

ECONOMIC FORECAST



Review of FY 2011

The national economy continued on a bumpy course of a sluggish recovery in FY 2011. The job market showed slight improvement, with job losses being replaced by marginal gains. The services sector drove the job gains while those sectors most closely related to the housing sector (construction and financial activities) continued to be a drag on employment growth.

The Virginia economy was expected to improve from the weak performance in FY 2010, although growth in both employment and income was projected to be modest and below trend through FY 2012. The ongoing slump in

the housing market, tight credit, and persistently weak consumer fundamentals were expected to continue to be a drag on the Virginia economy.

National economy - A Tale of Two Halves

Throughout the first half of FY 2011, the economic outlook had brightened: the economy had regained momentum, business and consumer confidence was improving, the unemployment rate was falling, and the recovery seemed close to becoming self-sustaining. As FY 2011 progressed, though, the outlook once again dimmed.

United States economy begins a slow climb

	Actual	Forecast		
	FY 2011	FY 2012	FY 2013	FY 2014
Real GDP	2.6%	1.7%	1.8%	3.2%
Total Employment	0.6%	0.9%	1.0%	1.8%
Unemployment	9.3%	9.2%	9.2%	8.7%
CPI	2.0%	2.7%	1.3%	1.9%

*Total nonagricultural employment. Figures represent percent change over previous year, except the unemployment rate, which is a percentage. Data based on the November 2011 Global Insight standard forecast. Source: Department of Taxation

The second half of FY 2011 ended up consisting of very weak GDP growth, a slowdown in consumer spending, and a stagnant unemployment rate. It was initially believed that these weaknesses were a result of temporary shocks – namely, high gasoline and food prices, supply-chain disruptions from Japan's natural disaster, and extreme weather in the U.S. – and that growth would rebound in the first half of FY 2012. However, downward revisions to both GDP and employment growth coupled with the U.S. debt-ceiling and the Eurozone sovereign debt crises have squashed these beliefs and prompted renewed fears of a double-dip recession. Nevertheless, the current consensus is that the economic recovery will continue, albeit very slowly.

Growth in U.S. Gross Domestic Product (GDP) rose in FY 2011. The value of all goods and services produced within the U.S., adjusted for inflation, increased by 2.6 percent in FY 2011. Total personal income increased by 5.4 percent, while wages and salaries rose by 3.7 percent.

Consumer spending growth remains weak. Consumer spending rose by 2.5 percent in FY 2011.

National employment increased by 0.6 percent in FY 2011. Employment in the construction, information, financial activities, and government sectors continued to decline, while employment in the professional and business services and the education and health services sectors experienced the greatest growth.

In Virginia, the economy continued to show weakness in FY 2011

Virginia's income statistics were slightly higher than projected in FY 2011. Total personal income increased 5.0 percent – 2.2 percentage point ahead of the forecast. Income from wages and salaries, which accounted for 55 percent of total personal income in FY 2011, grew 3.5 percent, ahead of the forecast of 2.6 percent growth. Net transfer payments rose 19.9 percent, far ahead of the forecast of 4.1 percent growth. Dividends, interest, and rental income grew to 7.2 percent, more than twice as much as forecast. The growth in proprietor's income of 7.1 percent also was ahead of the forecast. Supplements to wages and salaries, on the other hand, were slightly below forecast in FY 2011.

Payroll employment growth was also ahead of expectations in FY 2011. In the official forecast, total nonagricultural employment was projected to increase 0.7 percent, with the average annual employment level rising by 25,400 jobs. Actual job gains were 42,200, an increase of 1.2 percent. As expected, most of the growth was in the services sector, which added 38,600 jobs. Overall, eight out of ten major employment sectors met or exceeded the official forecast in FY 2011.

In terms of the number of jobs, the largest variance was in the high-paying professional and business services sector, which was expected to gain 10,400 jobs, but gained 19,500 jobs. This was followed by construction, which lost only 500 jobs, much less than the predicted loss of 5,800. Taken together, construction and financial activities, the two sectors most closely related to the housing market, grew by 200 jobs in FY 2011, much better than the predicted loss of 7,000 jobs. The growth followed four consecutive annual declines in housing-related employment. Federal government employment grew more than expected, adding 2,900 jobs compared with the forecast of 400. Other services gained 4,200 fewer jobs than expected. Manufacturing, trade, leisure, and education were all close to forecast.

HERE IS A LOOK AT REGIONAL EMPLOYMENT IN VIRGINIA DURING FY 2011:

Northern Virginia

In Northern Virginia, which represents 36 percent of all jobs in the state, total employment rose by 28,800 jobs, while a gain of 9,200 was projected. The professional and business services sector added 10,900 new jobs in FY 2011, almost twice the forecast of a 5,800 gain. The government sector added 3,000 jobs, compared with the forecast of a 4,400 loss. The housing market improved, with the construction and financial activities sectors adding a combined 200 jobs for the year, much better than the predicted loss of 5,700.

Richmond/Petersburg

Employment in the Richmond-Petersburg MSA (16 percent of state employment) grew 0.5 percent (3,000 jobs) in FY 2011, slightly ahead of the forecast of 0.1 percent. The largest variance was in manufacturing, which dropped only 700 jobs compared with the forecast of a loss of 2,300. Professional and business services and leisure and hospitality also grew more than expected.

Norfolk/ Virginia Beach/ Newport News

Employment in the Norfolk-Virginia Beach-Newport News MSA (20 percent of state employment) was below expectations in FY 2011, rising by just 0.2 percent compared with the forecast of 0.7 percent growth. The region gained only 1,500 jobs in FY 2011, compared with the forecast of 5,400. Growth was flat to slightly negative in most major sectors other than services. Hampton Roads was the only metro area where professional and business services grew more slowly than forecast. The region gained only 1,000 new jobs in this sector, while 3,100 were expected in the forecast. Employment in the tourism industry, long a staple of the area economy, grew more than expected, adding 1,800 jobs compared with a forecast loss of 800. Growth in government employment, which was forecast to be flat, fell 0.7 percent. The variance was attributable to a larger than expected drop in local government employment.

Balance of the state

Outside of the three major metro areas, the remainder of the state (28 percent of state employment) gained 8,900 jobs in FY 2011, less than the forecast of 10,400. However, professional and business services gained 4,800 jobs, instead of the small loss expected in the forecast. Other services came in far below expectations, gaining only 900 jobs while an increase of 6,700 was expected.

U.S. ECONOMIC OUTLOOK IS FOR A WEAK RECOVERY BUT NO DOUBLE-DIP RECESSION

The November forecast anticipates that the U.S. economic recovery is on firmer ground as economic data have been somewhat more optimistic and a “back-to-back” recession is now considered to be less likely. At the November meeting of the Governor’s Advisory Council on Revenue Estimates, the consensus economic forecast was for output growth averaging less than two percent for the next two years but increasing by 3.2 percent in FY 2014. Highlights of the economic outlook for the next two years include:

- Real Gross Domestic Product is projected to grow by 1.7 percent in FY 2012, 1.8 percent in FY 2013, and 3.2 percent in FY 2014.
- Employment is expected to be sluggish over the next three fiscal years.
- Real consumer spending is expected to grow by 2.0 percent in FY 2012, 2.1 percent in FY 2013, and 1.8 percent in FY 2014.
- Inflation is expected to be slightly higher in FY 2012, increasing by 2.7 percent. However, the rate of growth is expected to be less than two percent in FY 2013 and FY 2014.
- The Federal Reserve is expected to maintain the federal funds rate at zero through FY 2013.

Moderate growth expected over the forecast horizon

Employment in Virginia is expected to grow at close to one percent over the next two fiscal years. Much of the growth will be in the services sector. Growth in employment sectors related to the housing industry is anticipated to be sluggish. The government employment sector is expected to continue to shed jobs. Here is a look at what economists are predicting for Virginia:

- Personal income is expected to grow 3.9 percent in FY 2012, 3.5 percent in FY 2013, and 4.0 percent in FY 2014. Wages and salaries are expected to grow 3.3 percent in FY 2012, 3.7 percent in FY 2013, and 4.2 percent in FY 2014.
- Employment is expected to modestly increase by 1.2 percent and 1.0 percent in FY 2012 and FY 2013, respectively.
- Employment in the professional and business services sector is forecast to increase by 3.3 percent in FY 2012.
- Construction employment is expected to grow by 0.7 percent in FY 2012. FY 2012 would mark the first year of growth in this sector since FY 2006.
- Employment in trade, transportation and utilities is expected to increase by 2.4 percent in FY 2012.