

NEVADA ECONOMIC FORUM

Revenue Outlook: State 2% Sales and Use Tax, Gaming Percentage Fees

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Nevada Economic Forum

Revenue Outlook: State 2% Sales and Use Tax, Gaming Percentage Fees

BY SARAH CRANE

The following revenue forecasts link Nevada's general sales and use tax revenues (NRS 372) and its gaming percentage fee revenues (NRS 463) to measures of underlying economic growth. Sales tax collections impressed in the first half of fiscal 2019, raising expectations for the year. Despite sluggish gaming percentage fee collections in the first half of fiscal 2019, an upswing in the third quarter has put revenues on a stronger trajectory. Nevertheless, it will take time for gaming revenues to fully recover from a severely depressed base given changing consumer dynamics.

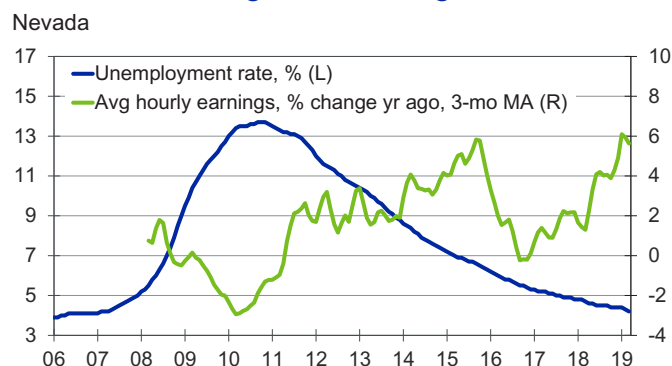
Regional economy

Nevada remains a regional and national standout, adding jobs and residents at the fastest pace in the U.S. in 2018 and starting the current year on the right foot. Job growth in leisure/hospitality trended up throughout 2018, but still pales in comparison to the West and national averages. Other private services are contributing more to growth, namely professional/business services, which are adding jobs at triple the U.S. pace. The state's manu-

facturers led the nation again in 2018, with Tesla's Gigafactory driving impressive gains in northern Nevada. Despite a surging labor force, the jobless rate has dropped to 4.2%, just a hair above its previous low in 2006. Consequently, growth in average hourly private-sector earnings has accelerated to its strongest pace since record keeping started in 2008 (see Chart 1). House prices are rising at an above-average rate, but fast-eroding affordability is weighing on home sales.

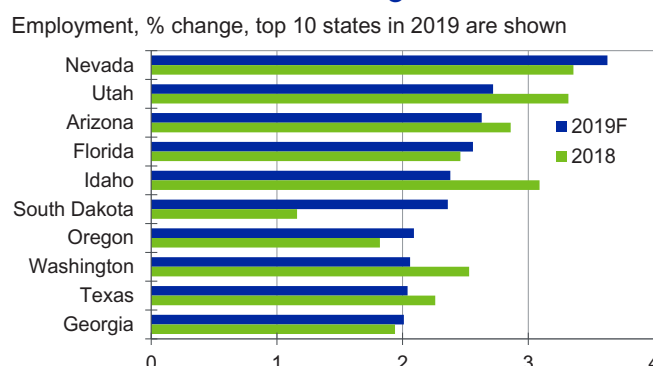
Nevada will be one of the country's top performers this year (see Chart 2). Leisure/hospitality hiring will kick into higher gear, while job additions at the Gigafactory and greater residential construction will lift goods industries. Northern Nevada, and Reno in particular, will play a bigger role in the state's economy as Tesla makes progress on its battery factory. Although the Gigafactory is only one-third complete, it now employs over 7,000 workers and is the largest battery cell factory in the world with an

Chart 1: Earnings Rise in Tight Job Market



Sources: BLS, Moody's Analytics

Chart 2: Nevada in a League of Its Own



Sources: BLS, Moody's Analytics

annual output of over 20 gigawatt hours. The facility is expected to employ up to 10,000 workers and reach 150 GWh of battery packs per year once operating at full capacity in 2020. The Gigafactory will help keep Nevada a step ahead of the West and the U.S. in manufacturing employment through the end of the year. Tesla's presence is attracting other firms and wages will extend their upward trend as employers compete for talent. Although the new high-paying factory jobs are great news for the economy, the Gigafactory's vulnerability to highly cyclical vehicle demand is a sore spot.

While secondary industries will make a greater contribution to state growth over the near term, tourism will remain Nevada's bread and butter throughout the outlook (see Chart 3). Leisure/hospitality continues to add jobs at a modest pace, and tourism-related investment is having a positive impact: Las Vegas has more than \$16.2 billion in tourism-related construction projects scheduled to be completed over the next five years. These include a \$1.8 billion stadium that will be home to the NFL's Las Vegas Raiders in 2020 and the \$7 billion Resorts World hotel-casino due to open in 2021. Leisure/hospitality payrolls will rise at a faster rate this year and next as projects are completed and rising wages put extra cash into consumers' pockets to spend on travel and recreation.

The real estate market will improve this year as robust population and income growth stir housing demand. However, affordability now appears to be a greater head-

wind than labor shortages. House price appreciation slowed slightly at the end of 2018, but prices are still 11% higher than at the end of 2017. Although demand continues to outstrip supply, house prices have been rising faster than average incomes, leaving markets overvalued and contributing to fewer home sales so far in 2018. A large upswing in construction employment last year signals that labor shortages have eased. Home price appreciation will thus cool as builders increase residential construction this year, while sales will rebound slightly as affordability steadies (see Chart 4).

Nevada's status as a major tourism destination makes it particularly sensitive to national economic conditions, and the expansion will wind down nationwide in 2020 as the lift from tax cuts fades, job gains shrink, lending standards tighten, and more limited trade and immigration weigh on the economy. As consumers pull back on spending, growth in Nevada's still largely tourist-dependent economy will decelerate as well.

The world economy has entered a soft spell since the end of last year. Should growth in global incomes slow or should incomes contract outright, demand for a range of travel services would dim. This would deal an outsize blow to Nevada's economy, where travel service exports are very large relative to the state's gross product. What is more, China has the ability to make things particularly difficult for U.S. companies relying on Chinese demand as a potential retaliatory measure in a trade war. This has the potential to impact several of the state's largest

gaming companies. We nonetheless look for the second half of the year to bring some solution to the Brexit chaos and to the U.S.-China trade war, which would for certain give a strong boost to sentiment and support a pickup in global economic momentum.

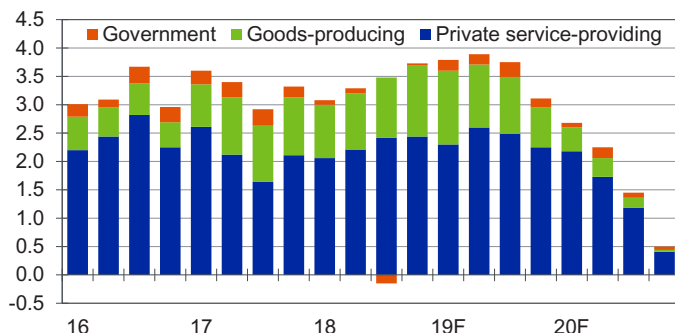
Sales and use taxes

Forecast. Sales tax collections in fiscal 2018 clocked in at 4.8% above fiscal 2017 collections, and fiscal 2019 is off to a very strong start. Sales tax collections surged in the second quarter, rising 9.1% from a year earlier. Combined with the 6.6% increase in the first quarter, that pushed collections in the first half of fiscal 2019 8% above those in the first half of fiscal 2018. The enduring U.S. expansion and exceptionally strong economic growth in Nevada underpin the optimistic near-term outlook. As the labor market tightens, unemployment will bottom out, wage growth will accelerate, and consumers will respond in kind. Sales tax collections are on track to increase by 7.9% in fiscal 2019. Collections then soften to 4.2% in fiscal 2020 and 1.5% in fiscal 2021 as the U.S. economy sees less stimulus from the federal government and likely confronts a major slowdown in growth if not outright recession (see Table 1).

Drivers. The main driver of sales and use tax collections is Nevada personal consumption expenditures, which shed light on tourism in Las Vegas. Even with gaming becoming legalized in more places across the globe, Las Vegas tops most other locations from an overall entertainment perspective. As

Chart 3: Gains Extend Across Industries

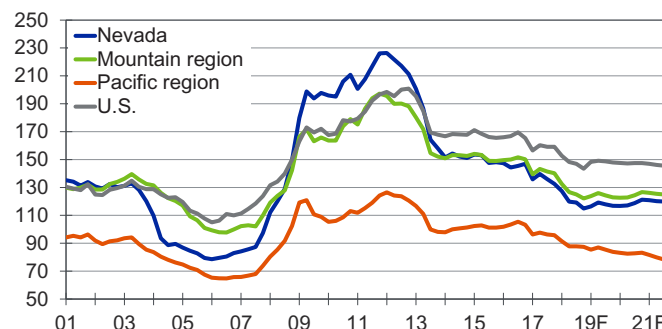
Nevada, contributions to % change yr ago employment, ppts



Sources: BLS, Moody's Analytics

Chart 4: Affordability Decline Will Subside

Housing Affordability Index



Sources: BEA, Census Bureau, NAR, Moody's Analytics

Table 1: April Sales and Use Tax Forecast

	Q1	Q2	Q3	Q4	Total
Fiscal 2018, \$ mil	280.74	291.20	278.23	292.63	1,142.80
% change yr ago	4.64	4.31	5.49	4.70	4.78
Fiscal 2019, \$ mil	299.27	317.74	298.40	318.05	1,233.46
% change yr ago	6.60	9.12	7.25	8.69	7.93
Fiscal 2020, \$ mil	317.32	330.34	310.36	327.11	1,285.14
% change yr ago	6.03	3.97	4.01	2.85	4.19
Fiscal 2021, \$ mil	323.56	334.70	313.61	331.92	1,303.78
% change yr ago	1.97	1.32	1.04	1.47	1.45

Sources: Nevada Legislative Counsel Bureau, Moody's Analytics

renovations and new projects are completed, Las Vegas tourism will strengthen in tune with the vibrant U.S. economy and improving consumer fundamentals. Rising wages nationwide will put extra cash into consumers' pockets to spend on recreation, further boosting visits to Las Vegas and hiring in consumer industries (see Chart 5).

Personal expenditures also capture purchases of large durable goods such as vehicles. Nevada vehicle sales are on track to remain stable through 2019, but now that much of the pent-up auto demand from the Great Recession has been released, sales are unlikely to rise much further. Coupled with higher interest rates over the next several years, consumers are due to take a bit of a pause from spending on new vehicles and other large durable goods as we get closer to 2020 and 2021.

Another significant variable determining the trajectory of the sales tax forecast is U.S. wage and salary income. Wages and salaries make up more than half of personal income

and help determine consumers' ability to spend in the U.S. economy. Solid employment growth coupled with gradually building wage pressures has generated an acceleration in wage and salary growth, compelling Americans to travel more.

National wage and salary income also serves as a helpful proxy for changes in the overall U.S. business cycle. As the U.S. economy pushes beyond full employment, the dwindling pool of available workers will eventually cause the pace of job creation to slow. In the meantime, the shortage of labor will put upward pressure on wages and prices. As the federal fiscal stimulus fades and deficits rise, most metrics will begin to look worse, leading to what is projected to be a broad-based slowdown in 2020.

Risks to the outlook still revolve around the potential for financial market volatility, as the Federal Reserve raises interest rates, and uncertainties related to the weaker expansion in China and other emerging market economies. In addition, there are a number

of unquantifiable risks to the forecast for sales tax collections. For example, in April 2012, Amazon announced an agreement with the state to begin collecting sales tax on items purchased by Nevada residents, and last year the Supreme Court opened the

door for states to begin collecting sales taxes on online purchases. The forecast does not explicitly account for any changes in the way that Nevada collects online sales taxes.

Finally, though many of the economic effects have been built into the baseline outlook, this revenue forecast has not been add-factored to explicitly account for the direct effects of the deal between the state and Tesla. The direct impacts and their spillover are not yet fully quantifiable in terms of their impact on sales tax revenues.

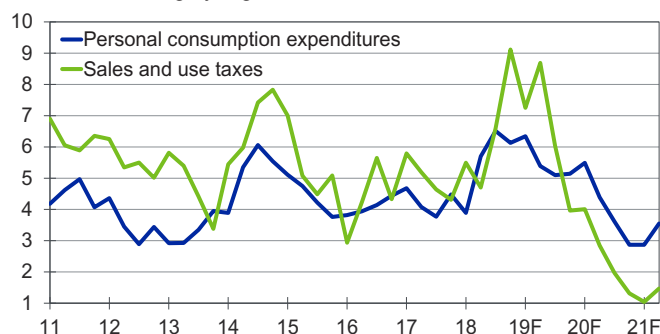
Gaming percentage fees

Forecast. Despite sluggish gaming percentage fee collections in the first half of fiscal 2019, a robust third quarter has put revenues on a stronger trajectory. Third-quarter collections came off of a depressed base, as collections in the third quarter of fiscal 2018 decreased from a year earlier. Although a thinner calendar of events contributed to a slight decline in visitor volume last year, Las Vegas casinos are holding strong amid growing competition from other states. Visitor volume has turned up since late 2018, and data on air traffic at McCarran International Airport point to an increase in international visitors, who tend to spend more on gaming than domestic visitors (see Chart 6). The forecast for fiscal 2019 is consequently more optimistic, with annual collections poised to grow by 1.9%. Nonetheless, a structural break in the relationship between visitor volume and gaming percentage fees will keep long-term growth well below the historical average, increasing just 0.9% in fiscal 2020 and 1.1% in fiscal 2021 (see Table 2).

Drivers. The cyclical drivers for Nevada's gaming percentage fees are similar to sales and use taxes but with a few exceptions. Gaming percentage fees tend to have a higher correlation with national and global economic trends, whereas sales are highly dependent on local consumer spending. National recreational services spending remains the best predictor of gaming percentage fee collections. Tourism, still the key driver in the gaming space, will perform well over the near term thanks to expanded entertainment options and the strong U.S. economy. Gaming revenue collections con-

Chart 5: Consumers Fuel Collections

Nevada, % change yr ago



Sources: BEA, Nevada Legislative Counsel Bureau, Moody's Analytics

tinue to be unsteady, however, as more play is concentrated across a smaller number of high-dollar games, particularly baccarat. Toward the end of the forecast horizon, the slowdown in national economic growth will take a toll on the pace of growth in gaming percentage fees. The baseline forecast calls for a substantial decline in the pace of growth by late 2020 that could result in outright recession.

Outside of the economic impacts, several structural issues will also play a part in the forecast. It remains to be seen how the spread of legal sports betting, and potentially interstate wagers, will affect Nevada's gaming industry. Nevada lost its monopoly on legal sports betting when the U.S. Supreme Court struck down the Professional and Amateur Sports Protection Act last May, opening the industry to other states. The development is unlikely to be a game changer since revenue from sports betting pales in comparison to that from other types of gambling. Sports betting in Nevada was booming over the last 12 months,

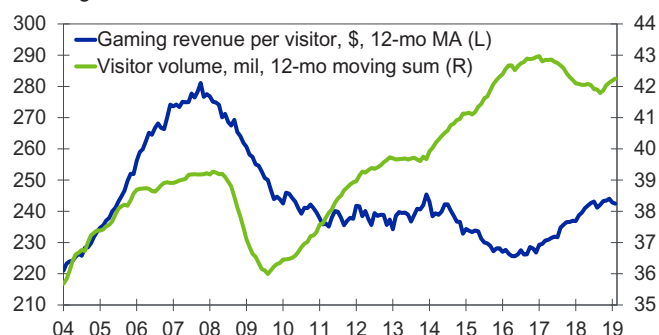
a sign that the Silver State maintains its appeal to sports fans.

Longer term, the structural break in the historical relationship between recreational spending and gaming is becoming increasingly clear and drives a large part of the disparity in forecast

growth rates for gaming compared with sales and use taxes. Increased competition from other states, international destinations such as Macau, and even online betting will further moderate Nevada's share of gaming in the years ahead. Las Vegas tourism has been relatively successful in addressing the changing gambling and entertainment landscape by diversifying beyond its traditional gaming image and branding itself more as

Chart 6: Visitors Bringing More to the Table

Las Vegas tourism indicators



Sources: Las Vegas Convention & Visitors Authority, Moody's Analytics

a comprehensive vacation destination that appeals to a wider range of visitors. As a result, live entertainment and sales and use taxes will increase at the expense of gaming percentage fees.

Complicating the forecast is the fact that the seasonal pattern inherent in historical gaming collections data has changed in the past two years, which is rather unusual. Actual gaming percentage fee collections since 2016 have not followed their long-standing seasonal pattern of hitting their peak in the second quarter and then falling off heading into the fall. It is yet unclear what might be contributing to this change in seasonality, or whether the causes are economic or noneconomic. What is certain, though, is that the lack of seasonal uniformity is causing greater variance in quarterly fluctuations within the gaming collections forecast model. Moody's Analytics will keep a close eye on this issue as more data become available to see what, if any, adjustments should be made to our modeling methodology in future forecast cycles.

Table 2: April Gaming Percentage Fee Forecast

	Q1	Q2	Q3	Q4	Total
Fiscal 2018, \$ mil	182.00	197.74	172.26	205.79	757.79
% change yr ago	4.22	5.92	-2.87	7.27	3.74
Fiscal 2019, \$ mil	180.34	182.78	198.54	211.02	772.68
% change yr ago	-0.91	-7.57	15.25	2.54	1.97
Fiscal 2020, \$ mil	181.05	196.49	187.93	214.51	779.97
% change yr ago	0.39	7.50	-5.34	1.65	0.94
Fiscal 2021, \$ mil	183.38	198.49	189.71	217.10	788.68
% change yr ago	1.29	1.02	0.94	1.21	1.12

Sources: Nevada Legislative Counsel Bureau, Moody's Analytics

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