

City of Philadelphia Revenue Outlook, 2018-2023

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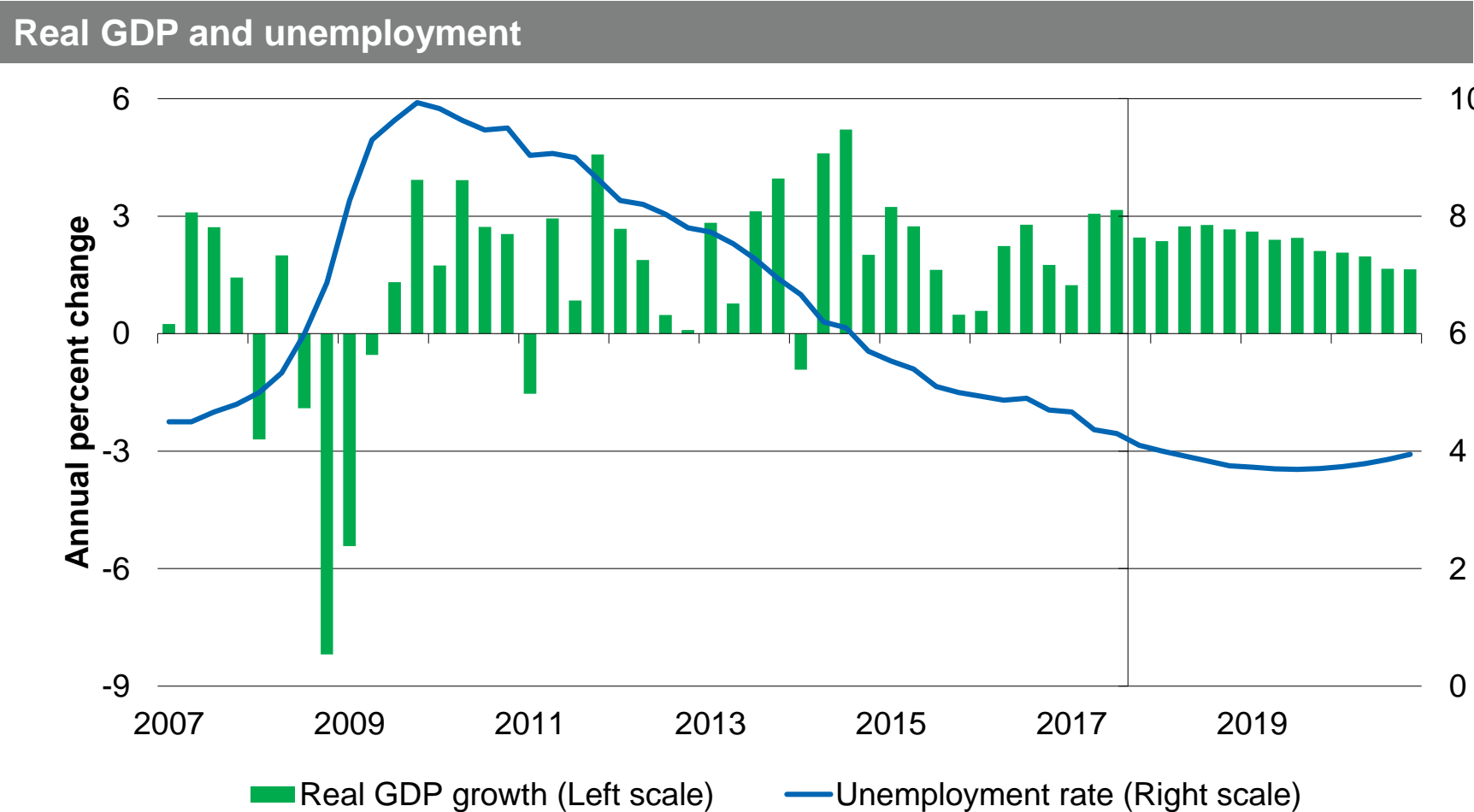


United States Economic Outlook

Solid momentum for US economic growth in 2018–21

- The US economy has solid momentum entering 2018. With the Tax Cuts and Jobs Act (TCJA) taking effect, annual real GDP growth is projected to pick up from 2.2% in 2017 to 2.7% in 2018.
- The TCJA will boost US economic growth by 0.1 percentage point in 2018, 0.2 point in 2019 and 2020, and 0.1 point in 2021. It's impact on growth is neutral in 2022–25 and turns negative in 2026–27, when provisions expire and rising federal debt crowds out private investment.
- Consumer spending continues to drive US growth, supported by rising employment, household wealth, and real incomes—all helped by tax cuts.
- Business fixed investment will benefit from expanding global markets, an easing of regulatory policies, and a more internationally competitive tax environment.
- Increasing household formation by young adults, low supplies of homes for sale, and rising prices will encourage more homebuilding.
- The Federal Reserve is expected to gradually raise the federal funds rate to a high near 3.5% in 2021, overshooting its long-run equilibrium of 2.75%.

The US Economic Expansion Will Continue



Source: IHS Markit

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Business Provisions of the Tax Cuts and Jobs Act

- Allow 20% deduction for pass-through income
- Expensing of newly placed business equipment
 - Expand Section 179 (small business) expensing
 - Full expensing of other equipment for five years, followed by a phase-out through 2026
- Limit interest deduction to 30% of taxable income
- Repeal the corporate AMT
- Limit or repeal a variety of business deductions
- Repatriation tax holiday (eight-year; two-tier rate structure)
- Shift to a territorial tax
- Provisions permanent except equipment expensing and tax holiday

US economic growth by sector

Real GDP and its components				
Percent change	2017	2018	2019	2020
Real GDP	2.2	2.7	2.6	2.0
Consumption	2.7	2.7	2.5	2.2
Residential investment	1.7	2.7	5.3	4.7
Business fixed investment	4.8	5.5	5.0	3.5
Federal government	-0.2	-0.4	-0.2	0.0
State & local government	0.0	0.9	0.9	1.1
Exports	3.4	5.3	4.3	3.7
Imports	3.8	6.2	4.8	4.2

Risks to the US Forecast

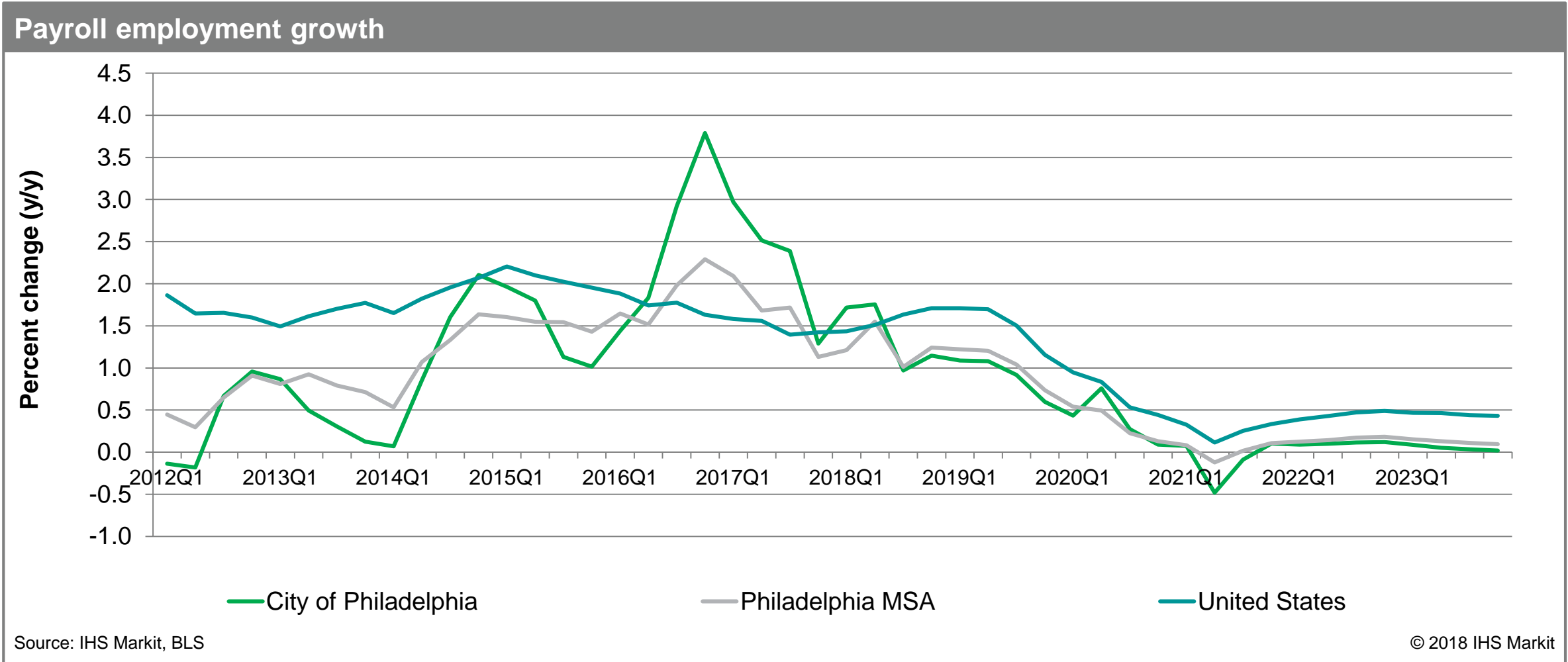
Scenario	Characteristics
<p>Recession caused by setback in commercial real estate and declining confidence (Probability = 20%)</p>	<ul style="list-style-type: none"> • Commercial real estate prices and construction turn down. • A drop in confidence weakens the dollar, fueling inflation and driving up long-term interest rates. • Stock prices plummet about 20% through early 2019. • Real GDP contracts mildly in the last two quarters of 2018.
<p>Housing bounces back (Probability = 15%)</p>	<ul style="list-style-type: none"> • Housing markets gain strength as household formation by young adults surges. • Higher incomes combine with lower oil prices, inflation, and interest rates to support robust consumer spending. • Stronger global economic growth helps exports.
<p>Baseline forecast (Probability = 65%)</p>	<ul style="list-style-type: none"> • The Federal Reserve gradually raises interest rates. • The Tax Cuts and Jobs Act boosts growth in 2018–21. • Consumer spending, homebuilding, and business fixed investment post moderate growth. • Global economic growth averages 3.1% in 2018–27.

Regional Economic Outlook

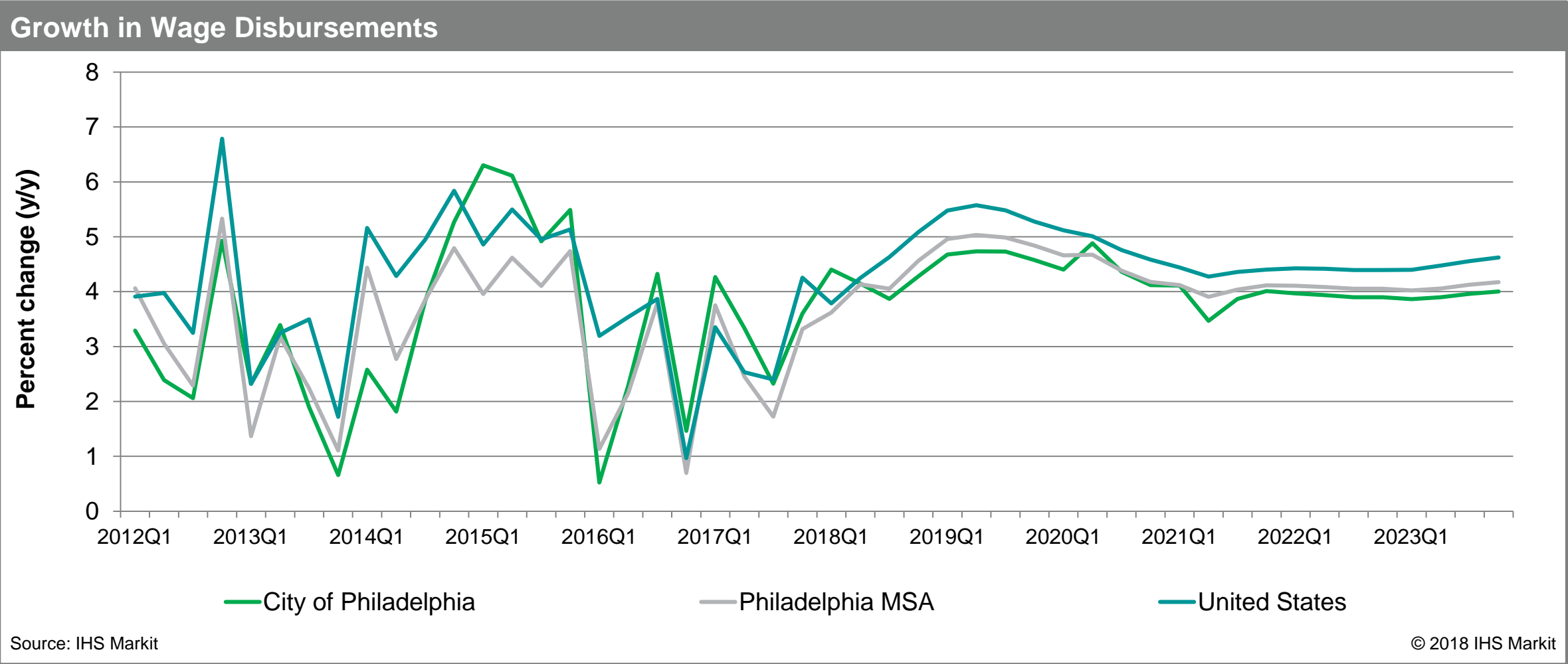
Highlights and risks of the regional economic forecast

- Revenue forecast is based on IHS Markit's January 2018 economic forecast
 - Forecast includes effects of TCJA (corporate tax cuts, etc.)
 - Forecast does not include new spending bill
- Fiscal stimulus from new spending adds upside potential to current forecast
- Main downside risk to forecast appears to be from policy uncertainty
 - Region is particularly vulnerable to big changes in health care policy
 - Likelihood of major change is not clear
- Retail, leisure and hospitality adding new spaces, but how much is additive vs. shifting existing business?
- Forecast features slowdown in economic growth at national level after stimulus effects over next two years, but no major downturn

Employment at all geographic levels slows later in forecast period



Wage growth strengthens as labor market tightens



Wage growth accelerates as Philadelphia region approaches full employment

Key Economic Indicators

	2016	2017	2018	2019	2020
Philadelphia MSA					
			<i>Percent change</i>		
Payroll employment	1.9	1.7	1.3	1.0	0.3
Average annual wage	0.1	1.1	2.8	3.9	4.1
Total wage disbursements	1.9	2.8	4.1	5.0	4.5
Personal income	2.3	3.0	4.1	4.7	4.5
Real gross metro product	1.2	2.4	2.3	2.0	1.8
City of Philadelphia					
Payroll employment	2.5	2.3	1.4	0.9	0.4
Average annual wage	-0.3	1.1	2.7	3.7	4.0
Total wage disbursements	2.1	3.4	4.2	4.7	4.4
Personal income	2.3	3.0	4.1	4.7	4.5
Real gross metro product	1.2	2.4	2.3	2.0	1.8

•Source: IHS Markit

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Forecast Methodology

Model Structure – Underlying Economic Drivers

- Wage and Earnings Taxes
 - wage income
- Sales Tax
 - personal income
- Business Income and Receipts Tax
 - Net Income - U.S. corporate profits, local proprietor's income
 - Gross receipts – local economic output
- Realty Transfer
 - Residential – home sales and prices
 - Commercial

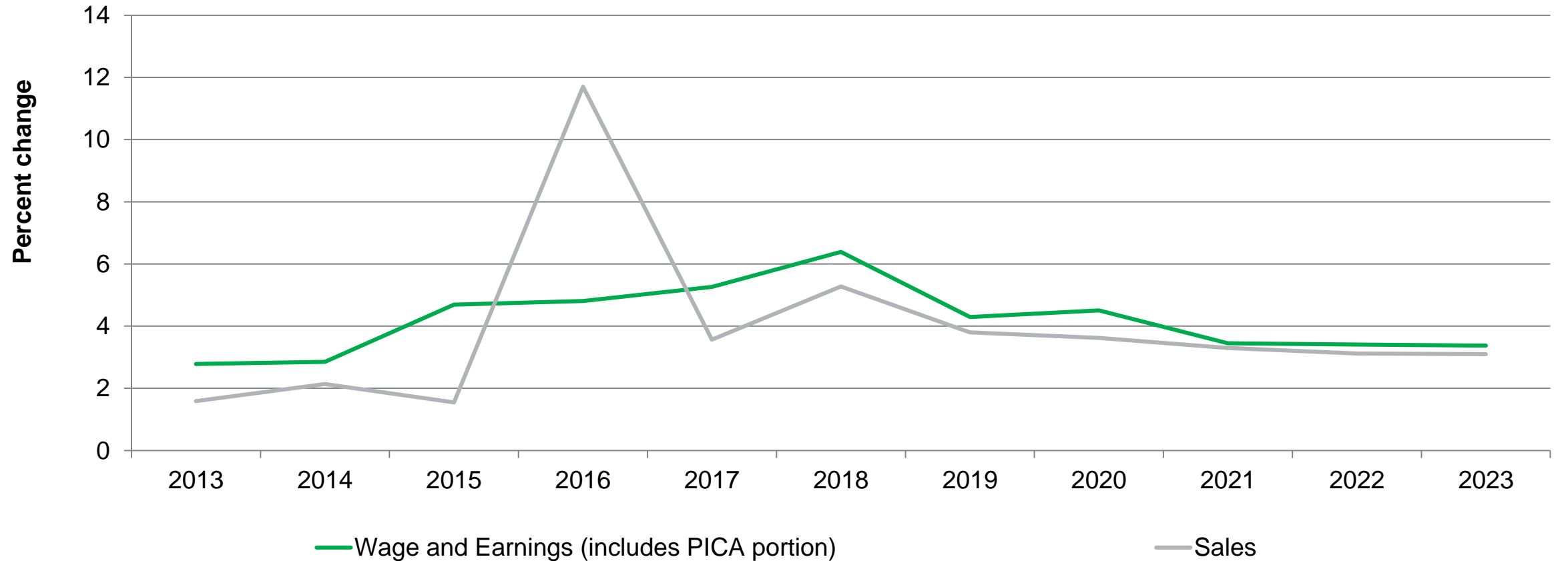
Model Structure, continued

- Net Profits Tax
 - Local proprietors' income
- Parking
 - MSA-level personal income
- Miscellaneous
 - Time series models

Revenue Outlook

Sales tax spike in 2016 partly due to jump in year-end accruals, while wage and earnings continues to perform very well

Wage and earnings tax and sales tax revenue growth



Source: IHS Markit, City of Philadelphia

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Realty transfer tax getting a big boost from commercial activity, while BIRT faces overhang of earlier years' overpayments

