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FINANCE ADVISORY COMMITTEE

March 19, 2004

Senate Hearing Room 1 - 9:00 a.m.

Members Present:

Mr. Tracy Clark, ASU
Dr. Tim Hogan, ASU
Mr. John Lucking, ECON-LINC
Ms. Georganna Meyer, DOR
Mr. Elliott Pollack, Elliott D. Pollack and Co.
Mr. Hank Reardon, Reardon Economics
Mr. Marshall Vest, UofA
Mr. Don Wehbey, Dept. of Economic Security

Mr. Richard Stavneak, Director, JLBC Staff, opened the meeting and welcomed everyone to the Finance Advisory Committee (FAC) meeting. In explaining how the JLBC FY 2004 and FY 2005 revenue estimates were put together, Mr. Stavneak noted that they were developed using a 4-sector consensus process. The first component was the FAC members' overall average growth rates based on a survey of the panel. The members were asked for estimates of how they thought the state's largest 3 revenues categories were going to grow. The consensus forecast also included the baseline and conservative model results from Marshall Vest's University of Arizona forecast. The final component was the JLBC Staff forecast. The four elements were then weighted equally, and averaged to come up with the January consensus numbers. The consensus forecast covers about 94% of the state's General Fund revenues. The remaining 6% of revenues, which represent smaller revenue categories, were forecasted by JLBC Staff.

Mr. Stavneak gave an update for FY 2004 revenue collections for the 2 months since the January forecast was published. Revenue collections through the first half of the fiscal year were about \$121 million over the original budget forecast that was used last spring to develop the budget. That surplus was then incorporated into the revised 2004 forecast that was published in January. Since that time, January and February collections are about \$15 million over that revised forecast.

Mr. Stavneak said that he would like to get the FAC members' views on job growth, inflation, interest rates, and what they expect to happen in these areas in Arizona over the next 18 months. He noted that he would also like the panel's perspective on the March update of the January consensus figures. The March numbers have been updated to reflect the recent survey of FAC panel members, Marshall Vest's updated baseline and conservative model results, and the revised JLBC Staff forecast.

Mr. Tim Everill, Mr. Hans Olofsson, Mr. Brian Cary, and Mr. Stavneak, JLBC Staff, provided a slide presentation and handout with an overview of the major revenue categories. (See Attachment 1).

Mr. Elliott Pollack gave a slide presentation and handout on the national economy (See Attachment 2). He said that 2004 is the "Best of All Possible Worlds" in the business cycle, and, short of a terrorist event, any surprise will likely be on the upside rather than the downside. That should be the case for the next few years.

Mr. Stavneak asked Mr. Pollack's view on the probability of strong growth of 9% to 10% in the state. Mr. Pollack said that growth in the 9% to 10% range is a possibility for the next year, mainly because of corporate profits, but also because employment is taking off. Arizona is one of the few states where employment is up.

Representative Johnson asked Mr. Pollack to address 2 issues. One is the massive printing of money by the federal government that is flooding the market, and it seems that our dollar is falling a lot. The other is the high trade deficit.

Mr. Pollack said that the falling dollar is more related to the trade deficit than to the printing of money. It has to do with the fact that we are running a huge trade deficit. Countries are sending us automobiles, computers, etc. and we are sending them dollars. Eventually they want something instead of those green pieces of paper, and that is when the dollar starts to decline. Right now China and Japan are content to hold the dollars and essentially put the money in treasury bills, and that is one reason why interest rates are still low in the U.S. With regard to printing money, he noted that right now, the money supply growth is in the 4% to 5% growth range, and he does not see that as a problem.

Mr. Stavneak asked if he sees energy prices serving as a drag on the economy. Mr. Pollack said not at this point. We are using a lot less energy than we used to. Next time around, people are going to buy more fuel efficient cars.

Representative Biggs asked how the federal deficit will affect 2006-2007. Mr. Pollack said it would cause higher interest rates. Higher interest rates will affect the housing market and all consumer goods, but mainly housing. Cheap housing is one of our major competitive advantages, much more so in this cycle than it has been in past cycles.

Mr. Tracy Clark gave a slide presentation and handout on the Arizona economy (See Attachment 3). Mr. Clark said we are getting to the point where we should see positive employment growth in manufacturing. He noted that gasoline, nationally, would have to get to \$2.55 a gallon before we would have the same real cost of gas that we had in the 1980s when we had the last bad run of gas prices. If gas prices go higher for the summer and prices stay there for an extended period of time, you have the potential for the economy to be significantly impacted. People have been buying a lot of SUVs and not very many gas efficient vehicles lately. If it just spikes and goes back down, there will not be a huge impact on the economy.

Mr. Stavneak asked Mr. Clark what are the chances for strong growth over the next 18 month.

Mr. Clark said that the best shot is with corporate taxes continuing to be very good. Corporate profit projections are good. There is some upside potential for personal income taxes because personal income growth has been strong. There may be a little upside from the stock market. The weakest case is for retail sales being any stronger than what JLBC showed. Primarily this is because people have really never stopped spending, and he doesn't see any reason why they would spend a lot more. At some point, auto sales will take a breather.

Mr. Stavneak asked the panel members for their closing comments on the economy.

Mr. Vest, University of Arizona, said he thinks the surprises are going to be on the upside for the economy, and for various revenue categories. The idea of the jobless recovery may play well in other parts of the country, but not for Arizona. If you look at the new numbers that just came out, we created 50,000 jobs statewide over the past year. During the boon years we were up around 100,000. A couple of years ago we were actually losing around 20,000 to 30,000 jobs. As the economy continues to grow he expects the population to move higher. Housing may even go higher. He does not think the debt issue is going to stop anything in the near term.

Ms. Georganna Meyer, Department of Revenue, said that they should be closing January Transaction Privilege Tax (TPT) early next week. She said they were on track with income tax return processing.

Mr. Tim Hogan, University of Arizona, said that he agrees that surprises will be on the upside. He has been astonished at how strong new home sales keep being at record levels.

Mr. Stavneak noted that DES released a report with new employment numbers yesterday. The good news for the second month in a row is the year-over-year job growth was above 2%.

Mr. Don Wehbey, Department of Economic Security, said that out of that job report they saw continued strengthening, as expected. Going back to their most recent forecast released at the end of August, they were forecasting a 2.5% rate of growth through this year. He still sees continuation of growth in most of the industries. Continued employment in manufacturing is expected, where the losses haven't shown a sustained recovery, but are trending in the right direction. A lot of this will depend on the continued strength of recovery in other countries and even in other regions of the U.S. For a couple of months, we were basically running 5th in the nation for job growth.

Mr. Hank Reardon said he cannot disagree with what has been said. The economy is growing and there is increased job growth. He thinks the risk for both economy and revenue will be on the upside and that needs to be considered probably selectively in revenue forecasting.

Mr. John Lucking said he is leaning toward the high end of forecasts. If you look for imbalances, there are 2 things that worry him. One is trade and that is being corrected because of the decline in the dollar, and that is going to continue. The Japanese have been supporting the yen but it is questionable if they will be able to do that forever. Historically countries have not been able to do that. The Chinese are probably, at some point, going to revalue their currency. Trade should come more closely into balance, but it is going to take some time. The deficit issue is certainly a concern, but it is a long-term issue. The financial markets are clearly telling us that they do not see it as a short-term issue. Things that might moderate things are consumers can expand as jobs creation accelerates, but debt is high and they are not going to be able to accelerate too rapidly. Arizona is well positioned in terms of demographics, technology, and particularly things that are happening in higher education.

Mr. Stavneak thanked the Committee members for their participation

The meeting adjourned at 10:15 a.m.

Cheryl Kestner, Secretary

Tim Everill, Revenue Section Chief