Update on the Economy & State Government Finances

Alison Felix
Economist & Branch Executive
Federal Reserve Bank of Kansas City
Denver Branch
The U.S. economy continues to grow at a modest pace.

**Real Gross Domestic Product (GDP)**

*Annualized Percent Change from Previous Period*

<table>
<thead>
<tr>
<th>Year</th>
<th>Q1 2012</th>
<th>Q2 2012</th>
<th>Q3 2012</th>
<th>Q4 2012</th>
<th>Q1 2013</th>
<th>Q2 2013</th>
<th>Q3 2013</th>
<th>Q4 2013</th>
<th>Q1 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>2%</td>
<td>0%</td>
<td>1%</td>
<td>2%</td>
<td>2%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>2008</td>
<td>1%</td>
<td>-1%</td>
<td>0%</td>
<td>2%</td>
<td>2%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>2009</td>
<td>-2%</td>
<td>-3%</td>
<td>-4%</td>
<td>1%</td>
<td>2%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>2010</td>
<td>3%</td>
<td>2%</td>
<td>1%</td>
<td>2%</td>
<td>2%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>2011</td>
<td>4%</td>
<td>3%</td>
<td>2%</td>
<td>1%</td>
<td>2%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
</tr>
</tbody>
</table>

*September 2012 FOMC Central Tendency Projections*

Source: Bureau of Economic Analysis & Federal Open Market Committee (FOMC)
Unemployment rates have fallen over the past year but remain stubbornly high.

**UNEMPLOYMENT RATE**  
*Seasonally Adjusted*

**United States**  
- 2005: 7.2%  
- 2006: 7.1%  
- 2007: 6.7%  
- 2008: 6.2%  
- 2009: 6.0%  
- 2010: 7.0%  
- 2011: 7.8%  
- 2012: 8.1%  
- 2013: 7.8%  
- 2014: Projections

**Kansas City**  
- 2005: 4.4%  
- 2006: 4.1%  
- 2007: 4.4%  
- 2008: 6.0%  
- 2009: 9.4%  
- 2010: 9.6%  
- 2011: 9.0%  
- 2012: 8.1%  
- 2013: Projections

**Missouri**  
- 2005: 5.4%  
- 2006: 5.0%  
- 2007: 5.0%  
- 2008: 4.8%  
- 2009: 4.8%  
- 2010: 7.2%  
- 2011: 7.1%  
- 2012: 6.7%  
- 2013: 6.2%  
- 2014: Projections

**Kansas**  
- 2005: 5.1%  
- 2006: 4.8%  
- 2007: 5.0%  
- 2008: 4.4%  
- 2009: 4.4%  
- 2010: 9.4%  
- 2011: 9.6%  
- 2012: 9.0%  
- 2013: Projections

*Source: Bureau of Labor Statistics & Federal Open Market Committee (FOMC)*
Inflation remains moderate despite increases in gasoline and food prices.

**U.S. Personal Consumption Expenditure (PCE) Inflation**

*Annualized Percent Change from Previous Period*

Inflation remains moderate despite increases in gasoline and food prices.

*Source: Bureau of Economic Analysis & Federal Open Market Committee (FOMC)*
“… the Committee also decided today to keep the target range for the federal funds rate at 0 to 1/4 percent and currently anticipates that exceptionally low levels for the federal funds rate are likely to be warranted at least through mid-2015.”

- FOMC October Statement

Effective Federal Funds Rate
“…the Committee will continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month.

- FOMC October Statement

**Federal Reserve Balance Sheet**

- **Assets**
  - Traditional Portfolio
  - Currency in Circulation
  - Federal Agency & Mortgage-Backed Securities
  - Short-Term Lending
  - Foreign Currency Swaps

- **Liabilities**
  - Reserves
  - Other

Source: Board of Governors of the Federal Reserve System
“The Committee also will continue through the end of the year its program to extend the average maturity of its holdings of Treasury securities, and it is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities.”

- FOMC October Statement
Source: Federal Reserve Bank of Kansas City
Most states have experienced positive job growth over the past year.

**SEPTEMBER 2012 NONFARM EMPLOYMENT**
*Year-over-Year Percent Change, Seasonally Adjusted*

- **United States**: 1.4%
- **Kansas City**: 0.1%

Source: Bureau of Labor Statistics
National employment has been increasing since early 2010 but remains 3.3% below peak levels.

**PAYROLL EMPLOYMENT GROWTH BY STATE**

*Index, 100 = September 2002, Seasonally Adjusted*

<table>
<thead>
<tr>
<th>State</th>
<th>Year-over-Year Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>1.4%</td>
</tr>
<tr>
<td>Kansas</td>
<td>0.8</td>
</tr>
<tr>
<td>Kansas City</td>
<td>0.1</td>
</tr>
<tr>
<td>Missouri</td>
<td>0.4</td>
</tr>
</tbody>
</table>

*Source: Bureau of Labor Statistics*
The professional and business services sector has been the strongest sector in Kansas City over the past year.

**Change in Nonfarm Employment, September 2012**

*Seasonally Adjusted*

- Professional & Business Services
- Local Government
- Wholesale Trade
- Leisure & Hospitality
- Retail Trade
- Education & Health Services
- Manufacturing
- Other Services
- Financial Activities
- Federal Government
- State Government
- Transportation & Utilities
- Information
- Mining, Logging & Construction

**Top Performing Industries**

**Worst Performing Industries**

Source: Bureau of Labor Statistics
Employment in the construction and information industries is down more than 30% from peak levels in Kansas City.

**Change in Nonfarm Employment, September 2012**

*Seasonally Adjusted*

Since December 2007

Professional & Business Services
Local Government
Wholesale Trade
Leisure & Hospitality
Retail Trade
Education & Health Services
Manufacturing
Other Services
Financial Activities
Federal Government
State Government
Transportation & Utilities
Information
Mining, Logging & Construction

Kansas City
United States

Source: Bureau of Labor Statistics
After declines in real wages last year, real wages have been flat to increasing this year.

**Real Hourly Wage Rate**

*Percent Change from the Prior Year, Seasonally Adjusted*

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>September 2012</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kansas</td>
<td>1.1%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kansas City</td>
<td>0.0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Missouri</td>
<td>2.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>-0.2</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Bureau of Labor Statistics
Residential construction activity is picking up but remains well below pre-recession levels.

**Value of Residential Construction**

*Percent Change, Cumulative Year-to-Date January through September 2012*

![Map showing the percent change in residential construction activity across the United States. The map highlights states with different percentage changes: 40+%, 20 to 40, 0 to 20, -20 to 0, and -20+. The United States as a whole shows a percent change of 26.4%.]*

*Source: McGraw Hill/F.W. Dodge*
Home prices have stabilized over the past year across most of the nation.

**Change in Home Prices Year-over-Year, 2012Q2**

*FHFA Purchase-Only Index, Seasonally Adjusted*

United States

3.0%

Source: Federal Housing Finance Agency
Despite recent gains, home prices remain below peak levels in most states.

**Change in Home Prices Peak to Current (2007Q1 to 2012Q2)**

FHFA Purchase-Only Index, Seasonally Adjusted

- United States: -17.6%
- North Dakota: -11.3%
- New Mexico: -3.7%

**Color Code**
- 10 to 19.2%
- 5 to 10
- 0 to 5
- -5 to 0
- -10 to -5
- -20 to -10
- -56 to -20

*Source: Federal Housing Finance Agency*
Improvements in infrastructure and non-residential construction activity have varied across the country.

Value of Non-Residential & Non-Building Construction

Percent Change, Cumulative Year-to-Date  January through September 2012

Source: McGraw Hill/F.W. Dodge
After expanding for three years in the Tenth District, the manufacturing sector slowed somewhat in October.

**Manufacturing Activity**

*Diffusion Index, Seasonally Adjusted, Month-over-Month*

<table>
<thead>
<tr>
<th></th>
<th>Kansas City District</th>
<th>United States (ISM)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>October 2012</strong></td>
<td>48.2</td>
<td>51.5</td>
</tr>
<tr>
<td><strong>September 2012</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Federal Reserve Surveys are computed on an ISM Basis (50 = no change)

Source: Institute for Supply Management & Federal Reserve Bank of Kansas City
Manufacturers in the Tenth District still expect higher levels of activity over the next six months but have become less optimistic.

**Tenth District Manufacturing Expectations**

*Diffusion Index, Seasonally Adjusted, Six Months Ahead*

Source: Federal Reserve Bank of Kansas City
Growth has slowed sharply in Europe this year and is expected to remain slow in 2013.

**World Economic Outlook Projections**

*Percent Change over Prior Year*

Source: International Monetary Fund (IMF) (October 2012 World Economic Outlook)
Kansas exports growth has slowed in recent months but is still flat compared to 2011.

**Kansas Exports by Trading Partner**

**Billions**

<table>
<thead>
<tr>
<th></th>
<th>YTD through August</th>
<th>August 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Percent Change</td>
<td>Source: WISERTrade</td>
</tr>
<tr>
<td>Total Trade</td>
<td>0.1%</td>
<td>Note: Eurozone includes the 27 EU member countries. *2011 Share</td>
</tr>
<tr>
<td>All Other</td>
<td>-3.1</td>
<td><strong>SHARE</strong></td>
</tr>
<tr>
<td>Japan</td>
<td>4.6</td>
<td>35.0%</td>
</tr>
<tr>
<td>Mexico</td>
<td>-7.1</td>
<td>5.7</td>
</tr>
<tr>
<td>Canada</td>
<td>-2.4</td>
<td>14.0</td>
</tr>
<tr>
<td>China</td>
<td>44.6</td>
<td>22.1</td>
</tr>
<tr>
<td>Eurozone</td>
<td>0.1</td>
<td>5.8</td>
</tr>
</tbody>
</table>

Source: WISERTrade  
Note: Eurozone includes the 27 EU member countries.  
*2011 Share
Missouri export growth has also slowed in recent months but is up slightly compared to 2011.

**Missouri Exports by Trading Partner**

*Billions*

**August 2012 Year-to-Date Percent Change**

<table>
<thead>
<tr>
<th>Total Trade</th>
<th>3.5%</th>
<th>SHARE*</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Other</td>
<td>0.8</td>
<td>25.6%</td>
</tr>
<tr>
<td>Japan</td>
<td>16.7</td>
<td>4.2</td>
</tr>
<tr>
<td>Mexico</td>
<td>23.7</td>
<td>10.2</td>
</tr>
<tr>
<td>South Korea</td>
<td>23.1</td>
<td>4.3</td>
</tr>
<tr>
<td>Canada</td>
<td>-2.1</td>
<td>30.3</td>
</tr>
<tr>
<td>China</td>
<td>3.6</td>
<td>8.2</td>
</tr>
<tr>
<td>Eurozone</td>
<td>-3.1</td>
<td>17.3</td>
</tr>
</tbody>
</table>

*Source: WISERTrade  
Note: Eurozone includes the 27 EU member countries.  
*2011 Share
Under current law, several tax increases and spending cuts could lead to a slowdown in economic growth next year.

GDP & THE “FISCAL CLIFF”

Percent Change (Annualized Quarterly Rates)

Source: Bureau of Economic Analysis & Congressional Budget Office (August 2012 Projections)
Many private forecasters expect that the fiscal cliff will be avoided and that the U.S. economy will continue to grow at a moderate pace.

**GDP & THE “FISCAL CLIFF”**

*Percent Change (Annualized Quarterly Rates)*

Source: Bureau of Economic Analysis, Congressional Budget Office (August 2012 Projections), & Blue Chip Economic Indicators (September 2012 Forecast)
Under current law, U.S. deficits are expected to fall sharply over the next several years.

**U.S. Deficit to GDP Ratio**

Source: Congressional Budget Office (August 2012 Projections)
U.S. Federal government debt levels as a percent of GDP are projected to fall sharply if the fiscal cliff occurs.

Source: Bureau of Economic Analysis & Congressional Budget Office (August 2012 Projections)
About 16.5% of all U.S. workers are employed by the government.

**Government Share of Total Nonfarm Employment, September 2012**

*Seasonally Adjusted*

<table>
<thead>
<tr>
<th></th>
<th>Local</th>
<th>State</th>
<th>Federal</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>10.6%</td>
<td>3.8%</td>
<td>2.1%</td>
</tr>
<tr>
<td>Kansas</td>
<td>13.3%</td>
<td>3.9%</td>
<td>1.9%</td>
</tr>
<tr>
<td>Kansas City</td>
<td>10.9%</td>
<td>1.6%</td>
<td>2.8%</td>
</tr>
<tr>
<td>Missouri</td>
<td>10.4%</td>
<td>3.8%</td>
<td>2.1%</td>
</tr>
</tbody>
</table>

Source: Bureau of Labor Statistics
Job losses in the government sector lagged private sector job losses by more than a year.

**CONTRIBUTION TO U.S. TOTAL NONFARM JOB GROWTH**

*Contribution to Percent Change, Seasonally Adjusted*

Source: Bureau of Labor Statistics
Tax revenue and intergovernmental revenue make up more than 60% of state and local government revenues.

**State & Local Government Revenue Sources, 2010**

**State Government**
- U.S.: 27.3%
- Kansas: 27.7%
- Missouri: 33.7%

**Local Government**
- U.S.: 29.2%
- Kansas: 28.0%
- Missouri: 24.6%

Other Revenue
- U.S.: 4.2%
- Kansas: 2.0%
- Missouri: 3.5%

**Taxes**
- State Government
- Local Government
- Federal Government

**Source:** Census Bureau
Taxes on sales and income make up more than 70% of state tax revenues.

**Composition of State Tax Portfolios, FY 2012**

- **U.S.**
  - General Sales: 20%
  - Individual Income: 40%
  - Corporate Income: 40%
  - Selective Sales: 0%
  - Severance: 0%
- **Kansas**
  - General Sales: 20%
  - Individual Income: 40%
  - Corporate Income: 30%
  - Selective Sales: 0%
  - Severance: 7%
- **Missouri**
  - General Sales: 30%
  - Individual Income: 40%
  - Corporate Income: 20%
  - Selective Sales: 0%
  - Severance: 7%

*Source: Census Bureau

*Selective sales includes taxes on alcoholic beverages, tobacco products, and other sales and gross receipts tax revenue.*
State tax revenues have partially recovered after sharp declines during the recession.

**Real Tax Revenue Growth, All 50 States**

*Moving Fiscal Year, Year-over-Year Percent Change*

Source: Census Bureau & Bureau of Labor Statistics
After two years of increases, tax revenue is expected to decline this year in Kansas due primarily to tax law changes.

**Kansas General Fund Revenue**

*Change over Prior Fiscal Year*

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Total</th>
<th>Individual Income</th>
<th>Sales &amp; Use</th>
<th>Corporate Income &amp; Franchise</th>
<th>Mineral</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 2009</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 2010</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 2012 Preliminary</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FY 2013 Forecast</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Kansas Legislative Research Department (June 2012 Revenue Estimate Adjustments)
Tax revenues are expected to continue to recover in Missouri during the current fiscal year.

MISSOURI GENERAL FUND REVENUE
Change over Prior Fiscal Year

Source: Missouri Office of Administration & FY 2013 State Budget
Update on the Economy & State Government Finances

This presentation will be available at http://www.kc.frb.org/denver/

Alison Felix
Alison.Felix@kc.frb.org