

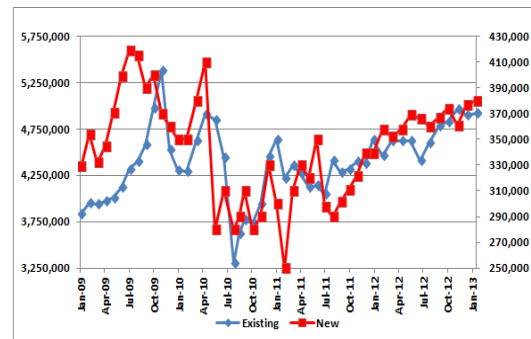
ECONOCAST™ UPDATE – February 25, 2013

U.S. Economy – Sequestration

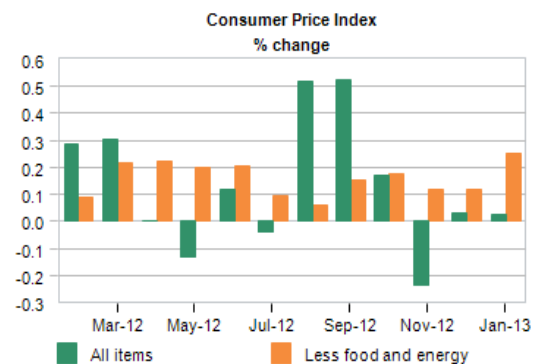
Sequestration is likely to begin March 1st. The reductions will be approximately 5% for nondefense programs and 8% for defense programs. However, since the cuts must be achieved over 7 months instead of 12, the effective percentage reductions are approximately 9% for nondefense and 13% for defense. These cuts will have noticeable and disruptive impacts across the entire array of federal programs since they are required to be pro rata across the board cuts in appropriated spending that do not allow the agencies much leeway. These cuts will reduce the growth in real GDP by about 0.5%-to-1% with most of the impact in the first half of 2013.

Fortunately, economic growth was picking up momentum so the cuts are unlikely to trigger a recession. Housing in particular is rebounding. Sales of existing homes were stable in January with 4.92 million annualized units. Months of supply continues to fall and was very low in January at just 4.2 months. The median existing-home price is up by 12.3% y/y. Supply is tight, and pricing is strong. A decline in listings, and not a surge in demand, is driving

the improvement: Inventory is down by 25% from this time last year. New home sales will be reported tomorrow and should continue to increase.



Inflation remained very low in January. Energy prices fell and January, but they have rebounded this month. Nevertheless, there is no indication of inflation in the near term. Producer prices rose just 0.2% in January, the first rise in 4 months.



Florida Economy: Sequestration and the Legislative Session

Sequestration will take a bite out of Florida's economy, particularly its defense sector. The White House published a report Sunday estimating that Florida would lose \$182 million defense spending with 31,000 civilian DoD employees furloughed. Most of this is concentrated in Jacksonville's Naval Aviation Depot's maintenance activities. Total federal spending will drop over \$300 million. Noticeable, but not fatal.

Florida's annual 60-day legislative session begins March 5th. The Governor proposed a \$74 billion budget which contrasts sharply to his prior budgets. Total spending would increase by \$4 billion and only very limited tax cuts are included in the plan.

Governor Scott's Budget FY 13-14 (\$ Billions)

Category	Spending	Change
Healthcare	\$26.7	\$1.59
Education	\$22.0	\$1.74
Transportation	\$9.1	\$0.92
Economic Development	\$1.2	\$0.26
Eldercare	\$0.3	-\$0.51
Environment	\$1.2	-\$0.20
Agriculture	\$1.4	-\$0.02
All Other	\$12.4	\$0.44
	=====	=====
Total	\$74.2	\$4.21

The Governor proposes substantial spending increases in healthcare, education and transportation. The biggest cut is to home and community services for the elderly. The Governor's budget includes across the board pay raises for

teachers and for state employees totaling nearly \$1 billion per year.

The legislative leadership has already rejected the proposals for across the board salary increases substituting much more modest merit pay improvements. In addition, although the recovery in State revenues is significant, it is not likely to be \$4 billion in 2013-14. Furthermore, the legislature is not likely to increase spending beyond \$3 billion of which \$1 billion is the current surplus in last year's budget. However, there are almost no calls for significant tax cuts this year. So, there will be very substantial increases in spending on healthcare, education, and transportation.

One of the most important economic issues facing the legislature is their pending decision concerning expanding Medicaid enrollment. Governor Scott reversed his longstanding opposition to the Affordable Care Act (ACA) embracing an expansion of Medicaid for the initial three years when the federal government funds 100% of the cost. This would increase enrollment by 900,000 and spending by \$7 billion. Such an increase funded by the federal government would be a powerful stimulant to Florida's economy.

Recently, Florida received federal permission to change its Medicaid program from a fee for service basis to an HMO per capita payment model. This will produce substantial savings. The Legislature is likely to approve the expansion for at least three years, and once started this change will likely be permanent. The new budget and Medicaid expansion are both positives for Florida.