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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 EMILY MANDEL AND HALEY CURTIN

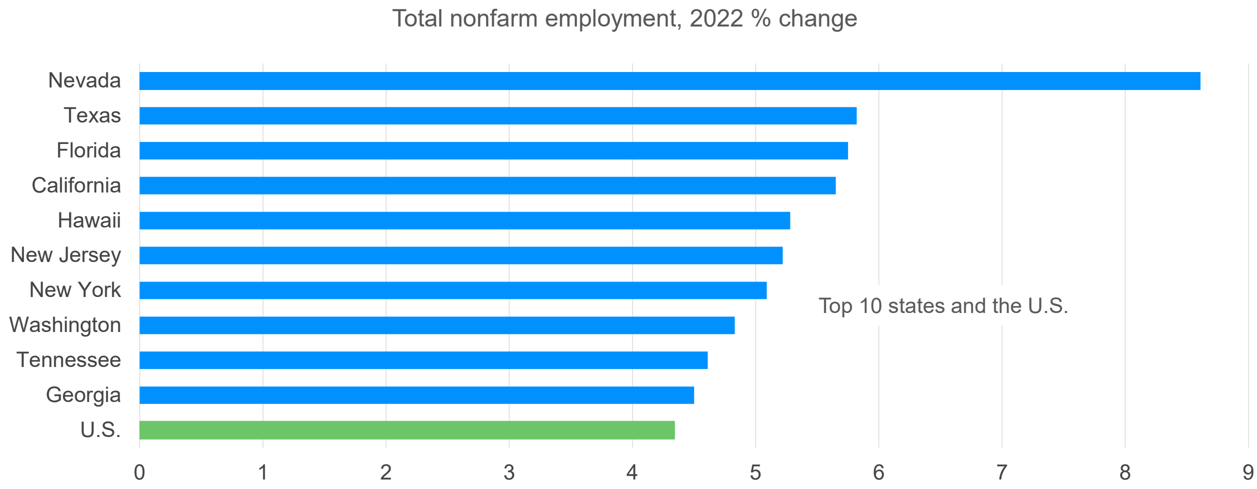
The following revenue forecasts link Nevada's general sales and use tax revenues (NRS 372) and its gaming percentage fee revenues (NRS 463) to measures of underlying economic growth. Sales tax collections made an impressive rebound from the hit sustained during the COVID-19 pandemic and surpassed precrisis levels by the end of fiscal 2021. Growth remained robust with pent-up demand and a rapidly growing economy pushing sales tax collections higher through the end of fiscal 2022. Since the end of the initial recovery period, revenue growth from the sales and use tax has cooled slightly through the first half of fiscal 2023 and will gradually slow to match pre-pandemic rates in the next several years. Though the recovery in gaming percentage fee collections started behind that of sales and use tax revenues, they also rebounded fully as restrictions were lifted. Gaming percentage fee revenues will hold on to the bulk of recent gains, but near-term progress will be slower as consumers pull back on recreational spending nationally.

Regional economy

Nevada's economy is one of the top performers in the country. Total nonfarm employment growth is outpacing that in every other state on a year-ago basis (see Chart 1). Strong tourist demand has allowed leisure and hospitality payrolls to finally regain pre-pandemic levels. However, construction, manufacturing and healthcare have been the real showstoppers driving the outperformance. The unemployment rate remains low despite upward pressure from extraordinary labor force growth during the last year. The housing market is a dim spot in an otherwise bright economy. Single-family house prices have decreased nearly 10% from their 2022 peak as the market begins to correct after two years of exceptional appreciation.

After a record-setting 2022, the near-term outlook for the outsize tourism industry is bright. Job growth in leisure and hospitality will slow compared with last year as higher wages and limited worker availability will hold back hiring, but payrolls will continue to climb beyond their pre-pandemic level. Data from the Las Vegas Convention and Visitors Authority show a nearly 25% increase from the prior record of economic output related to visitor spending set in 2019—and gaming revenues are at an all-time high. The tourism industry is still capitalizing on strong demand for travel financed in part by household savings built up through the pandemic. Domestic passenger volume at Harry Reid International Airport and Reno-Tahoe

Chart 1: Job Growth Ranks Highest in U.S.

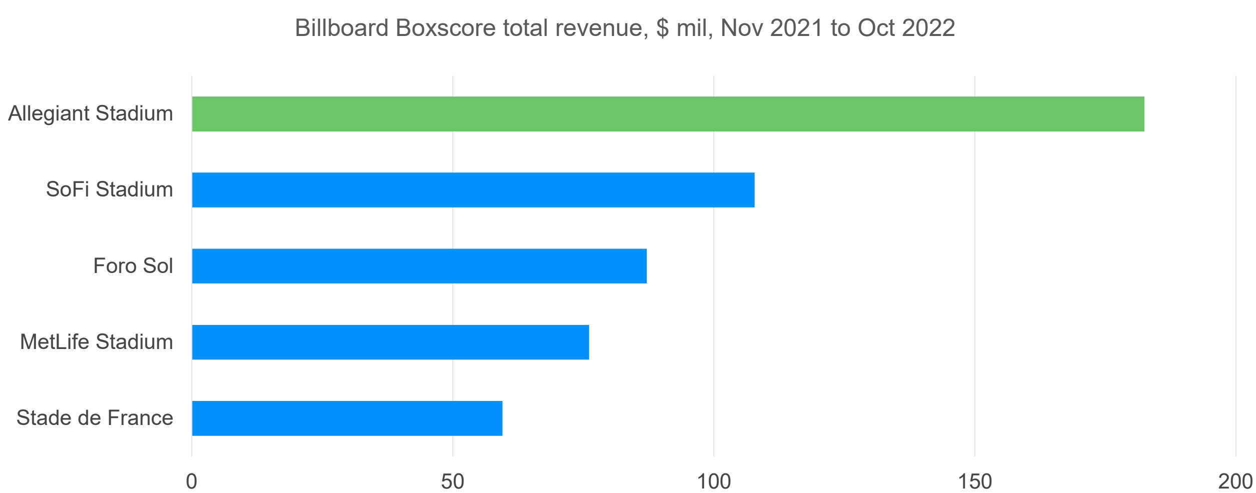


Sources: BLS, Moody's Analytics

International Airport is consistently above pre-pandemic levels and per-trip visitor spending increased more than 30% compared with 2019 spending levels.

While the tourism industry is highly vulnerable to economic downturns, additional high-profile concerts, conventions, conferences, trade shows, and major sporting events on the calendar will mitigate risk and keep visitor counts high. For example, the multiday Formula 1 Las Vegas Grand Prix will bring visitors to the city in November. The 2024 Super Bowl will be another major draw. The game will be played in Allegiant Stadium, which has brought in significant revenue after opening in 2020 (see Chart 2). This is good news for the state's economic outlook as the state's overall performance will be closely linked to the tourism industry. According to the Nevada Resort Association, tourism generates more than a third of the state's general fund tax revenue and contributes a quarter of total employment.

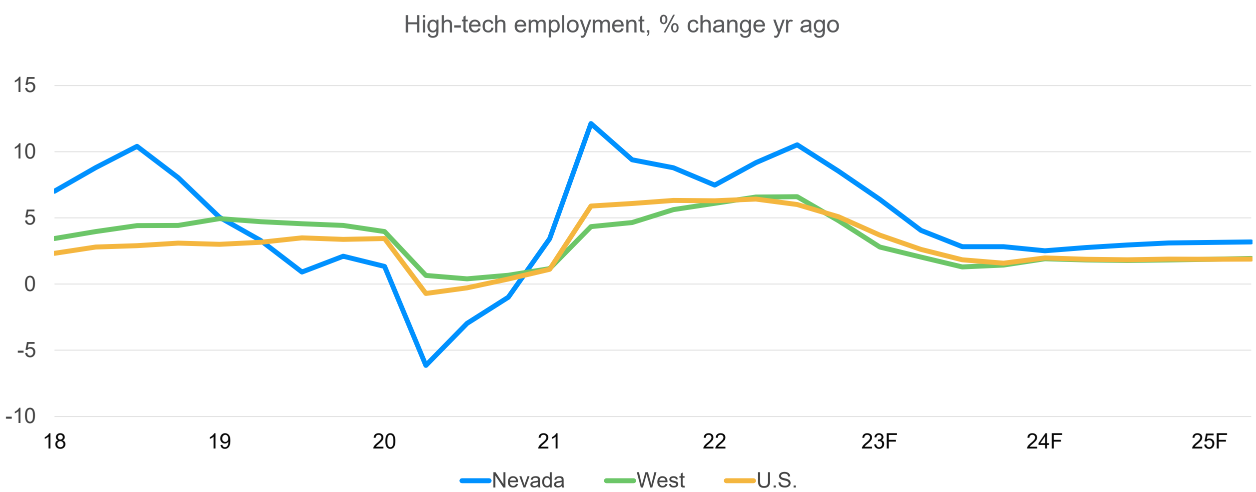
Chart 2: Investment in Allegiant Stadium Is Paying Dividends



Sources: Billboard, Moody's Analytics

Tourism will remain the cornerstone of the economy, but growth in most of Nevada's secondary industries will also impress. Manufacturing and nonresidential construction will be reliable job creators for the economy. Two major projects are in the works to bring thousands of mid- to high-wage manufacturing jobs to the state: a $2 billion battery material center that will create clean-energy union jobs, and a $3.6 billion Tesla battery and heavy-duty truck manufacturing facility where the tech giant will begin producing its electric semi-truck. This will expand Tesla's Nevada footprint as the state is already home to a large Gigafactory. These new projects will create thousands of construction jobs through the buildout stage and thousands of permanent jobs once completed. Industry payrolls will grow faster than the regional and national averages through the extended forecast. The burgeoning tech hub will also lend support and help diversify the state's economy. Nevada will appeal to tech companies with its relatively low business costs, large population of young professionals, and advantageous location. The state's concentration in tech-related manufacturing, particularly clean energy, will help it avoid the downturn currently being experienced by services-heavy tech hubs (see Chart 3). The healthcare industry will also be a standout thanks to strong demographics that will increase demand for health services. The state's hospitals and other healthcare providers will expand their payrolls faster than the national average to meet the needs of its thriving patient pool. Together, these growing secondary industries will reduce the state's overreliance on tourism and offer additional stability during economic downturns.

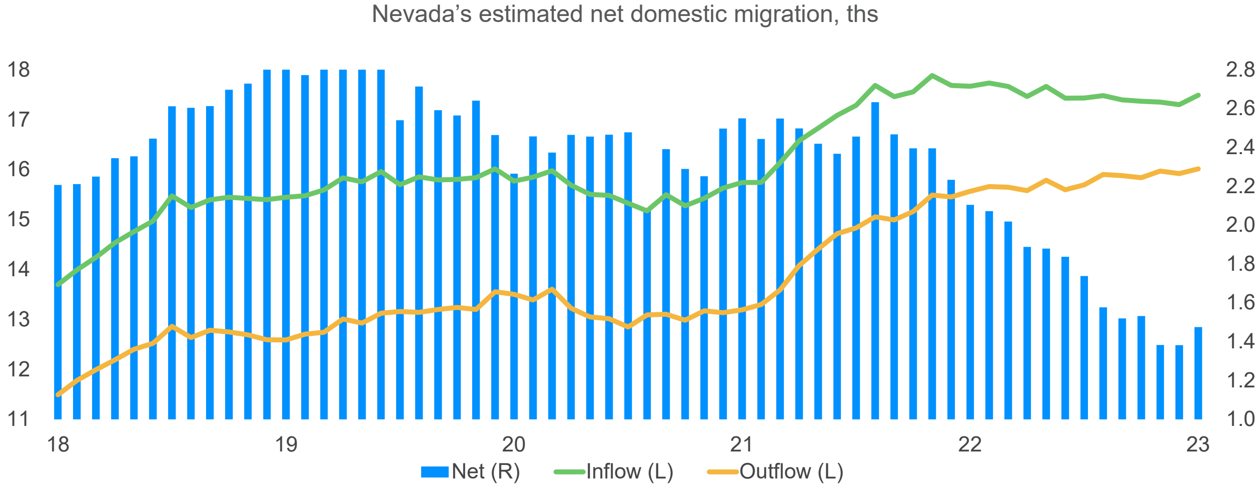
Chart 3: Nevada's Tech Industry Will Outperform



Sources: BLS, Moody's Analytics

Well-above-average population growth will bolster Nevada's long-term potential, though high-frequency data point to a near-term slowdown of net migration into the state. From 2016 to 2021, Nevada was the third-fastest-growing state in the U.S., but the rapid runup in housing costs in the past two years has severely eroded the state's housing affordability. As a result, out-migration has ticked up in recent months even as in-migration of new residents has plateaued (see Chart 4). Still, as housing costs fall during the next several years and the overvalued market corrects, affordability will improve along with in-migration. Nevada's high quality of life and tax climate with no state income tax and relatively low property taxes make the state an attractive place to live. Population growth well above the West and U.S. averages will keep demand for consumer services and healthcare high. Companies looking to set up shop or expand will also be attracted to the state's healthy labor force growth.

Chart 4: Higher Costs Weaken Nevada's Appeal to New Residents



Sources: Equifax, Moody's Analytics

Sales and use taxes

Forecast. Sales tax collections rebounded strongly throughout fiscal 2022 as the full reopening of the economy, higher nominal prices, and consumers' release of pent-up demand sent collections soaring 21.7% on a year-ago basis. Job and wage growth well above the West and U.S. averages supported consumer spending by Nevadans, while strength in tourism and record levels of visitor spending also contributed to the outperformance. With half of fiscal 2023 in the books, momentum has carried into the new year, albeit at a slightly reduced pace. The first- and second-quarter sales tax collections both increased nearly 9% on a year-ago basis—higher-than-average growth by pre-pandemic standards.

The forecast calls for growth in collections to decelerate further through the remainder of fiscal 2023 and into fiscal 2024, slowly returning to pre-pandemic norms as the rebound from the COVID-19 pandemic comes to an end. While consumers have spent much of their excess savings, Nevada's strong labor market and burgeoning population will support consumer spending. Still, in part because of nominal gains caused by inflation, full-year revenues for fiscal 2023 will come in 7.6% higher than the prior year. The pace of economic growth—and thus, collections—is projected to slow to a more moderate pace as higher interest rates weigh on demand for credit and cool the labor market. Growth in collections will ease in fiscal 2024 and fiscal 2025 to align with its historical performance (see Table 1).

This baseline forecast assumes that while the economy slows by the end of the year, an outright recession is avoided. This outlook assumes only one additional interest rate hike by the Federal Reserve. With inflation headed back into the Fed's target with increasing certainty, the job market easing, and the banking system fragile, more intervention by the Fed comes with a heightened risk of pushing the economy into recession.

Drivers. The main driver of sales and use tax collections is Nevada personal consumption expenditures on goods. This series captures organic growth in spending driven by Nevada's rapidly expanding population and contributions from Las Vegas tourism. Collections will benefit from the swift recovery in the tourism industry and greater spending tied to business travel as well as entertainment such as conventions, concerts and sporting events. Personal consumption expenditures also capture purchases of large durable goods such

Table 1: April 2023 Sales and Use Tax Forecast

	Q1	Q2	Q3	Q4	Total
Fiscal 2020, $ mil	321.60	344.69	284.28	264.13	1214.70
% change yr ago	7.46	8.48	-4.71	-17.41	-1.65
Fiscal 2021, $ mil	299.79	320.20	320.70	385.13	1325.81
% change yr ago	-6.78	-7.11	12.81	45.81	9.15
Fiscal 2022, $ mil	385.42	412.13	386.92	428.88	1613.34
% change yr ago	28.56	28.71	20.65	11.36	21.69
Fiscal 2023, $ mil	419.91	448.77	419.85	447.28	1735.81
% change yr ago	8.95	8.89	8.51	4.29	7.59
Fiscal 2024, $ mil	443.87	463.33	433.50	463.57	1804.27
% change yr ago	5.71	3.24	3.25	3.64	3.94
Fiscal 2025, $ mil	461.53	481.03	450.43	482.20	1875.19
% change yr ago	3.98	3.82	3.91	4.02	3.93

Sources: Nevada Legislative Counsel Bureau, Moody's Analytics

as vehicles. These sales are set to climb quickly as supply chains settle after China's end to its zero-COVID policy earlier this year and global producers adjust to the disruptions caused by Russia's war with Ukraine. Global vehicle production is already picking up and inventories are climbing from their low levels.

Despite these supports, total growth in goods spending will slow from the rates seen during the recovery as it struggles under the weight of high interest rates and a weakening housing market. As higher mortgage rates drive a lull in home construction and sales, the state will benefit less from accompanying taxable goods sales. Meanwhile, consumer balance sheets are starting to show some stress, with default rates for categories of debt tied to consumer spending rising above pre-pandemic levels. Given banks' tightening lending standards and higher rates discouraging borrowing, consumers will be more constrained in debt-financed spending.

Another significant variable determining the trajectory of the sales tax forecast is Nevada's wage and salary income. Wages and salaries make up more than half of personal income and are a major determinant of consumers' ability to spend. Solid employment growth coupled with wage pressures from a tight labor market has accelerated wage and salary growth. Accordingly, Nevadans have increased spending to keep up with higher prices. As incomes keep rising while the savings rate declines as consumers' spending habits return to pre-pandemic normalcy, this variable will produce a healthy outlook for Nevada sales and use tax collections (see Chart 5).

Gaming percentage fees

Forecast. Gaming percentage fee collections had a record year in fiscal 2022 as growth in collections increased 40.7% from the previous year. The first full year of lifted restrictions from casinos and pent-up demand for tourism drove a remarkably rapid rebound in activity. This placed collections for fiscal 2022 significantly above their pre-pandemic level; thus, fiscal 2023 is well on its way to surpassing last year's total. After a year of exceptional growth and confronting weakness in the global economy, gaming percentage fee collections retrenched slightly in the first half of fiscal 2023, declining 4.5% and 1.9% in the first and second quarters, respectively. However, the third quarter came back strongly as collections rose 15.4% from

Chart 5: Above-Average Income Growth Will Support Spending

Sources: BEA, Moody's Analytics

a year earlier. Thanks to the strong third quarter, growth will average 1.9% for the year before coming to a near-standstill in fiscal 2024. As the economy moves past the current monetary tightening cycle, revenues will gain momentum again in fiscal 2025 (see Table 2).

Table 2: April 2023 Gaming Percentage Fee Forecast

	Q1	Q2	Q3	Q4	Total
Fiscal 2020, $ mil	190.53	199.10	192.42	37.22	619.27
% change yr ago	5.65	8.93	-3.08	-80.46	-17.67
Fiscal 2021, $ mil	111.21	168.65	121.12	284.16	685.14
% change yr ago	-41.63	-15.29	-37.06	663.38	10.64
Fiscal 2022, $ mil	256.53	239.53	208.67	259.48	964.21
% change yr ago	130.67	42.03	72.29	-8.69	40.73
Fiscal 2023, $ mil	245.03	234.89	240.89	262.03	982.84
% change yr ago	-4.48	-1.94	15.44	0.98	1.93
Fiscal 2024, $ mil	229.58	248.47	230.86	275.19	984.11
% change yr ago	-6.31	5.78	-4.16	5.03	0.13
Fiscal 2025, $ mil	240.96	260.27	241.46	287.44	1030.13
% change yr ago	4.96	4.75	4.59	4.45	4.68

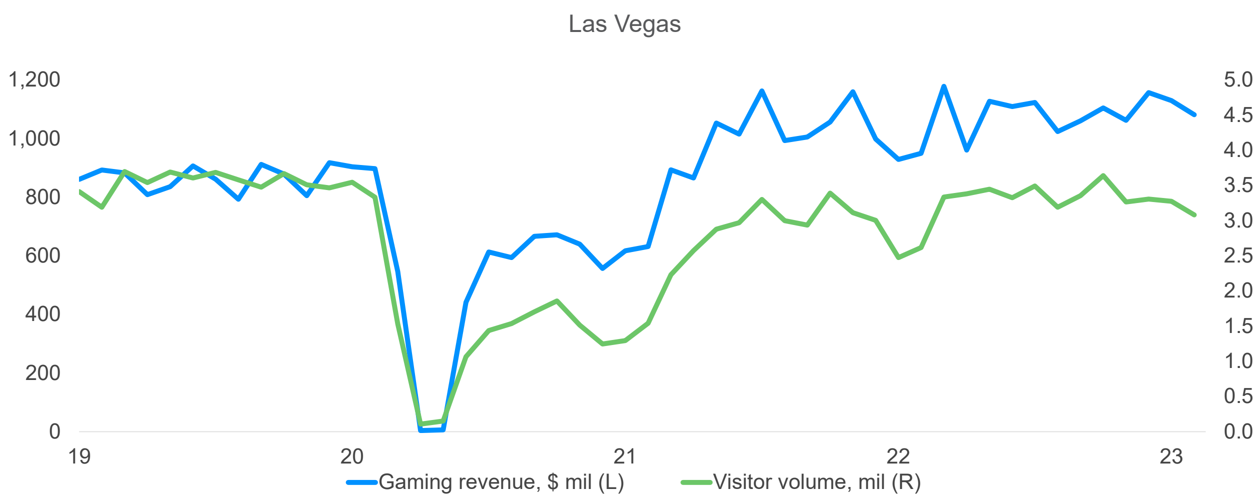
Sources: Nevada Legislative Counsel Bureau, Moody's Analytics

Drivers. Gaming percentage fees tend to have a high correlation with national and global economic trends in contrast to sales taxes, which are highly dependent on local consumer spending. Gaming percentage fees are also more sensitive to the business cycle. National recreational service spending remains the best predictor of gaming percentage fee collections.

Restrictions on activity severely affected spending on recreational services during the brief recession. Following the vaccine rollout and the full reopening of the economy, consumers unleashed their pent-up savings and demand for vacations. With many Americans now having spent a large portion of the savings accumulated during the pandemic, and with inflation further pressuring their budgets, they will be forced to cut back on discretionary spending. Strength in the labor market will prevent a severe contraction in expenditures, but weaker recreational services spending will cause gaming percentage fees to plateau near their current level during the next year and a half.

Domestic travel has been the main driver of Nevada's tourism recovery. Harry Reid International Airport was the first airport to surpass its pre-pandemic level of passenger volume in the country, handling more than 52 million passengers in 2022 and easily topping the earlier record set in 2019. However, air traffic data point to a mixed rebound in visitors when comparing domestic and international visitors. From March 2023 to May 2023, nearly 90% of the routes at Harry Reid International Airport are domestic, as international demand has not fully recovered. Las Vegas visitor volume has not completely reached its pre-pandemic level, though visitors are wagering more, enabling gaming revenue to far outstrip its earlier high (see Chart 6).

Chart 6: Revenues Hit Records Despite Incomplete Visitor Recovery



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

While the recent surge in domestic travel and higher per-trip spending by visitors has fueled the gaming industry's recent recovery, longer term, the industry would greatly benefit from a boost in international visitors. According to the Las Vegas Convention and Visitors Authority, international visitors made up 14% of total visitors in 2019 and these visitors spend more on average than their domestic counterparts. However, recent data suggest the international recovery is underway as February saw a 125% increase in international travelers compared with February 2022. A more complete return of international travelers is crucial for the gaming industry's long-term prospects. China's recent reopening adds upside risk for international tourist demand, but with a possible recession in much of Europe and Latin America, this upside will be tempered in the near term.

Outside of the economic impacts, several structural issues will play a part in the forecast. It remains to be seen how the expansion of legal sports betting across the country will affect Nevada's gaming industry, though the loss of monopoly power has not yet slowed down the state. As of early 2023, 33 states have legalized sports betting, with more still considering legalization. The Silver State used to be the only legal sports betting market, but in 2022 it ranked fourth in legal sports wagers behind New York, New Jersey and Illinois. However, this development is unlikely to be a game-changer for gaming percentage fees since revenue from sports betting pales in comparison to revenue from other types of gambling.

Longer term, the structural break in the historical relationship between recreational spending and gaming is becoming increasingly clear, driving the bulk of the disparity in forecast growth rates for gaming compared with sales and use taxes. Moreover, increased competition from other states and online betting will further moderate Nevada's share of gaming in the years ahead. Yet 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 a comprehensive vacation destination that appeals to a wider range of visitors. As a result, live entertainment and sales and use taxes will grow at the expense of gaming percentage fees.

About the Authors

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