Washington
Research Council

Policy Brief

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Slowing Economy Reduces Revenue Forecast

On June 15, the state Economic and Revenue Forecast Council reduced its forecast of state revenues for the 1993-1995 and 1995-1997 biennia by $181 million.

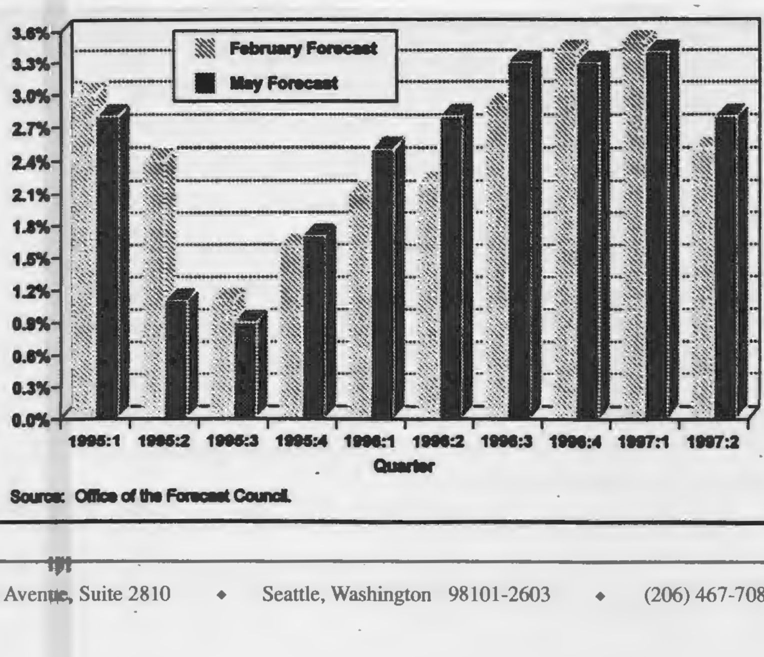
On June 15, the Forecast Council adopted its June General Fund-State revenue forecast. The revenue forecast was based upon an economic forecast prepared in late May. The new forecasts project slower economic growth and lower revenue for the 1995-1997 biennium than had been anticipated in March.

At the March meeting of the Forecast Council, the Executive Director, Dr. Chang Mook Sohn, observed that the economy had been very strong in the final quarter of 1994 but that growth had slowed in the first quarter of 1995. In the past nearly half of such slowdowns have turned into full recessions. Further, Dr. Sohn warned that the most recent state revenue collections were low, indicating considerable weakness in the economy.

The February national economic forecast, upon which the March revenue forecast was based, showed growth moderating in 1995 and then accelerating again in 1996.

After the February economic forecast, statistics revealed that the national economy was even stronger in the fourth quarter of 1994 than had appeared, and that the subsequent slowdown was more pronounced. The Commerce Department has revised upward its estimate of the fourth quarter growth rate for real Gross Domestic Product (GDP) from 4.5% to 5.1%, while the preliminary estimate of first quarter real GDP growth, 2.7%, was less than Forecast Council's predicted 3%. Actual national unemployment ran higher than in the February forecast. It is, thus, no surprise that the Forecast Council has revised downward its estimates of economic growth for 1995.

Figure 1
Growth in Real Gross Domestic Product



Source: Office of the Forecast Council.

The February and May forecasts for GDP growth are compared in Chart 1. The new forecast anticipates slower growth in the first three quarters of 1995 than did the old. This is then followed by four quarters in which the new forecast shows more rapid growth.

Job losses at the Hanford cleanup and at Boeing are now predicted to be more severe than had been the projected case in February. Together with the changes in the national economy, these reductions in employment contributed importantly to changes in the forecast for the state economy between February

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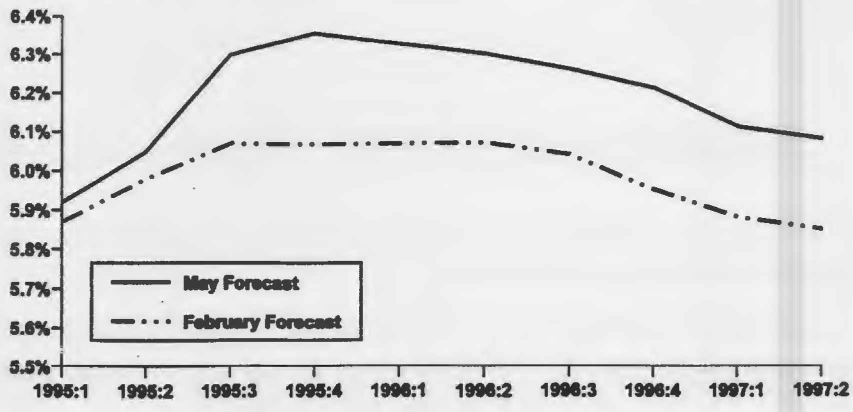
and May. The unemployment rates under the two forecasts are shown in Chart 2. Under the new forecast the unemployment rate rises to a peak of 6.4% in the fourth quarter of 1995, 0.3% above the level anticipated in the February forecast.

Figure 2
Washington State Unemployment Rate



Source: Office of the Forecast Council.

Figure 1 summarizes the March and June Forecast Council estimates. The total revision is $181.3 million dollars, of which $38.3 million is a reduction for the current biennium reflecting actual tax collections from March 11 to June 10. The reduction for the biennium that begins July 1 is $143 million, of which $60 million is due to the employment reductions at Boeing and Hanford and $72 million to the general economic slowdown. The final $11 million is a special adjustment for tax refunds anticipated by the Department of Revenue.

The economy may be considerably weaker in the second half of 1995 than the Forecast Council predicts. Dr. Sohn places a 30% probability that the economy will be weaker than forecast in the second half of 1995 and a 20 % probability that it will be stronger.

On June 2, following the preparation of the economic forecast, U. S. Department of Labor released data suggesting that the economy is even weaker. Superficially, this unemployment report seemed to indicate a healthy economy, as the unemployment rate fell from 5.8% to 5.7%. But the underlying employment figure revealed that payrolls fell by 101,000 from April to May. (The median forecast among economists had been for a 163,000 gain!)

Also on June 2 the Commerce Department released the Index of Leading Economic Indicators for the month of April. The index was down 0.6 for the month of April. This represented the third consecutive monthly decline, which is traditionally treated as a heads-up to the possibility of recession.

Figure 3
Changes to the General Fund State Forecast
(millions of dollars)

	March Forecast	June Forecast	Forecast Change
1993-1995 Biennium	16,569.6	16,531.3	(38.3)
1995-1997 Biennium	17,945.0	17,802.0	(143.0)
Total			**(181.3)**

Note: June forecast does not reflect tax changes passed by the Legislature

Source: Office of the Forecast Council.

Following these reports a number of economists lowered their forecasts of economic growth for the year. In Seattle on June 7, Alan Greenspan acknowledged that these weak numbers had raised the probability that the economy would experience a brief recession, although he remains quite optimistic about 1996 and beyond.

If the bad news continues, September could bring another round of forecast reductions.

—Kriss Sjoblom