Economic Summary; Volume VII

Week of May 29, 2020

Tennessee Economy in General

The legislature returned to Nashville this week. Recent statements from both chamber leaders revealed division in the expected composition of session; however, the state budget will need to be addressed prior to a final adjournment as revenue conditions continued to deteriorate.

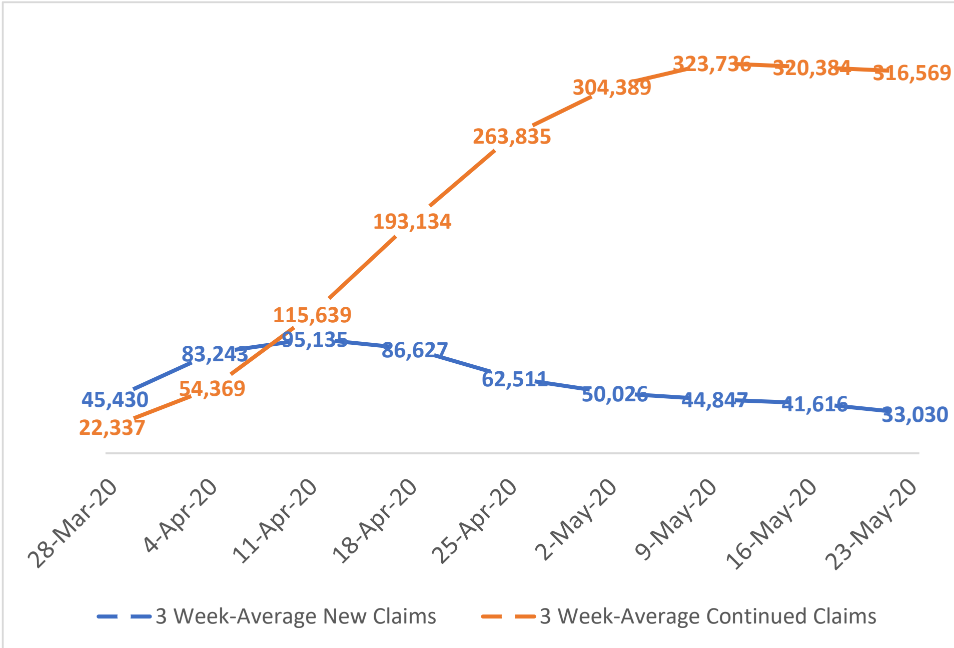
The State Funding Board met and heard presentations from state and regional economists on May 27. Each presenter noted the unprecedented uncertainty facing the economy. All presenters noted that GDP will likely fall much more in Q2 than Q1.

The state's budget will require large reductions. The Fiscal Year 2020-2021 budget assumed slightly over $13.1 billion in general fund revenue. The presenting economists projected between $558 million and $1 billion in potential reductions to recurring revenue. For reference, each economist projected less general fund revenue by the end of fiscal year 2021 than the state received in fiscal year 2019. Adjusting revenues for inflation, projected state revenues in fiscal year 2021 will be roughly the same amount as fiscal year 2003 and below fiscal 2007.

In the May 28th meeting of Senate Finance Ways and Means committee, Commissioner Eley stated that a combination of budget cuts, reserve usage, and bond issuances for capital expenditures will close an anticipated $600 million to $1.5 billion deficit. Governor Lee requested that State departments present 12% budget reductions; however, the Commissioner stated that the BEP and pension funding will not be cut. In addition, the Commissioner stated that the cumulative actions will likely result in a structural imbalance where recurring revenues will not match recurring expenditures in fiscal year 2021. This imbalance requires the use of non-recurring funds, such as reserves, to meet recurring expenses for an unspecified duration in order to balance the budget.

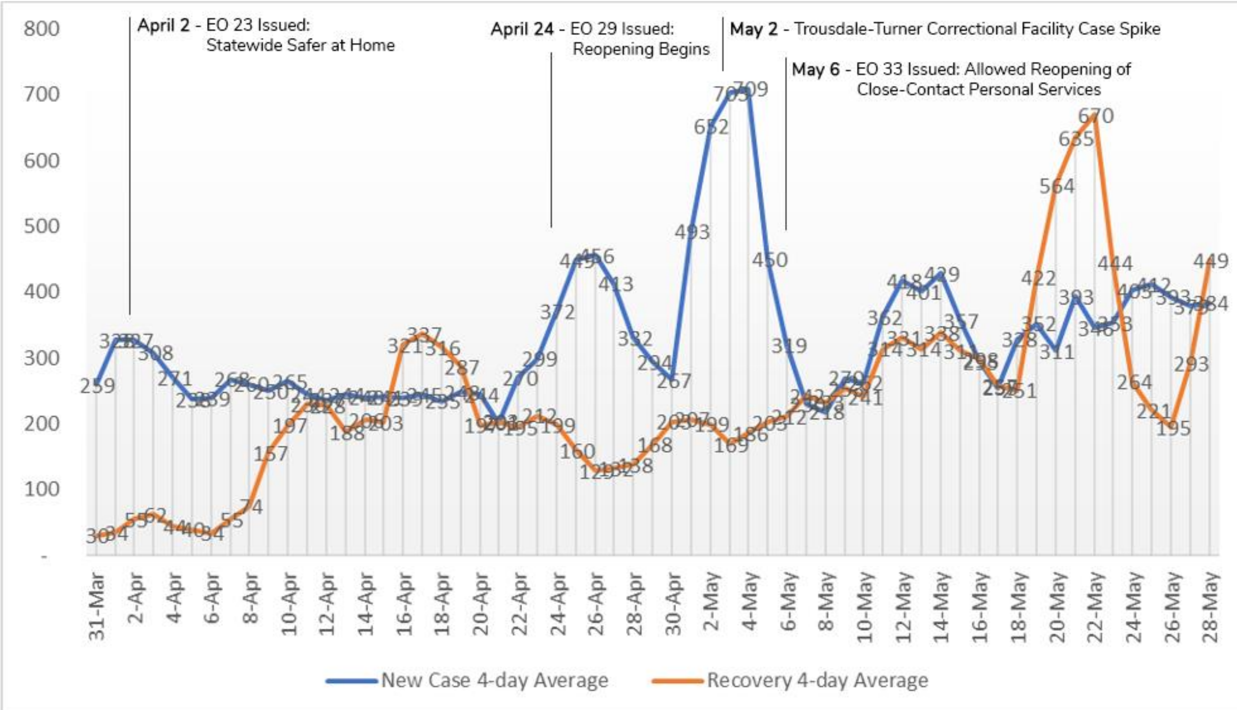
The immediate COVID-related job recissions appear to be slowing. The Tennessee Department of Labor and Workforce Development Weekly New Unemployment Claims reported another reduction in new claims. New unemployment claims increased by 26,041 for the week of May 23. Continuing Claims fell by 4,361 to 310,126. Chart 1 shows that based on three-week moving averages for both the new claims and continued claims are falling which suggests that the worst of the job losses is complete, and individuals are returning to the labor force.

Chart 1: Three-Week Moving Average New and Continued Claims



According to [statistics from the Tennessee Department of Health and COVID-19 Unified Command](), the state confirmed 2,718 new cases and 2,441 recoveries during the 7-day period ending May 14. Over a 14-day period, the state confirmed 4,980 new cases and 5,751 recoveries. Since the beginning of March, almost 416,000 have been tested. The University of Tennessee's CORE-19 team estimated that active cases increased slightly week over week to 6,691 and the 7-day average positivity rate increased slightly to 6% as of May 28. Finally, Chart 2 shows that average daily new COVID-19 cases have effectively flatlined while recoveries spike and fall.

Chart 2: 4-Day Average New Case and Recovery Data with Key Dates



Local Government Revenues and Budgeting

This week's summary will not focus on locally controlled revenue sources. State shared revenues comprise a large portion of local government budgets. Cities and counties receive a portion of a variety of state levied taxes including state sales, fuel, gross receipts, and income taxes. Aside from the Hall Income tax which is scheduled to end January 2021, the state shares revenues to municipalities on a per capita basis. The amounts of these shared revenue sources are independent of local decision making and are generally solely influenced by state collections. As discussed in the Tennessee Economy section, state economists project a decline in state revenues next year which may likely reduce shared revenues to municipalities. The University of Tennessee's Municipal Technical Advisory Service creates an annual estimate of shared revenues which serves as a great resource for local government officials.

State Shared Sales Tax

The state shared sales tax is the largest state shared revenue source to municipalities. State law apportions the state sales tax among many budget areas and other government subdivisions according to a complex formula; however, the state shares 4.603% of the remaining 5.5% of the state's 7% general sales tax rate and 4.603% of the state's 4% food item tax rate, or an estimated $300 million in fiscal year 2019, on a per capita basis with municipalities. As previously mentioned, the state's panel of economists revised sales tax estimates for fiscal year 2020 and fiscal year 2021 due to COVID-19. The state shared sales tax outlook for this current and next year appears bleak. As Table 1 shows, cities and towns should not anticipate receiving more state shared sales tax revenue in FY2021 than they received in FY2019.

Table 1: Per Capita State Shared Sales Estimates Based on Economists Projections

Assuming $300 million FY2019 Municipal State Shared Sales Revenues				
Economist	FY2020 Growth	Estimated FY20 Shared Sales Tax	FY2021 Growth	Estimated FY21 Shared Sales Tax
UTK-Boyd Center	0.90%	302,700,000	-0.60%	300,900,000
Dept of Revenue	0.34%	301,000,000	-2.56%	293,300,000
Fiscal Review Committee	1.25%	303,800,000	2.79%	312,300,000
ETSU	2.74%	308,200,000	-4.80%	293,400,000

Gasoline and Motor Fuel Taxes

State shared gasoline and motor fuel taxes fund local road construction and transportation. Counties receive roughly twice as much as cities and towns; however, municipalities receive 12.7% of the total gasoline tax and 8.7% of the total motor fuel tax. These shared revenues likely represent most local road improvement revenues and may be a top five revenue source for many cities and towns. The IMPROVE Act rate increases are now fully phased-in so consumption changes will now be the sole driver of fuel tax revenue changes. Business closures and other COVID-related actions reduced traffic and thus consumption during April and May; and there are no current, reliable projections of when or whether traffic will return to prior patterns.

These two revenue sources exemplified uncertainty more than any others. As Table 2 shows, the state's economists project a wide range of scenarios for transportation related revenue sources for both the current and upcoming fiscal year. Local officials should budget very cautiously.

Table 2: Shared Gasoline and Motor Fuel Tax Estimates Based on Economists Projections

Assuming $129.4 million FY2019 Municipal State Shared Total Fuel Revenues					
Economist	FY2020 Growth	Estimated FY20 Shared Total Fuel Taxes	FY2021 Growth	Estimated FY21 Shared Total Fuel Taxes	Variance from FY19
UTK-Boyd Center	2.99%	133,400,000	1.20%	135,000,000	4.2%
Dept of Revenue	0.59%	130,300,000	-8.52%	119,200,000	-8.0%
Fiscal Review Committee	-0.41%	129,000,000	7.29%	138,400,000	6.8%
ETSU	-0.56%	128,800,000	-5.75%	121,400,000	-6.3%

Macro-economic Commentary

The Federal Reserve Beige Book for May articulated the depths of the COVID-related disruption on the economy. Consumer spending, retail, leisure and hospitality felt the most severe declines. Residential home sales plunged, and construction activity vanished in many districts. Many tenants began to defer or miss payments on commercial real estate. Employment continued to decline in many sectors, and wage pressures were mixed as lower-wage workers lost jobs. Weak demand weighed on some prices while supply chain disruptions increased other prices. Respondents stated that the outlook remains highly uncertain and most contacts are pessimistic about the potential recovery pace.

Our local Federal Reserve branches were slightly more optimistic than other regions in general, but the local economy experienced hardship. The Atlanta District, which covers East and Middle Tennessee, reported general economic decline, large job losses, and reduced consumer spending. The St. Louis

District, which includes West Tennessee, reported moderate declines in economic activity, large job losses but recent employment stability due to PPP, and more than half of responding firms preparing for re-opening within five weeks. However, it should also be noted that nearly 80% of businesses anticipate lower demand for goods and services for the remainder of 2020.

Additional [economic data trickled out of The Commerce department]() this week. The second GDP estimate for the first quarter was revised to negative 5% based in part on additional reductions in private inventory investment. In addition, corporate profits and durable goods purchases fell sharply to start the year. As the first quarter represents January, February, and March, most economists anticipate a much larger contraction for many of these items in the second quarter.

Weekly new unemployment claims continued at unprecedented levels. The [U.S Department of Labor reported another 2.1 million new weekly claims]() for the week ended May 23. 40 million filed new claims for unemployment over the last nine weeks, or one-quarter of the US labor force. The Department stated that the advance insured unemployment rate was 14.5% for the week ended May 16. Please refer to prior summaries for discussion about the variance between the insured unemployment rate and job losses as a percent of the labor force.

Finally, while many of the traditional economic metrics appear to be moderating, some newer metrics present a different picture. As Chart 3 shows, this week's Business Expectations index plummeted last week to the lowest reading since the pandemic began and its lowest reading in the five-year history. This index is a simple survey of firm expectations of growth of their own sales, employment, and capital expenditures over the next 12 months.

Chart 3: Business Expectations Index

Additionally, employment may not rebound in the anticipated manner. As Chart 4 shows, the Business Expectations Employment Growth Index fell to a historic low. This index reflects firms' mean subjective expectations about the growth of their own employment over the next 12 months.

Chart 4: Business Expectations Employment Growth Index

It appears that despite the improving economic situation, the uncertainty that the state's economists referenced in comments this week is very prevalent and should be monitored closely. If businesses do not rehire quickly then the potential for long-term, systemic labor-force disruptions and sustained high unemployment increases.