

ECONOCAST™ UPDATE – April 17, 2017

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U.S. Economy – More Weak Data

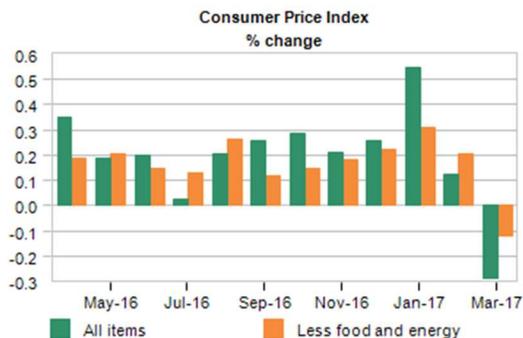
More weak data were reported for the U.S. economy last week. Retail sales were down, prices were down, and interest rates retreated. Most analysts, including me, adjusted their growth forecasts downward. Here are the details.

Retail fell 0.2% in March, and February's result was revised from up 0.1% to down 0.3%. Most of the declines came from lower car sales, which accounted for all of the decline in March and for much of the downward revision to February. Core sales, excluding auto dealers and gas stations, were essentially unchanged for the second straight. Department store sales were down 4.5% compared with last year, but online retailers, were up 12%. Overall, sales were 5.2% above their year-ago level.



Some of the weakness in retail sales comes from a lack of pricing power. The CPI dropped 0.3% in March, so real sales were higher than the dollar value of sales reported in March. Also, given the recent slow growth in incomes, weak sales are not a surprise. Even so, the fundamentals appear poised to support growth going forward based on rising employment and accelerating wage gains.

Despite the March dip in the CPI, the fundamentals support stronger inflation. Indeed, the PPI rose 0.1% in March with core PPI prices rising 0.4%. Even though the prospects for Trump's fiscal stimulus program have dimmed, I still expect prices to drift higher this year.



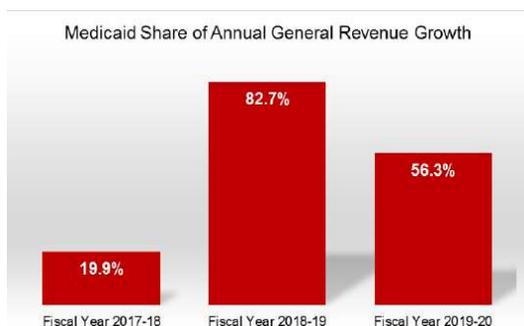
Unless core inflation continues to be below 2%, I expect that the Fed will hew to its plan to increase the funds rate two more times this year.

Florida Economy: Florida's Budget for FY 2017-18

Last week the Florida legislature passed two competing versions of the budget for the fiscal year beginning July 1st. The House proposes to cut State spending by \$1.1 billion while the Senate wants to increase spending by \$2.6 billion or by 3%.

The State budget will be over \$81 billion even under the House plan, and spending at this level has significant macro impacts on the State's economy since it amounts to about 8% of Florida's gross state product. However, consider that Florida's population is growing at 1.75% and that inflation is running at about 2%. Therefore, even under the Senate's budget, real State spending per capita would decline by nearly 1%. So, State government is likely to be a drag on the State's economic growth in 2017-18.

According to a September 2016 report by the Legislature's Office of Economic and Demographic Research, Florida's State budget has a growing structural imbalance that will result in widening budget gaps of \$1.3 billion next year and \$1.9 billion two-years out. The structural imbalance is largely a function of two forces: (a) unsustainable growth in Medicaid and (b) an inadequate revenue structure.



This looming budgetary problem is largely what drove the House to cut spending. However, the House's approach misses the mark for two reasons. First, the House treats increases in property tax revenues arising from higher property values as tax increases. This is simply incorrect. With no change in tax rates there is not a tax increase, there is a revenue increase which is needed to fund the growing requirements for education, which is what these funds are primarily used for along with other local governmental needs. Second, simply cutting State spending on Medicaid as the House proposes, and to a lesser extent the Senate, fails to resolve the Medicaid problem. These cuts will mostly shift these healthcare costs to the hospitals who will shift them to the insured patient base in Florida. What is needed is a change in the payment system from fee-for-service to an HMO model of per capita payment to providers. Florida has a pilot program that has shown promise.

In addition, Florida will need to reform its sales taxation system to allow it to generate the revenues needed to fund the State's general fund, which pays for healthcare, education, and other State needs. Over time the sales tax system has accumulated a host of exceptions and exemptions, many of which are now outmoded, including exemptions for bottled water and super bowl tickets.

Finally, we need to change the focus from cutting taxes and shrinking State government, to one of balance and the need to have an efficient system that meets our State's growing needs for healthcare, education, transportation, and environmental protection.