

Economic and Budget Outlook

Fiscal Years 2021-22 to 2026-27



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Welcome to the Annual Five-Year Outlook

Report to be posted at IFO website at end of presentation

Both presentations run ~45 minutes – questions at end

Purpose: provide assessment of long-term fiscal outlook

Method: assume economy reverts to long-term trends

Key Themes and Issues

Federal Stimulus, Labor Force, Inflation

Navigating the Waters: How States are Spending Fiscal Recovery Funds

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Key Themes

Demographics updated for the Decennial Census

- Little change | potential workforce still contracts
- COVID: ~30,000 excess deaths in 2020 + 2021 | small baby bust 2021
- No longer-term impacts

Economics jobs and inflation

- Will workers return? | impact of general price and asset inflation
- Does a wage-price spiral emerge?

Revenues permanent real and inflation gains from COVID

Expenditures significant increase in healthcare costs

- Unclear how wage pressures and inflation will impact costs
- SERS pension costs decline

Four Key Assumptions

Inflation decelerates, but does not reverse

- Nominal sales and use tax, personal and corporate income revenues

Some pandemic-induced changes partly reverse

- Very high profit margins
- Consumer spending: more goods, fewer services, less gasoline

Others fully revert: labor force participation rates recover

- But permanent job loss remains ~350k

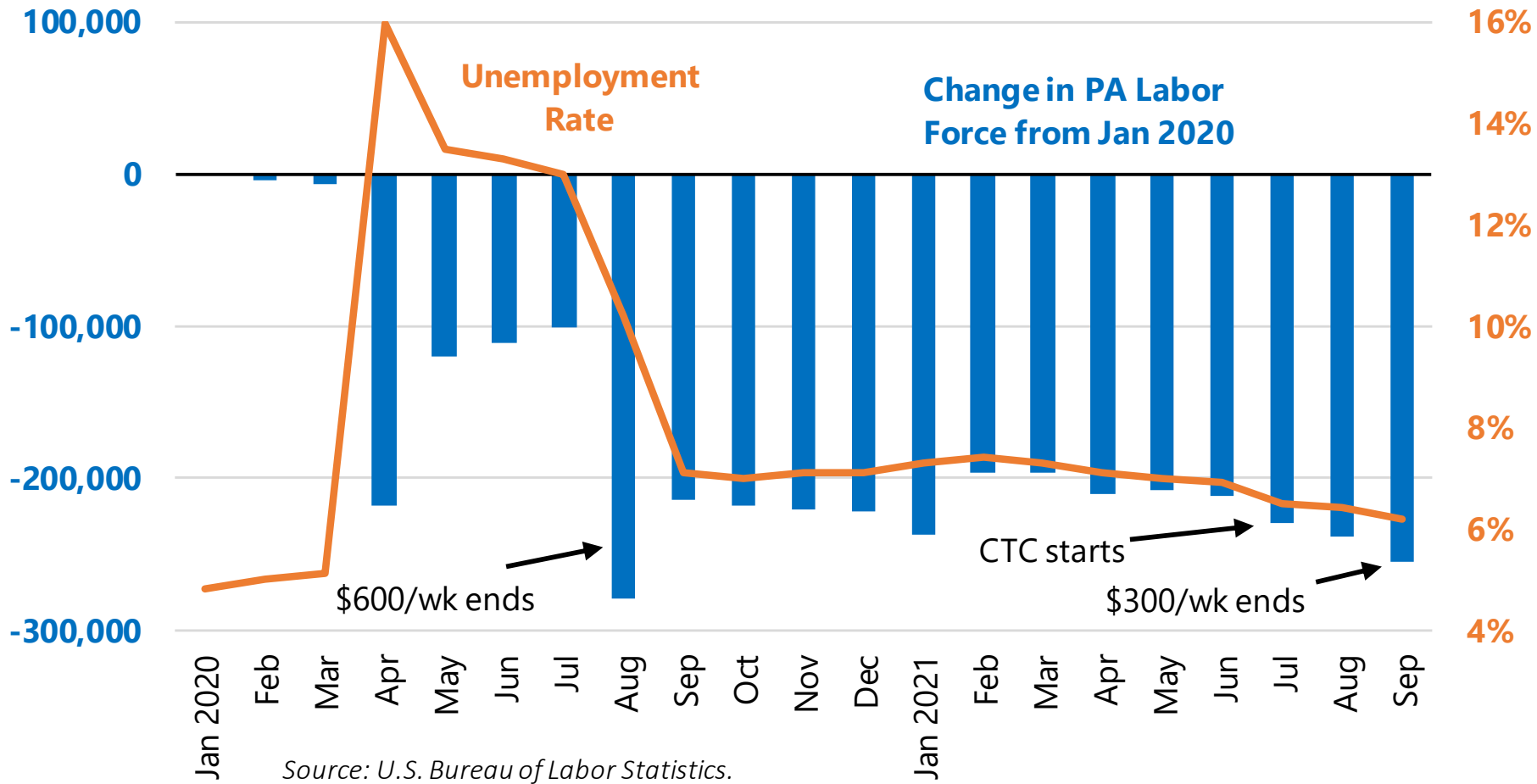
No further COVID variants that warrant mitigation efforts

Pennsylvania Demographics - Decennial Census Update

Age Cohort	Number (000s)			Change (000s)		Avg. Ann. Growth	
	2010	2020	2030	10-20	20-30	10-20	20-30
0 to 19	3,173	3,005	2,879	-168	-126	-0.5%	-0.4%
20 to 64	7,566	7,506	7,188	-60	-318	-0.1%	-0.4%
65 to 79	1,343	1,862	2,200	520	338	3.3%	1.7%
80+	<u>620</u>	<u>629</u>	<u>823</u>	<u>9</u>	<u>194</u>	<u>0.1%</u>	<u>2.7%</u>
Total	12,701	13,003	13,090	301	87	0.2%	0.1%

Source: U.S. Census Bureau. Forecast by IFO.

PA Labor Force Contraction Continues

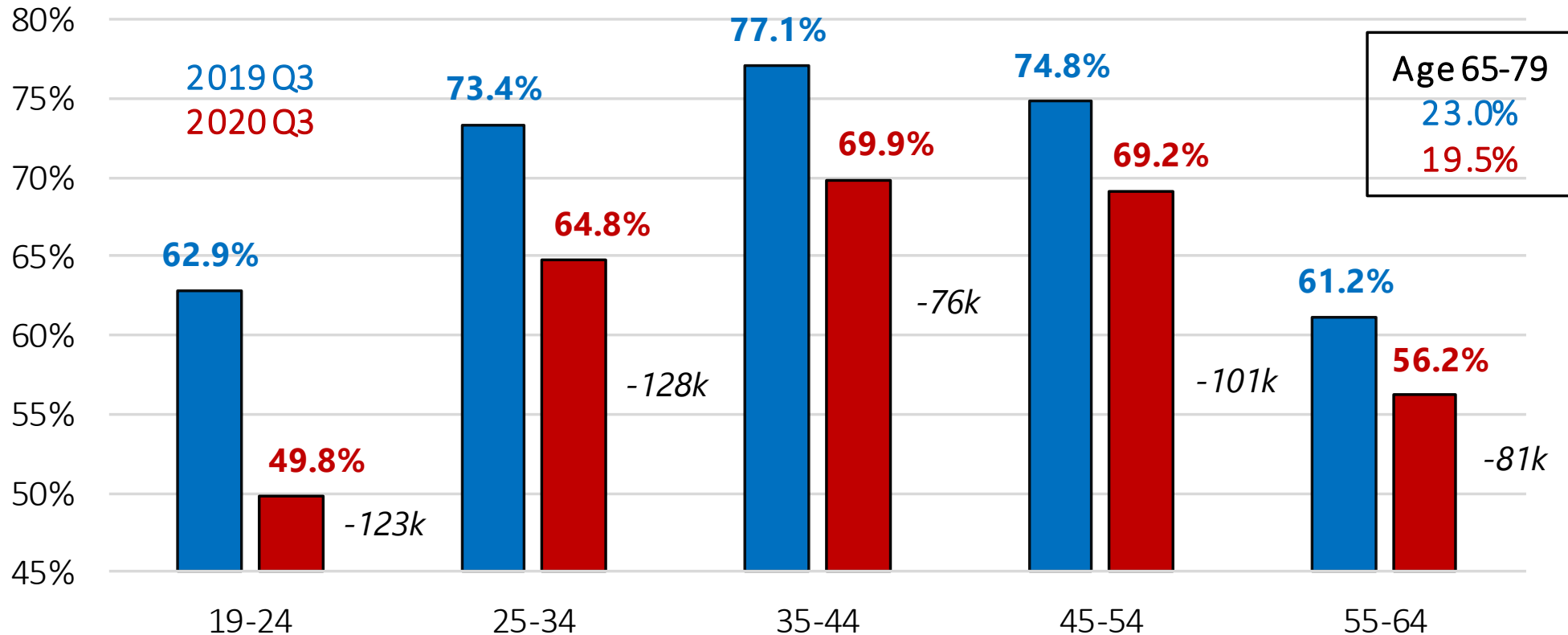


Labor Force =
Employed + Unemployed

- Labor Force Contraction
- Federal programs
 - Childcare
 - Eldercare
 - Home schooling
 - COVID concerns
 - Savings cushion
 - Lifestyle change
 - Early retirements

Who Stopped Working? Not Just the Elderly

PA Employment / Population Ratio by Age Group



Source: U.S. Census Bureau, Quarterly Workforce Indicators.

Pennsylvania Economic Forecast: COVID Bubble

	Pre-COVID		COVID Bubble			Reversion	
	2018	2019	2020	2021	2022	2023	2024
Real GDP	1.4%	1.7%	-4.5%	4.4%	2.3%	2.1%	2.1%
Wages and Salaries	4.3%	4.4%	-0.3%	7.7%	5.2%	4.4%	4.0%
Philadelphia CPI-U	1.3%	2.0%	0.9%	4.3%	3.9%	2.4%	2.3%
Payroll Job Gains (000s)	69	56	-463	115	80	65	59
Stimulus (\$ billions)	---	---	\$64	\$54	\$2	---	---

Note: Payroll Job Gains exclude self-employed.
Source: U.S. Bureau of Economic Analysis and U.S. Bureau of Labor Statistics. Forecast by IFO.

Pennsylvania Payroll Employment Still Lags

	Number (000s)		2-Year Change	
	Sept 2019	Sept 2021	Number	Percent
Payroll Employment	6,096	5,767	-329	-5.4%
Construction	273	254	-19	-6.9%
Manufacturing	572	550	-22	-3.9%
Retail and Wholesale Trade	817	784	-32	-3.9%
Transportation and Warehouse	303	314	10	3.4%
Professional and Technical	360	367	8	2.1%
Admin and Waste Management	326	280	-46	-14.2%
Healthcare and Social Assistance	1,061	1,016	-45	-4.2%
Arts and Entertainment	106	84	-22	-20.8%
Accommodation and Food Service	479	403	-76	-15.9%
Other Services	261	238	-24	-9.0%
All Government (includes local SDs)	716	680	-36	-5.0%
All Other	822	797	-25	-3.0%

Note: Data are not seasonally adjusted. Figures for September 2021 are preliminary. **Excludes self-employed.**
Source: U.S. Bureau of Labor Statistics, State and Metro Area Employment.

Subsector Detail: Staying at Home Drives Jobs Change

	Number (000s)		2-Year Change	
	Sept 2019	Sept 2021	Number	Percent
Full-Service Restaurant	196	165	-31	-15.9%
Employment Service (temps)	123	92	-31	-24.9%
Nursing and Residential Care	202	176	-26	-12.9%
Accommodations	61	46	-16	-25.6%
Amusements and Gaming	75	61	-15	-19.5%
Local Government - Education	275	264	-11	-4.0%
Services to Buildings	82	74	-9	-10.4%
Transit and Ground Passenger	39	30	-9	-22.2%
Limited-Service Restaurant	161	154	-8	-4.9%
Colleges and Universities	163	156	-8	-4.7%
Child Care	47	43	-5	-9.5%
Warehousing and Storage	94	108	14	15.2%
Courier and Messengers	36	47	11	30.5%
Building and Garden Retail	44	48	4	8.8%

Source: U.S. Bureau of Labor Statistics, CES State and Metro Area Employment.

High Inflation Impacts Sales Tax

	Year-Over-Year Growth in CPI-U for 2021				CPI-U Weight
	April	June	Aug	Oct	
Philadelphia CPI-U - All Items	3.5%	4.9%	4.6%	5.6%	100.0%
CPI-U less Shelter	5.0%	6.7%	6.1%	7.1%	67.0%
Subject to Sales Tax					
Dining Out	4.1%	3.4%	3.1%	3.3%	7.6%
Home Furnishings	8.3%	11.0%	12.4%	11.6%	5.3%
Used Cars	20.7%	45.3%	32.3%	27.2%	2.2%
New Cars	8.7%	18.7%	20.8%	24.2%	3.1%
Not Subject to Sales Tax					
Shelter	0.6%	1.1%	1.7%	2.7%	33.0%
Medical Care	4.4%	2.8%	0.0%	0.8%	8.7%
Food at Home	-2.5%	-1.0%	0.5%	3.9%	8.0%

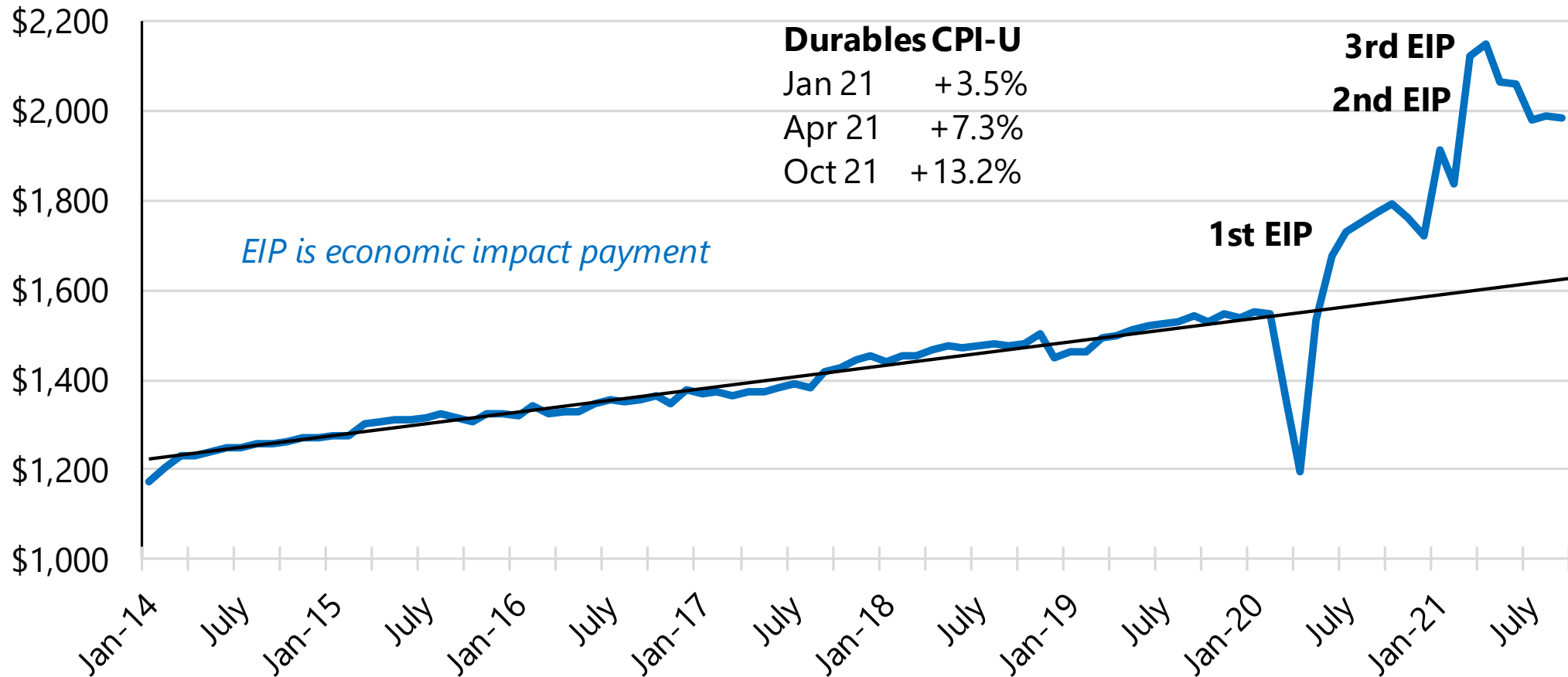
Note: The CPI less Shelter excludes the Shelter component, most of which is rent imputed to homeowners.
Source: U.S. Bureau of Labor Statistics.

Any Stimulus Left? Yes, but....

Wealth Group	U.S. Checkable Deposits Q2 (\$ billions)				Change or Growth		
	2018	2019	2020	2021	Amount	Percent	
Top 1%	\$226	\$181	\$307	\$999	\$795	391%	<i>likely not stimulus</i>
80% to 99%	451	394	570	1,274	851	201	
60% to 80%	184	164	247	611	437	252	<i>PA share is ~4% or about \$31 billion</i>
40% to 60%	116	93	141	356	252	242	
20% to 40%	74	64	88	160	91	132	
0% to 20%	<u>51</u>	<u>55</u>	<u>67</u>	<u>67</u>	<u>14</u>	<u>26</u>	<i>most is spent</i>
Total	1,101	951	1,421	3,467	2,441	238	
	Debt Holdings (October, \$ billions)				Change or Growth		
	2018	2019	2020	2021	Amount	Percent	
Securities Held by Fed	\$3,973	\$3,624	\$6,547	\$8,061	\$4,263	112%	<i>a direct increase in money supply</i>

Note: Change or Growth compares 2021 to average for 2018 and 2019.
Source: Federal Reserve Board.

U.S. Durable Goods Purchases Still Very High



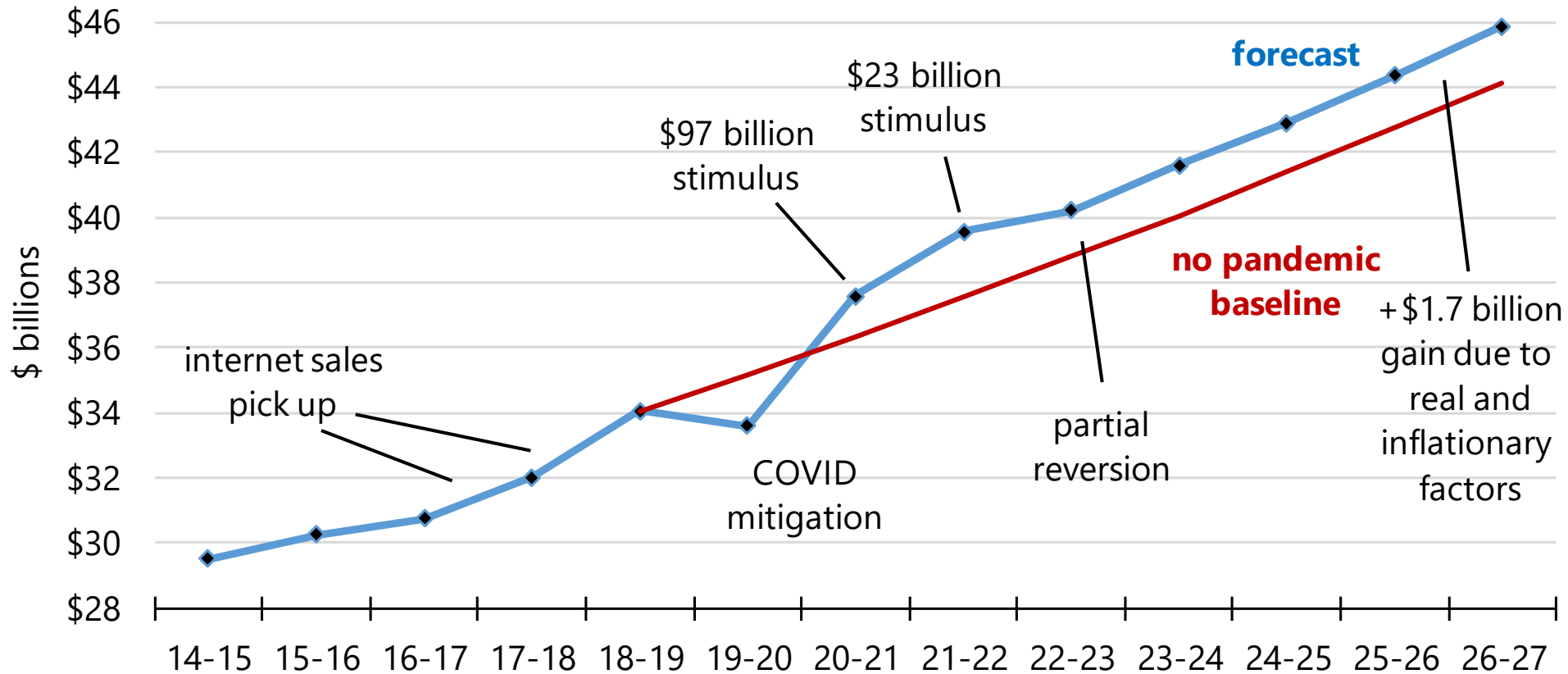
Note: Billions of dollars. Nominal dollars. Source: U.S. Bureau of Economic Analysis, Table 2.8.5.

Inflated Economy: Revenue Growth for July to October

Revenue Source	YOY Growth	Notes
Sales - Motor Vehicle	-5.7%	decline due to shifted sales in prior year
Realty Transfer	26.2%	
Corporate Net Income	50.6%	forecast assumes profits up +30% in CY 2021
Sales - Non-Motor	13.5%	
PIT - Withholding	10.4%	beginning to decelerate slightly
Inheritance	20.9%	strong stock and housing markets
PIT - Non-Withheld	17.7%	small business profits and capital gains
All Taxes	14.9%	

Note: YOY is year-over-year. Growth rates adjusted to reverse for the shift of revenues to FY 2020-21, as well as the impact of one-time transfers or extra due dates (i.e., Wednesdays for employer withholding).

General Fund Tax Revenues: A Permanent COVID Gain



Note: Forecast line controls for revenue shifts in FY 19-20 and FY 20-21.

Forecast
includes permanent
real and inflationary
gains

No Pandemic Baseline
assumes normal growth
from FY 18-19
~3.3% per annum

Real and Inflationary Revenue Gains

Real (structural)

- Remote work – productivity
- Higher profit margins (less travel, higher productivity)
- Shift to taxable purchases
- Lower gasoline consumption

Inflationary

- Assets: Stock market and home values
- Higher prices (cars, durables)
- Potential wage-price spiral (too early, not assumed)

COVID Bubble: Revenues, Economics and Financials

	AAGR 2013-19	COVID Bubble, YOY Growth			AAGR 2023-27
		CY 2020	CY 2021	CY 2022	
Revenues					
All Sales Tax	3.1%	0.5%	16.0%	0.5%	3.0%
Corporate Net Income	5.4%	13.7%	19.4%	3.0%	3.8%
Wages-Salaries	3.7%	-0.3%	7.7%	5.2%	4.0%
Economics					
Nominal GDP	3.0%	-3.5%	8.9%	6.1%	4.2%
Philadelphia CPI-U	1.1%	0.9%	4.3%	3.9%	2.3%
Financials					
S&P 500 (annual avg)	10.1%	10.3%	30.1%	--	--
PA Home Values	3.7%	4.7%	16.4%	--	--
Stimulus (\$ billions)	--	\$64	\$54	\$2	--

Note: AAGR is average annual growth rate. Growth rates are year-over-year. All data are on a calendar or tax year basis. S&P 500 for 2021 through October. Historical sales tax growth rate excludes revenue gains from extra internet sales taxes. Home values based on Q2. Sources: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, FHFA, IFO.

Annual Change in General Fund Expenditures

Program	22-23	23-24	24-25	25-26	26-27	AAGR
All Medical Assistance	\$670	\$222	\$262	\$306	\$331	4.2%
Long-Term Living	694	201	239	278	302	4.6
County Child Welfare	67	45	46	46	46	3.1
Intellectual Disability	228	82	84	86	89	3.3
Basic-Special Education	225	188	189	193	198	2.3
PSERS	200	78	65	74	71	2.4
SERS	58	-18	-44	-22	-9	-2.3
General Obligation Debt	30	67	33	96	39	4.5
All Other	<u>559</u>	<u>329</u>	<u>326</u>	<u>365</u>	<u>333</u>	<u>2.6</u>
Total Annual Change	2,731	1,193	1,199	1,423	1,399	3.0

Note: Millions of dollars. Excludes \$165 million transfer to Worker's Compensation Fund in FY 24-25. AAGR is average annual growth rate from FY 22-23 to FY 26-27.

One Time Factors

FY 21-22	Amount	Notes
ARPA federal funds transfer	\$3,840	replace revenue loss due to COVID-19
Enhanced FMAP	\$1,190	assumed through Q2, extended to Q3
JUA transfer	\$200	court challenge, assume supplemental
REHP reduction	~\$90	contributions for retiree healthcare

FY 22-23	Amount	Notes
Remaining ARPA transfer	\$2,410	covers annual budget deficit

Note: Millions of dollars. Amounts reflect figures carried in the budget enacted June 2021.

General Fund Financial Statement

	20-21	21-22	22-23	23-24	24-25	25-26	26-27
Beginning Balance	-\$2,715	\$0	--	--	--	--	--
Current Year Revenues	40,392	44,173	\$42,875	\$41,847	\$43,144	\$44,587	\$46,107
Less Refunds	<u>-1,262</u>	<u>-1,325</u>	<u>-1,300</u>	<u>-1,325</u>	<u>-1,350</u>	<u>-1,375</u>	<u>-1,400</u>
Net Revenues	39,130	42,848	41,575	40,522	41,794	43,212	44,707
State Expenditures	-34,013	-38,589	-41,320	-42,513	-43,878	-45,135	-46,534
Current Year Balance	2,402	4,259	255	-1,991	-2,083	-1,923	-1,828
Reduced Spending	0	763	0	0	0	0	0
Plus Prior Year Lapses	<u>-2,402</u>	<u>110</u>	<u>110</u>	<u>110</u>	<u>110</u>	<u>110</u>	<u>110</u>
Prelim Ending Balance	0	5,132	365	-1,881	-1,973	-1,813	-1,718

Note: Millions of dollars. Prior year lapses include transfers to the Budget Stabilization Reserve Fund.

Outlook - Uncertainty and Risks Unusually High

Significant policy risks

- Stimulus impact lingers, but how much longer?
- Some remains | child tax credit and SNAP
- Student loan moratorium ends Jan 31, 2022 (began Mar 2020)
- Federal Reserve taper and interest rate adjustments
- New, expanded or extended federal programs (e.g., BBB)?

Significant economic risks

- Workers eventually return
- No wage-price spiral that further broadens inflation
- No major stock or housing market correction

Presentation is Posted to IFO Website

Questions?

Submit to contact@ifo.state.pa.us