

COUNCIL ON REVENUES

Office on Aging Conference Room
No. 1 Capitol District Building
250 S. Hotel Street
Fourth Floor, Room 410
Honolulu, HI 96813

Wednesday, October 29, 2008
2:00 P.M.

PRESENT:

Council Members:

Paul Brewbaker (Chair), Jack Suyderhoud (Vice-Chair), Carl Bonham, Pearl Imada Iboshi (late), and Richard F. Kahle, Jr.

Staff Members:

Department of Taxation: Tu Duc Pham, Yvonne Chow, Hamid Jahanmir, and Cathleen Tokishi

Department of Budget and Finance: Neal Miyahira, Keith Shimada, Karen Matsunaga, and Terri Ohta

Others:

Gordon Arakaki, Senate Committee on Ways and Means
Calvin Azama, Office of the Speaker of the House
Huong Bassford, Department of Budget and Finance
Nancy Cook Lauer, Stephens Media
Nandana Kalupahana, House Committee on Finance
Kurt Kawafuchi, Department of Taxation
Michael Ng, House Committee on Finance
B. J. Reyes, Honolulu Star-Bulletin
Donald Rousslang, Department of Taxation
Titin Sakata, Department of Taxation

ABSENT:

Council Members:

Dean Hirata and Albert Yamada

CALL TO ORDER:

The Chair called the meeting to order at 2:02 P.M. with a quorum present.

COMMUNICATIONS TO THE COUNCIL:

The Chair acknowledged the receipt of a letter dated October 8, 2008, from Senate President Colleen Hanabusa and Speaker of the House Calvin Say asking the Council to review its September 2008 General Fund revenue estimates. This topic is included as item V on the agenda. Dr. Pham noted that there was a problem that resulted in a delay in obtaining the original letter from the Legislature; steps were taken to ensure that the problem is not repeated in the future.

MINUTES OF THE MEETING OF SEPTEMBER 3, 2008:

The Chair asked if there were any questions or comments regarding the minutes of the September 3, 2008, meeting. There were none, so the Chair called for a motion to approve the minutes.

It was moved by Dr. Suyderhoud, and seconded by Mr. Kahle, that the minutes of the September 3, 2008, meeting be accepted. The Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Yes
Jack Suyderhoud	Yes
Carl Bonham	Yes
Dean Hirata	Absent
Pearl Imada Iboshi	Yes
Richard F. Kahle, Jr.	Yes
Albert Yamada	Absent

TOTAL PERSONAL INCOME (TPI) FORECAST:

The Council considered its forecast of nominal TPI growth for calendar year (CY) 2008 and CY 2009. At their July 2008, meeting, the Council had forecast 4.5% for CY 2008 and 4.0% for CY 2009. The most recent calendar year 2007 estimate from the Bureau of Economic Analysis (BEA) is 5.9%; for CY 2008, the current first quarter growth estimate is 4.9%, and the current second quarter estimate is 5.7%.

Possible future revisions to the latest BEA estimates were of concern to the Chair, because the dramatic revisions to the payroll and employment numbers released by the Quarterly Census of Employment and Wages program (AKA ES-202 program; FKA Covered Employment and Wages program) in February took the equivalent of 1 percentage point off of real growth. He expects the recent estimates of non-agricultural wage and salary jobs growth—0.9%, 0.4%, and 0.0% for the first three quarters of the year, respectively—to be revised downward by another percentage point due to the airline shutdowns and the drop in tourism and be negative for the

entire year. If so, that will affect revisions to the quarterly and annual TPI estimates and reduce TPI growth by a significant proportion.

It was noted that there was a second quarter bump in the TPI of almost a full percentage point to 5.7% from the first quarter, in part due to the federal fiscal stimulus. Dr. Bonham's jobs forecast for the year is about -0.2%, for a TPI forecast of about 4.25%; he believes that the data for the first half of the year are too high, and that the estimates will be negative going forward and for the year.

The Chair noted that, in nominal terms, there has been a pattern of wage setting both in the building industry in multi-year contract formats and in the public sector unions, which is coming up for renegotiation, wage increases of 4% to 5% that are currently locked in. However, he argues that there will be significant disinflation due to reduced economic prospects associated with the mainland recession and rapidly decreasing energy costs. In nominal terms, that should exert downward pressure on prices that will, in principle, affect wage setting in 2010 and 2011. The core U.S. inflation rate is 2.5% for the first half of CY 2008, but is expected to drop precipitously.

After further discussion, the Chair called for a motion on the CY 2008 TPI forecast.

It was moved by Dr. Suyderhoud, and seconded by Dr. Bonham, that the Council's forecast of nominal total personal income growth for CY 2008 be 4.3%. The Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Yes
Jack Suyderhoud	Yes
Carl Bonham	Yes
Dean Hirata	Absent
Pearl Imada Iboshi	Yes
Richard Kahle, Jr.	Yes
Albert Yamada	Absent

The Council discussed the forecast for CY 2009, particularly with respect to the effect of a steep, long term disinflation that began in mid-September. Both the Chair and Dr. Bonham believe that TPI, in real terms after inflation, will be flat at best, such that the current 4.0% forecast for CY 2009 is too high assuming inflation of approximately 2.5%. They also noted that the unemployment rate, a lagging indicator, is rising and is expected to go higher well into 2009; Dr. Bonham's jobs forecast is currently flat for CY 2008 and -1.2% for CY 2009. If real TPI is about -0.2% or -0.3%, and if inflation is about 2.5% or 3.0%, then the nominal TPI will be just under 3.0%. However, since fluctuations in income are smoother than job fluctuations, 2.5% may be too low.

After further discussion, the Chair called for a motion on the CY 2009 TPI forecast.

It was moved by Dr. Suyderhoud, and seconded by Mr. Kahle, that the Council's forecast of nominal total personal income growth for CY 2009 be 3.0%. The Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Yes
Jack Suyderhoud	Yes
Carl Bonham	Yes
Dean Hirata	Absent
Pearl Imada Iboshi	Yes
Richard Kahle, Jr.	Yes
Albert Yamada	Absent

GENERAL FUND REVENUE FORECAST:

The Council's September General Fund tax revenue forecast was 1.0% for fiscal year (FY) 2009, and 4.0% for FY 2010. In view of the continuing crisis in the national financial markets, the downward trend in both the national and global stock markets, and the impacts these events are having on Hawaii's economy, the Legislature asked the Council to review its earlier forecasts.

Based on preliminary data, General Fund tax revenue collections for the first quarter of FY 2009 is up only 1.5% compared to the first quarter of FY 2008. However, Dr. Pham explained that it would have been flat were it not for a one-time \$16.5 million franchise tax collection.

The Council's mean economic assumptions used in the model in preparation for the meeting were too optimistic with respect to the TPI growth rate and visitor arrivals. They believe that this recession will be deeper and longer than recent recessions, and do not expect an upturn until the second quarter of CY 2009.

The Chair noted that, if they had used a bigger decrease in the visitor count and a smaller increase in the TPI, then the blend of their forecasts would be roughly 0.0%. However, the more the Chair's latest economic assumptions are used, the more negative the blended forecast.

Dr. Bonham noted that, although nominal TPI forecasts are generally fairly smooth, the same cannot be said for the behavior of the General Fund revenue time series over the last few cycles. However, the General Fund model has a smoothing effect and, when combined with the blended forecast, tends to not capture the big events.

Further discussion ensued regarding the conditions of past cycles, with the downturns in 1982 and the mid-1990s being particularly illustrative. Unlike the previous more transitory events that resulted in downturns, the current situation is much more persistent with a number of significant events over the last 6 to 9 months. The general consensus of the Chair, Dr. Bonham, Mr. Kahle, and Dr. Suyderhoud was that the Council's forecast for FY 2009 should fall between -1.0% and

-2.0%, perhaps -1.5%, and that the Council should not wait until the January meeting to move into negative territory.

Dr. Imada Iboshi was uncomfortable with a negative number since actual first quarter collections were up 1.5% even if it was due to a one-time franchise tax collection. She believed that the current quarter could be flat and the third quarter -1.0% or -2.0%, but she thinks that the last quarter would be much stronger, particularly when compared to the terrible fourth quarter of FY 2008 (-4.9%). However, the others did not believe a flat or positive revenue growth for FY 2009 was possible. The decline in visitor arrivals from -10.1% for the second quarter of 2008 to -16.6% in the third quarter, particularly given the larger base in the third quarter when tourism peaks, the negative wealth effect of decreased spending as people's actual and/or perceived wealth decline, and declines in consumer confidence were cited. On the other hand, the large fuel and airfare price increases that occurred at that time have since declined.

Discussion was held regarding the impact that changing the visitor arrival forecasts would have on the model's revenue forecast, as the two forecasts prepared for the Council members who had revised their visitor arrival forecasts in line with recent data (approximately -14%) were negative, whereas the two forecasts prepared for the Council members who had not yet revised their visitor arrival forecasts from approximately -7% were positive. The consensus was that changing the tourist arrival forecast from -7% to -14% would result in a decrease in the General Fund tax revenue forecast of approximately 1.5 percentage points, which would result in a negative revenue forecast.

Dr. Suyderhoud asked Department of Taxation representatives if they could provide any preliminary information about the October tax revenues. Director Kawafuchi stated that there was a negative weekend effect (September 2007), and that income tax revenues were way down. He noted that estimated income taxes were lagging and withholding was flat. The Chair noted that the effect of capital losses from the stock market downturns would eventually also negatively affect income tax revenues.

After further discussion, the Chair called for a motion on the revised General Fund tax revenue forecast for FY 2009.

A -0.5% loss for FY 2009 was proffered, but both Dr. Bonham and the Chair thought a larger decline closer to -2.5% was more likely. Should the Council adopt the -0.5% forecast, however, Dr. Bonham emphasized the importance of conveying the uncertainty that the Council had in making that forecast. The wide dispersion of the Council's individual forecasts—1.5% to -2.6%— is very atypical and, as the Chair noted, is a reflection of the extraordinary extent of the Council's uncertainty. The consensus was that this is an extremely uncertain moment to be making a forecast and more time is needed to gauge the impacts of recent events, the future \$700 billion federal bailout, and various other factors. The Chair will communicate that and include an observation that the forecast could fall further unless the situation bottoms and stabilizes before the end of the fiscal year.

It was moved by Mr. Kahle, and seconded by Dr. Suyderhoud, that the below-the-line growth rate for FY 2009 be -0.5%. The Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Yes
Jack Suyderhoud	Yes
Carl Bonham	Yes
Dean Hirata	Absent
Pearl Imada Iboshi	Yes
Richard F. Kahle, Jr.	Yes
Albert Yamada	Absent

Discussion of the forecasts for FY 2010 through FY 2015 began with a review of the Council's previous forecasts before shifting to the model of the Council mean forecasts, which resulted in forecasts of 3.5%, 3.9%, 4.5%, 5.7%, 6.0%, and 4.5%, respectively. Following the current trough, the Council expects a stronger recovery than the model forecasted in the later years.

After further discussion, the Chair called for a motion on the revised General Fund tax revenue forecasts for FY 2010 through FY 2015.

It was moved by Dr. Suyderhoud, and seconded by Mr. Kahle, that the below-the-line growth rates for FY 2010 through FY 2015 be 3.5%, 4.5%, 5.3%, 6.0%, 6.5%, and 6.5%, respectively. The Chair called for the vote, and the motion passed with the following votes:

Paul Brewbaker	Yes
Jack Suyderhoud	Yes
Carl Bonham	Yes
Dean Hirata	Absent
Pearl Imada Iboshi	Yes
Richard F. Kahle, Jr.	Yes
Albert Yamada	Absent

NEXT MEETING:

As previously scheduled during the Council's meeting on May 29, 2008, the next meeting will be held on Friday, January 9, 2009, to meet the January 10, 2009, General Fund forecast reporting deadline. The meeting will be held at 2:00 P.M. in the Office on Aging Conference Room.

ADJOURNMENT:

The meeting adjourned at 3:35 P.M.