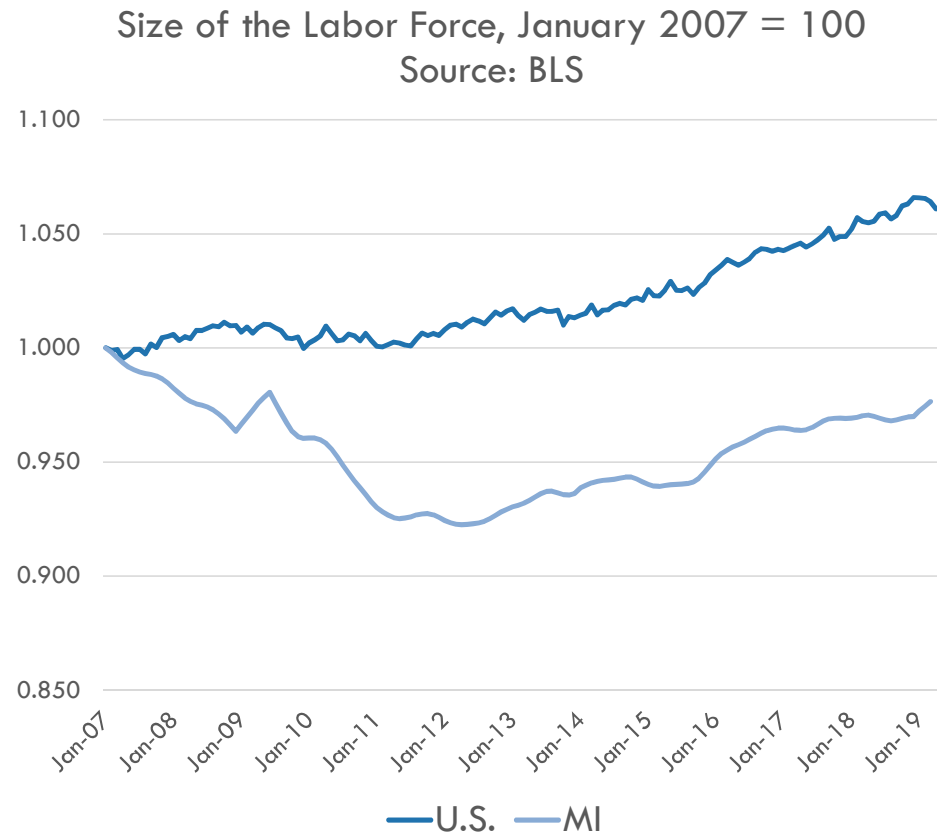
UNEMPLOYMENT
RATES —
CHASING THE
U.S.

LONG-TERM COMPARISON OF EMPLOYMENT GROWTH

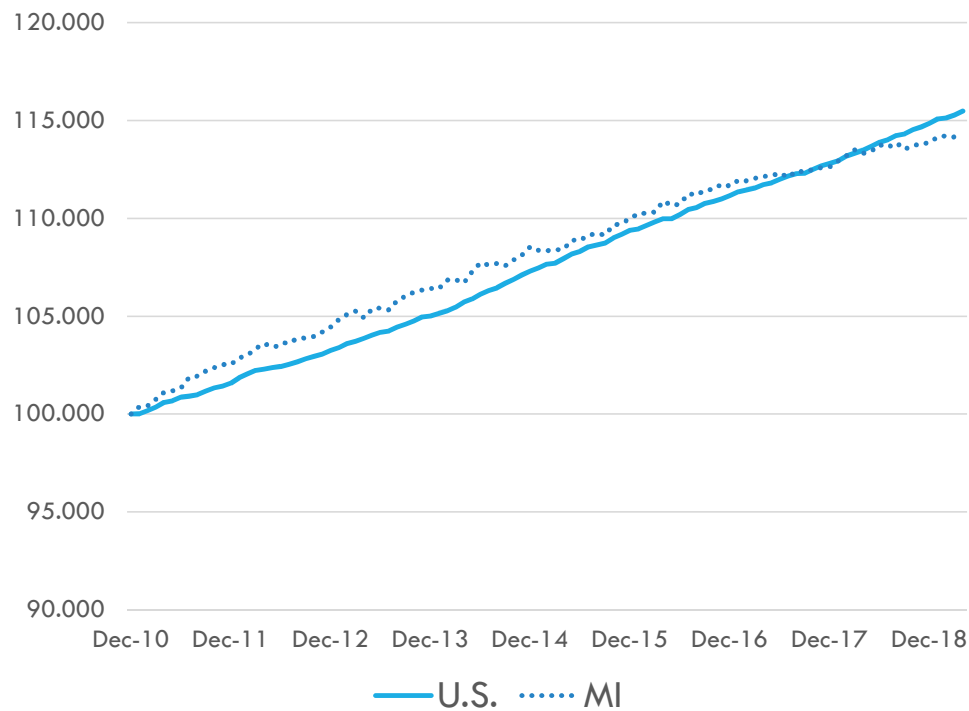


Source: BLS

IT'S NOT JUST PAYROLLS



Michigan and U.S. Payroll Employment,
December 2010 = 100

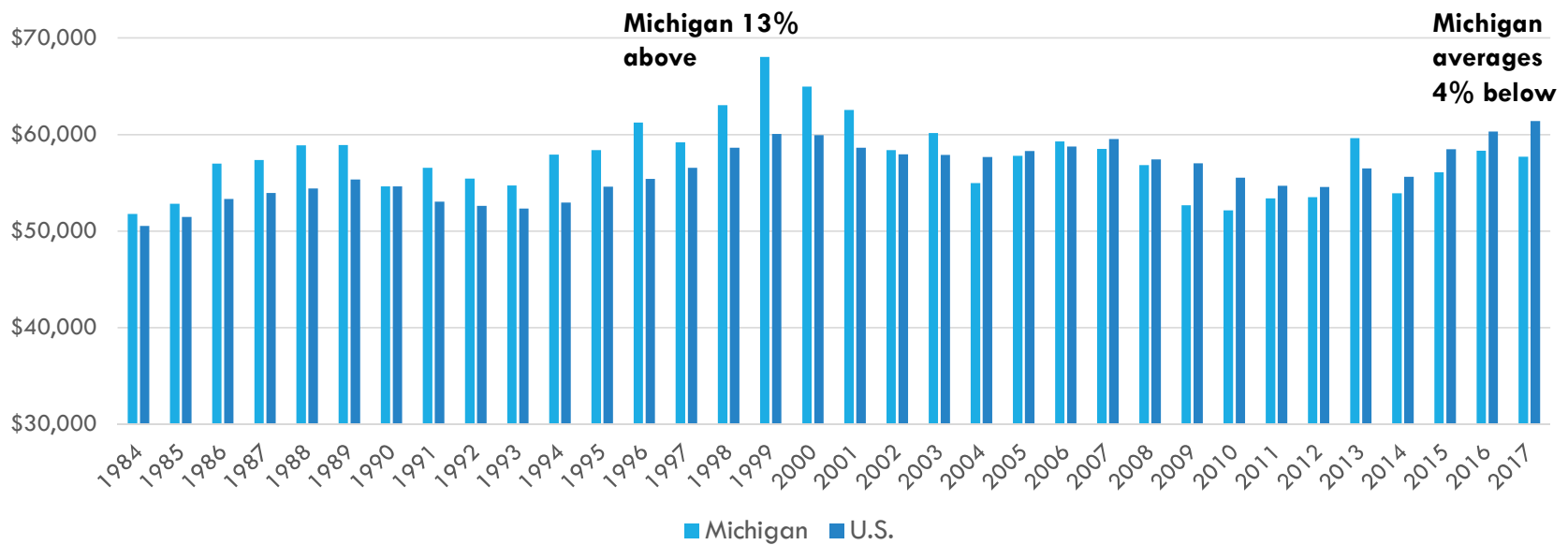


Source: BLS

**MICHIGAN
EMPLOYMENT
GROWTH
SLOWING, 2011
— 2019**

MICHIGAN FALLS BEHIND IN MEDIAN HOUSEHOLD INCOME

Median Household Income, 2017 Dollars



Source: Census

FINAL THOUGHTS ON THE U.S. LABOR MARKET

Payroll employment growth has been strong, especially outside of Michigan

New claims for unemployment insurance continue to be extremely low

Wage growth isn't as strong as the low unemployment rate might suggest

Payroll employment growth is exceeding household employment growth

Economists generally prefer the payroll measure

Household employment includes self-employment so a switch from being a contractor to an employee raises payroll employment but not household employment

TAX CUTS AND JOBS ACT - 2017

Lower tax rates for both individuals and corporations (from 35% max to 21%)

Reduced deductions

- SALT, mortgage and miscellaneous for individuals

- Interest and losses for businesses

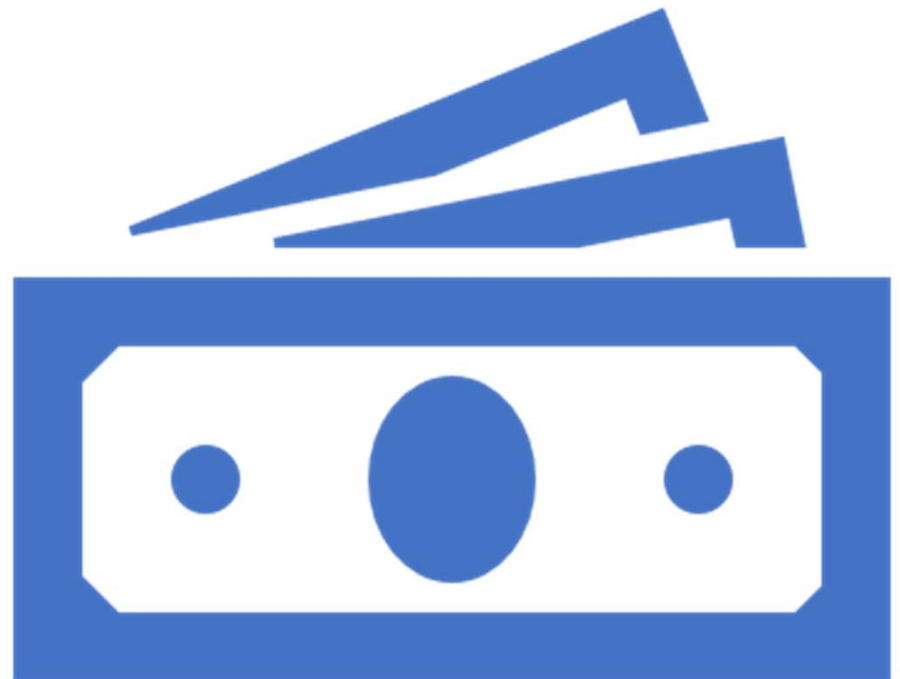
Increased standard deduction

Increased child credit

20% deduction for pass-throughs

Corporate AMT repealed

Changes to taxing income from abroad



IMPACT ON MICHIGAN

Most states use federal adjusted gross income or taxable income as a basis for state taxation.

The TCJA generally expanded the tax base for individuals and corporations.
In Michigan:

- Very modest net expansion for individuals (disallow business losses);
- About a 9% expansion for corporations overall, from specific items.

Legislature offset the tax base expansion by increasing the personal exemption for individuals.

- TY 2018: +\$50 per exemption
- TY 2019: +\$300
- TY 2020: +\$550
- TY 2021: +\$600

Withholding – Tax Liability =
Refund (**Balance Due**)

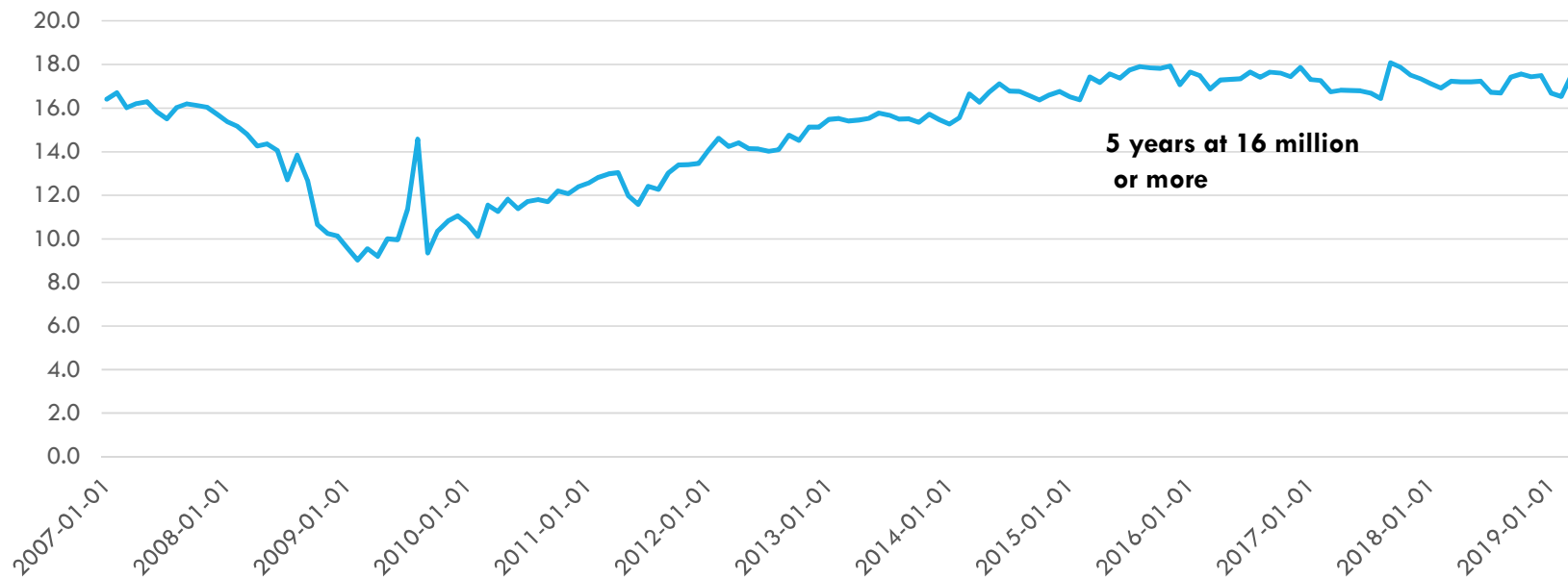
If you change both withholding and the tax amount, it can be hard to predict what happens to refunds

Nearly $\frac{3}{4}$ of all returns for 2017 received refunds averaging \$2,899. The average refund for 2018 is down about 1.6% with about 942,000 fewer refunds (0.9%), as of 5/3/2019 from IRS.

TAX CHANGES

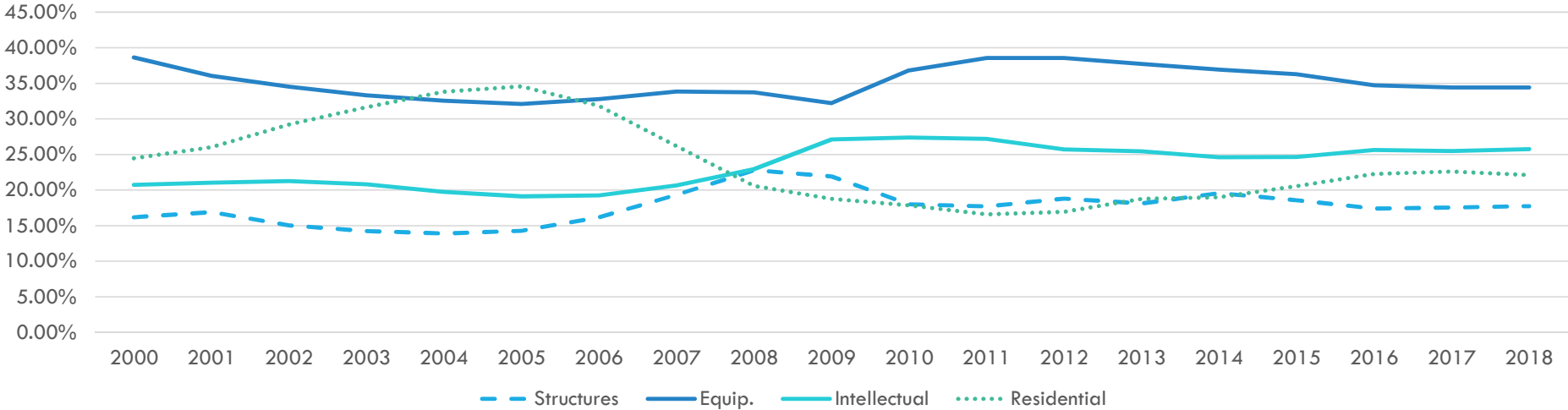
CAN WE HOLD ON TO 17 MILLION?

Light Vehicle Sales – Seasonally Adjusted Monthly Sales at an Annual Rate
(millions)



Source: BEA

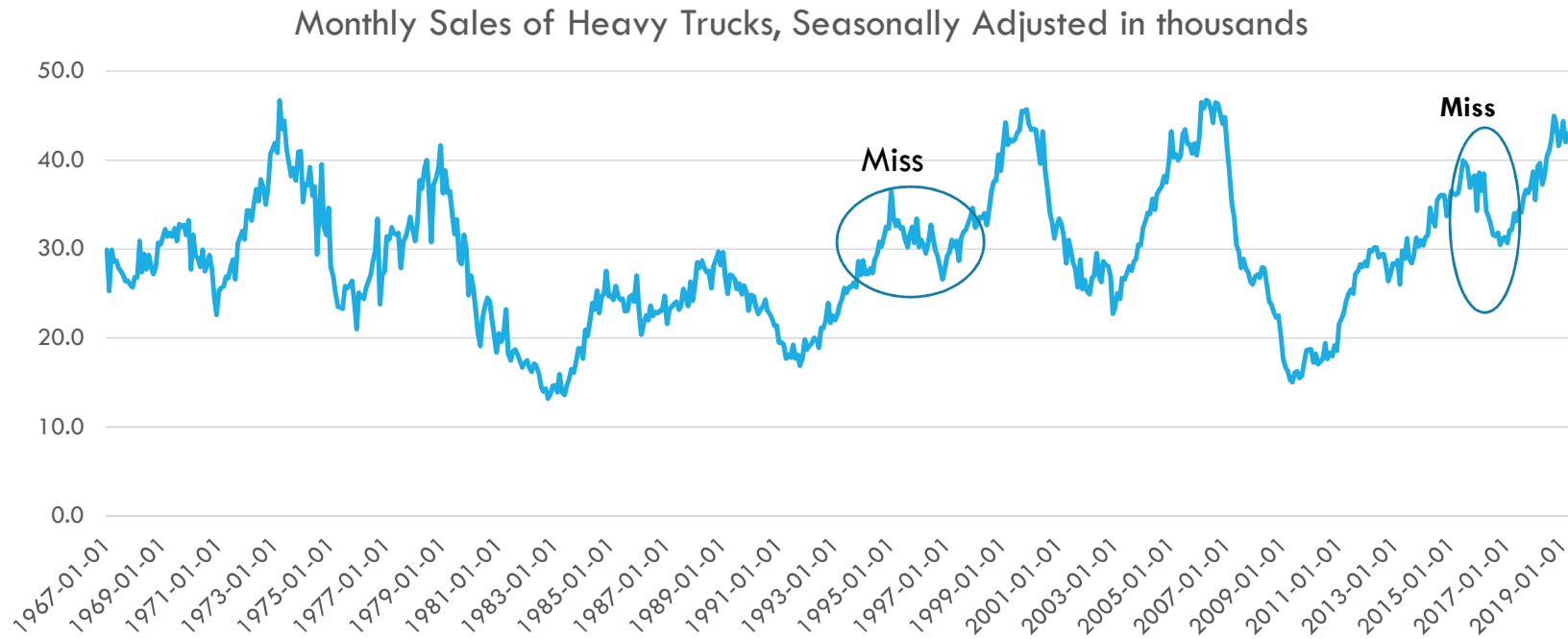
Share of Annual U.S. Private Fixed Investment



Source: BEA

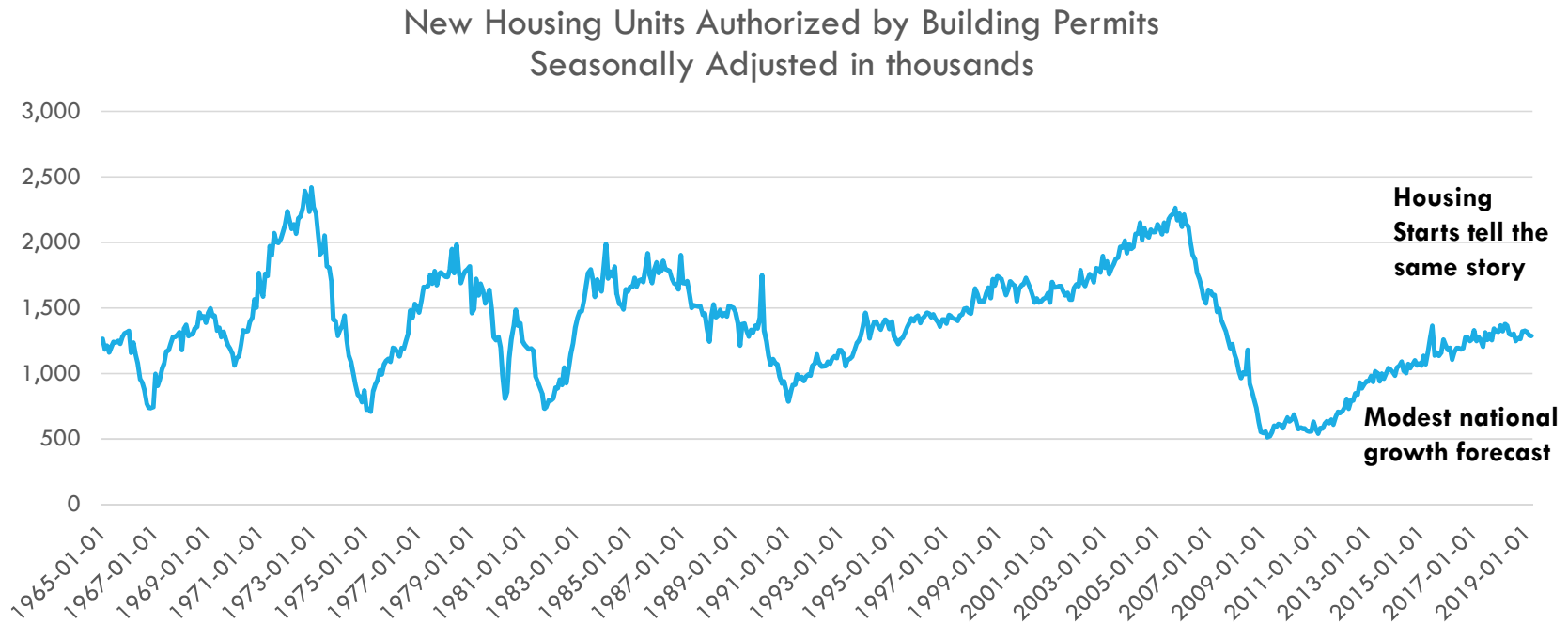
EQUIPMENT AND INTELLECTUAL PROPERTY LEAD THE WAY IN NEW INVESTMENT

HEAVY TRUCKS — A RECESSION INDICATOR AS SALES FALL BEFORE AND RISE AFTER



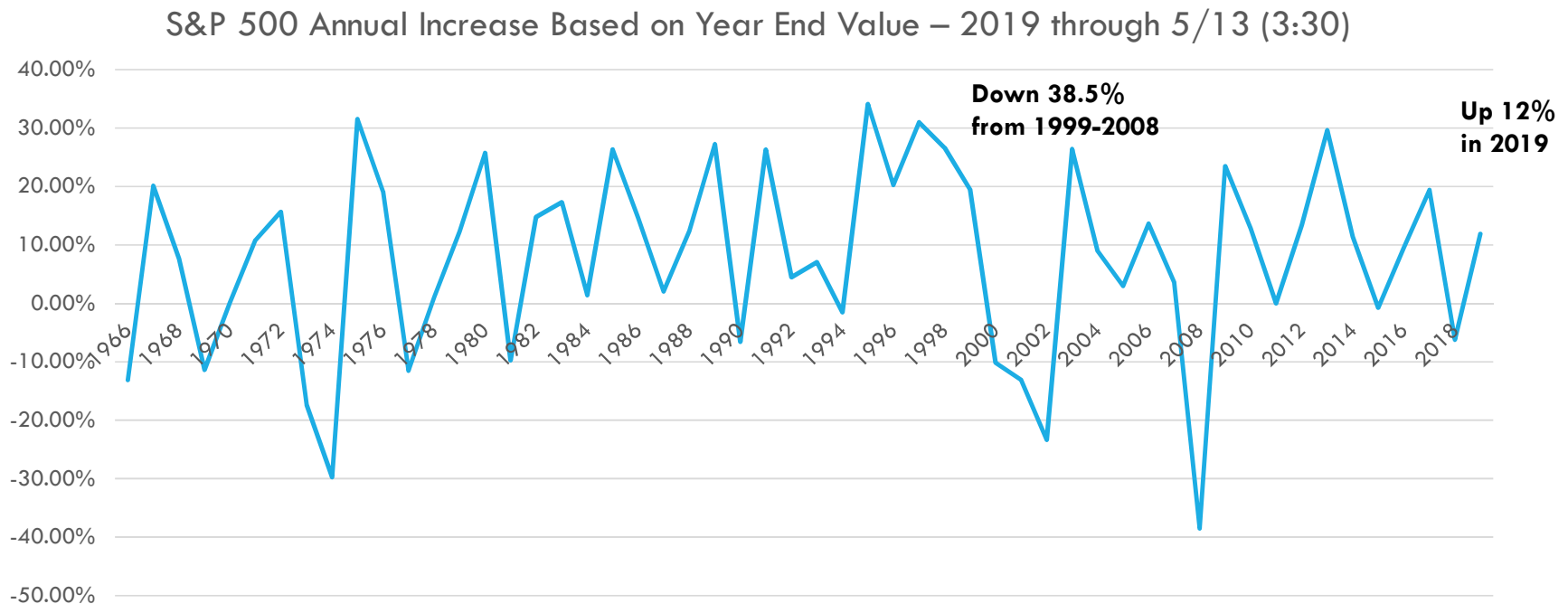
Source: BEA

HOUSING'S NEW NORMAL?



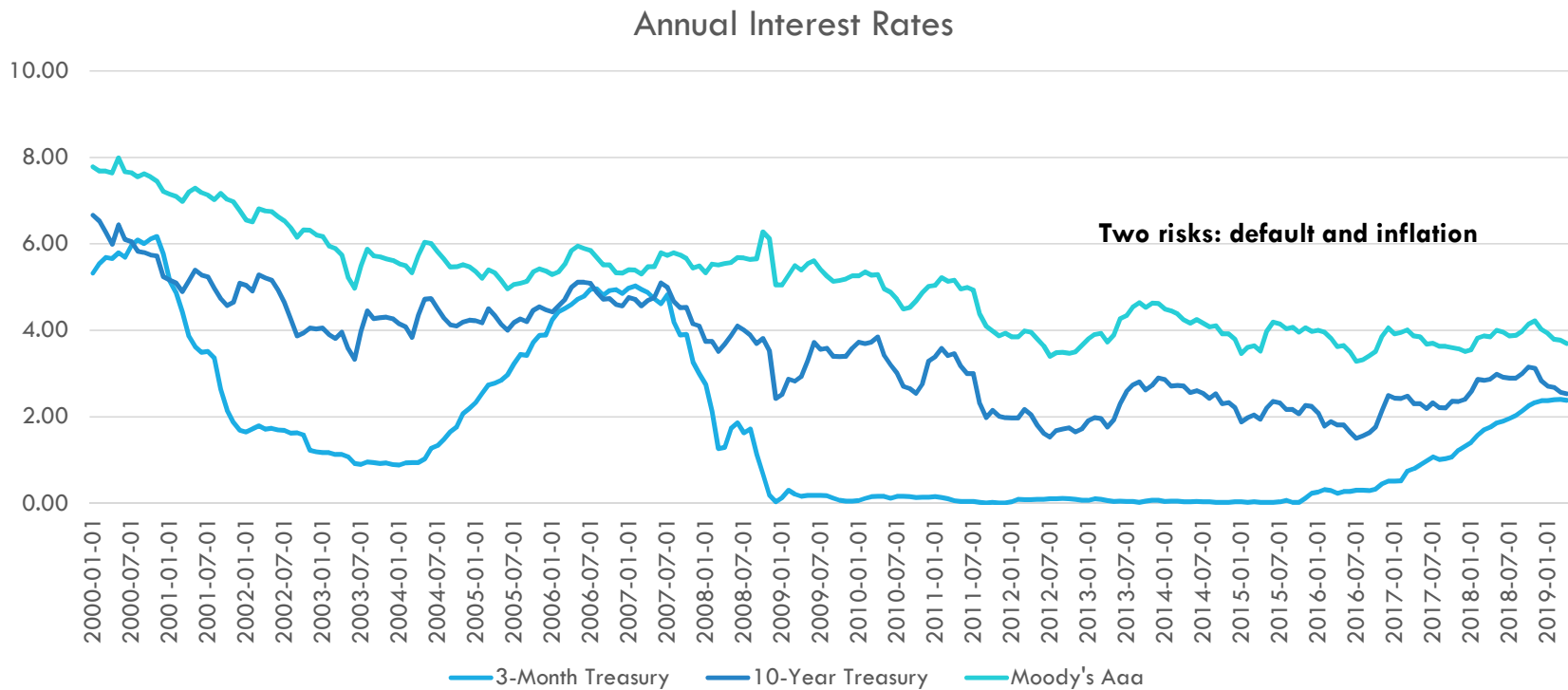
Source: Census

S&P 500 HAS BEEN STRONGER THAN THE ECONOMY – UP 211% SINCE END OF 2008



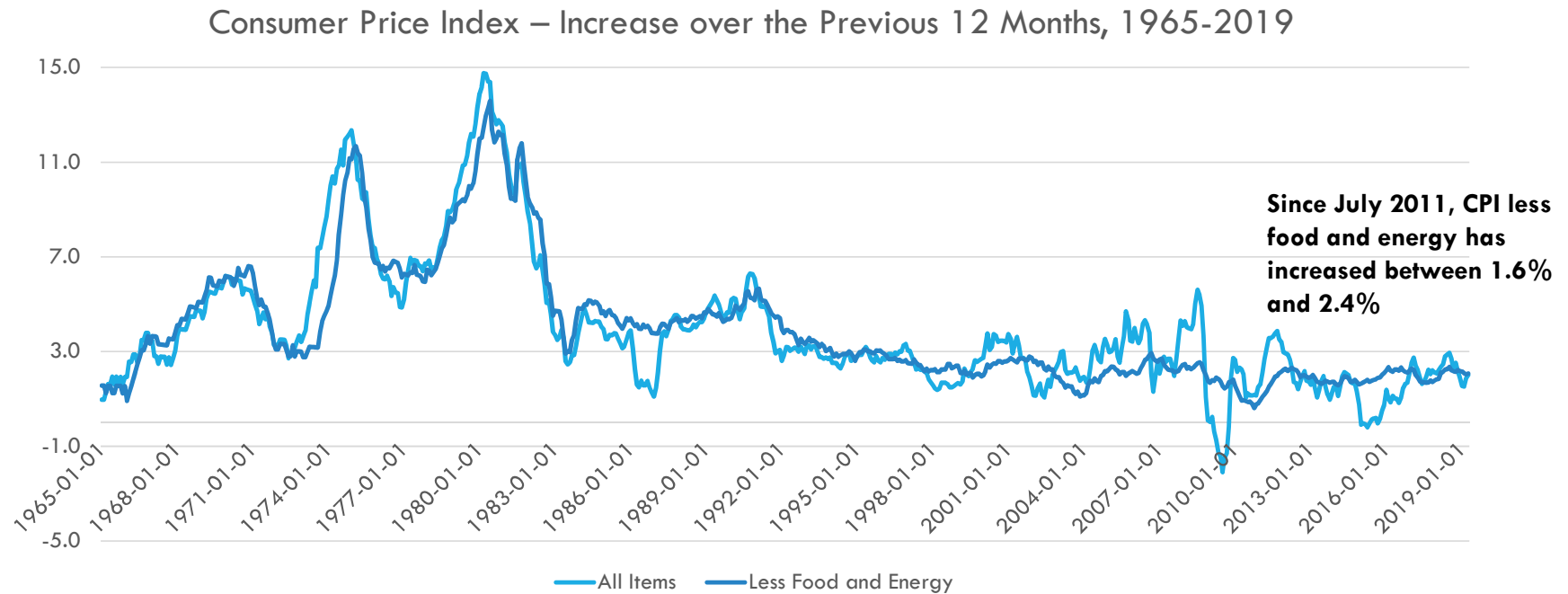
Source: Treasury tracking history

INTEREST RATES ARE LOW AND INFLATION RISK IS DISCOUNTED



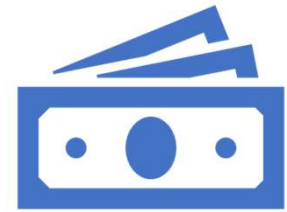
Source: Federal Reserve Economic Data, St. Louis Federal Reserve Bank

INFLATION REMAINS SUBDUED



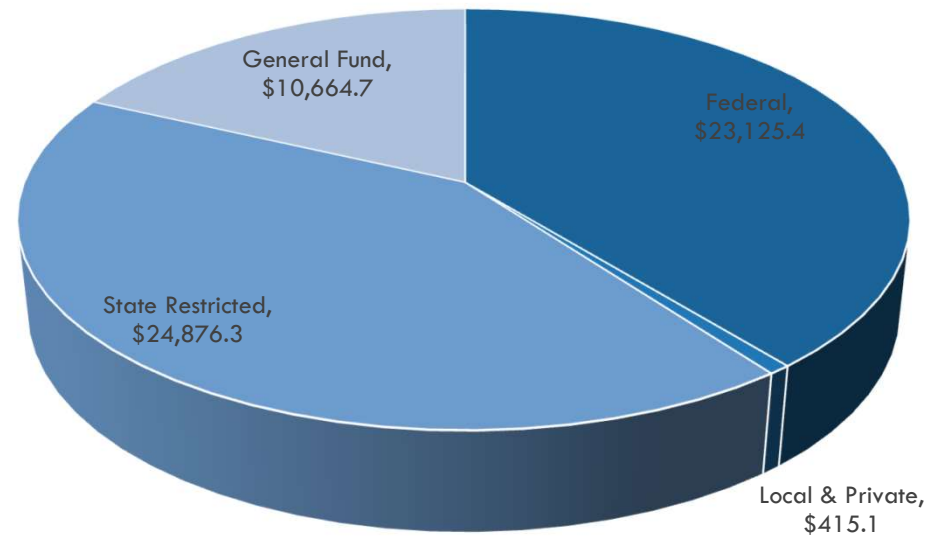
Source: BLS

MICHIGAN'S BUDGET

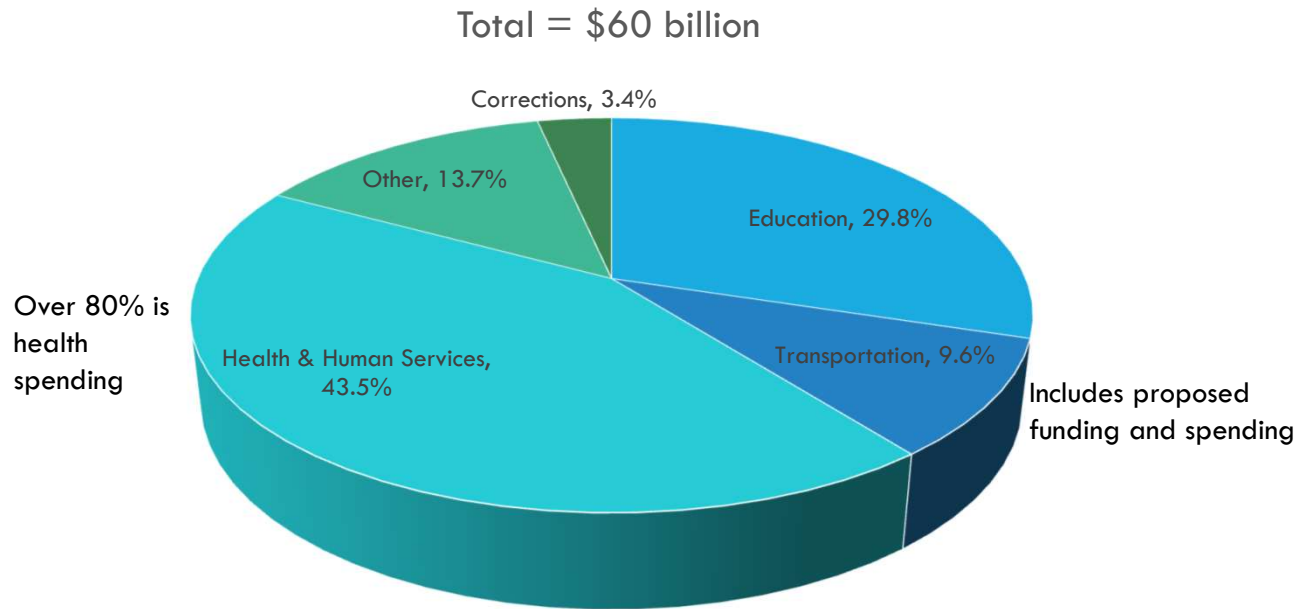


2020 GOVERNOR'S BUDGET RECOMMENDATION

Source of Funds
\$59,081.5 million



WHERE DOES THE MONEY GO? THE 2020 BUDGET PROPOSAL



HOW IS 2020 DIFFERENT?

Approach

New transportation revenue to support increased investment

Eliminate general fund support for transportation and restore funding for higher education

Shift K-12 funding approach to incorporate a “cost of education” approach

New Spending

Area	Amount (\$millions)
School Aid	\$526.7
Health & Human Services	\$651.4
Transportation	\$764.4
Total	\$2,031.9

MICHIGAN ROADS

In 2018, the American Society of Civil Engineers gave Michigan a D- for roads.

A 2015 study from the Tax Policy Center/Brookings put Michigan at 46 out of 51 in per capita highway funding.

We added funding for roads in 2015, although the new revenue didn't start until 2017. Added \$1.0B from FY 2017 to FY 2019.

The price tag to fix the roads is put at \$2.2B to \$2.7B per year.

The existing allocation of road funding, as provided in PA 51, sends about 48% of the funding for Road and Bridge Programs to local road agencies.

Part of the challenge is to address more funding to roads that are more heavily travelled and more often in need of repair.



THE GOVERNOR'S PLAN TO FIX THE ROADS

A 10-year plan to get 90% of the roads in good or fair condition (currently 78%)

Increase gas and diesel taxes

- 15 cents on October 1, 2019
- 15 cents on April 1, 2020
- 15 cents on October 1, 2020
- Eliminate Income Tax earmark to roads from 2015 legislation (\$468M for FY 2020)
- Raises \$2.5B per year when fully implemented

The new revenue will go to the Fixing Michigan Roads Fund, with existing revenue staying under PA 51 formula.

The new distribution formula targets new revenue to the most heavily travelled and economic significant roads.

BUDGET TAX PROPOSALS

Higher motor fuel tax rates

Repeal the “pension tax”

- Prior to 2012, the state taxed very little retirement income
 - All public source benefits were exempt
 - Benefits from a private source were generally deductible (limit at \$45,842 in 2011, \$52,808 in 2019)
- Beginning in 2012, the deductions were limited based on age

Replace the revenue with a tax on pass-through income at 6%

- Matches the corporate income tax rate
- Individual income tax credit to avoid “double taxation”

Raise the EITC to offset the impact of the motor fuel tax increase on working families



THE ECONOMIC OUTLOOK

SUMMARY OF THE FORECAST

United States

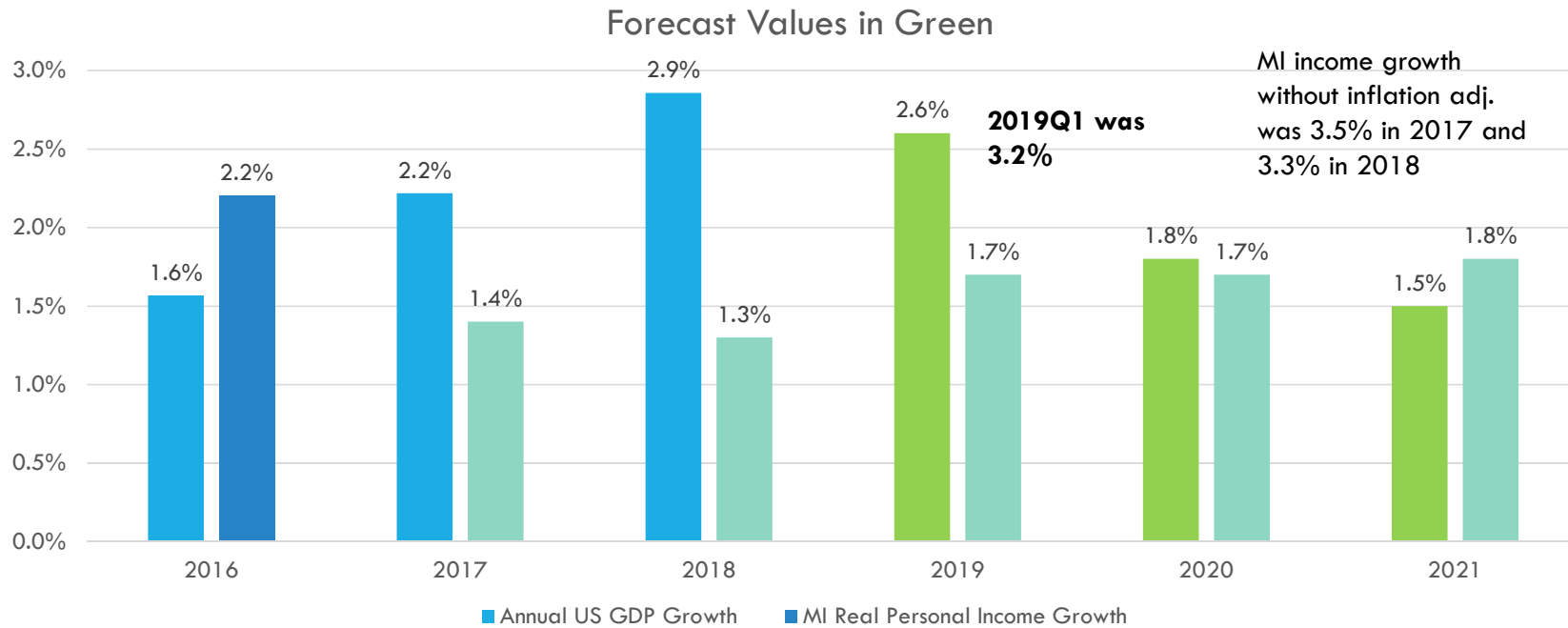
	2019	2020	2021
Real GDP	2.6%	1.8%	1.5%
CPI	2.2%	2.2%	2.3%
3-Mo. Treasury	2.7%	3.0%	3.4%
Unemployment	3.6%	3.6%	3.7%
Employment Growth	1.4%	1.0%	0.6%
Light Vehicles	16.8M	16.6M	16.5M

Michigan

	2019	2020	2021
Real Pers. Income	1.7%	1.7%	1.8%
Employment Growth	0.8%	0.5%	0.4%
Unemployment	3.9%	3.9%	3.9%
Wage and Salary Income	3.7%	3.8%	3.6%
GF/GP + SAF	-0.1%	1.6%	1.9%

Consensus Revenue Estimating Conference, January 2019.

FORECAST FOR GDP AND PERSONAL INCOME GROWTH



Source: BEA

MICHIGAN EMPLOYMENT GROWTH FORECAST TO CONTINUE TO SLOW

Year	Employment (000s)	Employment Increase	Percentage Increase
2015	4,243.2	61.5	1.5%
2016	4,319.7	76.5	1.8%
2017	4,369.1	49.4	1.1%
2018	4,418.6 4,428 Jan. forecast	49.5	1.1% 1.3% at Jan. forecast
2019	4,464	45.4	1.0% (0.8% in Jan.)
2020	4,486	22.0	0.5%
2021	4,504	18.0	0.4%

Source: BLS

REVENUE ESTIMATES BY MAJOR FUND UNDER CURRENT LAW

Estimates from January Consensus Revenue Estimating Conference for GF/GP and School Aid.

Transportation estimates are administration estimates, do not include any proposed revenue changes, but include transfers from the general fund.

Fund	FY 2019	Percent Increase	FY 2020	Percent Increase	FY 2021	Percent Increase
GF/GP	\$10,700.2	-2.2%	\$10,717.8	0.2%	\$10,852.6	1.3%
School Aid	\$13,550.5	1.6%	\$13,926.7	2.8%	\$14,264.4	2.4%
Michigan Transportation Fund	\$3,103.0	10.5%	\$3,363.1	8.4%	\$3,543.8	5.4%

Consensus Revenue Estimating Conference, January 2019.

MAJOR STATE TAXES

Individual income includes earmarks to MTF and Renew Michigan, but the GF/GP share is reduced.

Use tax excludes local share of use tax.

Current law estimates for motor fuel tax.

Tax (\$ millions)	FY 2019	Percent Increase	FY 2020	Percent Increase	FY 2021	Percent Increase
Individual Income	\$10,186	0.2%	\$10,440	2.4%	\$10,692	2.2%
Sales/Use	\$9,779	2.8%	\$10,094	3.2%	\$10,343	2.5%
Business Taxes	\$866	9.5%	\$812	-6.3%	\$839	3.4%
SET/RET	\$2,438	4.3%	\$2,505	2.7%	2,571	2.6%
Lottery	\$942	-3.9%	\$947	0.5%	\$953	0.6%
Motor Fuel	\$1,464	-0.2%	\$1,465	0.1%	\$1,465	0.0%
Vehicle Registration	\$1,328	2.5%	\$1,361	2.5%	\$1,393	2.4%

Consensus Revenue Estimating Conference, January 2019.

WHAT HAVE WE LEARNED SINCE JANUARY

On the economy

Payroll employment is stronger than forecast.

1st quarter GDP was strong (3.2%).

Light vehicle sales are holding up and housing is in line with the forecast.

Federal Reserve is probably on hold with interest rate increases.

Inflation remains subdued.

No trade war.....yet!

On revenues

The annual payments for income tax were really good.

Sales tax and withholding are growing but blah.

Use tax is really strong.

Corporate income tax is strong, but not as strong as in other states.

Lottery is doing a bit better than expected.

RISKS TO THE FORECAST

What gives me joy?

Employment growth

Very few layoffs

Hints of wage growth acceleration

Stock market returns

U.S. economy is predisposed to grow

Divided government

What gives me consternation?

Geopolitical tensions

Trade tensions

Global growth slowdown

Business and consumer sentiment

Vehicle sales

Divided government

Twitter

DATA SOURCES

U.S. Bureau of the Census (Census), U.S. Department of Commerce.

U.S. Bureau of Economic Analysis (BEA), U.S. Department of Commerce.

U.S. Bureau of Labor Statistics (BLS), U.S. Department of Labor.

Senate Fiscal Agency (SFA), Michigan Senate.