EXECUTIVE SUMMARY

June 2018

The U.S. economy continues to perform well. Economic growth remains above potential and job gains are strong enough to pull down the unemployment rate even as more individuals are looking for a job. The business cycle is not yet waning and the near-term prospects for economic growth are good. The consensus of forecasters peg the probability of recession over the next year at just 15 percent. However, longer-run forecasts remain relatively muted, in part due to the impact of an aging population and the temporary provisions in the federal fiscal stimulus. From today's relatively strong cyclical vantage point, three real downside risks stand out. First is the Federal Reserve's ability to engineer a soft landing. Second is the potential for deteriorating international relations and trade. Third is the recent run-up in energy prices which crimp household budgets in the near-term. To date, actual constraints on growth appear to be minimal, but bear watching in a mature expansion.

In Oregon, the outlook remains bright as the economy continues to hit the sweet spot. Wages are rising faster than in the typical state, as are household incomes. That said, growth is slower today than a few years ago as the regional economy transitions down to more sustainable rates. While housing affordability is set to improve due to rising income and more new construction, the impact on household budgets and migration flows makes it a risk. All told, the forecast calls for ongoing growth and there are no real concerns seen in the Oregon data.

Oregon's General Fund revenues are heavily dependent upon personal income tax collections. As such, the April peak tax filing season often makes or breaks the state budget. This year's tax collections came in at a healthy rate, somewhat faster than what was assumed in the March 2018 forecast. If not for the payment of kicker credits from the 2015-17 biennium, Oregon's growth would have ranked among the top handful of states.

Typically, year-end payments and refunds are the most difficult tax components to forecast. This season refunds will likely end around $150 million short of expectations, while payments closely matched the outlook. However, the biggest surprises came from usually stable sources -- quarterly estimated payments and withholdings.

2017 fourth-quarter estimated payments of personal income taxes were up nearly 50% relative to last year, and continued to post strong gains in early 2018. Advanced corporate tax payments have been up sharply in recent months as well, with the first quarter of 2018 coming in 79% larger than last year. Furthermore, large year-end bonuses are driving withholdings significantly above what recent wage growth alone could explain.

This strong growth across payment types was not unique to Oregon, with many other states reporting even stronger gains. That sort of uniformity is rare, and suggests that tax planning around the federal Tax Cuts and Jobs Act is already affecting the timing of tax collections. Taxpayers rushed to take advantage of expiring breaks, including an uncapped deduction for state and local taxes paid, even as Oregon does not allow the prepayment of state taxes. Some of the recently strong revenue growth will no doubt evaporate going forward.

While changes in the timing of tax payments are already evident, it will take some time before it becomes clear how many taxpayers will change their filing status in light of TCJA provisions. Some workers could choose to file as businesses. Some businesses could change from pass-through entities into C-Corporations, or the other way around. While the exact magnitude of the tax law changes is uncertain, it is sure to be large. These changes are expected to directly add hundreds of millions of revenue dollars over the next few budget cycles.

Together with healthy economic growth and strong tax collections, law changes have helped push both personal income taxes and corporate income taxes over their kicker thresholds. If this outlook holds true, $555 million in personal income tax kicker credits will be paid out two years from now, and an additional $197 million will be dedicated to spending on K-12 education next biennium.