

Economic and Budget Outlook

Fiscal Years 2020-21 to 2025-26



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January 21, 2021

Today's Presentation

Four Parts

- Demographics a contracting labor force
- Economics job recovery slows, some permanent job loss
- Revenues solid, income surge due to federal stimulus
- Expenditures significant growth due to one-time measures

Analysis finds a ~\$2.0 billion structural deficit

- November 2019 IFO Outlook identifies a ~\$1.0 billion structural deficit
- What has changed? | Why is it worse?

Questions taken at end of presentation

Pennsylvania Demographics

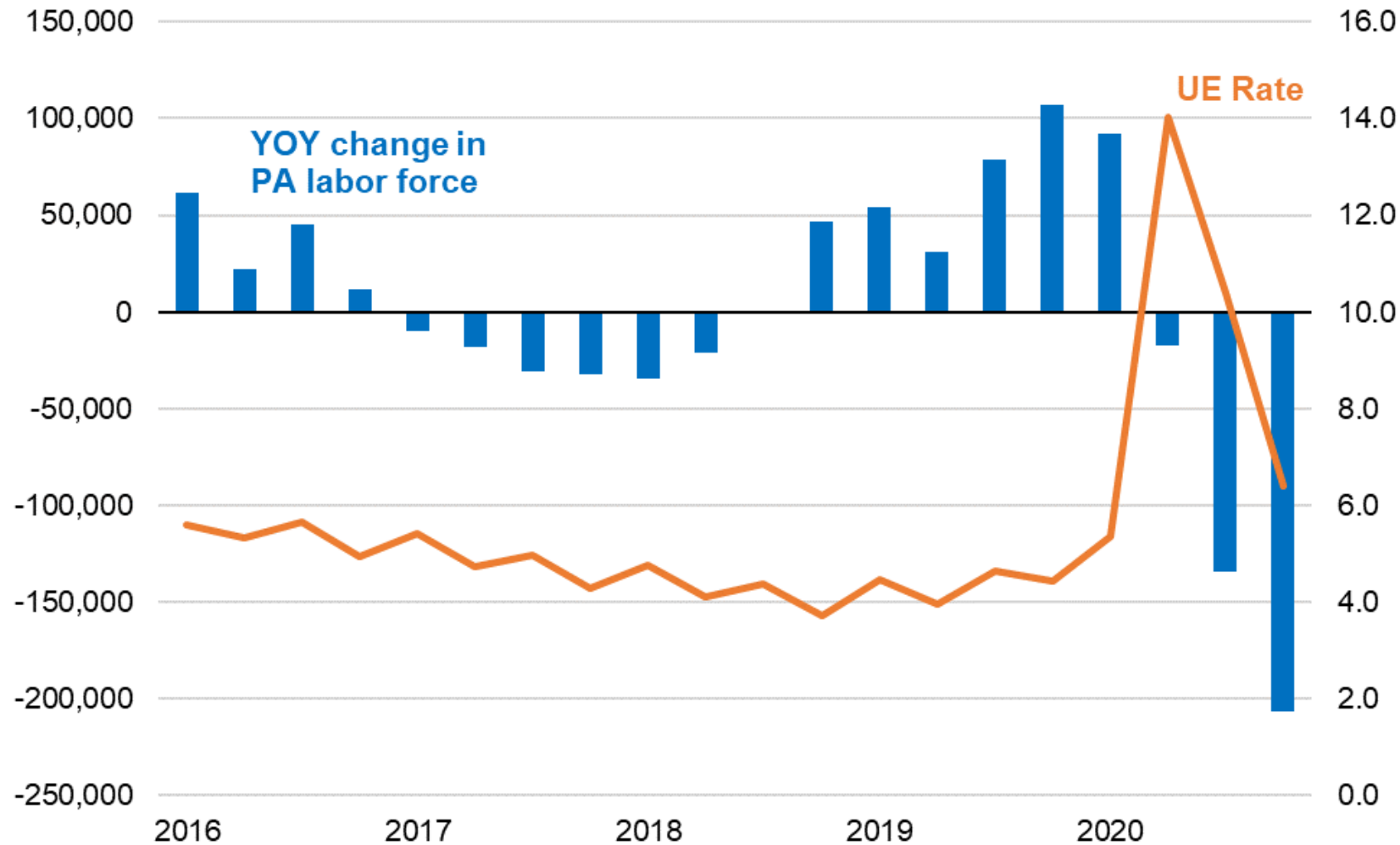
Age Cohort	Number (000s)				Change (000s)			Avg. Annual Growth		
	2015	2020	2025	2030	15-20	20-25	25-30	15-20	20-25	25-30
0 to 19	3,040	2,956	2,867	2,768	-83	-89	-99	-0.6%	-0.6%	-0.7%
20 to 64	7,568	7,389	7,137	6,933	-179	-252	-204	-0.5%	-0.7%	-0.6%
65 to 79	1,561	1,834	2,080	2,140	272	246	61	3.3%	2.6%	0.6%
80+	<u>616</u>	<u>623</u>	<u>684</u>	<u>827</u>	<u>7</u>	<u>61</u>	<u>142</u>	<u>0.2%</u>	<u>1.9%</u>	<u>3.9%</u>
Total	12,785	12,802	12,768	12,668	17	-34	-101	0.0%	-0.1%	-0.2%

Note: Forecasts do not include impact from COVID-19.
Source: U.S. Census Bureau. Forecast by IFO.

More Residents Working Offsets Demographics

Age Group	Share Employed		Change
	2010	2019	
19 to 24	51.8%	57.7%	+5.8%
25 to 34	70.0%	73.1%	+3.1%
35 to 44	70.0%	76.6%	+6.6%
45 to 54	68.2%	74.6%	+6.4%
55 to 64	54.9%	60.8%	+5.9%
65 to 79	18.8%	22.5%	+3.7%
ALL	57.2%	60.4%	+3.1%
<p>Note: Excludes jobs held by residents under age 19. Shares are number working in age group divided by number of residents in age group. Figures are lower than labor force participation rates reported by the US Bureau of Labor Statistics. Source: U.S. Census Bureau QWI Explorer.</p>			

Recent Exodus from PA Labor Force



Source: U.S. Bureau of Labor Statistics. Data are not seasonally adjusted.

Annual Growth Rates for PA Economic Variables

	2019	2020	2021	2022	2023	2024	2025	2026
Real GDP	2.4%	-4.1%	3.5%	2.8%	2.4%	2.1%	2.0%	1.9%
Wages and Salaries	4.3%	-1.2%	4.8%	4.4%	4.3%	4.2%	4.1%	4.0%
Philadelphia CPI-U	2.0%	0.9%	1.6%	2.1%	2.2%	2.2%	2.2%	2.2%
Payroll Job Gains (000s)	54	-450	120	100	80	59	54	48
				recovery	“typical” economic growth			
Note: Payroll Job Gains exclude self-employed.								
Source: U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. Forecast by IFO.								

Recent PA Economic Growth Rates or Change

	2019	2020 Q1	2020 Q2	2020 Q3	2020 Q4
Real GDP	2.4%	-5.8%	-34.0%	35.5%	--
Personal Income	3.6%	2.5%	13.1%	9.6%	--
Wages and Salaries	4.3%	3.3%	-6.6%	-2.6%	0.6%
Unemployment Rate (level)	4.4%	5.4%	14.0%	10.4%	6.6%
Change Payroll Jobs (000s)	54	28	-849	-504	-460
Change Labor Force (000s)	68	92	-17	-134	-206
U.S. Labor Productivity	1.7%	-0.3%	10.6%	4.6%	--
<p>Note: Real GDP is quarterly annualized growth rate. Wage growth for 2020 Q3 and Q4 based on adjusted withholding. Change in Payroll Jobs and Labor Force is change from prior year. Labor market data are not seasonally adjusted. U.S. Labor Productivity is for All Nonfarm Businesses and is a quarterly annualized rate. State productivity data not published.</p> <p>Sources: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics.</p>					

Payroll Jobs Recover Quickly, but Then Decelerate

	YOY Number Change (000s)			YOY Percent Change		
	April	Aug	Nov	April	Aug	Nov
Total Employment	-1,062	-502	-455	-17.5%	-8.3%	-7.4%
Construction	-104	-16	-7	-40.1%	-6.0%	-2.7%
Manufacturing	-77	-39	-37	-13.3%	-6.7%	-6.5%
Retail and Wholesale Trade	-155	-72	-62	-18.9%	-8.7%	-7.3%
Transport and Warehouse	-27	-22	1	-9.1%	-7.5%	0.2%
Financial and Real Estate	-3	0	-1	-0.9%	0.0%	-0.3%
Professional and Technical	-21	-18	-18	-5.8%	-5.0%	-4.8%
Admin and Waste Management	-53	-34	-36	-16.8%	10.7%	-10.8%
Education (excludes local SD)	-42	-12	-38	-16.1%	-5.9%	-14.5%
Healthcare-Social Assistance	-120	-50	-34	-11.4%	-4.7%	-3.2%
Arts-Entertainment	-58	-32	-19	-60.9%	-25.5%	-21.4%
Accommodation-Food Service	-280	-140	-115	-58.6%	-28.6%	-24.3%
Other Services	-86	-36	-34	-32.8%	-13.4%	-12.9%
All Government	-17	-7	-33	-2.3%	-1.0%	-4.5%
All Other	-21	-23	-23	-8.2%	-9.2%	-8.9%

Note: Data are not seasonally adjusted. Figures for November are preliminary. YOY is year-over-year. **Excludes self-employed.**

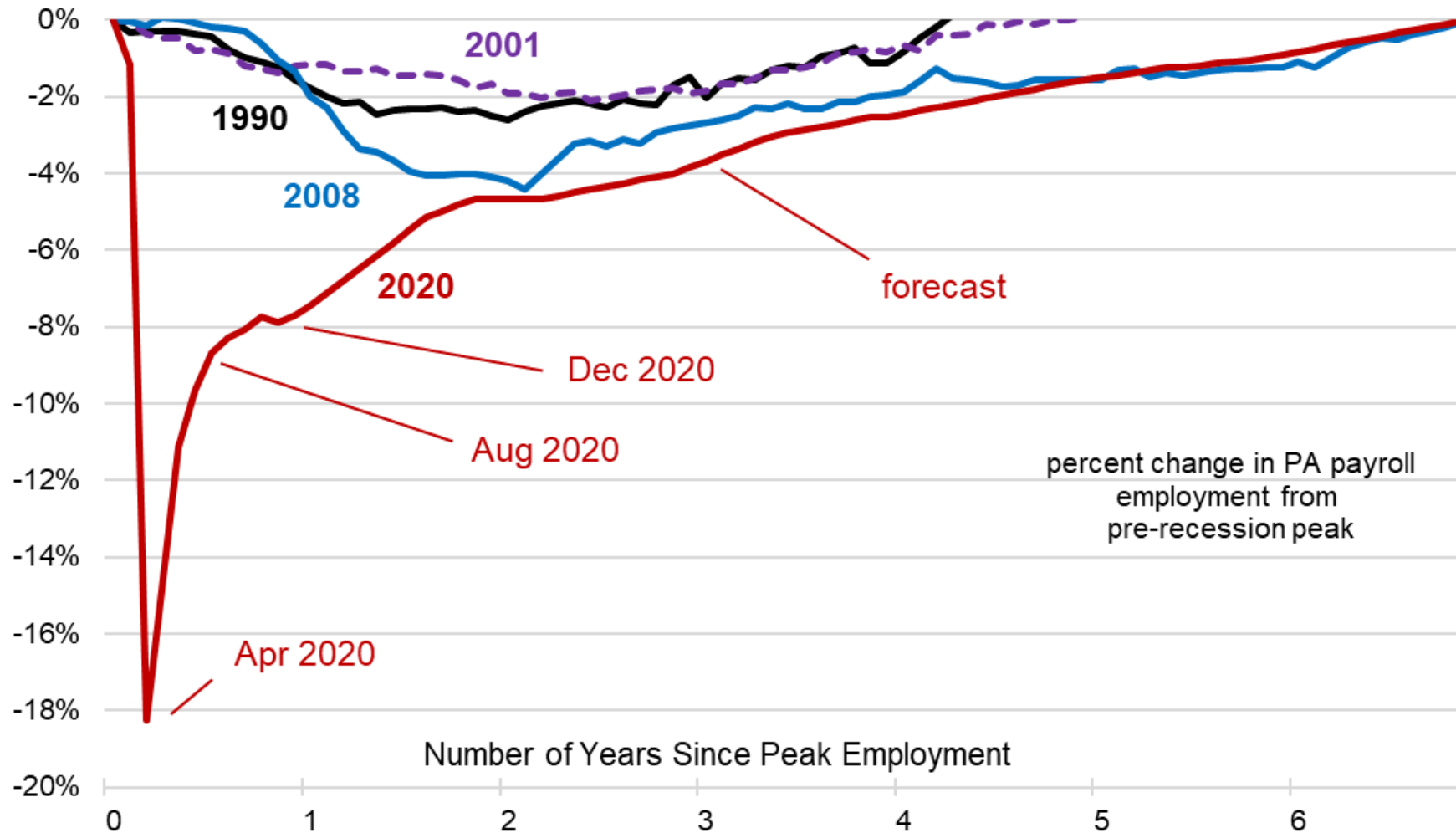
Source: U.S. Bureau of Labor Statistics, CES State and Metro Area Employment.

Permanent Job Loss, But Some Subsectors Gain

	Number (000s)		Change	
	Nov 2019	Nov 2020	Number	Percent
Full-Service Restaurant	194	146	-48	-24.7%
Colleges, Universities, Professional	183	152	-31	-17.1%
Limited-Service Restaurant	162	135	-27	-16.6%
Employment Service (Temps)	12	104	-24	-18.6%
Personal Care-Dry Cleaning	73	50	-23	-31.2%
Local Government	465	443	-22	-4.7%
Retail – Clothing Stores	45	23	-22	-48.8%
Accommodations	59	38	-21	-35.2%
Nursing and Residential Care	202	189	-13	-6.2%
State Government - Education	63	54	-9	-14.4%
Air Transportation	13	8	-6	-41.8%
Courier and Messengers	42	49	7	16.5%
Home Health Care	69	72	3	3.8%
Real Estate	45	48	3	5.6%

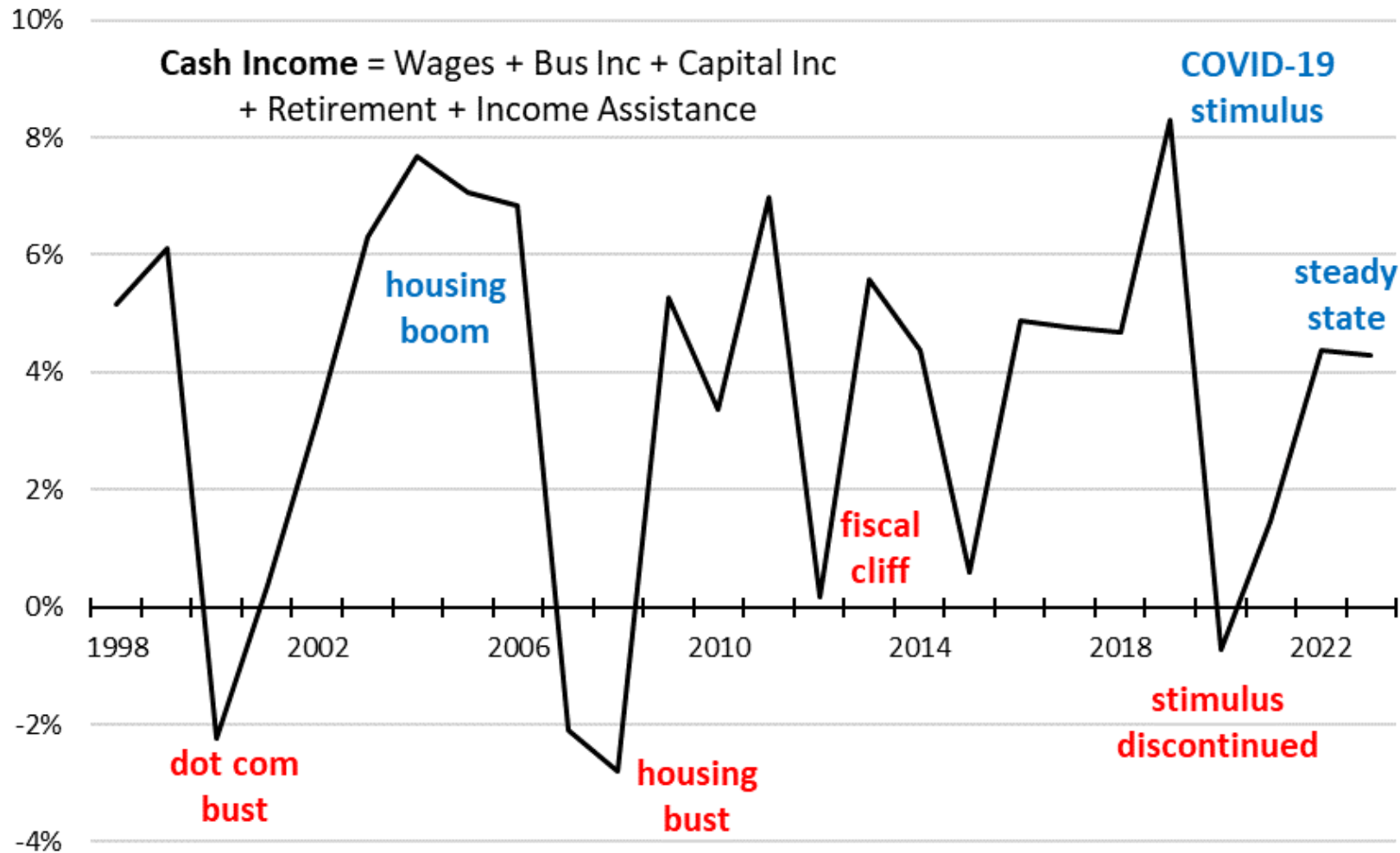
Source: U.S. Bureau of Labor Statistics, CES State and Metro Area Employment.

Years Needed for Full PA Jobs Recovery



Source: U.S. Bureau of Labor Statistics. Forecast by IFO.

CY 2020 PA Cash Income Growth Very Strong



Source: Various state and federal agency websites. See IFO Official Revenue Estimate Methodology (June 2020).

Disconnect: Labor Market vs Other PA Indicators

Economic Negatives

Payroll Jobs	-460k 2020 Q4
Labor Force	-260k 2020 Q4
Small Bus Revenue	-28% 2020 Q4
Rental Market	
Low Income HH	

Economic Positives

Cash Income	+8.3% CY 2020
Home Values	+8.0% 2020 Q3
Sales Tax	+6.9% 2020 Q3-Q4
Credit Card Debt	-8.6% 2020 Q2-Q3
S&P 500 Index	+8.8% CY 2020

Lost Economic Growth Drives Larger Structural Deficit

	2019	2020	2021	2022	2023	Notes
Nominal GDP (\$ billion)						
November 2019 forecast	\$823	\$854	\$887	\$923	\$961	no recession
January 2021 forecast	<u>\$809</u>	<u>\$783</u>	<u>\$824</u>	<u>\$865</u>	<u>\$905</u>	COVID-19 recession
Change	-\$14	-\$71	-\$63	-\$58	-\$56	permanent loss to growth
Wages Paid (\$ billion)						
November 2019	\$353	\$395	\$380	\$395	\$410	reduces PIT by ~\$350 million
January 2021	<u>\$354</u>	<u>\$350</u>	<u>\$366</u>	<u>\$382</u>	<u>\$399</u>	reduces SUT by ~\$150 million
Change	\$1	-\$16	-\$13	-\$12	-\$11	
Payroll Jobs (000s)						
November 2019	6,060	6,105	6,151	6,194	6,237	
January 2021	<u>6,054</u>	<u>5,614</u>	<u>5,734</u>	<u>5,834</u>	<u>5,914</u>	
Change	4	-491	-417	-360	-323	

Revenues Outperform in First Half of Fiscal Year

Revenue Source	YOY Growth	Notes
Sales - Motor Vehicle	+16.6%	shift to small pickups, used cars prices +10%
Realty Transfer	+12.8%	home values up +8.0% in Q3
Corporate Net Income	+12.2%	<u>very</u> strong December payment
Sales - Non-Motor Vehicle	+3.8%	appliance purchases, remodels
Cigarette	+3.2%	
All Other Tax	+1.6%	
Personal Income - Withholding	-1.0%	turned positive in Q4
Inheritance	-3.4%	possible delayed filings
Personal Income - Other	-6.4%	small business income, better than expected
Total Tax Revenues	+2.9%	
Note: YOY is year-over-year. Amounts adjusted to reverse shift of revenues to FY 2020-21 and one-time transfers.		

Revenue Outlook: Weak Growth for FY 2021-22

	Adjusted FY 20-21	Base Yr FY 21-22	Growth	FY 25-26	Avg Ann Growth
Personal Income	\$14.47	\$15.03	3.9%	\$17.87	4.4%
Sales and Use	12.17	12.42	2.1%	13.59	2.3%
Corporate Net Income	3.40	3.25	-4.5%	4.47	8.3%
Inheritance	1.13	1.14	1.1%	1.26	2.4%
Gross Receipts	1.00	1.06	5.8%	1.11	1.1%
Cigarette	0.94	0.86	-7.8%	0.72	-4.4%
All Other	<u>3.39</u>	<u>2.91</u>	<u>-14.3%</u>	<u>3.32</u>	<u>3.4%</u>
Total General Fund	36.50	36.68	0.5%	42.32	3.6%

Note: Billions of dollars. FY 20-21 adjusted for delayed tax payments and extra withholding day, but includes one-time transfers from special funds.

Corporate Net Income: Policy, Shifts and Behavior

Estimated payment pattern in 2020 highly unusual

- March +3% | June -31% | September -5% | December +35%

Short-term factors

- Likely some payments made on PPP loans
- Payroll tax shift to 2021 and 2022
- Possible shifting in anticipation of tax rate increase (e.g., TCJA of 2017)

Long-term factors

- Corporations have likely increased relative profitability (i.e., margins)
- Cost saving measures, reduced travel, productivity gains

Sales Tax: Consumers Receive Much Support

Many factors bolster taxable spending

- 2020: federal UC \$26.5b | \$11.0b impact payments
- 2021: federal UC \$5.7b | \$6.3b impact payments
- State UC: \$5.2b (2020, pandemic only) | \$1.6b (2021)
- Shift from services to goods | big ticket items - appliances, remodels
- Mortgage refinancing's break record (lower payments, cash out)
- Wealth effects: housing and stock markets raise consumer confidence

Long-term: only a partial reversion to old spending patterns

- A permanent acceleration to online purchases
- Redirected spending: gasoline purchases, dry cleaning, concert events

Expenditure Outlook: Strong Growth for FY 2021-22

		Base Yr				Avg Ann
	20-21	21-22	Growth		25-26	Growth
Education	\$14.43	\$14.75	2.2%		\$16.52	2.9%
Human Services	12.68	15.68	23.6%		17.95	3.4%
Criminal Justice	1.61	2.69	67.3%		2.98	2.5%
Treasury	1.24	1.28	3.9%		1.51	4.2%
All Other	<u>3.18</u>	<u>3.57</u>	<u>12.1%</u>		<u>4.00</u>	<u>2.9%</u>
Total General Fund	33.14	37.98	14.6%		42.97	3.1%

Note: Billions of dollars.

CARES Act \$1.33 billion
Enhanced FMAP \$2.07 billion
Cost Shifts \$1.06 billion

Primary Cost Drivers: Annual Change in Spending

Program	21-22	22-23	23-24	24-25	25-26
All Medical Assistance	\$2,292	\$357	\$354	\$374	\$361
Intellectual Disability	351	72	73	75	77
County Child Welfare	146	56	44	44	44
Mental Health	55	28	26	26	28
PSERS Contribution	114	164	150	143	169
Basic and Special Education	146	174	174	168	165
PlanCon	0	0	192	0	22
State Correctional Institutions	962	69	43	36	45
PSP MLF Funding Shift	41	40	31	29	33
General Obligation Debt	45	36	65	29	96
All Other	<u>682</u>	<u>250</u>	<u>212</u>	<u>203</u>	<u>220</u>
Total Annual Change	4,835	1,247	1,363	1,126	1,260

Note: Millions of dollars. Excludes \$165 million transfer to Worker's Compensation Fund in FY 24-25.

One Time Measures Boost Revenues, Reduce Expenditures

	FY 20-21	Notes
Special funds transfer	\$431	
Rainy day fund	\$100	
Revenue shifts	\$1,938	delayed due dates
Payment on PPP loans	\$100	affects personal income tax
JUA transfer	\$200	court challenge
CARES Act	\$1,330	used for DHS, PSP, DCJ, DOH
Enhanced FMAP	\$2,070	assumed to end 2021 Q2
DHS cost shifts	\$555	managed care, county child welfare
REHP reduction	~\$90	contributions for retiree healthcare
Note: Millions of dollars.		

General Fund Financial Statement

	19-20	20-21	21-22	22-23	23-24	24-25	25-26
Beginning Balance	\$30	-\$2,734	--	--	--	--	--
Current Year Revenues	32,276	38,437	\$36,675	\$37,851	\$39,352	\$40,828	\$42,321
Less Refunds	<u>-1,150</u>	<u>-1,300</u>	<u>-1,326</u>	<u>-1,353</u>	<u>-1,380</u>	<u>-1,407</u>	<u>-1,435</u>
Net Revenues	31,126	37,137	35,349	36,498	37,972	39,421	40,885
State Expenditures	-34,090	-33,141	-37,975	-39,223	-40,586	-41,877	-42,971
Current Year Balance	-2,934	1,263	-2,626	-2,725	-2,613	-2,455	-2,086
Plus Prior Year Lapses	<u>200</u>	<u>219</u>	<u>125</u>	<u>125</u>	<u>125</u>	<u>125</u>	<u>125</u>
Prelim Ending Balance	-2,734	1,481	-2,501	-2,600	-2,488	-2,330	-1,961
Note: Millions of dollars. Prior year lapses include transfers to the Budget Stabilization Reserve Fund.							

Summary

Top 2020 economic terms: “unprecedented” and “unchartered waters”

- But both are true | we have not seen this dichotomy before
- Most middle and upper income homeowners faring well
- Very different for low income renters | outlook also unclear
- Permanent jobs loss and long-term unemployment are significant concerns

COVID-19 imposes abrupt and painful economic changes

- Much permanent | teleworking, spending patterns, productivity gains, online shopping
- Short-term loss of economic growth | greater long-term potential

Much uncertainty remains that could improve or harm fiscal outlook

- Short-term: low income households, federal policy, vaccine effectiveness
- Medium-term: impact on labor force and early retirements
- Long-term: impact on birth rates, household formation and migration patterns

Presentation is Posted to IFO Website

Questions?

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