

## **Additional April Finance Advisory Committee Summary**

As a result of the panel discussion at the April Finance Advisory Committee (FAC) meeting, questions have been raised about the future likelihood of a recession in Arizona, along with how the 4-Sector forecast compared to the Executive budget revenue estimates. Below is a further discussion of these issues.

### Probability of a Recession

During the FAC meeting, 2 panelists commented about a “zero percent” likelihood of a recession in FY 2013. These comments raise the question of whether the 4-Sector forecast should include the (2.5)% UA model result (*see April FAC Revenue and Budget Update for more information*).

The 4-Sector forecast does not automatically include a recession scenario. Two of the models are base forecasts - they provide the most likely revenue outcome. These base forecasts represent a 50% probability of exceeding and 50% probability of falling below the projection. The 4-Sector also includes 2 “lower risk” scenarios. These forecasts reflect lower revenue projections than the base forecasts - they may either be slower growth or an actual decline in revenues.

As noted, 2 of the FAC panelists suggested that the risk of Arizona entering another recession over the forecast horizon was 0%. The U.S. economy has experienced a total of 11 recessions in the post-World War II era. Many of these recessions resulted from unexpected economic events, or shocks, such as the oil embargo in 1973 and the 9/11 terrorist attack in 2001.

Given the inability of economic forecasters to predict unexpected events, JLBC Staff believes it is prudent to assume more than a 0% chance of a recession in the near term. This is especially true considering the weakness of the ongoing economic recovery, which makes the current economy even more susceptible to shocks than under more normal circumstances.

I.H.S. Global Insight, a large forecasting company that provides economic forecasts for the U.S. and other nations, is currently placing the odds of another recession within the year at 20%. This recession scenario assumes a surge in oil prices due to further deterioration in U.S. - Iran relations and panic in financial markets as Europe’s sovereign debt problems become increasingly severe. Under this “20% probability” scenario, the U.S. economy would contract in the second half of 2012 as the labor market weakens, housing foreclosures rise, and household income declines.

As a result, JLBC Staff continues to believe that a recession scenario has an appropriate role in the current 4-sector forecast. The magnitude of the UA (2.5%) downturn is debatable, but the possibility of such a scenario should not be dismissed.

### Comparison with Executive Revenue Estimates

With the release of the April 4-sector scenario, there has been renewed discussion of the Executive’s Revenue Estimates. The Executive states their FY 2013 base growth rate is 5.0%.

When comparing the revenue estimates of the various forecasts, a common starting point is base revenue. This base estimate is designed to reflect the underlying growth in the economy and excludes tax law changes, Urban Revenue Sharing, and other one-time factors.

The January 4-Sector reflects FY 2013 base revenue growth of 5.1%. In comparison, the Executive has said their FY 2013 base growth rate is lower - 5.0%. Since the Executive’s forecast exceeds the January forecast by \$133 million in FY 2013, there are clearly methodological differences in the JLBC and Executive estimate. After analyzing the 2 estimates, the primary issue is the treatment of Urban Revenue Sharing to cities, which is based on 15% of income tax collections from 2 years prior.

Due to the recovery of income taxes in FY 2011, Urban Revenue Sharing (URS) will increase by \$89.2 million, or 21% in FY 2013. The JLBC estimates exclude the URS changes. The Executive has chosen to apply this General Fund revenue loss to their growth rate. This adjustment, however, artificially dampens their projected growth. After adjusting for this issue and other methodology differences, the Executive growth rate is 6.4% compared to 5.1% in the January forecast. Please see [Comparison of Legislative and Executive Revenue Estimates](#) for more information.

*Table 1* summarizes these different base revenue projections:

<b>Table 1</b>	<b><u>FY 13</u></b>
January 4-Sector	5.1%
April 4-Sector	3.4%
April Alternate	5.0%
Executive	5.0%
Adjusted Executive <sup>1/</sup>	6.4%

<sup>1/</sup> Reflects same calculation method as JLBC

NOTE: A full audio recording of this meeting is available at the JLBC Staff Office, 1716 W. Adams. A full video recording of this meeting is available at <http://www.azleg.gov/jlbc/meeting.htm>