REVENUE NOTE

New York City Council
Hon. Melissa Mark-Viverito, Speaker
Hon. Julissa Ferreras-Copeland, Chair, Finance Committee

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Economy and Tax Revenues

The Finance Division forecasts that the national economy will continue to grow at a modest pace with real GDP growth averaging around 2.2 percent. This rate will be sufficient to continue improvements in the labor market keeping unemployment below 5 percent during the forecast period. As the labor market tightens the Division expects a sustained increase in real wages.

The City economy has slowed down from the rapid growth of recent years. For the City the economic data has been mixed and has been a source of concern to the Division. However, a key measure of current economic conditions, personal income tax withholding, has picked up since August. Like the national economy, the City's growth is forecast to continue but at reduced pace.

Tax revenues will continue to grow very slowly this year but will pick up in Fiscal 2018 to 4.4 percent, and average 4.3 percent in the outyears. In aggregate the tax revenue forecast is essentially the same as OMB's for Fiscal 2017 and $237 million below it in Fiscal 2018. Over the plan the Division's forecast has $350 million less in tax revenue than OMB's.

The national forecast was completed in early November and does not consider any of the policy proposals of the incoming Administration.

National Economy

Real Gross Domestic Product (GDP) rebounded in the third quarter of 2016 by an annual rate of 3.2 percent, the fastest pace since the third quarter of 2014. Consumer spending was a highlight, growing at 2.8 percent. Inventories bucked their five-quarter trend of subtracting from growth and contributed 0.61 percentage points to GDP. IHS Global Insight sees this as an anomaly and expects inventories to again subtract from growth for two more quarters – though much more mildly, followed by a sustained inventories contribution.

During the last three months, payroll employment maintained its strong expansion, averaging 176,000 more jobs per month.[a] Job growth, however, was not as dynamic as in the past two years, with its 200,000-plus jobs per month. Both the unemployment rate and labor force participation rate have remained fairly constant over the last few months. As of November 2016, the unemployment rate has fallen to 4.6 percent, indicating a tight labor market. The labor force participation rate, however, has also fallen to a very low 62.7 percent. Both are slight improvements from this time last year.

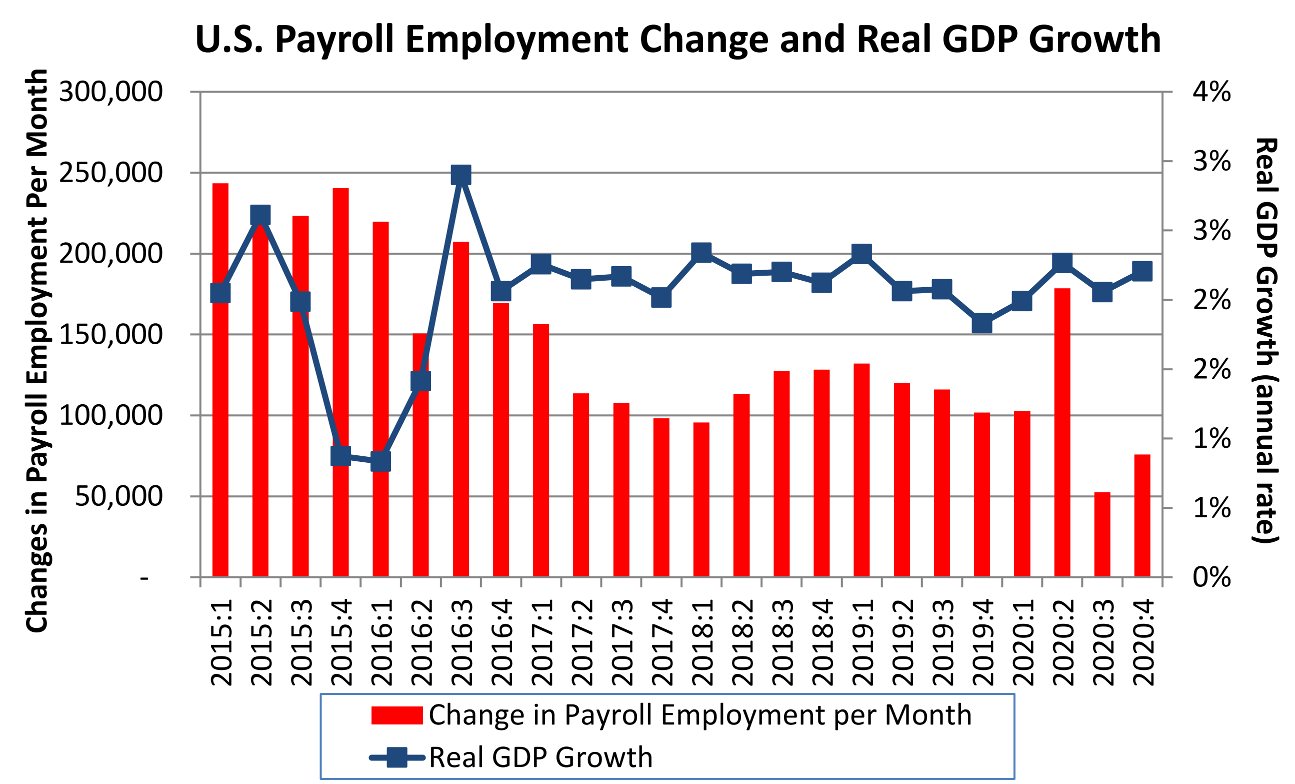
[a] U.S. Bureau of Labor Statistics. Employment Situation Summary. November 2016. http://www.bls.gov/news.release/pdf/empsit.pdf

The good news is the tightening labor market is finally benefiting workers, as average hourly earnings are up 2.8 percent year-over-year, the biggest increase since 2009. Personal income growth was stronger than expected in October, being up 0.6 percent versus expectations of only 0.4 percent. Much of this growth came from increased wages and salaries in the service sector, which were up $32 billion.

U.S. corporate profits are again showing strength, increasing by $133.8 billion in the third quarter, compared to a $12.5 billion decrease in the second quarter, and a $64 billion decline in all of 2015.[b] U.S. companies are benefiting from less of an inventories drag, and rising commodity prices, but still have to contend with a stubbornly strong dollar.

The Federal Reserve has signaled that it is likely to hike interest rates in December, the first increase in nearly a year. At the November 1-2 meeting, the Fed left its benchmark rate unchanged (0.25-0.5 percent). However, Fed Chair Janet Yellen has warned that the speed at which rates will continue to rise will depend upon the fiscal policy agenda of the incoming administration.

IHS Global Insight forecasts national employment growth to gradually decelerate from 1.7 percent in 2016, to 1.2 percent in 2017 and 0.9 percent in 2018. IHS also projects real GDP growth to decelerate to 2.1 percent in the fourth quarter and continuing to average 2.2 percent in the next three years.[c]



***Source**: IHS Global Insight, U.S. payroll employment, and growth in real GDP, November 2016*

[b] U.S. Bureau of Economic Analysis. Gross Domestic Profits / Corporate Profits. Third Quarter 2016. http://www.bea.gov/newsreleases/national/gdp/2016/pdf/gdp3q16_2nd.pdf

[c] IHS Global Insights. US Executive Summary. November 2016. Ihs.com

City Economy

The City's economy is showing signs of slowing - most acutely in the labor market. In the third quarter of 2016, about 94,000 jobs were added to the City economy, year-over-year. This number is down from 106,000 jobs in the first quarter and 96,000 jobs in the second quarter, year-over-year. The continuous decline in job growth this year is underlined by the sluggish nature of job growth in the major sectors. Professional and business services, which covers a wide range of decent-paying jobs, grew only 1.5 percent, year-over-year, in the third quarter of 2016 – which was well below the 4.2 percent and 2.8 percent growth rates in the first and second quarters, respectively. The third quarter growth in professional and business services jobs was also the slowest since the second quarter of 2010.

While various sectors have seen significant declines in job growth, others have actually lost jobs in 2016. The high-value financial activities super-sector lost approximately 1,400 jobs year-over-year in the third quarter of 2016 – after gaining over 5,000 jobs as of the first quarter and 1,000 as of the second quarter. Also, the retail sector has continued to lose jobs year-over-year for five consecutive quarters. In the third quarter of 2016, retail employment dropped by 4,000 year-over-year or 1.2 percent. Between December 2014 and October 2016, the retail sector has lost around 10,700 positions, seasonally-adjusted.

Health care and social assistance has long generated strong payroll growth, even during the last recession. Job growth in health care slowed slightly in the third quarter of 2016 to a still very dynamic 2.7 percent, after soaring by over 3 percent in the first two quarters. This slight softening probably does not indicate any fundamental weakening of the sector.

One bright spot has been the leisure and hospitality super-sector, whose job growth rate soared 5.9 percent year-over-year in the third quarter, the most dynamic since the second quarter of 2014.

Turning to unemployment, the jobless rate for the City increased for a fourth consecutive month to 5.9 percent in October – the highest since April 2015. The rise in the City's unemployment rate is due to the continuous increase in the number of unemployed New Yorkers during the last four months, and not from any net inflow into the labor force. In fact, the City's labor force participation rate also remains a major concern, as it has been declining significantly since April 2016. The labor force participation rate dropped to 59.5 percent in the third quarter of 2016, from 60.8 percent in the second quarter and 61.4 percent in the first quarter.

Like the labor market, average wage growth in the City has been disappointing in 2016. The private sector average wage is estimated to have grown by only 1.2 percent in the third quarter of 2016 over the previous year – an improvement from a 0.4 percent increase in the second quarter and a 2.1 percent decline in the first quarter.

The slow average wage growth, however, has been driven by the securities industry, whose average wage dropped 4.2 percent in 2015 as a result of a 10.5 percent decline in Wall Street profits. Wages in the securities industry are estimated to have dropped by another 5.8 percent during the first three quarters of 2016 compared to the previous year. Pushing down the average wage further is the diminishing share of astronomically-paying securities jobs in the City. The average wage in the securities industry was 388,000 in 2015.[d] The weak-to-negative growth in securities payroll

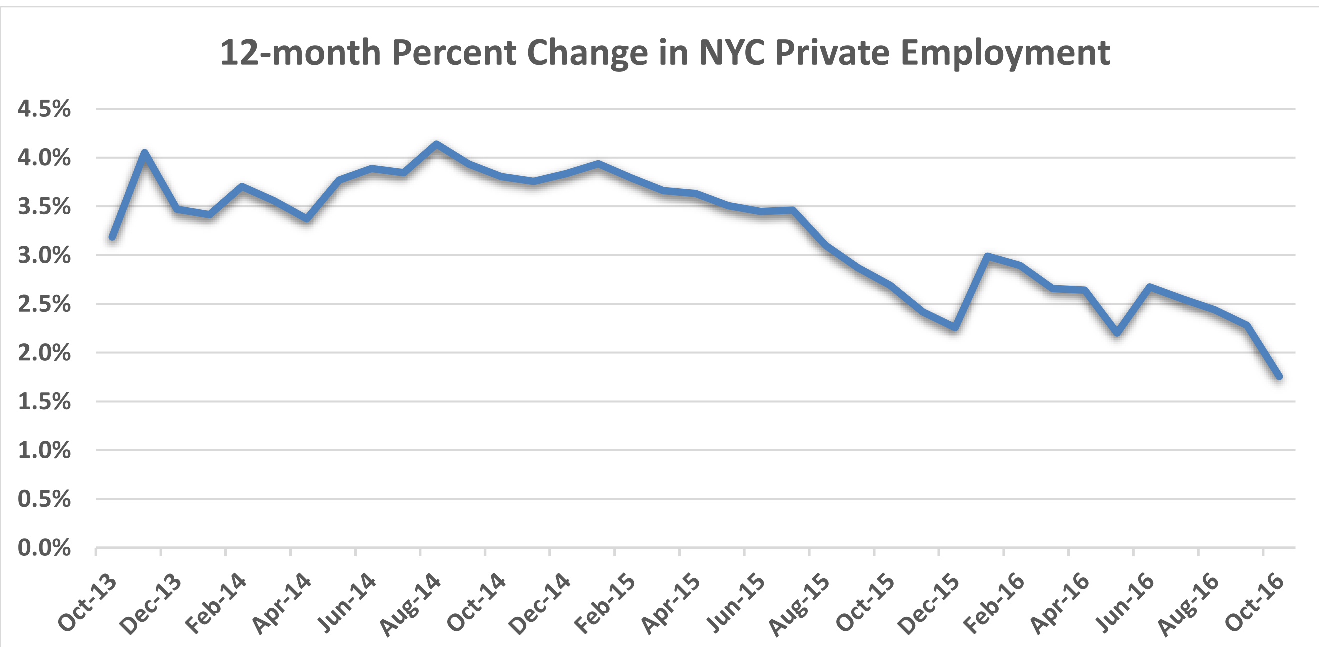
[d] U.S. Bureau of Labor Statistics, Quarterly Census of Employment and Wages (QCEW).

coupled with stronger growth in the other sectors has been pushing down overall average wage growth.

City real estate markets have been mixed. New office leasing in Manhattan has fallen 6.2 percent during the first three quarters of 2016, compared to a year ago. On-the-other-hand, third quarter leasing this year was the third highest in a decade.[e] The residential market has also been mixed. Prices for co-ops and condos in Manhattan have recently edged-down for luxury apartments, and have held steady for more moderately-priced units. Sales have softened somewhat. In Brooklyn and Queens, prices and sales have continued to climb.[f] The rental market has been mostly steady, but weaker for luxury apartments. In October 2016, the median one-bedroom apartment rented for $3,400 and $2,718 a month in Manhattan and Brooklyn respectively. Both were a percentage or two below a year ago.[g]

The hotel industry's revenues have been cumulatively unchanged. Between January and September 2016, an average of 2.86 million hotel room-nights were rented each month - a 3.2 percent increase over the same period a year ago. This was almost entirely offset, however, by a 3.0 percent drop in the average daily rate to $269 per night.[h]

Looking ahead, the Council's Finance Division expects private sector employment in the City to grow by 2.5 percent in 2016, slowing to 1.5 percent by 2020. OMB projects total employment growth of 2.0 percent in 2016, slowing to 0.8 percent by 2020. After meager 0.9 percent growth in 2015, the Finance Division expects the private sector average wage to be flat in 2016, strengthening to above 3 percent by 2018. OMB expects total average wage growth of 1.2 percent in 2016, surpassing 3 percent by 2017.



Source*: New York State Department of Labor, Current Employment Statistics, October 2016*

[e] Cushman & Wakefield, 'Marketbeat: Manhattan Office, Q3 2016.'

[f] Federal Reserve Bank, Beige Book, New York City District 2, November 30, 2016.

[g] Miller Samuel, October 2016.

[h] NYC & Company, 'NYC Hotel Occupancy, ADR & Room Demand,' September 13, 2016.

Forecast of Selected Economic Indicators: National and New York City, CY2016-2020					
	CY16	**CY17**	**CY18**	**CY19**	**CY20**
NATIONAL ECONOMY					
Real GDP %	**1.5**	**2.2**	**2.2**	**2.2**	**2.0**
Private Employment					
Level Change, '000	2,329	1,674	1,286	1,337	1,063
Percent Change, %	1.9	1.4	1.0	1.1	0.8
Unemployment Rate, %	**4.9**	**4.7**	**4.6**	**4.6**	**4.7**
Total Wages %	**2.1**	**2.6**	**3.1**	**3.1**	**3.1**
Interest rates %					
3-Month Treasury Bill	0.30	0.71	1.37	2.24	2.58
30-Year Conventional Mortgage Fixed	3.58	3.92	4.66	5.39	5.68
NEW YORK CITY ECONOMY					
Real GCP %	**2.5**	**2.3**	**2.1**	**1.7**	**1.5**
Private Employment					
Level Change, '000	91.0	63.8	52.3	60.0	59.0
Percent Change, %	2.5	1.7	1.4	1.5	1.5
Average Private Wages %	**0.04**	**2.4**	**3.2**	**3.0**	**2.8**
Total Private Wages %	**2.6**	**4.2**	**4.6**	**4.6**	**4.3**
NYSE Member Firms %					
Total Revenue	-1.7	2.9	5.2	3.0	0.7
Total Compensation	-2.8	4.8	6.4	5.2	3.8

Source: *IHS Global Insight, November 2016 (Nat'l); New York City Council - Finance Division (City)*

Economic Forecast Risks

The Finance Division's forecast over the next four years is one of slower growth for the City - but not a recession. There are, however, significant downward risks, most of which filter down from the national level or global events. The dollar may further appreciate, weakening net exports of American firms. This could be due to its role as a safe-haven if global instability flairs-up, whether from Brexit, weakness in strategic foreign markets, or major terrorist attacks. The Federal Reserve's cautious approach to raising short-term rates may not be circumspect enough, pushing rates up to levels that discourage business and consumer borrowing. The OPEC nations may fail to meet their promise to cap the production of crude, keeping energy prices down, U.S. oil rigs shuttered, and overall business fixed-investment depressed. Global instability could again put equity markets in a tail spin, wiping out wealth and discouraging new business investment and consumer spending.

Turning to New York City, the current signs of a slowdown may become more pronounced, as the obstacles faced by U.S. companies - which are the clients of City businesses, filter down to the five boroughs, shrinking Gross City Product and employment. Any turbulence on Wall Street will disproportionately batter the City's financial sector. Soaring costs in housing and construction may deter households and firms form locating in the City, stifling additional growth. IHS Global Insight gives a 20 percent probability of a two-quarter recession from the fourth quarter of 2017 to the first quarter of 2018.

There are upward risks as well. GDP may grow faster than anticipated, reinvigorating capital investment and maintaining strong employment growth. Struggling global markets, such as Europe and China may recover more quickly, increasing net exports, and lowering the relative position of the dollar. IHS gives a 15 percent probability of the economy doing better than expected. The above risks do not attempt to factor-in the significant impacts and changes that the new Trump Administration is likely to usher-in, both positive and negative. These economic changes are expected to reflect fiscal stimulus, redistribution of resources, and economic nationalism.

Tax Revenue Forecast and Risks

The Finance Division forecasts a 2.0 percent increase in tax collections in Fiscal 2017, following a 3.3 percent increase in Fiscal 2016. This would be the second consecutive year of reduced growth in tax revenue, reflecting a less dynamic City economy. Collections are expected to rebound in Fiscal 2018 by 4.4 percent, and average 4.3 percent in the outyears, as business activity and equity markets regain a stronger footing.

Property tax collections will maintain strong growth throughout the financial plan, driven by rising billable assessed values. Collections will soften only slightly in Fiscal 2018 as higher long-term interest rates decelerate the climb in market value – but not by much.

The transaction taxes - real property transfer (RPTT) and mortgage recording (MRT), lost their double-digit annual growth in Fiscal 2016, which they enjoyed for the prior five years. Collections are expected to fall in Fiscal 2017, driven by fewer high-end commercial sales. Positive growth will return in Fiscal 2018 and the outyears, but will be in the single-digits, as long-term interest rates begin to rise.

Personal income tax collections (PIT) experienced sharply slower growth in Fiscal 2016, as the 10.5 percent drop in Wall Street profits in 2015 took a huge toll on bonus payments, and falling stock prices on capital gains realizations. Revenues are expected to recover some momentum in Fiscal 2017, thanks to a more stable equities market, and increasing employment and wages. The outyears are expected experience slower growth compared to 2017, reflecting more modest gains in employment.

Collections from the two business taxes – general corporation (GCT) and unincorporated business (UBT), went in different directions in Fiscal 2016. The UBT, which taxes generally smaller, more locally-based businesses, maintained healthy growth, which is expected to slow – though not dramatically through the Plan. The GCT, which is more nationally-oriented, suffered a steep decline in collections, reflecting the reduced corporate profits in 2015. There is also some question as to whether the business tax reforms may have contributed to reduced revenues, either due to delayed timing of collections under the new rules, or because the overall reforms were not as revenue-neutral as designed. Last September (a major tax month), GCT collections were finally strong, although the following month was weak again. Collections may well be on the cusp of an upturn, reflecting a rebound in corporate profits during the third quarter. Like the UBT, GCT collections are expected to grow modestly in the outyears, reflecting a softer economy.

Sales tax collections were considerably slower in Fiscal 2016, as reduced retail employment pointed to weak sales. High-end stores have reported reduced spending from foreign tourists, attributable in part to the stronger dollar. It's also possible that a share of the increased shopping online is escaping local taxation. IHS expects national consumer spending to likely cool in the next couple of years, with growth of 2.6 percent expected in 2016 (calendar year) and 2.5 percent in 2017 and 2018. Consequently, collections in the outyears are expected to be moderate.

In short, weaker collections from the PIT, business, transactions and sales taxes are reflecting a City economy that's still growing, but more slowly. Even these lackluster tax revenue forecasts - like the underpinning economic conditions, are subject to considerable downside risks. They rest upon global markets remaining stable, the dollar at least not rising further, energy prices rising, continued employment growth, and maintaining confidence among consumers and firms. Of course the reverse applies if these conditions improve beyond expectations.

One downward risk that is highly likely is OMB's assumption that the City can renegotiate the $600 million reimbursement to New York State for savings from refinancing the Sales Tax Asset Receivable Corporation (STARC). The November Plan, like the Executive Budget, only acknowledges a $50 million repayment in Fiscal 2016 and a $150 million repayment in 2017. It does not recognize the remaining payments of $50 million more in 2017, $200 million in 2018, and $150 million in 2019. If the State refuses to waive the remaining payments, the City will face a total cost of $400 million through reduced sales tax revenues.

Council Forecast: Difference from OMB Forecast

Dollars in Millions

	FY17	FY18	FY19	FY20
Real Property	$0	$38	$145	$402
Personal Income	27	(8)	(26)	(46)
General Corporation	(45)	(139)	(35)	(103)
Unincorporated Business	21	9	(59)	(164)
Sales	(81)	(288)	(362)	(415)
Commercial Rent	5	5	5	5
Real Property Transfer	17	46	109	152
Mortgage Recording	44	70	64	54
Utility	6	7	14	28
Hotel	23	22	14	3
All Other*	0	0	0	0
Audits	0	0	0	0
Total Taxes	**$17**	**($237)**	**($130)**	**($85)**

Source: *New York City Council Finance Division, OMB Fiscal 2017 Novembe*

Council Forecast: Growth Rates

	FY16*	FY17	FY18	FY19	FY20
Real Property	8.0%	5.1%	5.9%	6.4%	5.6%
Personal Income	1.0%	4.5%	3.0%	3.5%	3.7%
General Corporation	(11.4%)	5.6%	6.0%	2.6%	(0.5%)
Unincorporated Business	4.0%	2.4%	3.4%	1.3%	0.2%
Sales	2.5%	2.1%	3.1%	3.4%	3.8%
Commercial Rent	6.0%	4.0%	4.3%	4.1%	4.0%
Real Property Transfer	0.6%	(11.3%)	4.7%	7.1%	5.2%
Mortgage Recording	6.9%	(8.5%)	1.4%	2.0%	1.4%
Utility	(7.8%)	8.8%	4.0%	5.2%	6.0%
Hotel	1.6%	0.8%	2.7%	2.7%	2.4%
All Other**	(0.3%)	(19.1%)	(2.4%)	(0.3%)	(0.3%)
Audits	2.6%	(36.2%)	(3.4%)	0.0%	0.0%
Total Taxes	**3.3%**	**2.0%**	**4.4%**	**4.6%**	**4.1%**

* Actuals

Source: *New York City Council Finance Division, Fiscal 2017 November Plan*

Council Forecast: Levels

Dollars in Millions

	FY16*	FY17	FY18	FY19	FY20
Real Property	$22,861	$24,025	$25,449	$27,065	$28,593
Personal Income	10,733	11,212	11,544	11,946	12,389
General Corporation	3,622	3,824	4,055	4,161	4,139
Unincorporated Business	2,040	2,088	2,159	2,187	2,190
Sales	6,911	7,054	7,269	7,518	7,801
Commercial Rent	779	810	845	880	915
Real Property Transfer	1,775	1,575	1,649	1,765	1,857
Mortgage Recording	1,234	1,129	1,145	1,168	1,185
Utility	354	385	401	421	447
Hotel	565	570	585	601	616
All Other	1,472	1,190	1,162	1,159	1,156
Audits	1,161	741	716	716	716
Total Taxes	**$53,508**	**$54,604**	**$56,979**	**$59,589**	**$62,003**
OMB	$53,508	$54,586	$57,217	$59,719	$62,088

**Actuals*

Source: *Council Finance Division, Fiscal 2017 November Plan*

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