

City of Renton Economic Forecast
2012 - 2016

Prepared for the

Department of Finance and Information Technology
City of Renton

by

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Introduction and Summary

This report updates the City of Renton Economic Forecast dated January 31, 2012. It relies on the July 2012 national economic forecast from *Blue Chip Economic Indicators*, and the June 2012 Puget Sound forecast from Conway Pedersen Economics, Inc., as published in *The Puget Sound Economic Forecaster*. The Renton forecast is prepared with the aid of a simple econometric model developed for the City.

Uncertainty has replaced optimism in the U.S. outlook. Weakening growth worldwide and worries about the risk of sovereign debt, combined with doubt about resolving domestic fiscal imbalances, are holding back GDP growth and new hiring. The Blue Chip forecast still calls for growth over the near term, but at a lackluster pace insufficient to lower the unemployment by more than just a few tenths of a percentage point.

The Puget Sound economy is growing faster than the U.S. economy—2.9 percent job growth, for example, over the last four quarters versus 1.6 percent. The job creation, supported by expansion in aerospace is, in turn, boosting growth in personal income and retail spending. Like the national economy, housing is showing signs of recovery as home prices finally rise. Regional growth should continue to outpace national growth.

Soaring 737 orders, higher production rates, and rising Boeing and non-Boeing employment will sustain the Renton economy over the forecast period. More than 5,000 additional jobs and nearly 8,800 new residents are expected. The drag on taxable retail sales from the construction sector will be lifted.

Comparative Growth Rates, 2012 – 2016

Average Annual Percent Change

	United States	Puget Sound	Renton
Employment	1.8	2.3	2.1
Population	0.8	1.2	1.8 ¹

¹ Excludes effect of annexations

Economic Conditions and Forecasts

The U.S. Economy

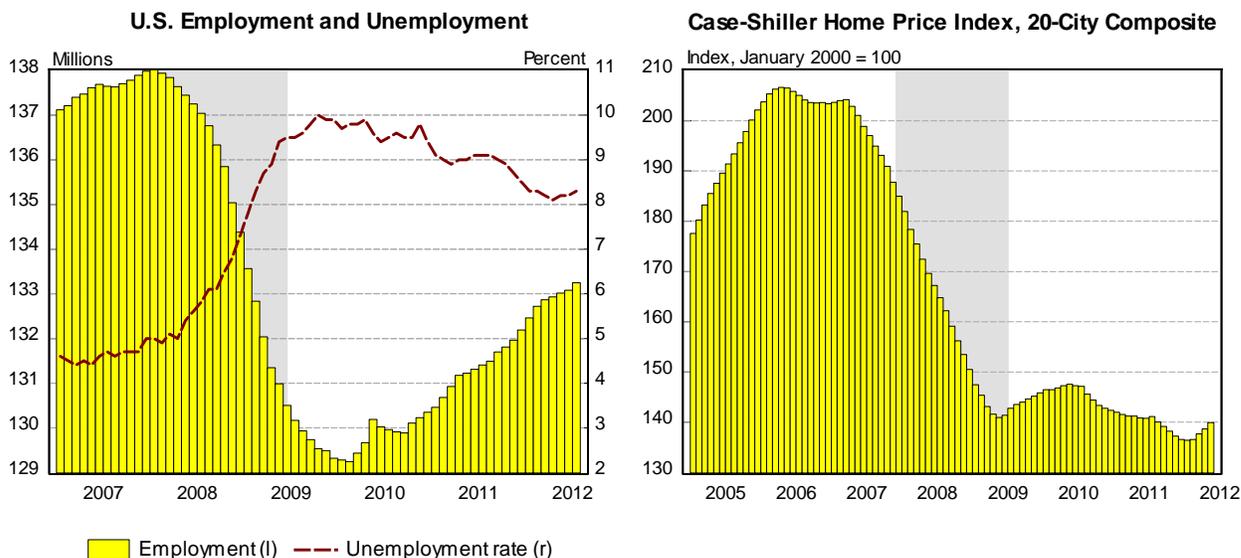
Although the U.S. economy continues to advance, there is considerable uncertainty among consumers, employers, and investors about the outlook. The economic unease has surfaced and resurfaced during the three-year recovery every time there is a string of weaker than expected economic announcements, or heightened financial institution or sovereign credit risk. This, in turn, has affected spending and hiring.

Currently, slowing global growth appears to be softening demand for U.S. goods (except airplanes) exactly at the same time that the European economic and financial crisis, discomfort about the upcoming U.S. elections, and the looming year-end fiscal cliff are

weighing on the economy. While the odds of a new recession within the next twelve months are put at one-in-four by participants in the latest Blue Chip survey of economists, their forecast calls for the recent subpar GDP growth to gradually accelerate over the forecast period averaging 2.9 percent per year from 2014 to 2016.

Current Conditions and Prospects

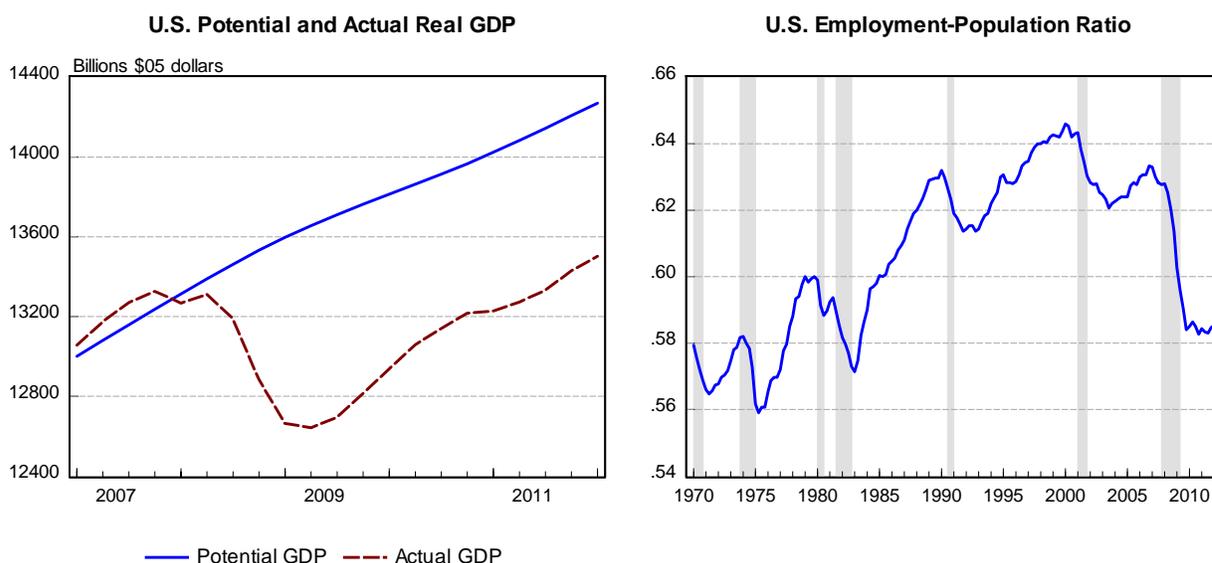
The defining feature of the economic recovery to date is the woefully weak rate of job creation. In the three years since the end of the recession, the economy has added back about four million payroll jobs, just 44 percent of the total number lost during the downturn. Employment is still nearly five million jobs short of the pre-recession peak. What is needed, are more labor reports like the one for July, which showed a gain of 163,000 jobs for the month spread broadly across major industry sectors. But, this is unlikely for the remainder of this year according to the Blue Chip panelists. They project increases of 132,400 per month in the second half, which will likely keep the unemployment rate above 8 percent. Growth in 2013, however, is expected to be somewhat stronger, averaging 167,100 net new jobs per month pushing the unemployment rate down to 7.7 percent by the fourth quarter.



Notwithstanding the disappointing job showing, there are some favorable developments in the recovery, perhaps most encouragingly in the housing market which shows improvement in home sales, housing starts, and prices. The Case-Shiller 20-city composite home price index has risen in each of the last four months (through May) and also shows an increase over the latest six-month period. Positive appreciation rates like this, assuming they can be sustained, should provide incentive to both home buyers and builders to re-enter the housing market. Other plusses for the recovery include continued pickup in bank lending (both business loans and consumer credit), lower delinquency rates, and continued easing in household debt service payments as a share of disposable income.

In evaluating the recovery, there has been much discussion about whether the loss in real GDP associated with the recession will ever be made up. Real GDP growth has averaged just 2.2 percent in the twelve quarters since the recession ended leaving it well below potential or trend growth. Usually, after a severe recession, the rebound in growth lifts real GDP back to its trend line. But this time, actual growth is paralleling rather than catching up with potential growth leaving a persistent gap.

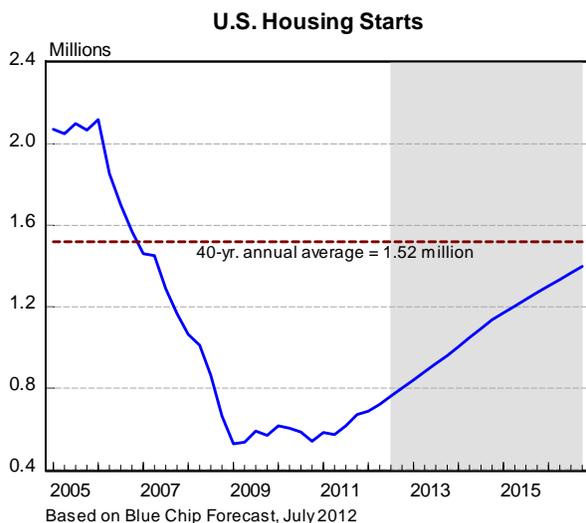
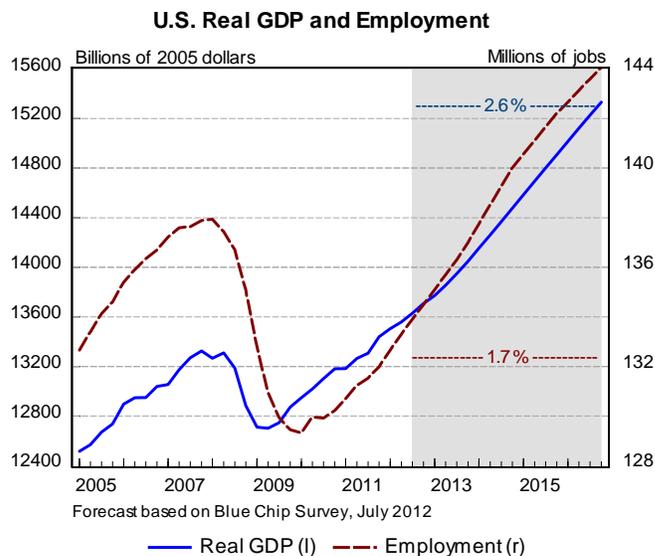
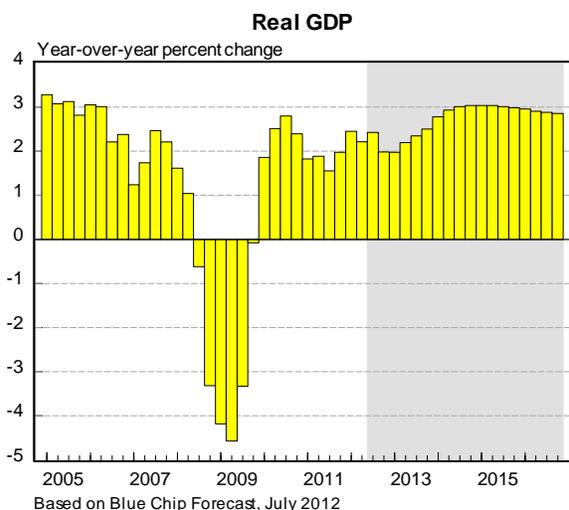
Is this shortfall in growth due to cyclical factors and therefore amenable to policy initiatives, or have there been structural changes in the economy that dictate below trend growth in the future? This debate is currently in full swing among economists with monetary and fiscal policymakers seeking to close the gap via stimulative measures, and other analysts pointing to structural shifts in the labor force. The latter may be evident in the dramatic drop in the employment-population ratio. About one-half of the decline is estimated to be cyclical as the unemployment rate increased from less than five percent to ten percent. The other half is related to shifting demographics, particularly in the age structure of the population, which would be expected to continue for at least the next decade as the large baby boom cohort transitions to retirement. The implication is that 2-2½ percent growth may be the new norm. The gap between potential and actual GDP will close but because potential growth is reduced.



Forecast

Whether or not this notion is guiding the Blue Chip economists, their short-run forecast is consistent with below-trend growth prospects. Real GDP growth amounted to only 1.5 percent on an annualized basis in the second quarter of this year, and is forecast by the consensus to average 2.1 percent for the entire year picking up to 2.3 percent in 2013. Growth rates may tick higher later on, but over the entire forecast period (2012-2016) real GDP will rise at an annual rate of 2.6 percent. If the rate of job creation improves

next year as predicted, and can be sustained, then employment growth will average 1.7 percent over the forecast period, according to the consensus, eventually lowering the unemployment rate to below 7 percent in 2016.



U.S. Summary Forecast
July 2012

	2011	2012	2013	2014-16
GDP(\$05)	1.8	2.1	2.3	2.9
Employment (% chg.)	1.2	1.7	1.8	1.8
Unemployment rate (%)	9.0	8.2	7.8	6.8
Housing starts (mil., units)	0.612	0.740	0.880	1.233
Consumer price index (% chg.)	3.2	2.0	1.9	2.4
10-Yr. T-note (%)	2.79	1.90	2.40	3.71

Based on Blue Chip Economic Indicators, July 2012

The consensus predicts a notable improvement in the outlook for housing. Over the next six quarters (by the fourth quarter of 2013), housing starts are forecast to climb to an annual rate of 960,000 units, 80 percent above the low point in the first quarter of 2009. Yet this will still amount to only about 60 percent of the long-run average. Not until the end of 2016, will housing starts approach an annual rate of 1.5 million units. Is there a structural issue here? If mortgage lending standards have permanently tightened as a result of the financial crisis/recession, is the reduced rate of homebuilding also, at least partly structural?

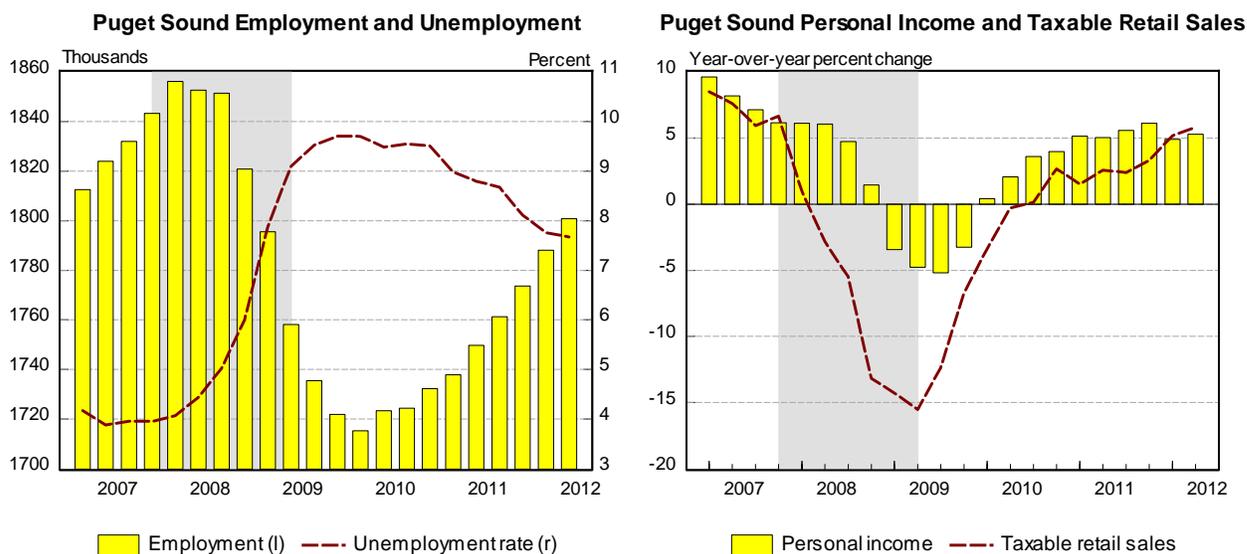
The Puget Sound Economy

Puget Sound labor and housing markets continue to improve as job creation builds, unemployment shrinks (albeit slowly), home sales and prices climb, and housing starts rise. Presuming no major shocks, employment and personal income growth rates this year will be the highest since 2007.

Current Conditions and Prospects

The Puget Sound job recovery has been stronger than that for the national economy. The region has gained back about 85,000 jobs since the low point, which amounts to 60 percent of the jobs lost during the recession. It remains about 55,000 jobs short of a complete recovery. Meanwhile, the unemployment rate has dropped below 8 percent.

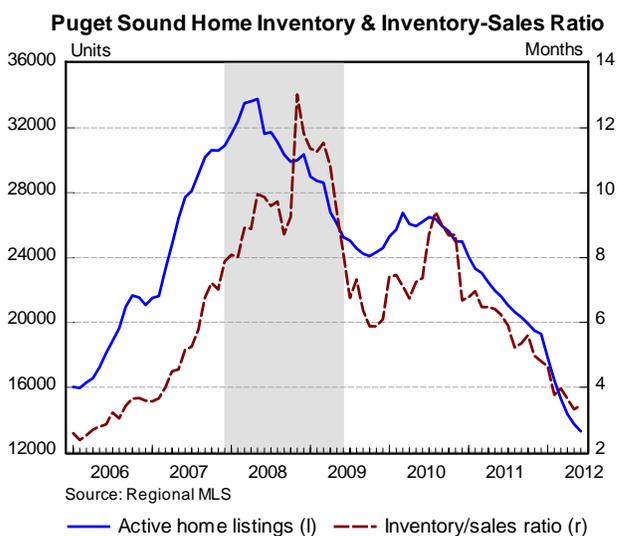
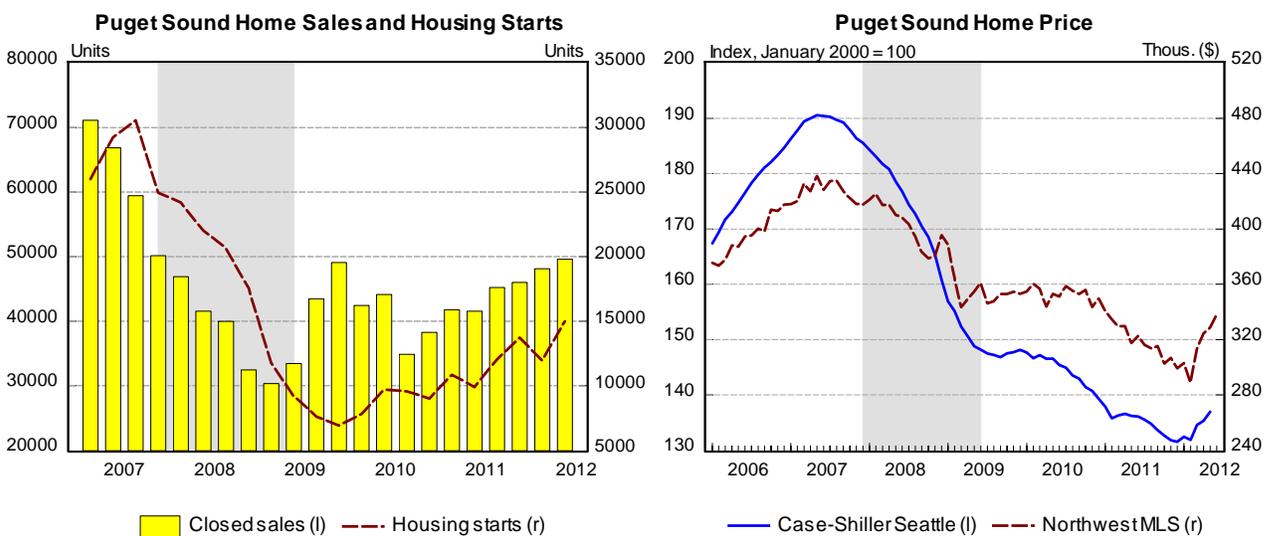
Job growth has accelerated nicely in the last four quarters with 51,100 net new workers added to payrolls between the second quarter of 2011 and the second quarter of 2012—a growth rate of 2.9 percent. Growing industries include professional and business services, education and health services, leisure and hospitality services, as well as manufacturing (up 11,000 jobs, 8,000 in aerospace) and construction (up by 4,100 jobs, 4.9 percent). The weak sectors include finance, insurance, real estate, and government. The pickup in job growth has, in turn, boosted growth in personal income which has led to a strengthening in taxable retail sales. Year-over-year growth in retail spending in the second quarter is estimated at slightly over 5 percent, the best showing since the fourth quarter of 2007.



Like the national economy, Puget Sound home sales and housing starts are rising—the latter running at a 15,000-unit annual rate in the second quarter of this year. While more than double the pace at the low point in 2009, new building is still well below the long-

run average of 22,000 units per year. Multi-family units have accounted for more than fifty percent of activity in recent quarters.

But the best news with respect to housing activity is the turn in prices. Both the monthly Case-Shiller repeat sale home price index for the Puget Sound area and the Northwest Multiple Listing Service measure of the average home price are finally on the rise. The latest data show these series increasing not only on a month-to-month basis, but also over the last three-month, six-month, and twelve-month intervals—a definitive reversal. This is not to say that the effect of distressed sales and the shadow inventory are no longer weighing on the housing market, but that fundamental demand conditions (represented by the pickup in job creation) and supply conditions (represented by the decline in inventories) have improved to the point where prices are finally responding.



Puget Sound Summary Forecast¹

	Annual Percent Change			
	2011	2012	2013	2014-2016
Puget Sound²				
Employment	1.8	2.8	2.3	2.1
Personal income	5.5	5.4	5.2	5.4
Taxable retail sales	2.4	5.8	5.7	5.4
Housing permits	11.1	30.9	36.6	6.0
Consumer price index	2.6	2.1	2.2	2.5
Population	1.0	1.3	1.4	1.2

¹ *The Puget Sound Economic Forecaster*, June 2012

² Includes King, Kitsap, Pierce, and Snohomish counties

Forecast

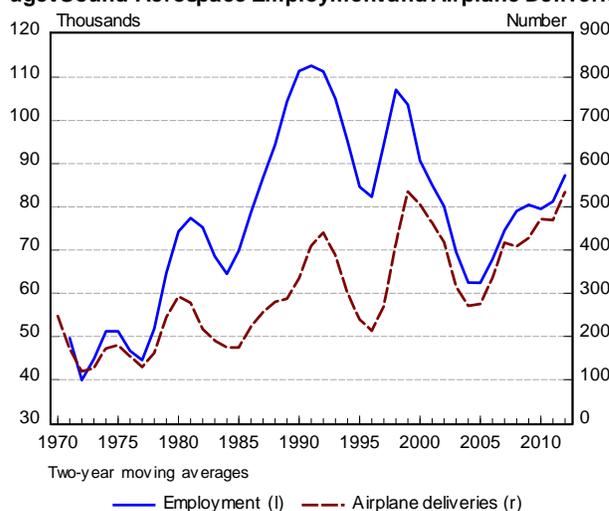
In general, the Puget Sound outlook reflects an economy that continues to gain strength. As shown in the table above, the forecast calls for regional job growth in the 2-3 percent range over the forecast period supporting personal income and taxable retail sales growth of around 5.5 percent. The pickup in housing activity will show sharp percentage gains, although the level of permits will remain below the long-term trend. A slight uptick in the population growth rate is expected and inflation will remain contained.

A Note on the Impact of Aerospace

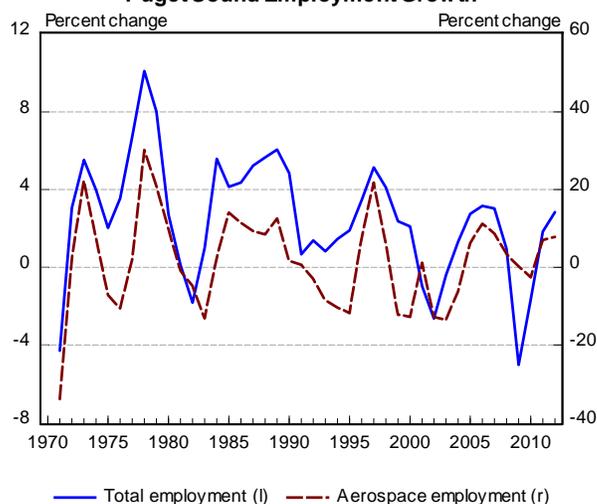
Regional aerospace employment and airplane deliveries are, of course, closely tied—they move up and down together and the peaks and low points coincide. In 2012, total Boeing deliveries will approach 600 planes according to company announcements and regional aerospace jobs will reach 90,000, relatively “boomy” conditions last experienced in the second half of the 1990s. This growth builds on the relatively benign impact that the recession had on aerospace. Regional aerospace jobs, for example, actually increased in 2008, were flat in 2009, and fell by just 2,100 in 2010.

Since then, they have been climbing and having the predictable ripple effects on the rest of the economy. Of the 85,000 jobs added to Puget Sound payrolls between the first quarter of 2010, which was the low point for overall employment, and the second quarter of this year, aerospace directly accounted for 12,000 jobs. But, taking into account the indirect effects, the impact amounts to 32,000 jobs using a multiplier of 2.7. This means that aerospace has accounted for about 37 percent of the regional job recovery so far. Another simple way to see the connection is in the correlation of growth rates. Over the last forty years, changes in total employment closely track changes in aerospace employment.

Puget Sound Aerospace Employment and Airplane Deliveries

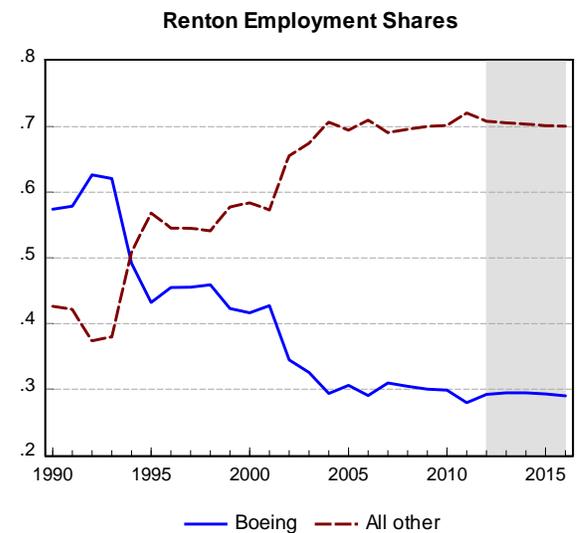
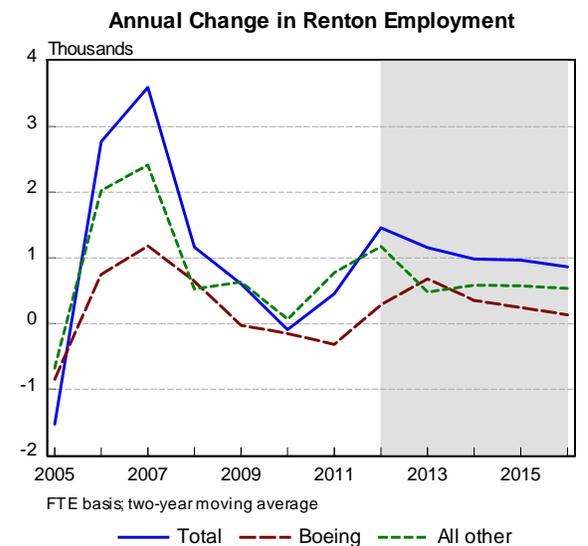
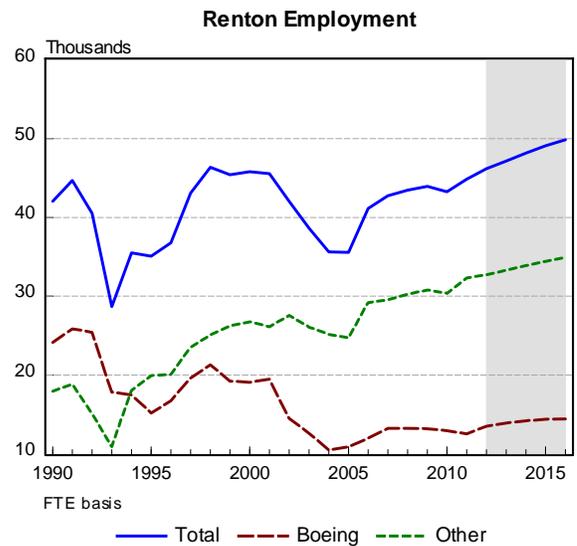
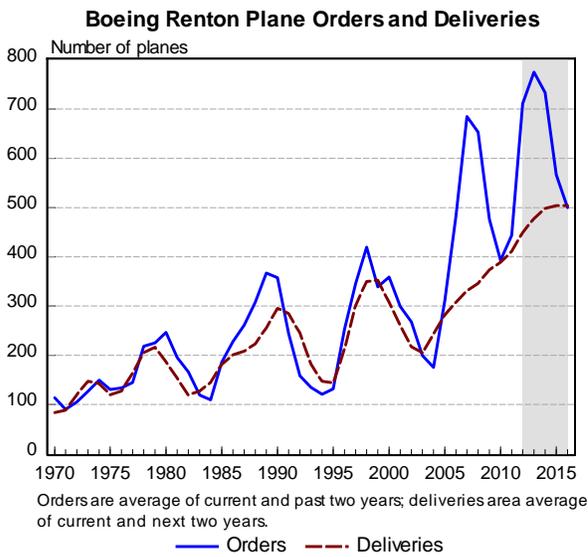


Puget Sound Employment Growth



Outlook for the Renton Economy

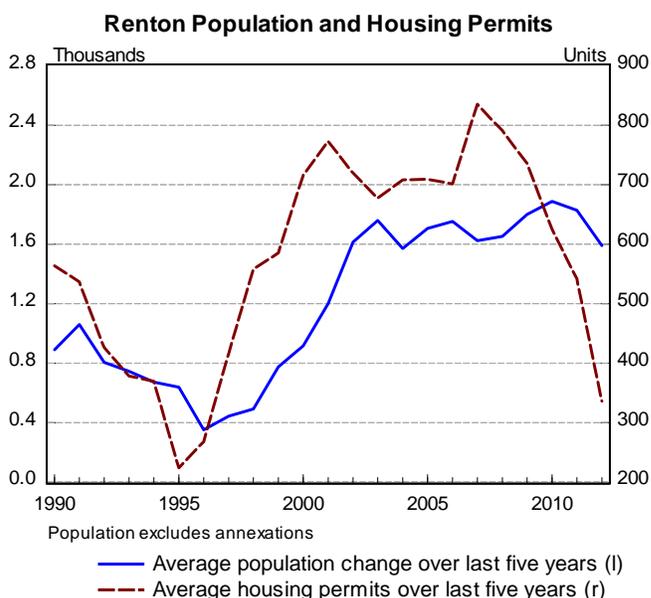
The Renton economy, like the Puget Sound economy is expected to forge ahead over the forecast period as 737 production rates climb, Boeing and non-Boeing payrolls rise, and residential building and retail spending recover. Over the five-year forecast period (through 2016), total employment is expected to increase by 5,000 jobs on an FTE basis (11.2 percent), population (excluding annexations) will grow by 8,800 new residents (9.5 percent), and 1,800 new single-family and multi-family housing units will be added to the housing stock. Taxable retail sales will eventually surpass pre-recession highs.



The impetus for the increase in plane output that is underway is, of course, the bulging 737 order book. At the end of July, the total 737 backlog amounted to about 2,800 planes, 650 of which were the planned 737 MAX. Boeing statements suggest a considerably higher total by year-end. Over the long-run, demand for Boeing single-aisle airplanes is estimated at about 580 planes per year based on a fifty percent market share and Boeing's latest Current Market Outlook forecast which calls for a total of 23,240 single-aisle deliveries from 2012 through 2031. As shown above, there is a two-year lag, on average, between swings in orders and swings in deliveries, thus the ramp up in production in progress. Based on Boeing announcements, 737 deliveries are expected to climb from 372 planes in 2011, to 418 planes this year, and further to slightly over 500 planes by 2015—an impressive plan.

The outlook for Boeing employment in Renton is based on the regional forecast for aerospace employment and expected plane deliveries from the Renton plant relative to total deliveries. This methodology results in a forecast calling for the addition of 2,400 jobs over the forecast period. At the same time, non-Boeing employment, which tracks non-aerospace employment in the rest of the Puget Sound economy, is expected to rise by about 2,600 jobs. Of the 5,000-job total, 1,300 will be added this year, a growth rate of 3.0 percent. Subsequent gains average about 2 percent. Employment shares are little changed with this forecast—non-Boeing jobs remain at 70 percent of the total while Boeing jobs make up 30 percent.

The Renton population and housing forecasts are based on the outlook for Puget Sound population and housing, but there is also feedback from housing to population and vice-versa. Over longer time periods it appears that changes in housing activity in Renton tend to lead changes in population. This is reasonable for sub-county areas, although it would not be expected to hold for the overall regional economy (where population would lead). Through 2016, Renton population (excluding annexations) is expected to increase



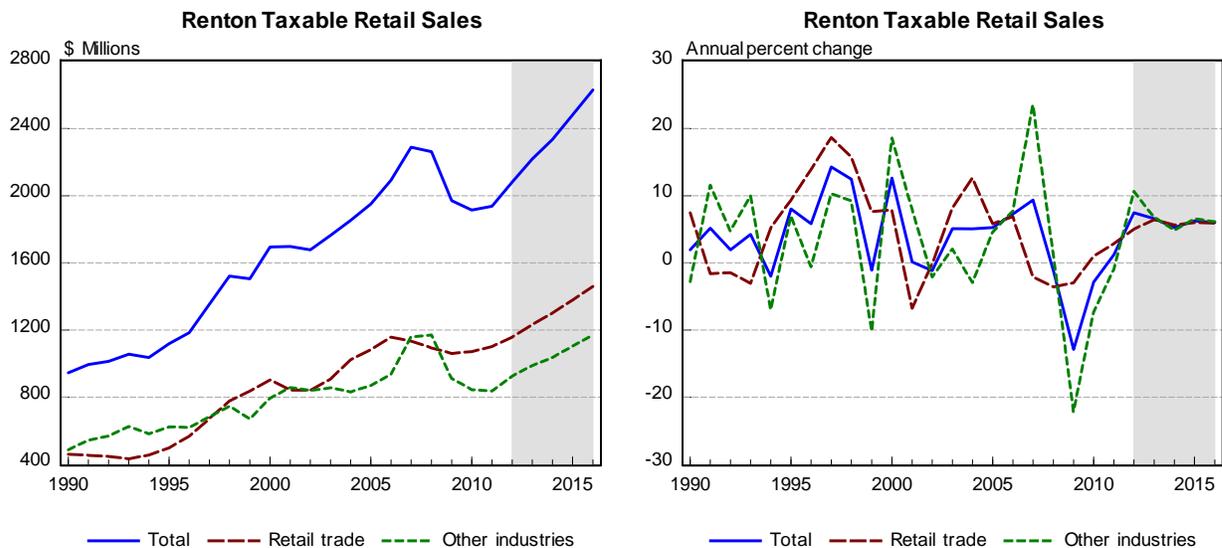
Factors Affecting Puget Sound Taxable Retail Sales
Annual Averages

	2010-11	2012-13	2014-16
Personal inc. growth (%)	4.0	5.3	5.4
Housing permits (units)	10,900	17,800	23,700
Unemployment rate (%)	9.1	7.5	6.8
10-year Treas. note (%)	3.00	2.15	3.71

by an average of 1,800 new residents per year (1.9 percent) reaching more than 101,000. Housing permits are expected to climb from 280 units last year, to 290 units this year rising to 430 units at the end of the forecast period.

The economic uncertainty, fiscal worries, and political dysfunction weighing on the national economy (noted in the discussion of the U.S. outlook) are also in play in the regional economy, although it is difficult to quantify their impact. In the case of retail sales, however, their drag is expected to be offset over the forecast period by improvement in some of the fundamental determinants of spending as summarized above: pickup in personal income growth, recovery in housing activity, and decline in the unemployment rate. Higher interest rates after next year are the only negative, but this impact is expected to be relatively weak.

For the Renton economy, taxable retail sales are already off to a good start in 2012. In the first quarter total taxable retail sales climbed 6.7 percent above the year-earlier level with retail trade sales up 3.9 percent and all other retail sales up 10.5 percent led by construction, wholesale trade, and accommodation and food services. Based on the regional retail sales forecast and the expected growth in local population and housing relative to regional growth, the outlook calls for annual gains (not adjusted for inflation) averaging 6.1 percent after this year. A key difference in the outlook compared to recent years is improvement in the construction sector.



**City of Renton
Baseline Economic Forecast
July 2012**

	----- Actual -----				----- Forecast -----				
	2008	2009	2010	2011	2012	2013	2014	2015	2016
Boeing Renton Plant									
Orders (Planes)	474	197	508	625	1,000	700	----- 500/yr. -----		
Deliveries (Planes) ¹	290	372	376	372	418	443	486	504	504
Renton Employment²									
Total	43,461	43,946	43,274	44,848	46,184	47,159	48,144	49,085	49,865
Percent Change	1.7	1.1	-1.5	3.6	3.0	2.1	2.1	2.0	1.6
Boeing ³	13,224	13,169	12,913	12,528	13,478	13,885	14,276	14,669	14,936
Percent Change	0.0	-0.4	-1.9	-3.0	7.6	3.0	2.8	2.7	1.8
Other	30,237	30,777	30,361	32,320	32,706	33,274	33,868	34,416	34,929
Percent Change	2.4	1.8	-1.4	6.5	1.2	1.7	1.8	1.6	1.5
Renton Population⁴									
Percent Change	29.2	6.4	3.7	1.8	1.4	2.0	1.9	1.9	1.9
Renton Building Permits⁵									
Residential - New Construction									
Units Authorized	448	326	335	281	290	300	360	400	430
Value (\$ Mil.)	77.137	66.916	70.797	77.539	74.557	73.669	89.806	104.367	117.314
Average Value (\$ Thou.)	172.2	205.3	211.3	251.0	257.1	245.6	249.5	260.9	272.8
Renton Taxable Sales⁶									
Retail Trade (\$ Mil.)	1,092.4	1,060.1	1,070.4	1,101.2	1,156.7	1,231.1	1,300.7	1,378.8	1,460.2
Other Industries (\$ Mil.)	<u>1,170.0</u>	<u>910.5</u>	<u>843.8</u>	<u>835.7</u>	<u>924.9</u>	<u>987.8</u>	<u>1,035.5</u>	<u>1,103.5</u>	<u>1,170.8</u>
Total (\$ Mil.)	2,262.4	1,970.6	1,914.2	1,936.9	2,081.6	2,218.9	2,336.2	2,482.3	2,631.0
Percent Change	-1.2	-12.9	-2.9	1.2	7.5	6.6	5.3	6.3	6.0

¹ 2008 deliveries affected by machinist strike in September and October

² FTE employees working in Renton based on City of Renton business license records

³ 2011 4th quarter actual reported at 13,551; 2008 Boeing employment estimated at 13,537 absent strike

⁴ Reflects inter-census revisions, 2000-2010; includes annexations of approx. 17,100 persons in 2008, 3,600 in 2009, 1,000 in 2010, 16 in 2011 and 447 in 2012

⁵ U.S. Census Department series; average value affected by mix of single family and multi-family permits

⁶ Washington Department of Revenue series