

Economic and Revenue Outlook

Presented to
Heritage Bank Executive and Division
Management Teams

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Olympia, Washington



WASHINGTON STATE
ECONOMIC AND REVENUE FORECAST COUNCIL



Summary

- Our economic forecast expects continued growth in the U.S. and Washington economies but at a slightly slower pace than in November and with lower inflation
- Oil prices have declined dramatically; moderate growth is expected over the forecast period
- The forecast assumes the Federal Reserve will increase interest rates twice this year
- Risks to the baseline include slowing global and U.S. economic growth, impact of a stronger dollar on exports, and weaker manufacturing activity



Economic news continues to suggest risks to forecast

Upside:

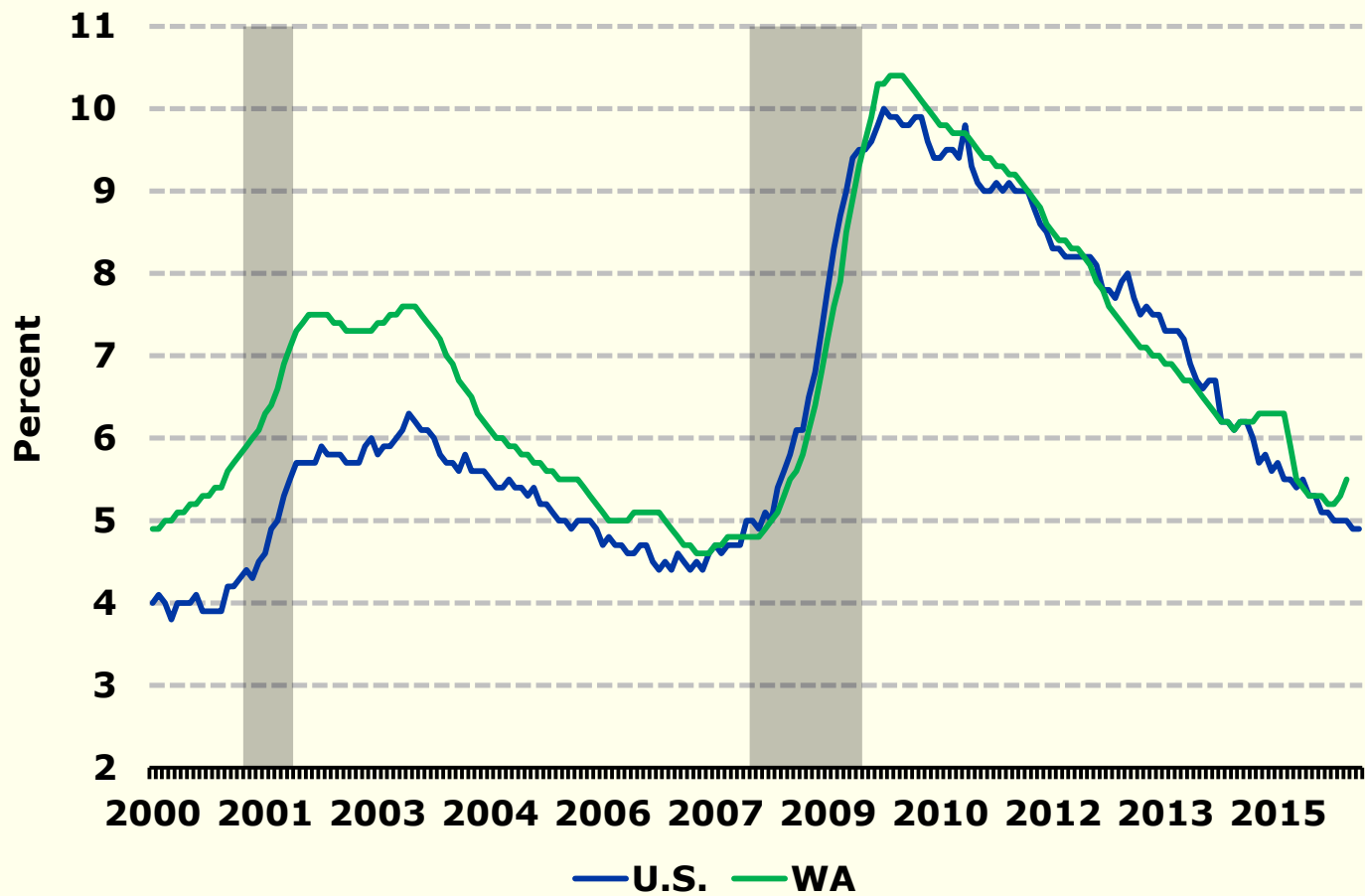
- Declining unemployment rates
- Rising wage growth
- Stronger housing starts and home sales (new and existing)
- Lower oil prices

Downside:

- Slower U.S. GDP growth
- Slowing global economy
- Negative impact of stronger dollar on exports
- Stock market volatility



U.S., WA unemployment rates trending down



Source: Bureau of Labor Statistics; U.S. data through Feb. 2016; WA data through Dec. 2015

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Number of long-term unemployed workers remains above pre-recession levels

Long-term unemployed as share of all unemployed:

Apr. 2010: 45%

Feb. 2016: 28%

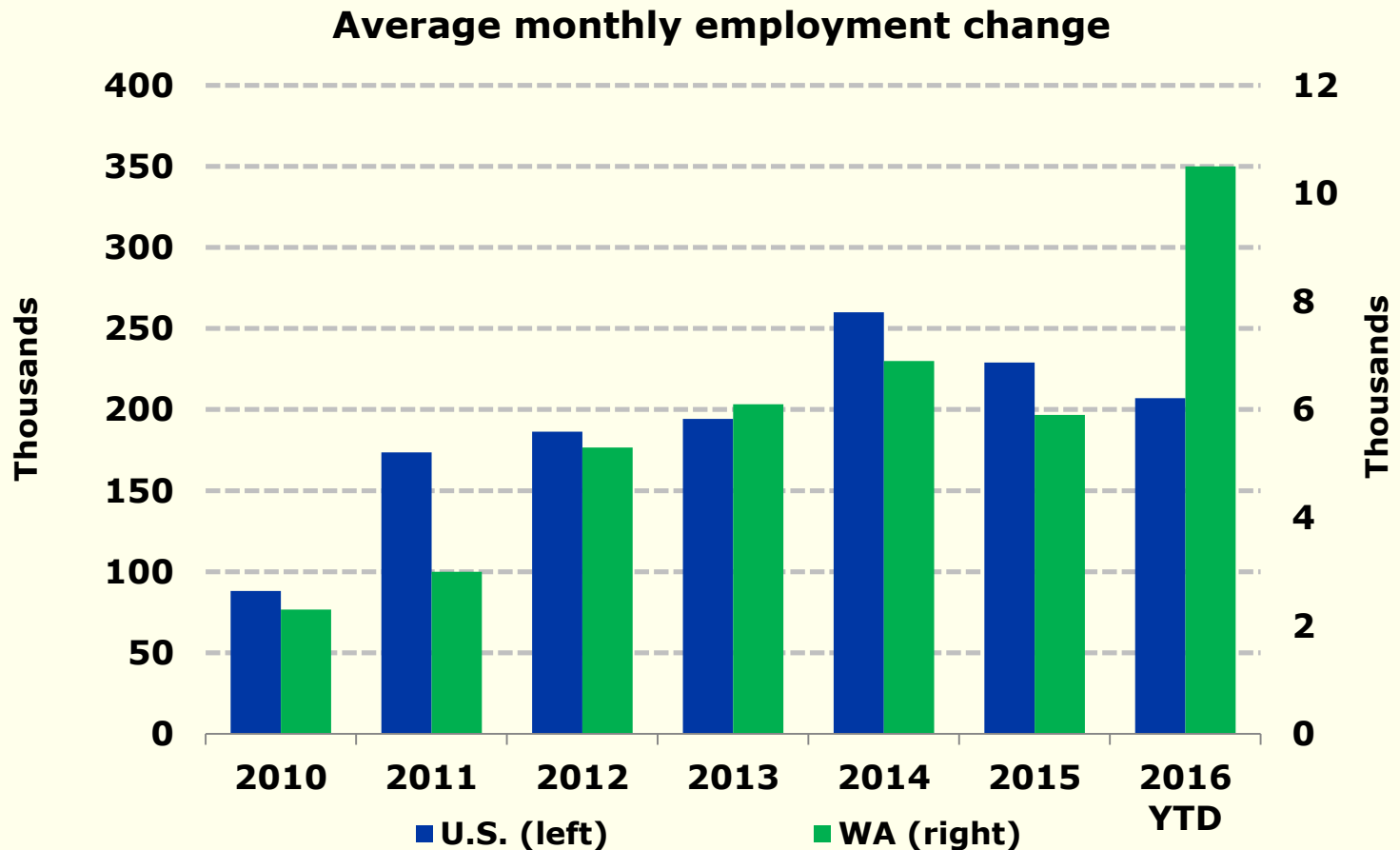


Source: Bureau of Labor Statistics; data through February 2016

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Job creation slightly weaker in 2015 than 2014; WA strong in January 2016



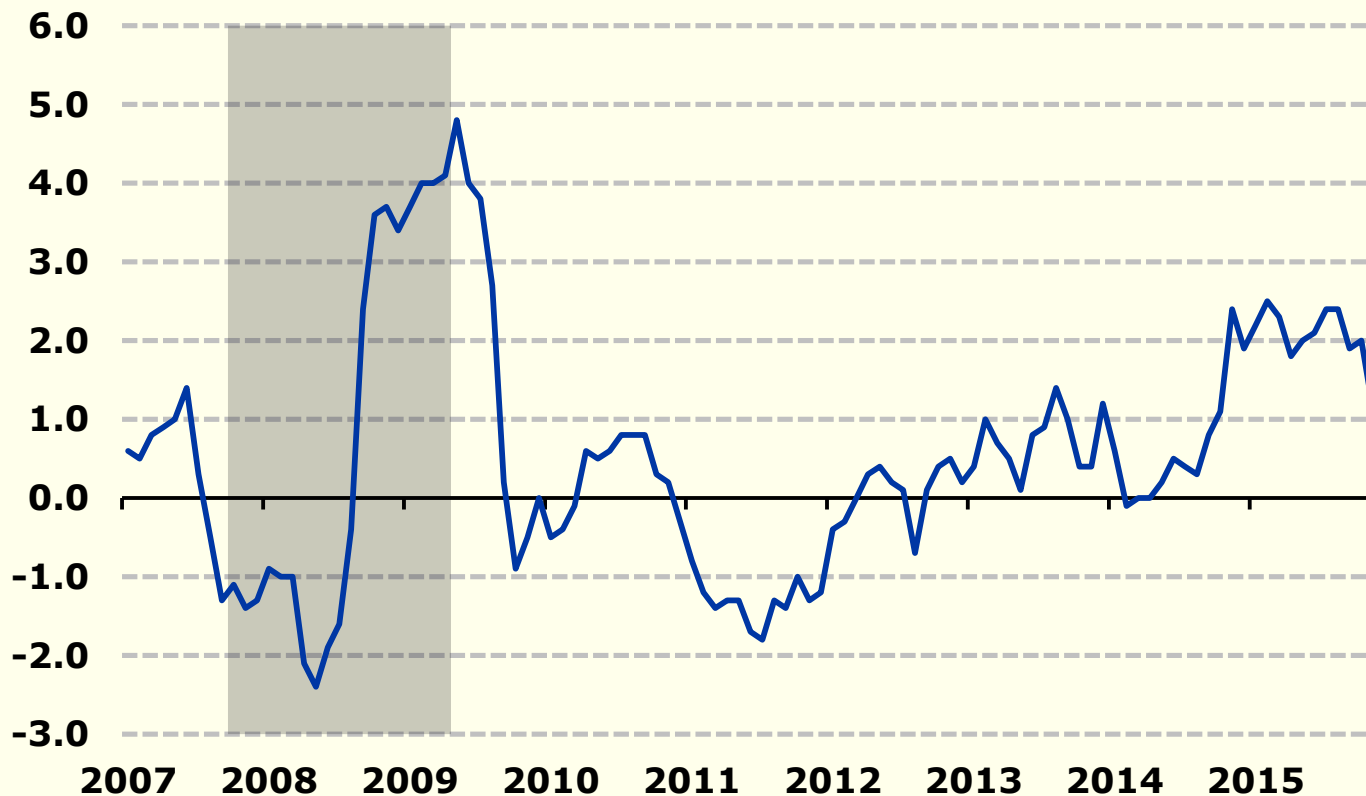
Source: Bureau of Labor Statistics, ERFC; U.S. data through Feb. 2016; WA data through Jan. 2016

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Average U.S. wage growth has turned positive but slowed in January

Year-over-year Growth in U.S. Real Hourly Wages

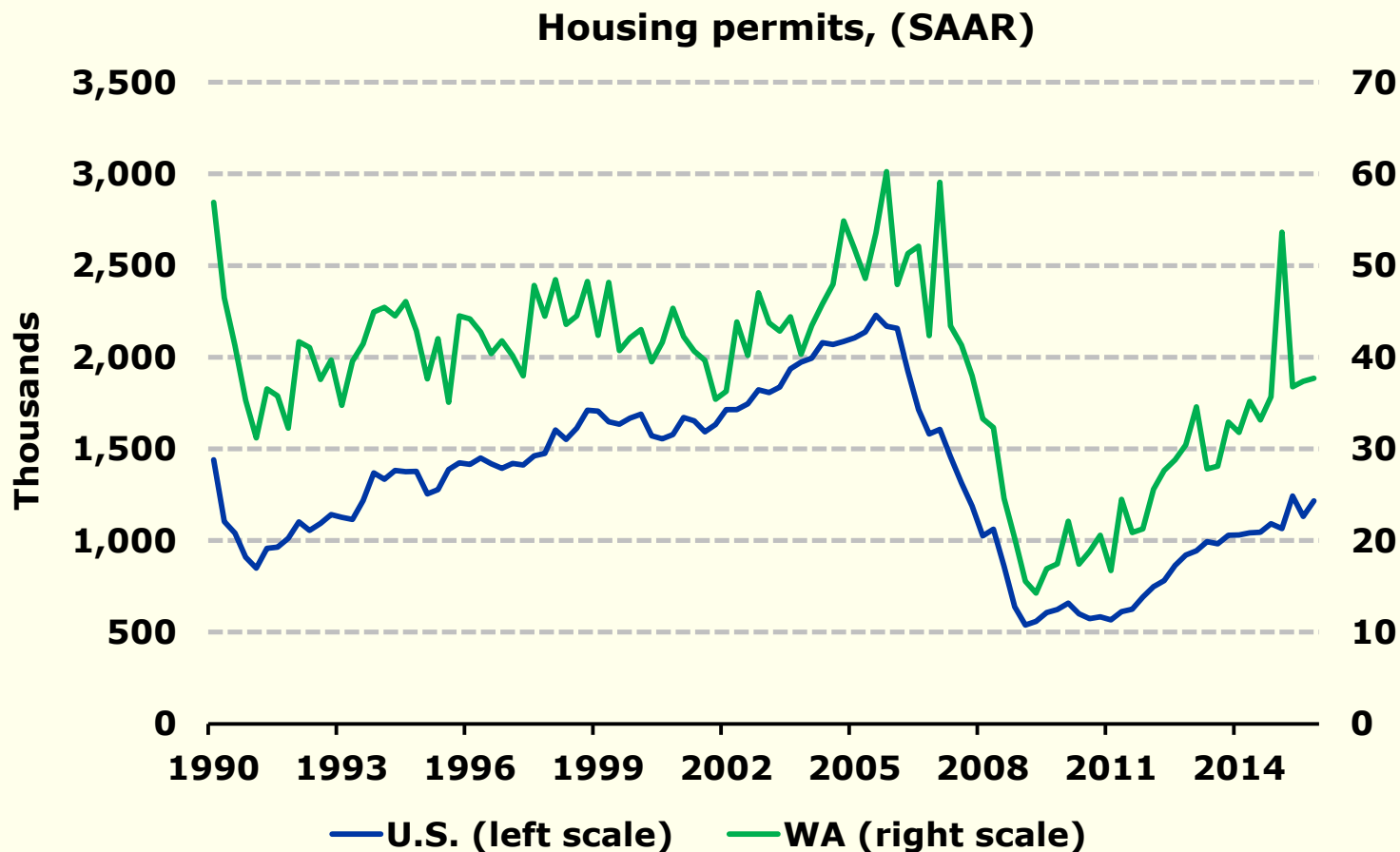


Source: U.S. Bureau of Labor Statistics, data through Jan. 2016

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Both U.S. and WA housing permits trending up since 2011

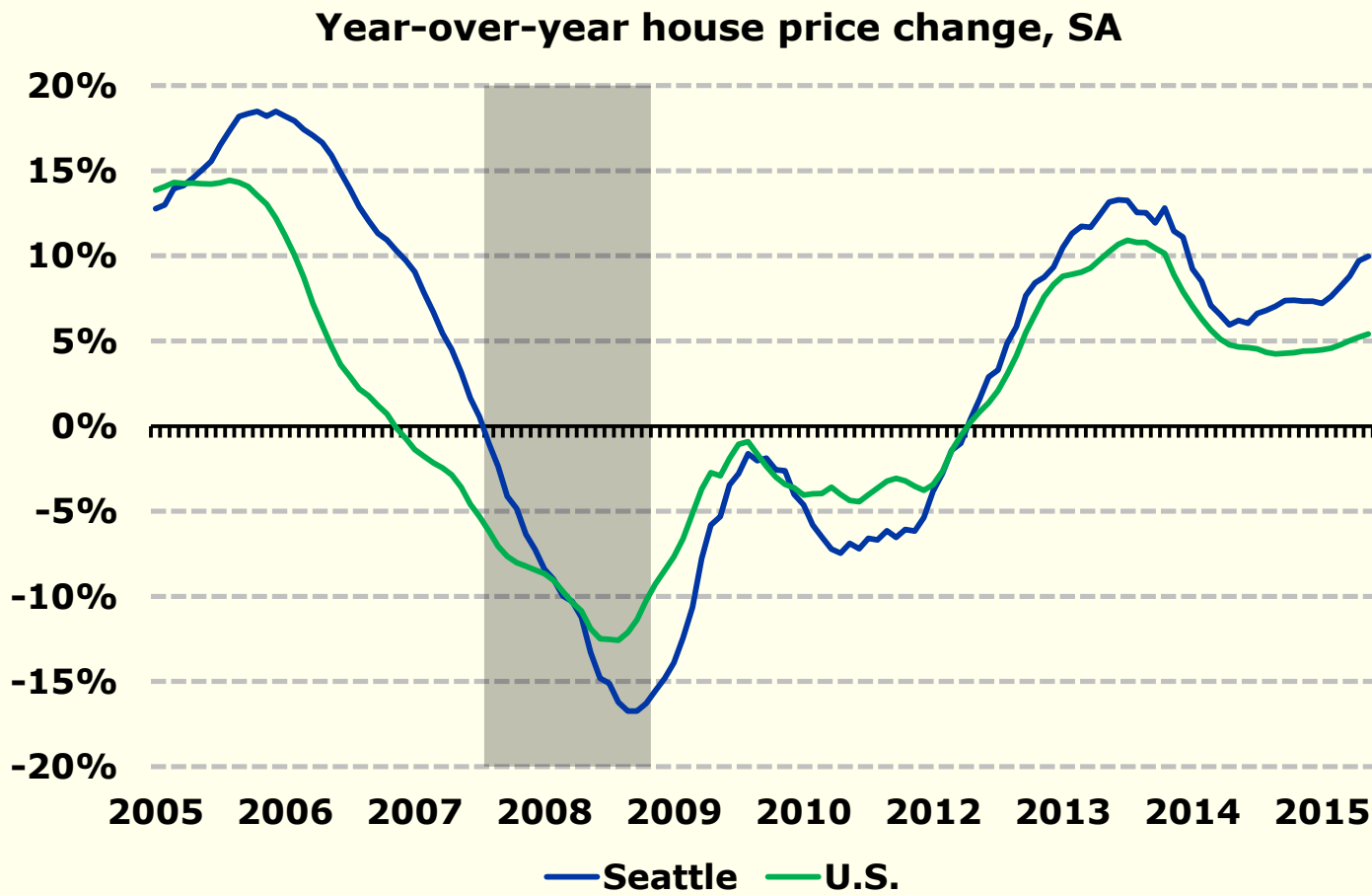


Source: U.S. Census Bureau, data through 2015 Q4

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Seattle home prices have been rising faster than prices nationally



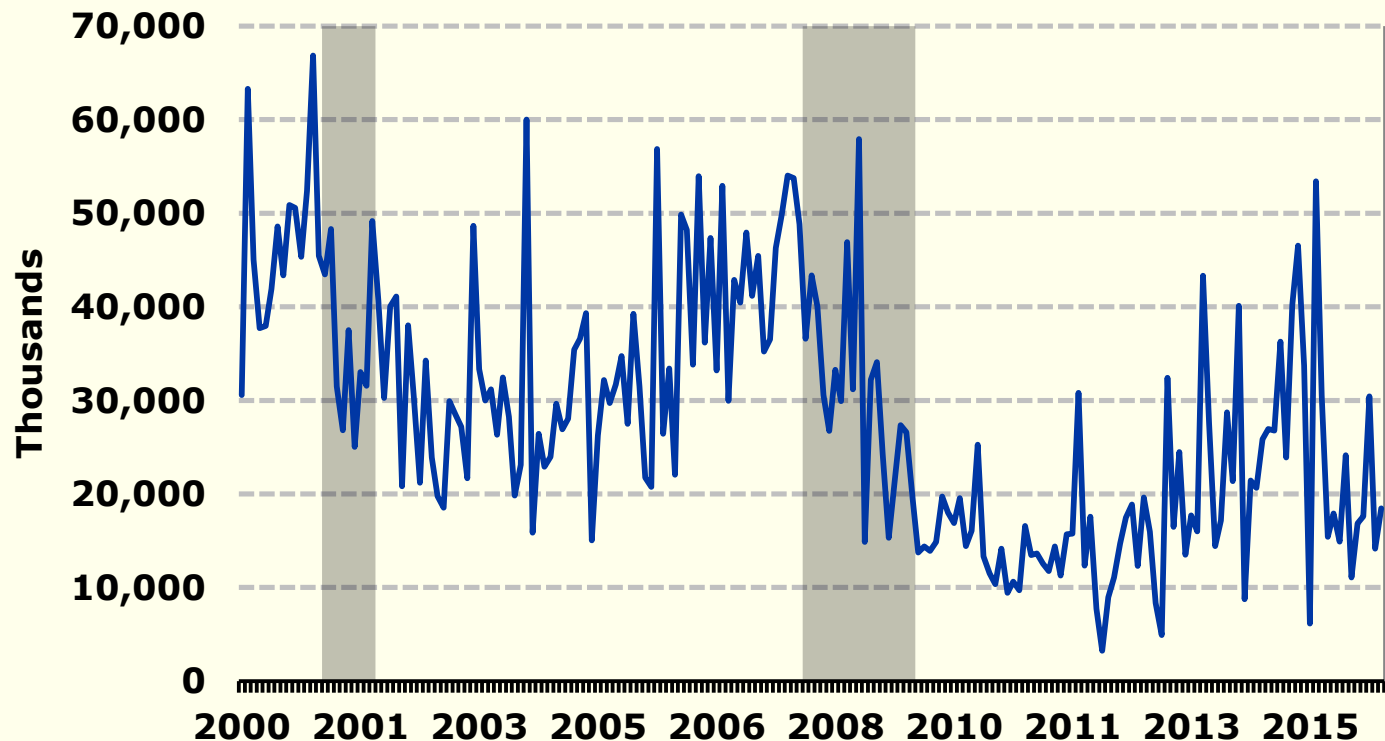
Source: S&P/Case-Shiller; data through Dec. 2015

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Nonresidential construction activity appears to be slowing

Square feet under contract, WA nonresidential projects
(SAAR)

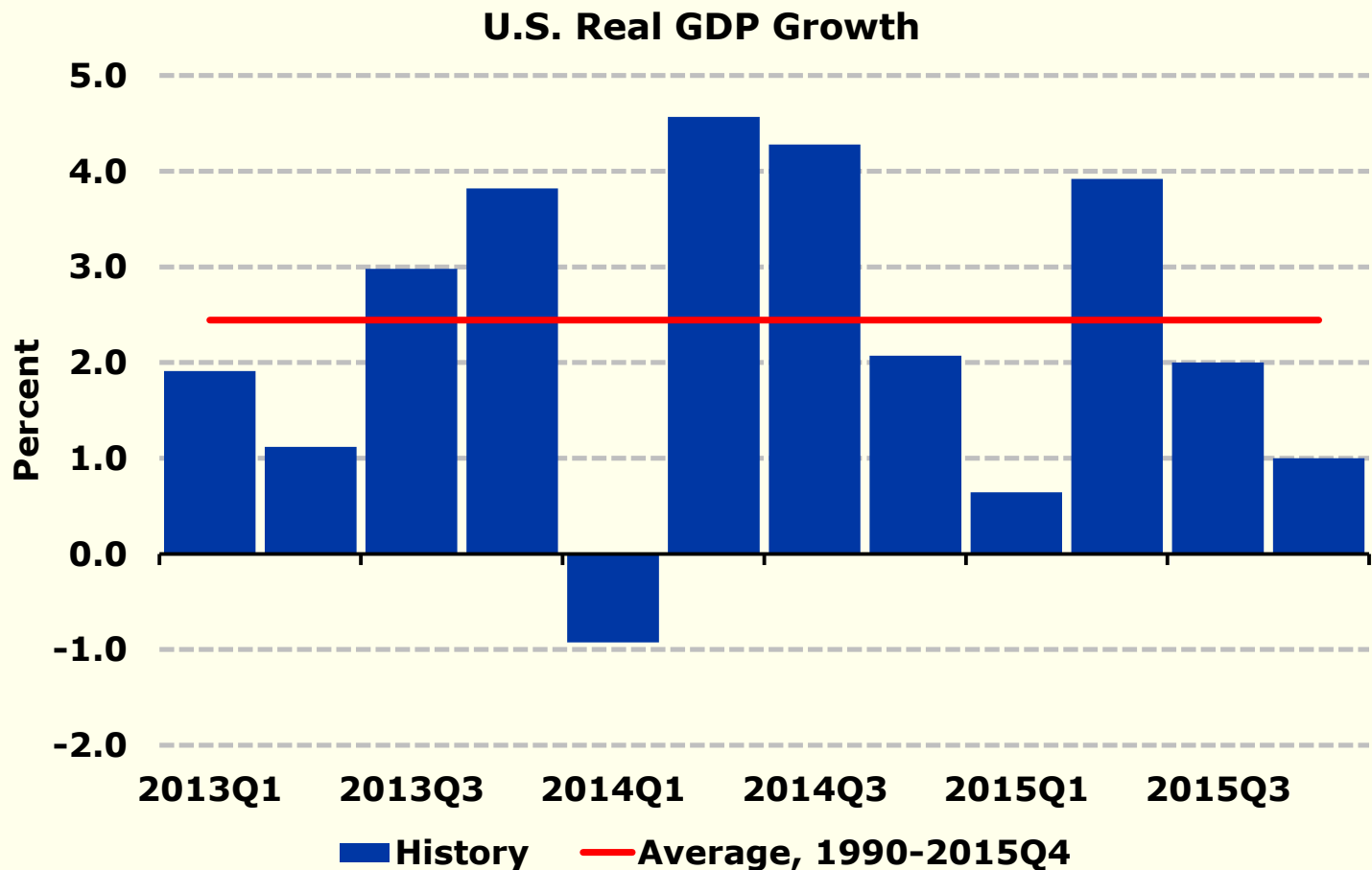


Source: Dodge Data & Analytics; data through Jan. 2016

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U.S. economic growth weakened in the third and fourth quarters

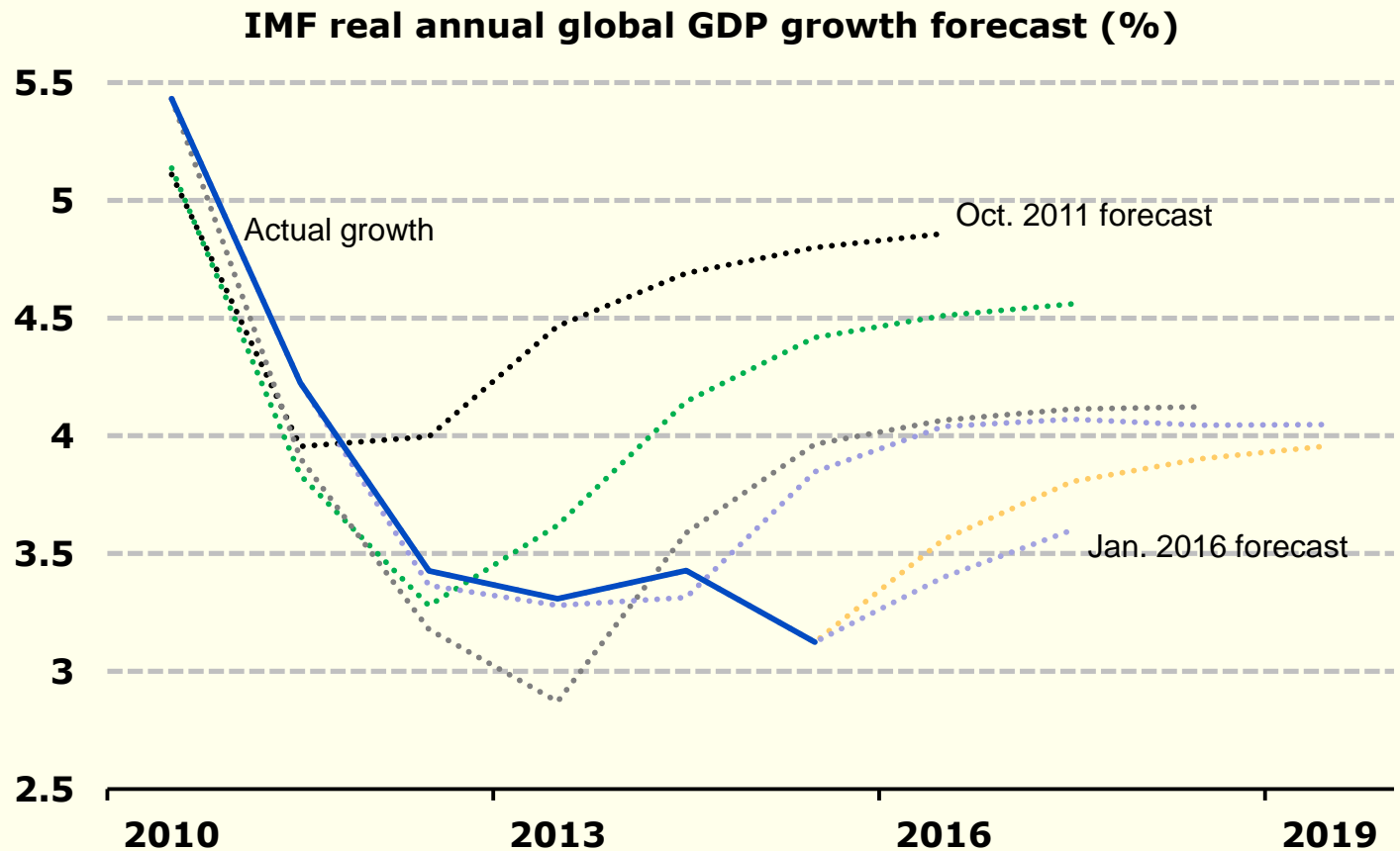


Source: U.S. Dept. of Commerce, BEA, data through 2015Q4

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Global GDP forecasts have been consistently revised down

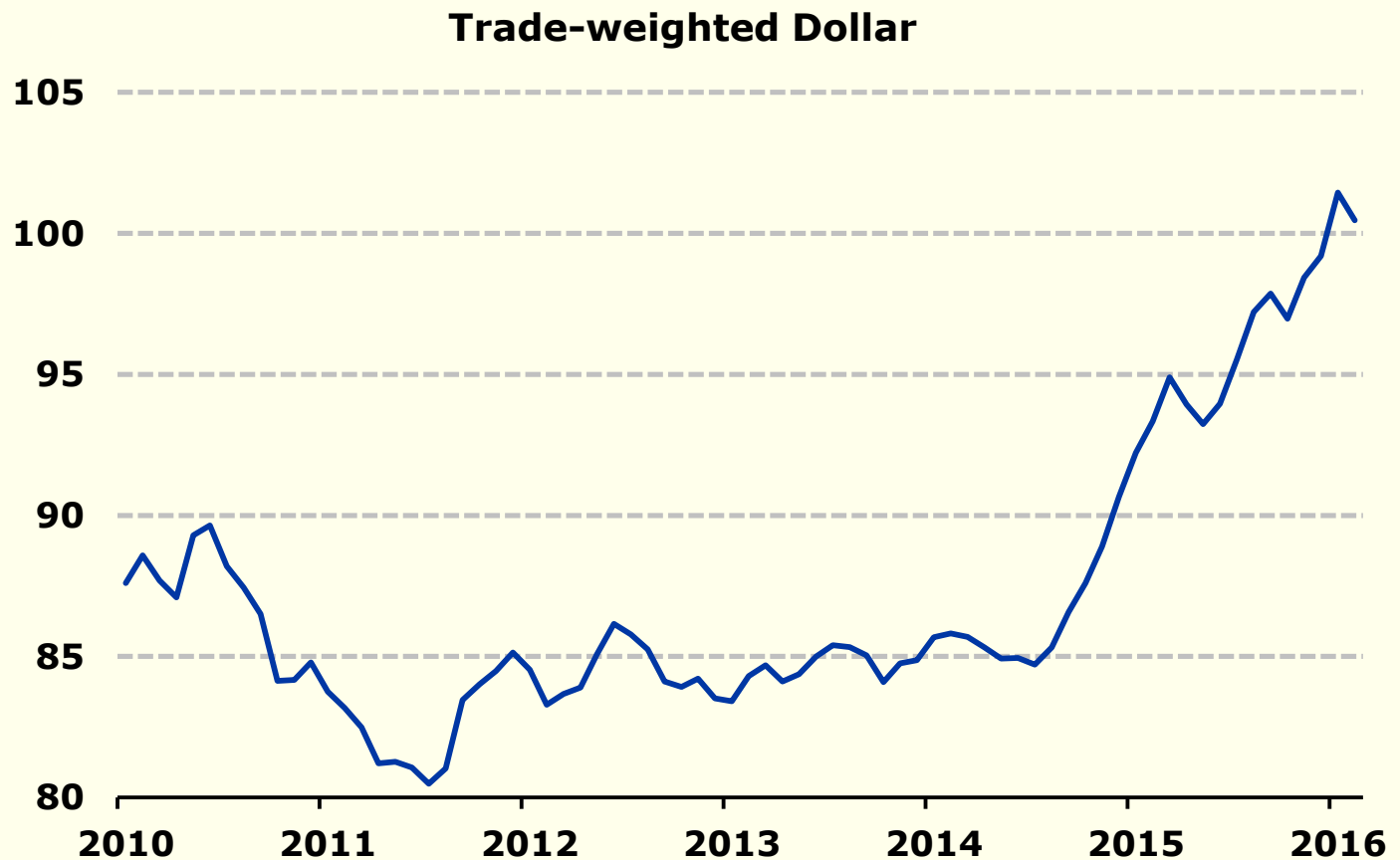


Source: International Monetary Fund, World Economic Outlook; historic data through 2015

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The dollar has increased in value relative to currencies of U.S. trading partners



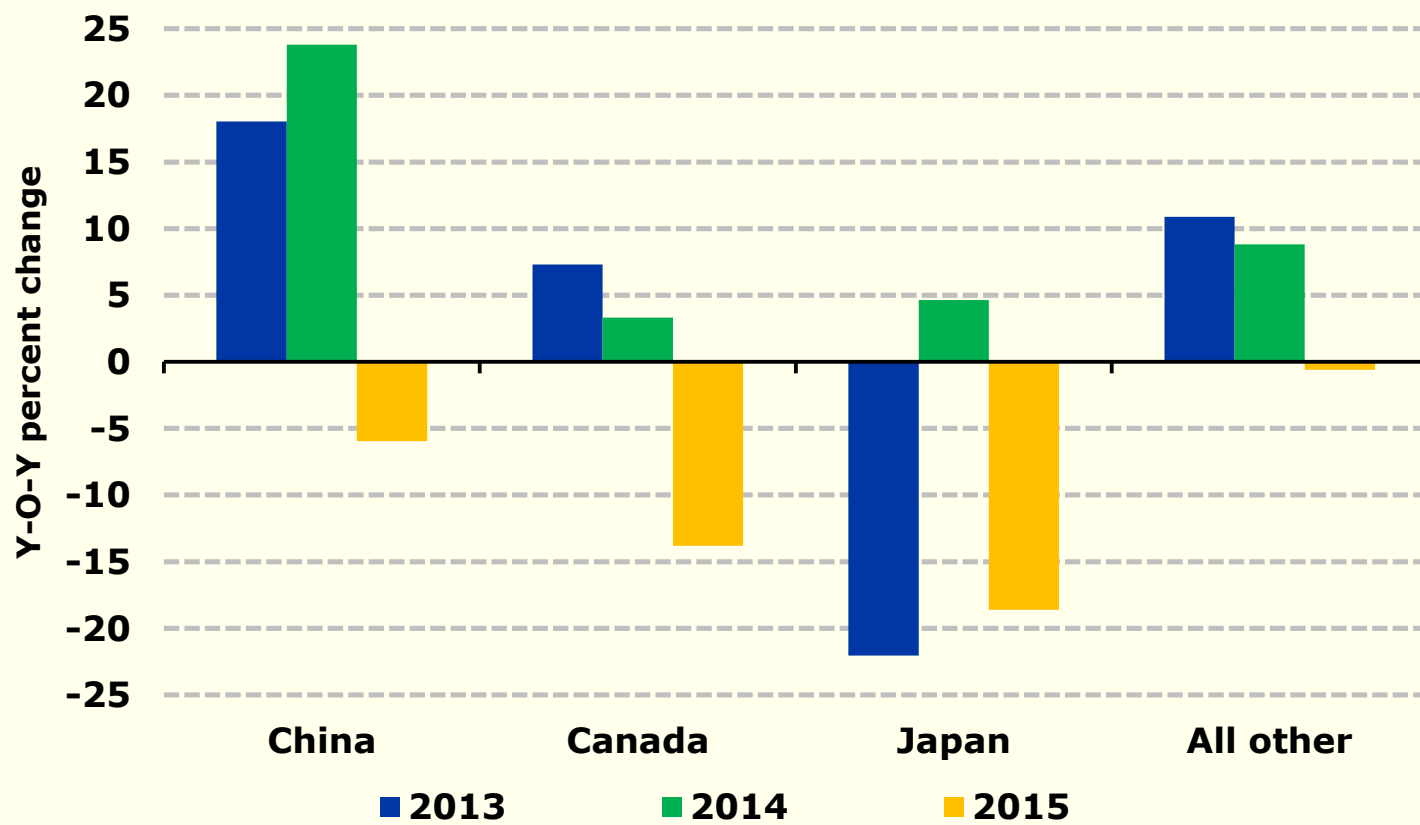
Source: Federal Reserve; data through February 2016

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WA exports in 2015 declined for the first time since 2009

Year-over-year growth in export value

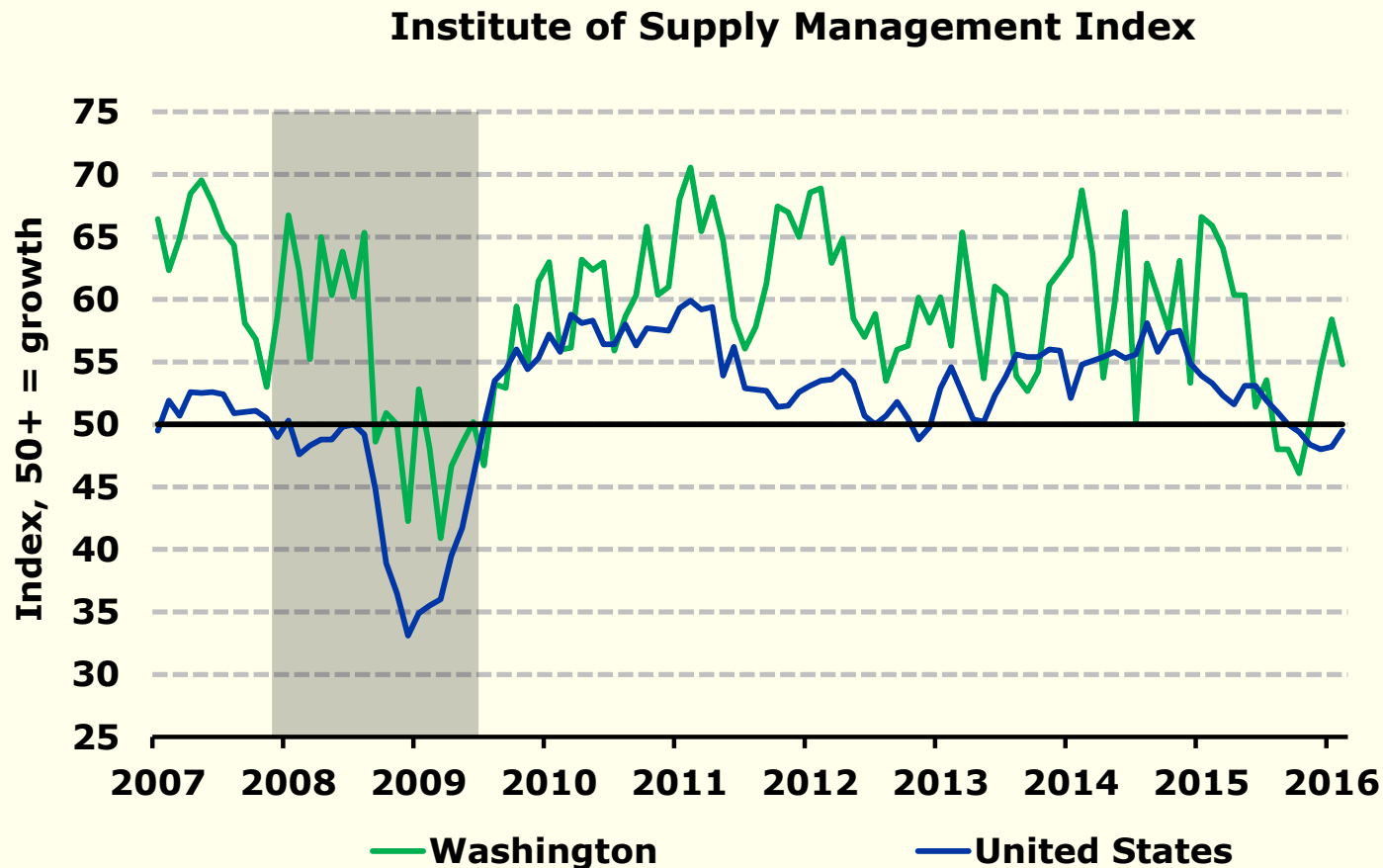


Source: WISERTrade; data through December 2015

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Manufacturing: slowing nationally, improving in Washington

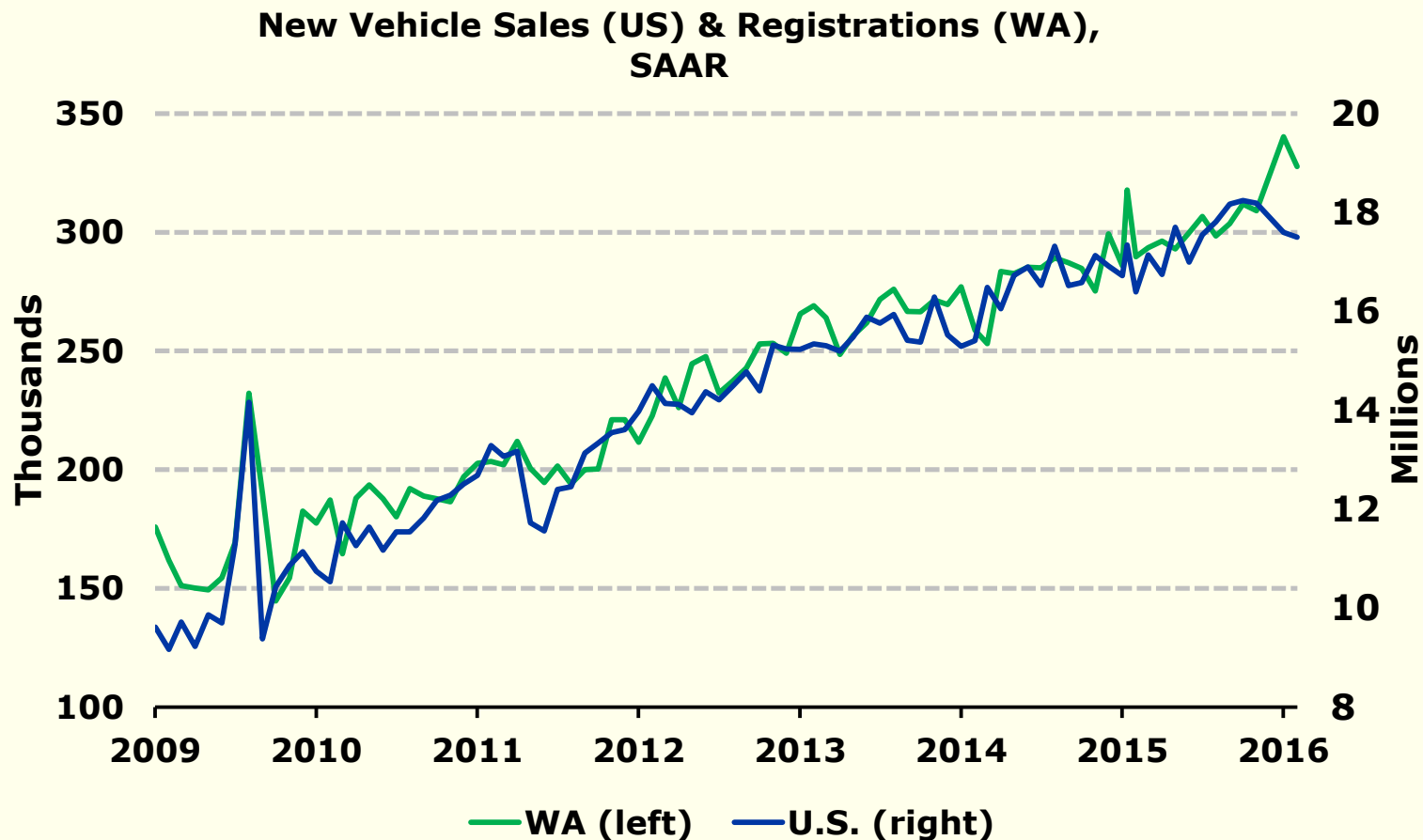


Source: ISM; data through Feb. 2016

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New vehicle sales remain strong; WA had record new car registrations in January



Source: Dept. of Licensing, ERFC, MotorIntelligence.com; data through February 2016

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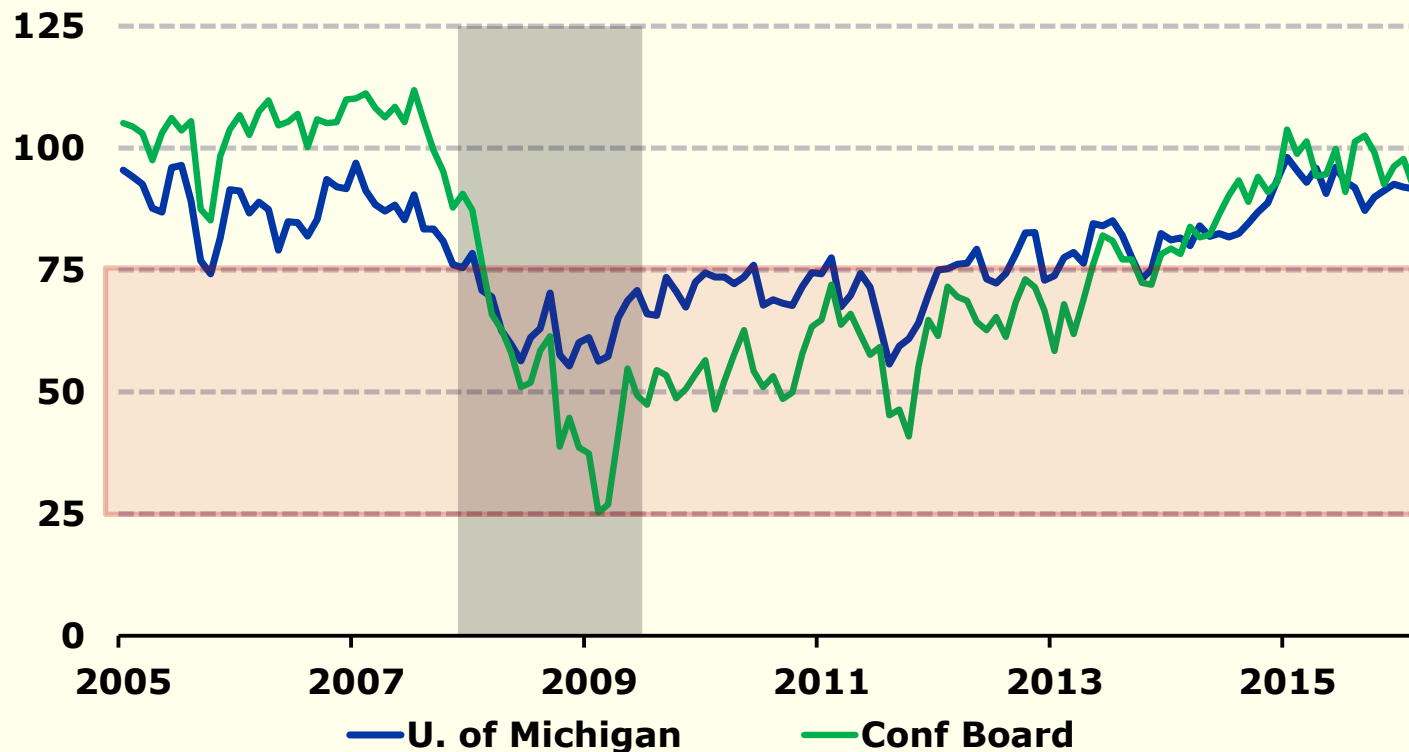


Conference Board, U. of Michigan indexes both down in February

Index

Mich: 1966Q1 = 100, SA

Conf Board: 1985 = 100, SA

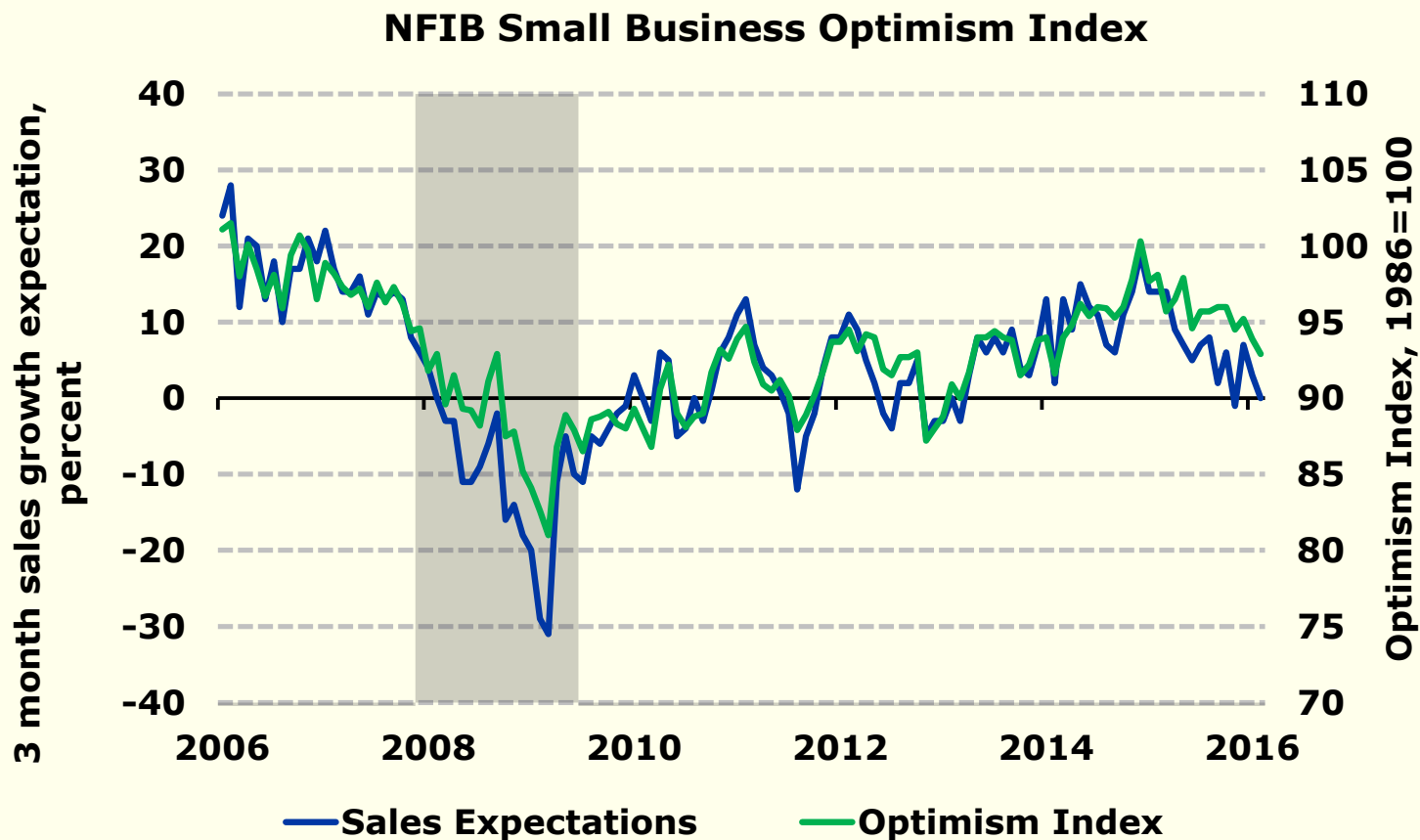


Sources: University of Michigan, Conference Board; data through February 2016

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Small business optimism and sales expectations weakened in 2015

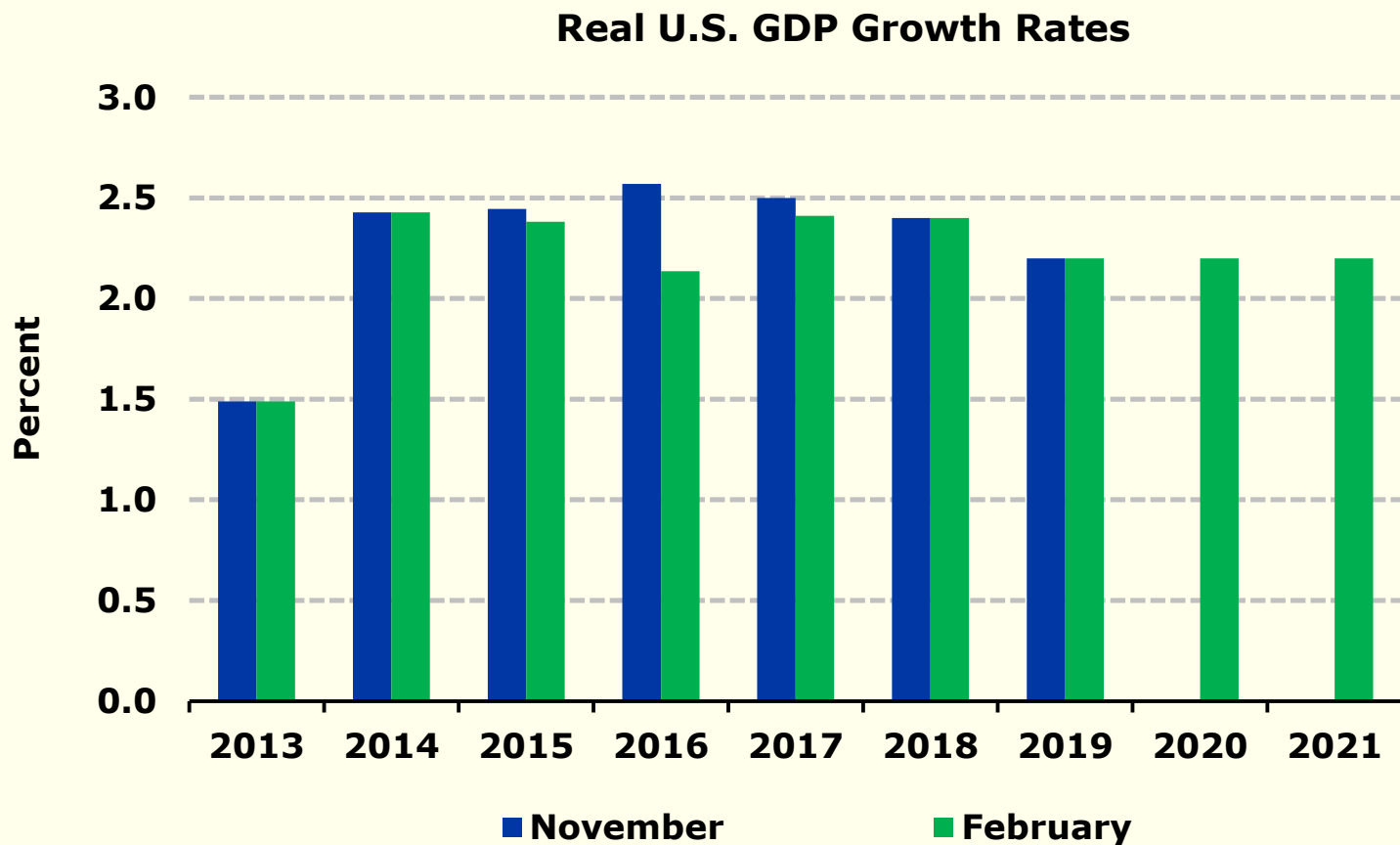


Source: National Federation of Independent Business; data through February 2016

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Forecasted real GDP growth is lower in 2015, 2016 & 2017 compared to the November forecast

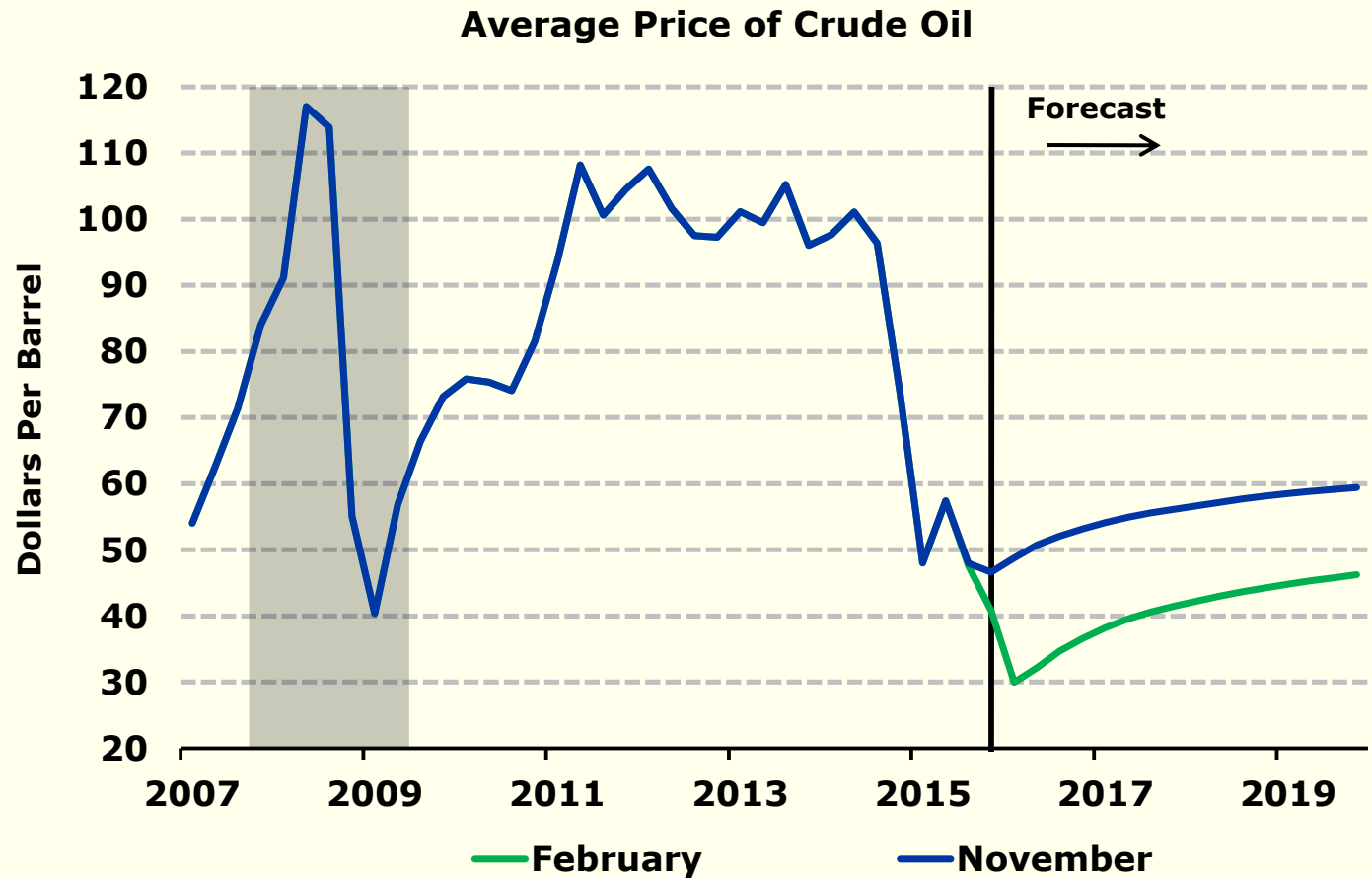


Source: ERFC February 2016 forecast; historical data through 2015

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Oil prices have fallen since the November forecast

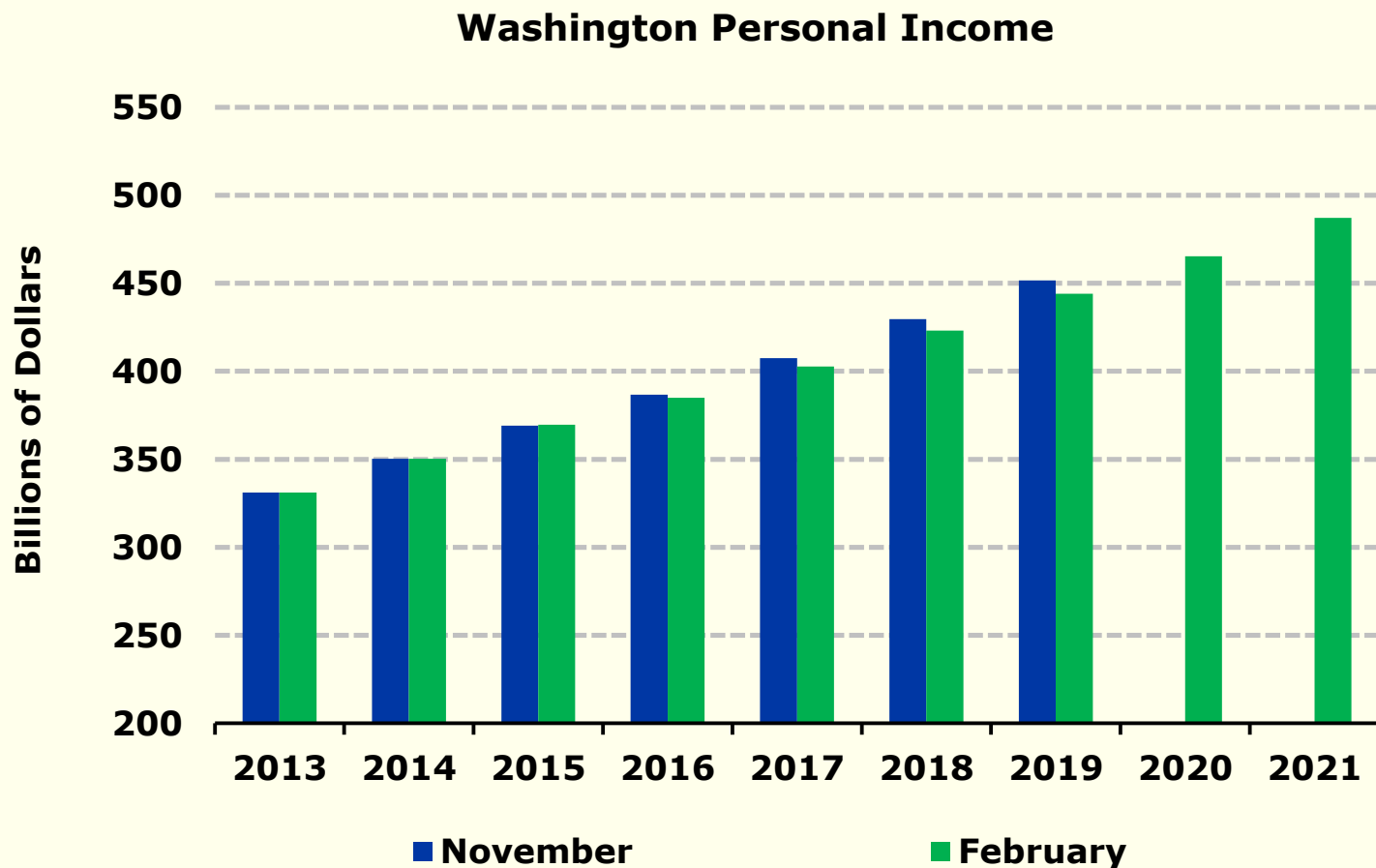


Source: DOE, ERFC February 2016 forecast; historical data through 2015Q4

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Washington personal income is lower in 2016 – 2019 compared to the November forecast

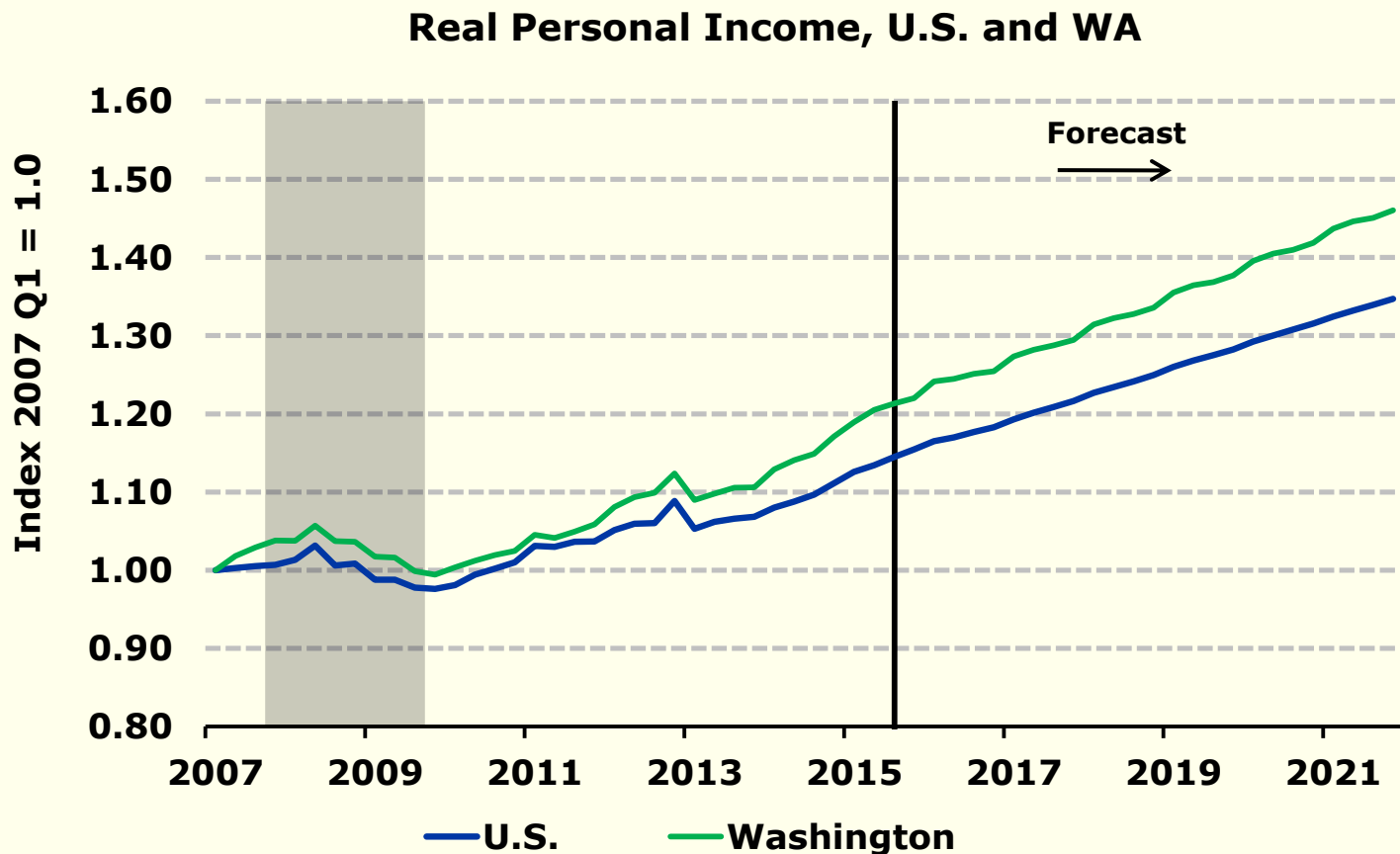


Source: ERFC February 2016 forecast; historical data through 2015

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State personal income will continue to grow slightly faster than the U.S.



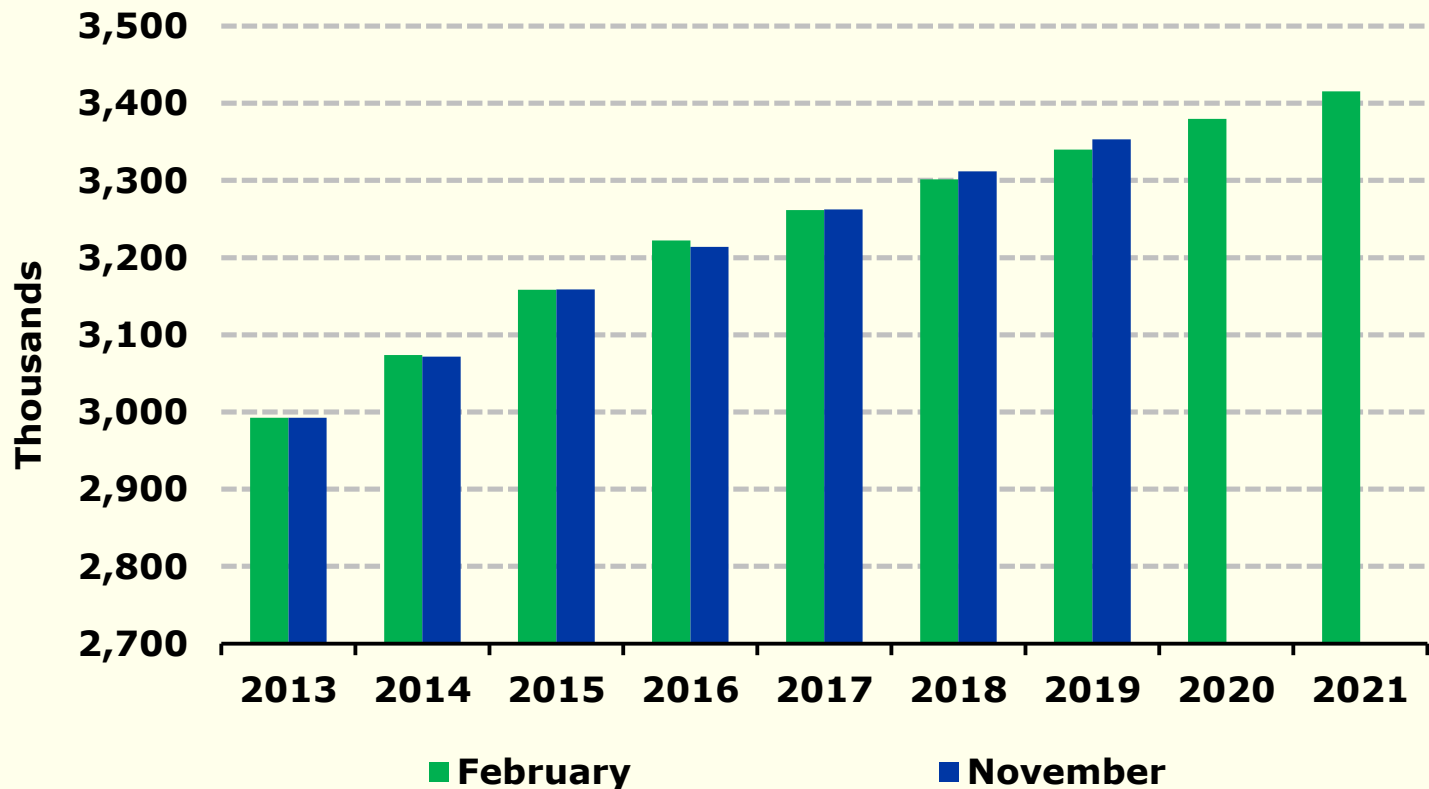
Source: ERFC February 2016 forecast; historical data through 2015Q3

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Washington employment forecast revised down slightly in 2017 - 2019

Washington Nonfarm Payroll Employment

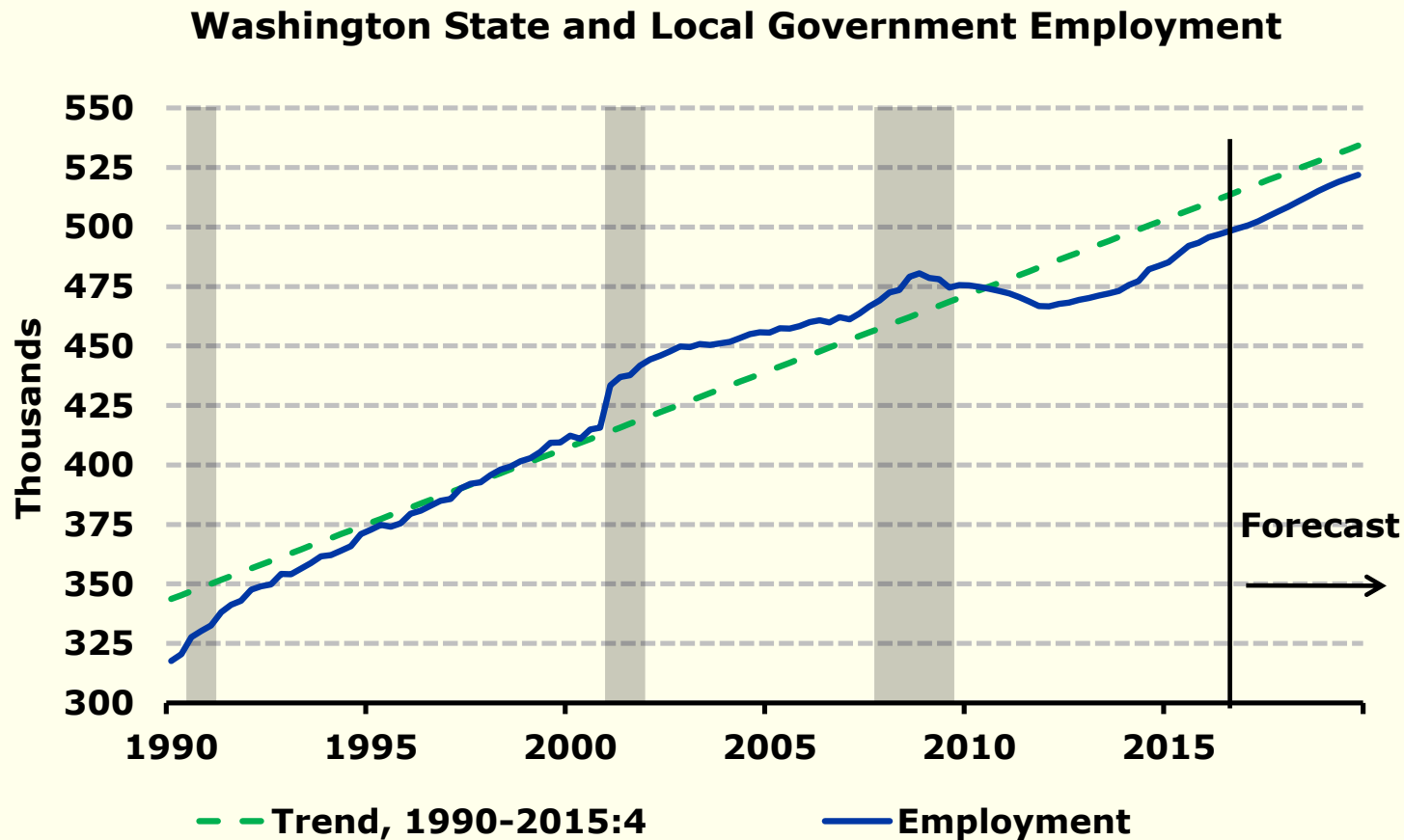


Source: ERFC February 2016 forecast; historical data through 2015

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State and local government employment is growing but will remain below its historic trend



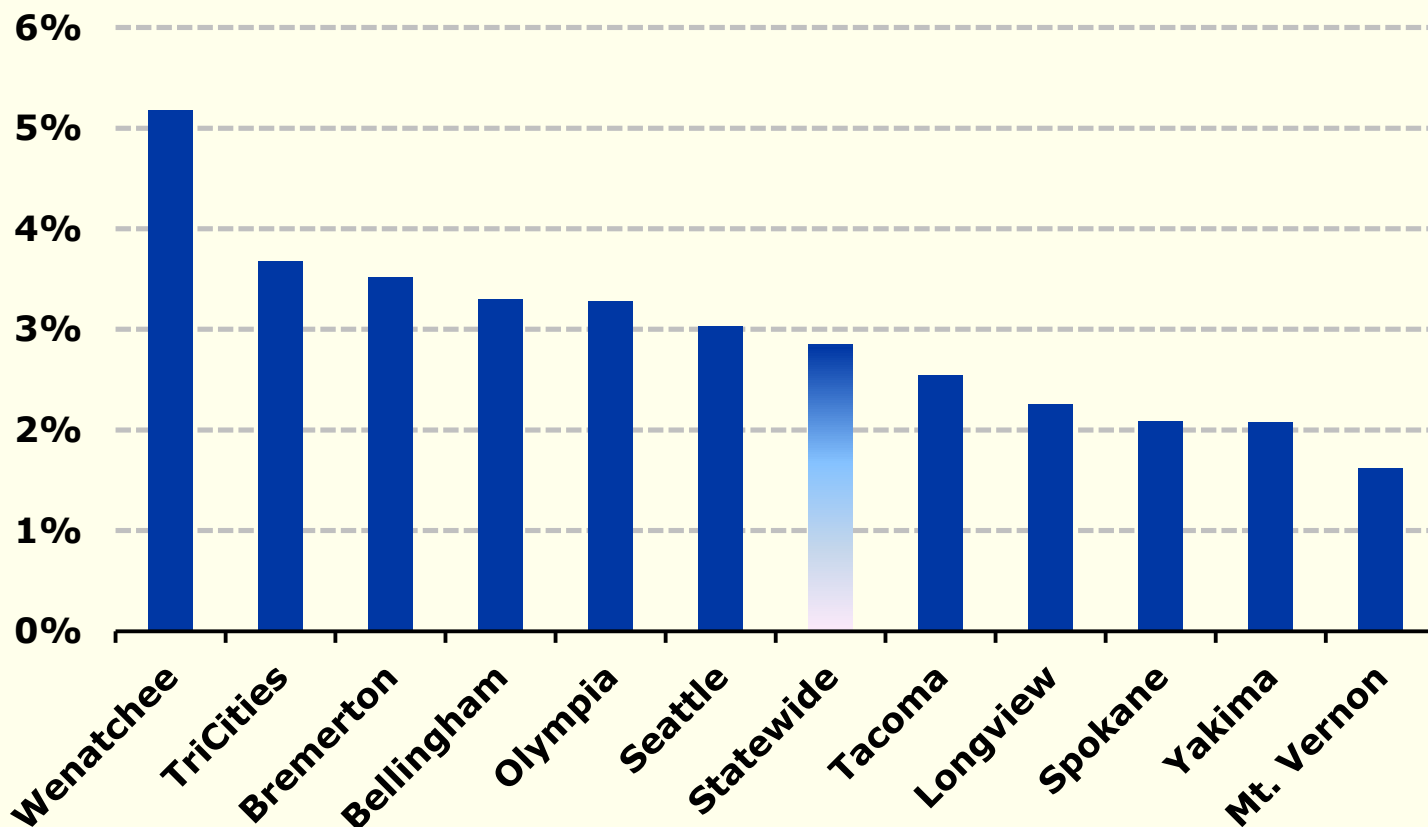
Source: ERFC February 2016 forecast; historical data through 2015Q4

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Employment growth varied widely across state metro areas

2015 employment growth by metro area

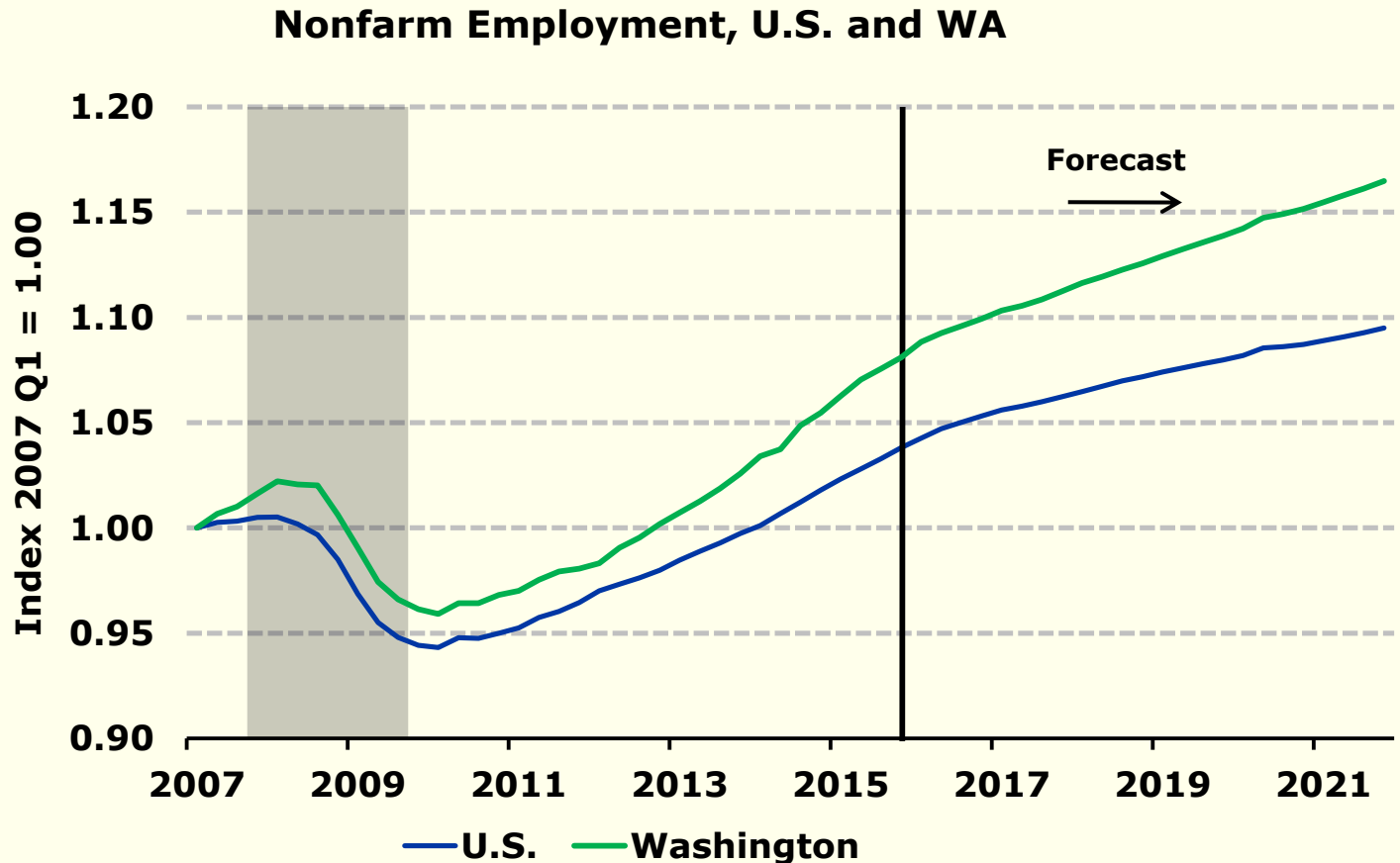


Source: WA State Employment Security Department

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Washington employment will continue to grow slightly faster than the U.S.

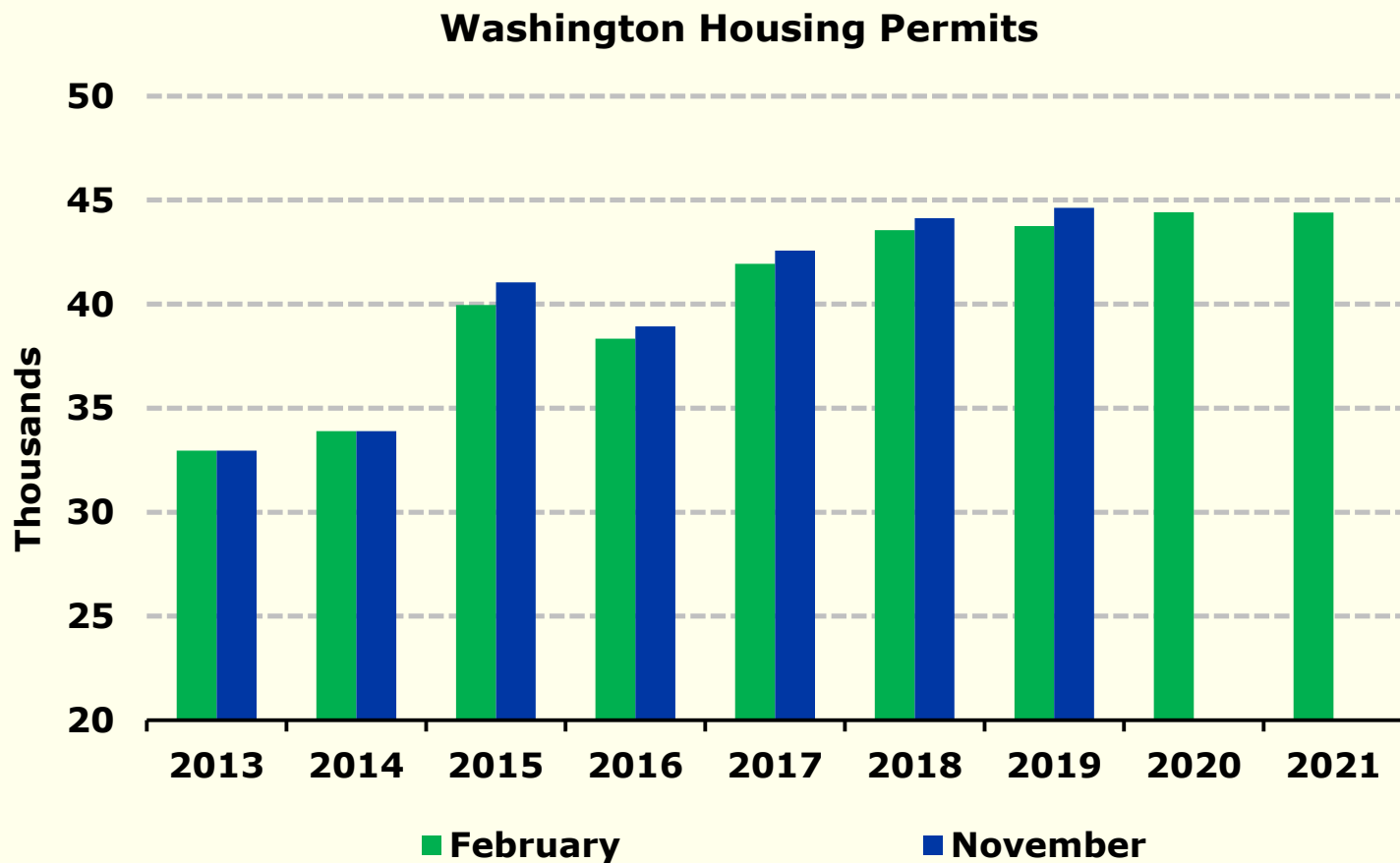


Source: ERFC February 2016 forecast; historical data through 2015Q4

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Washington housing permits forecast is slightly lower than in November

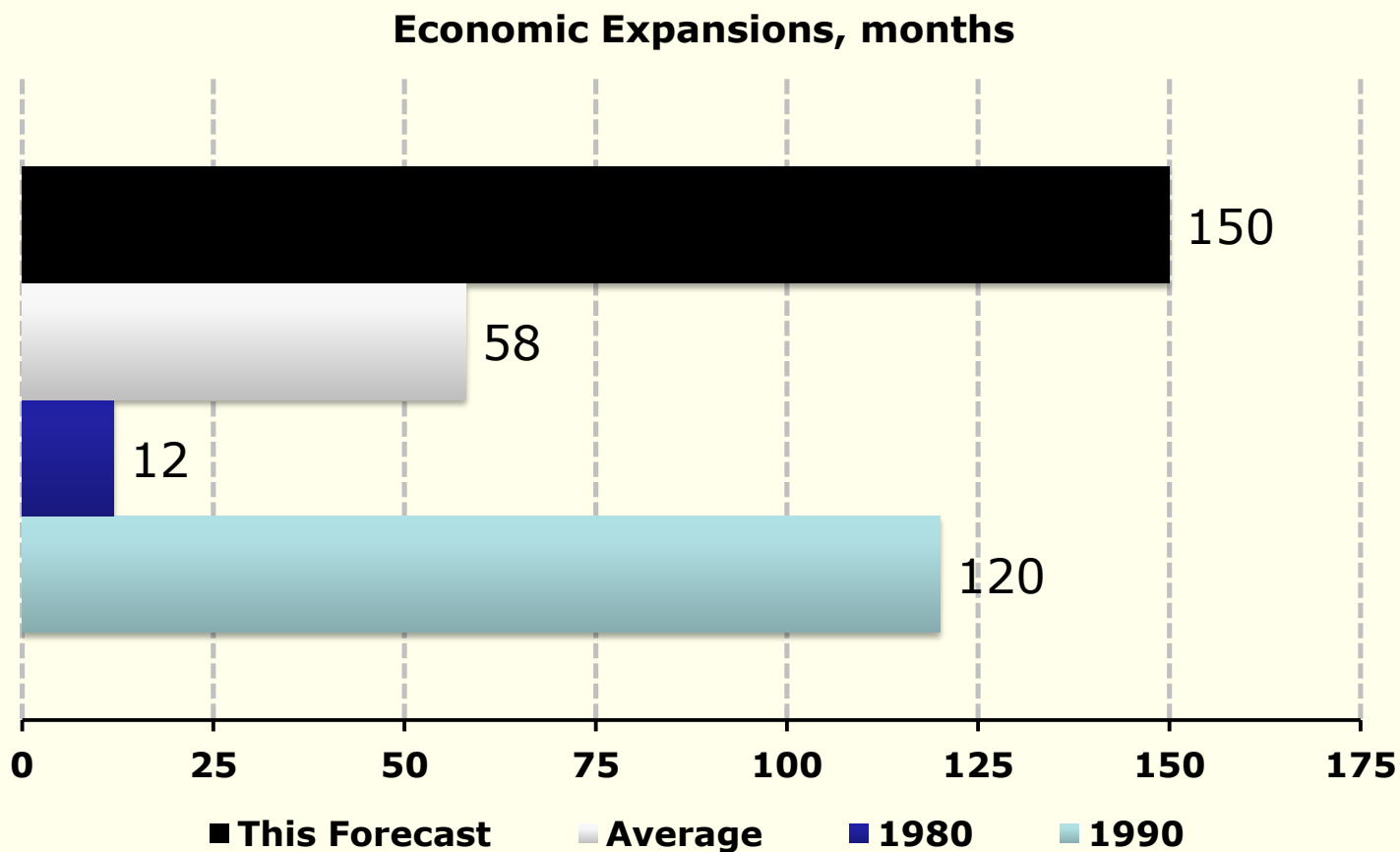


Source: ERFC February 2016 forecast; historical data through 2014

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U.S. Economic Expansions since 1945



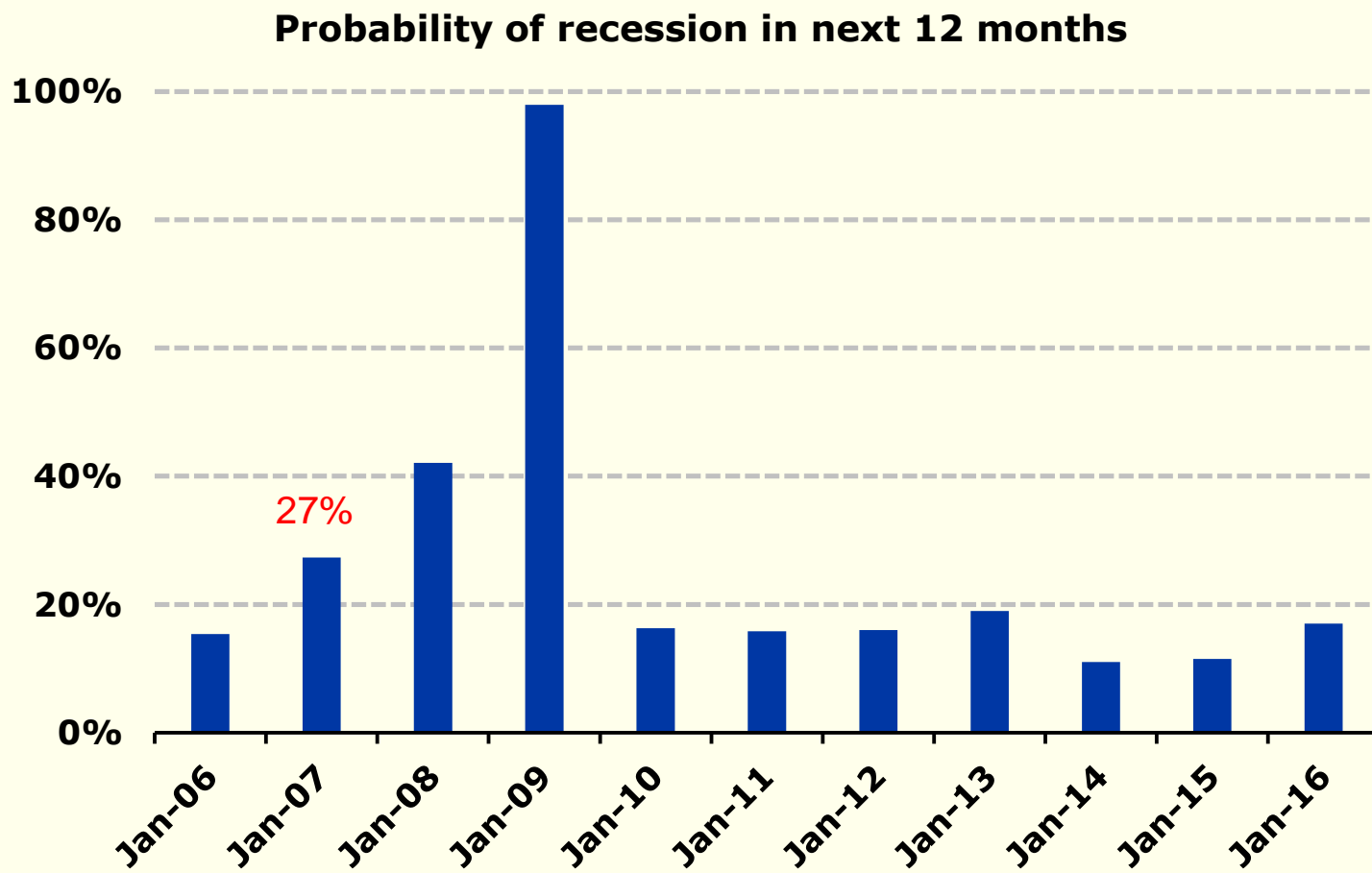
Sources: NBER, ERFC February 2016 Preliminary forecast

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Wall Street Journal survey shows low but rising probability of recession

Feb. 2012
WSJ survey
places
probability at
21%



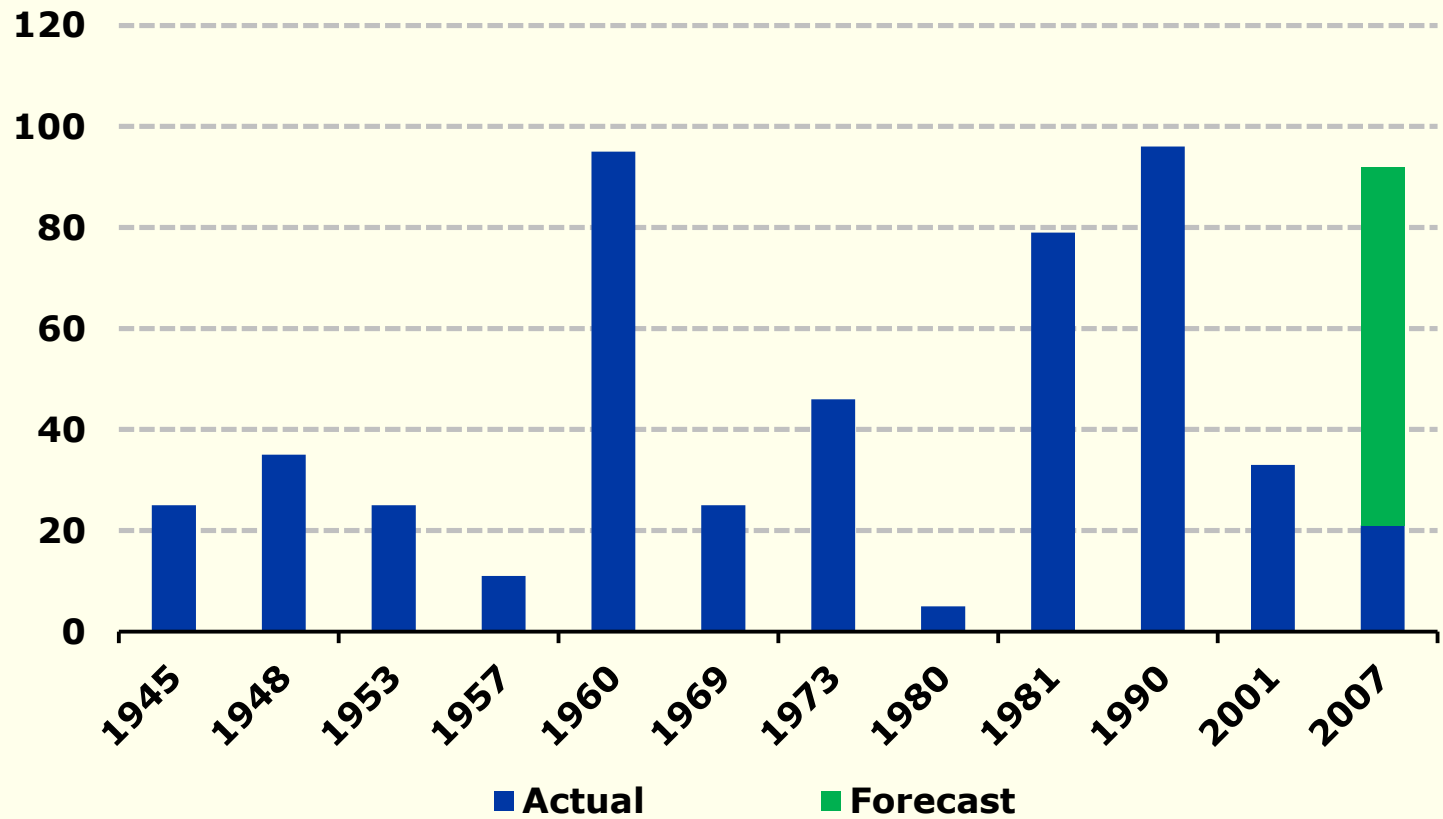
Source: Wall Street Journal Economic Forecasting Survey

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Initial slow recovery points to extended expansion

Months of Recovery After Reaching Previous Peak in Employment

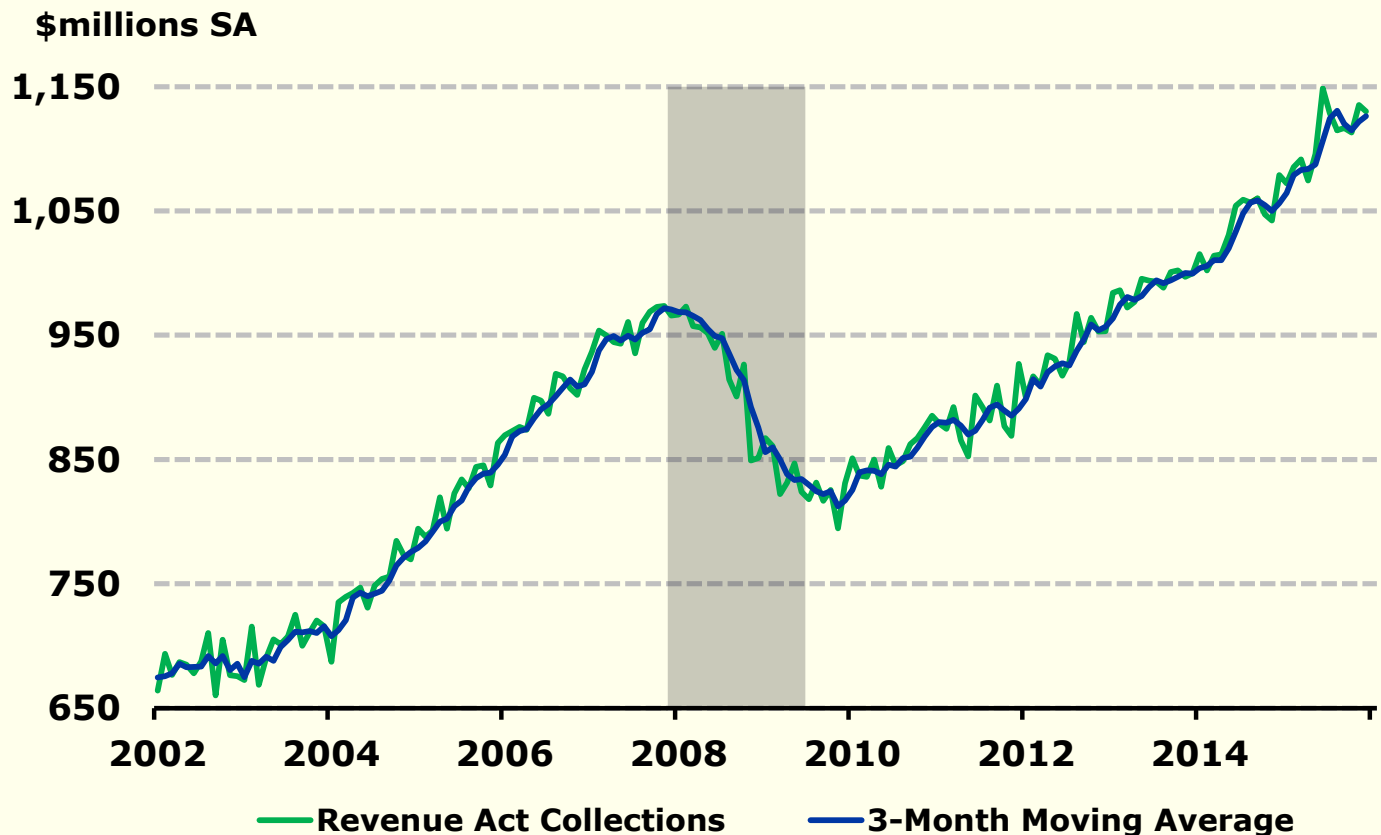


Sources: NBER, ERFC February 2016 forecast

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Revenue Act collections close to previous trend after spike in August collections



* Adjusted for large one-time transactions, amnesty payments and reporting frequency change, current definition of Revenue Act

Source: DOR and ERFC; monthly data through estimated December 2015 activity

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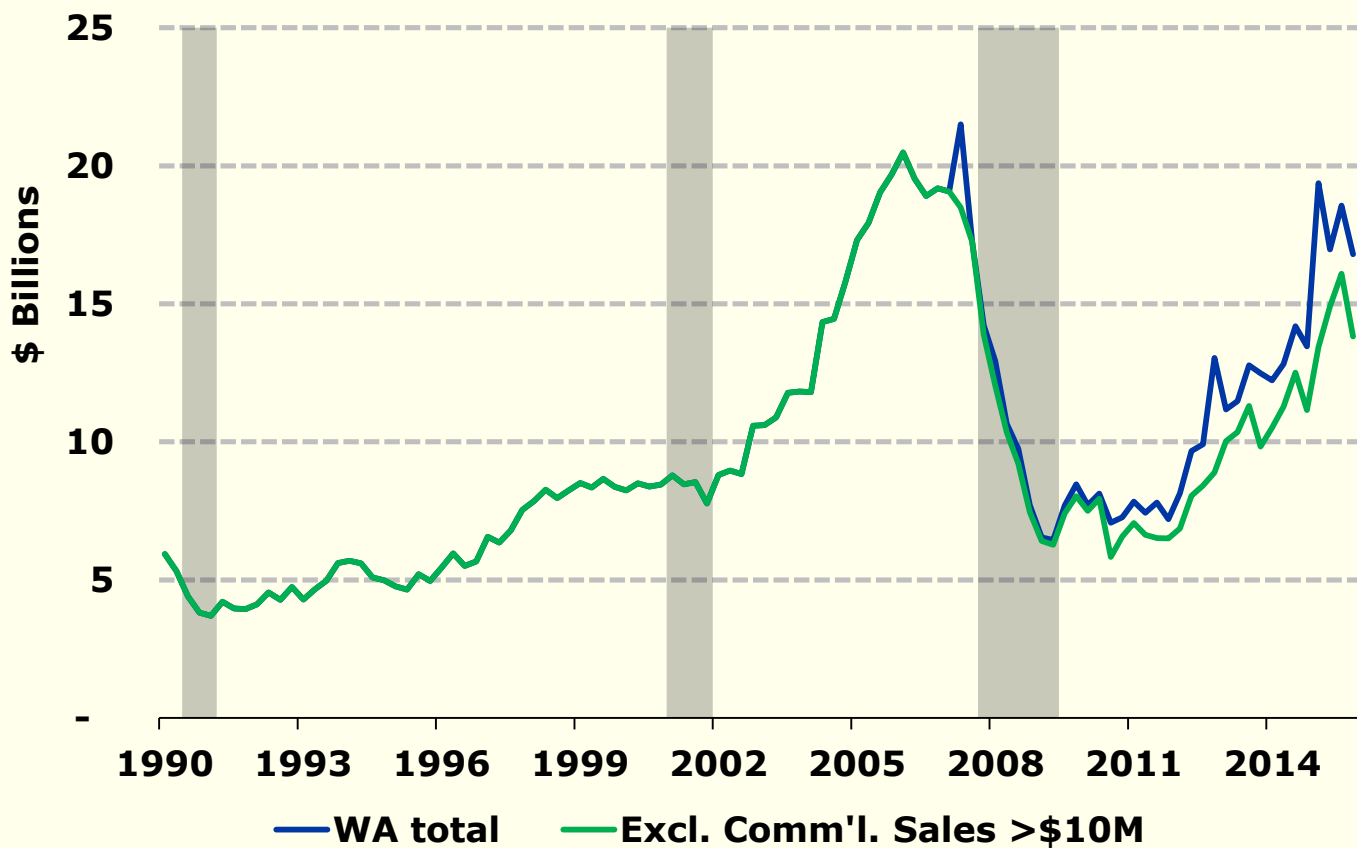


Large commercial property sales have had major impact on REET collections

Residential taxable activity and smaller commercial sales grew rapidly for the first 3 quarters of 2015 but declined in the 4th quarter.

Large commercial property sales are expected to decrease from the elevated levels of the past few years.

Taxable real estate sales, SA



Source: ERFC, data through 2015 Q4

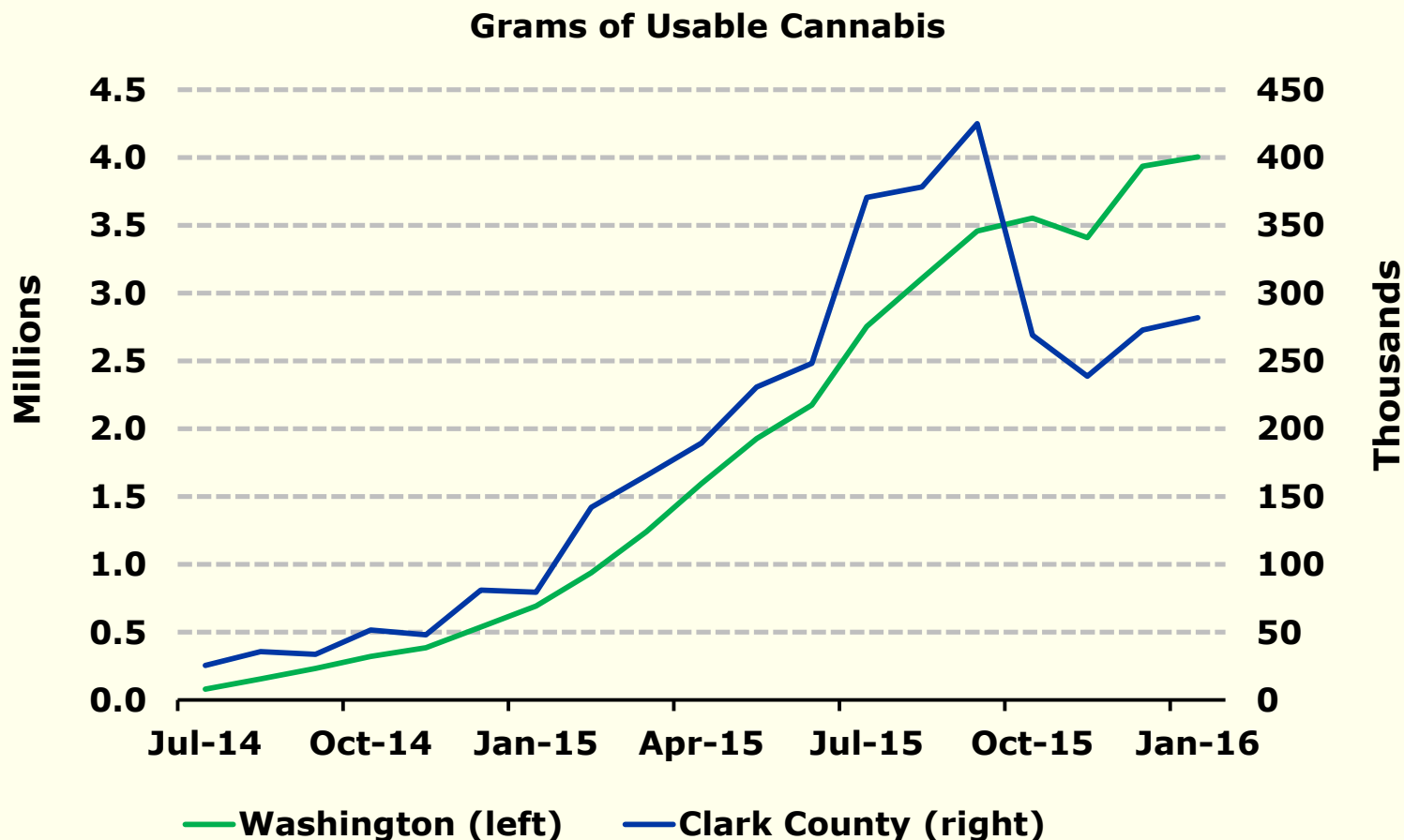
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Oregon legalization may have affected Clark County but statewide sales continued to grow

Prior to legal retail sales in Oregon, Clark County accounted for 12% of total sales by quantity.

In January, Clark County accounted for 7% of total sales by quantity.



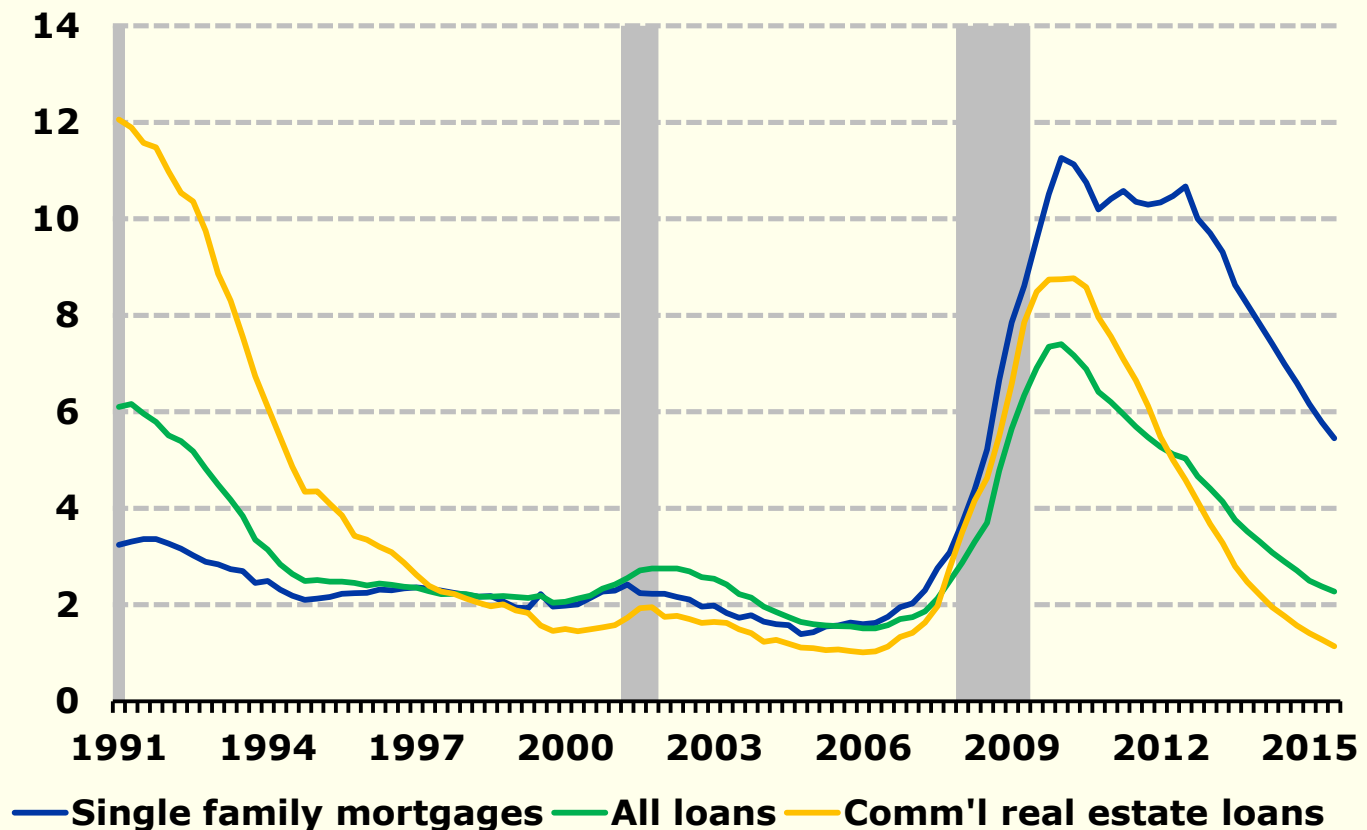
Source: WA LCB; data through January 2016

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Single family mortgage delinquency rates remain high relative to other loan types

Delinquency rates (%), all U.S. commercial banks, SA

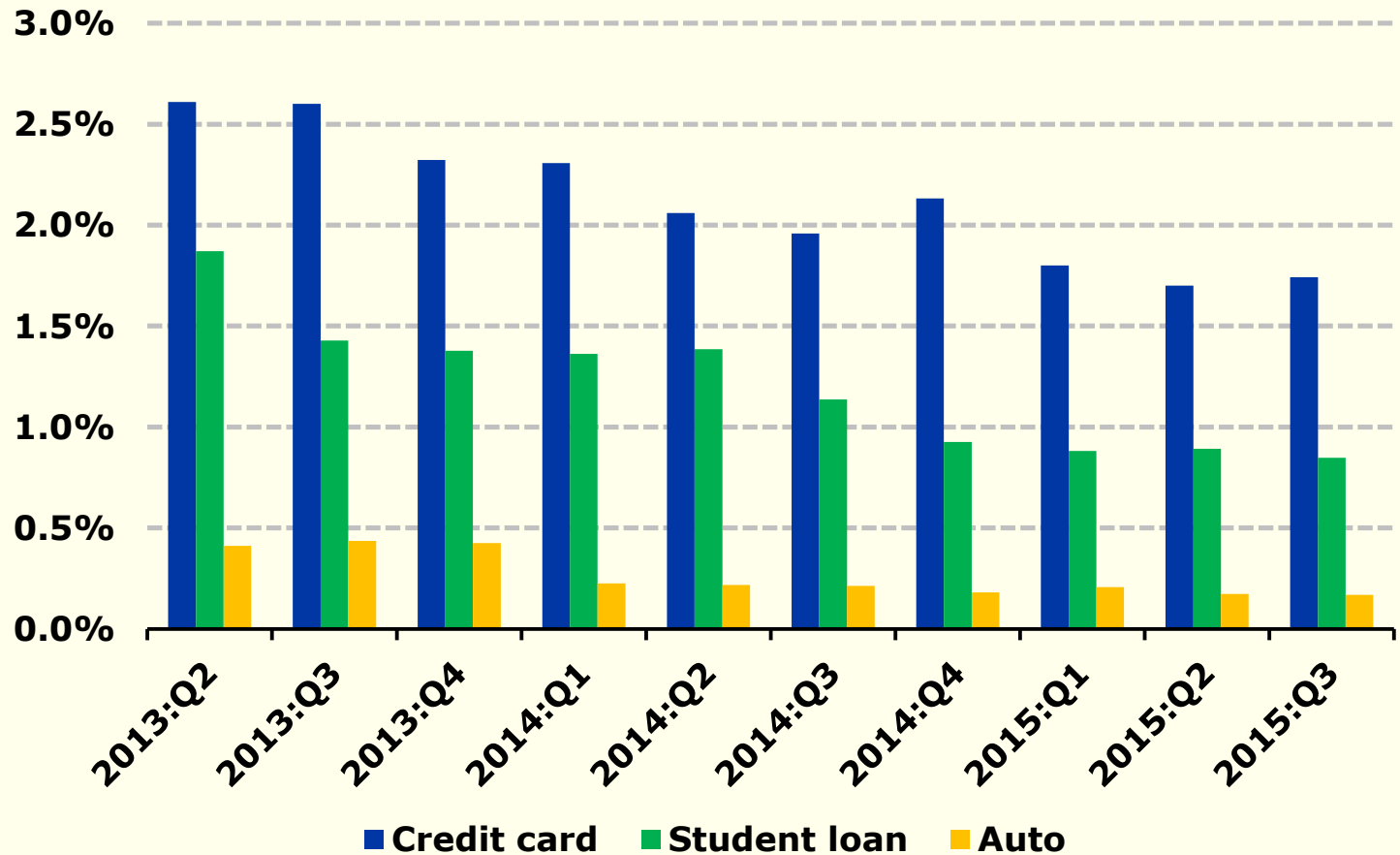


Source: Federal Reserve Board; data through 2015 Q3

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Percent of loan value with default probability of 30% or higher



Source: Federal Reserve Board, EFA Project, data through 2015 Q3

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Conclusion

- The economic forecast expects slower growth in U.S. GDP, WA personal income and WA employment than in November
- We continue to expect the WA economy to outperform the U.S. by a small margin
- GF-S revenues are expected to grow 10.3% between the 2013-15 and 2015-17 biennia and 8.0% between the 2015-17 and 2017-19 biennia
- The level of uncertainty in the baseline remains elevated, with downside risks outweighing upside risks



Questions



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