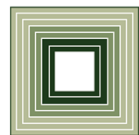


# QUARTERLY GENERAL FUND REVENUE REPORT



**October 2013**  
**Barry Boardman, Ph.D.**  
**Fiscal Research Division**  
**North Carolina General Assembly**



**FISCAL RESEARCH DIVISION**  
A Staff Agency of the North Carolina General Assembly

# Highlights

- Prior year General Fund revenues were \$537.6 million (2.7%) above the \$20.04 billion budgeted amount.
- General Fund collections for the first quarter of the current fiscal year are \$79 million above the revenue target.
- Corporate income tax revenue is the main reason collections are ahead of target. Signs of weakness in wage and salary income tax withholding may be a cause for some concern.
- A steady, moderate growth pattern emerged this spring and summer and is expected to be with us throughout the fiscal year. Most economic forecasts anticipate an improving economy with growth slightly below average for most of 2014.
- Employment growth remains a problem. If the Eurozone economies stabilize and continue to improve, and emerging economies, especially China, gain solid footing, then a stronger growth cycle in the US economy may spur employment gains.

# FY 2013-14 First-Quarter Revenue

- Through September, General Fund revenue was \$80 million *above* the \$5.0 billion target set for the first quarter of the fiscal year.
  - Stronger than expected Corporate Income tax revenue (up almost \$52 million) is the main reason collections are ahead of target.
  - Total Personal Income collections were \$15 million over target; however, wage and salary withholding was one percent below its target for the quarter (\$26 million below a \$2.4 billion target).
  - Sales Tax collections were \$19 million over target; gross collections were up 4.2 percent over last year.
  - Other tax revenue was bolstered by unanticipated revenue of \$14 million in Estate tax collections. The revenue represents settlements from previous tax years. The Estate tax was repealed beginning with the 2013 tax year.
- **Reminder:** The first several months of the fiscal year are typically the least important months as an indicator of revenue trends for the full fiscal year.
  - The major receipts in these months (sales, withholding tax) closely track the experience of the last few months of the prior fiscal year. Revenue from volatile sources (corporate and non-withholding personal income) are not fully realized until the second half of the fiscal year.

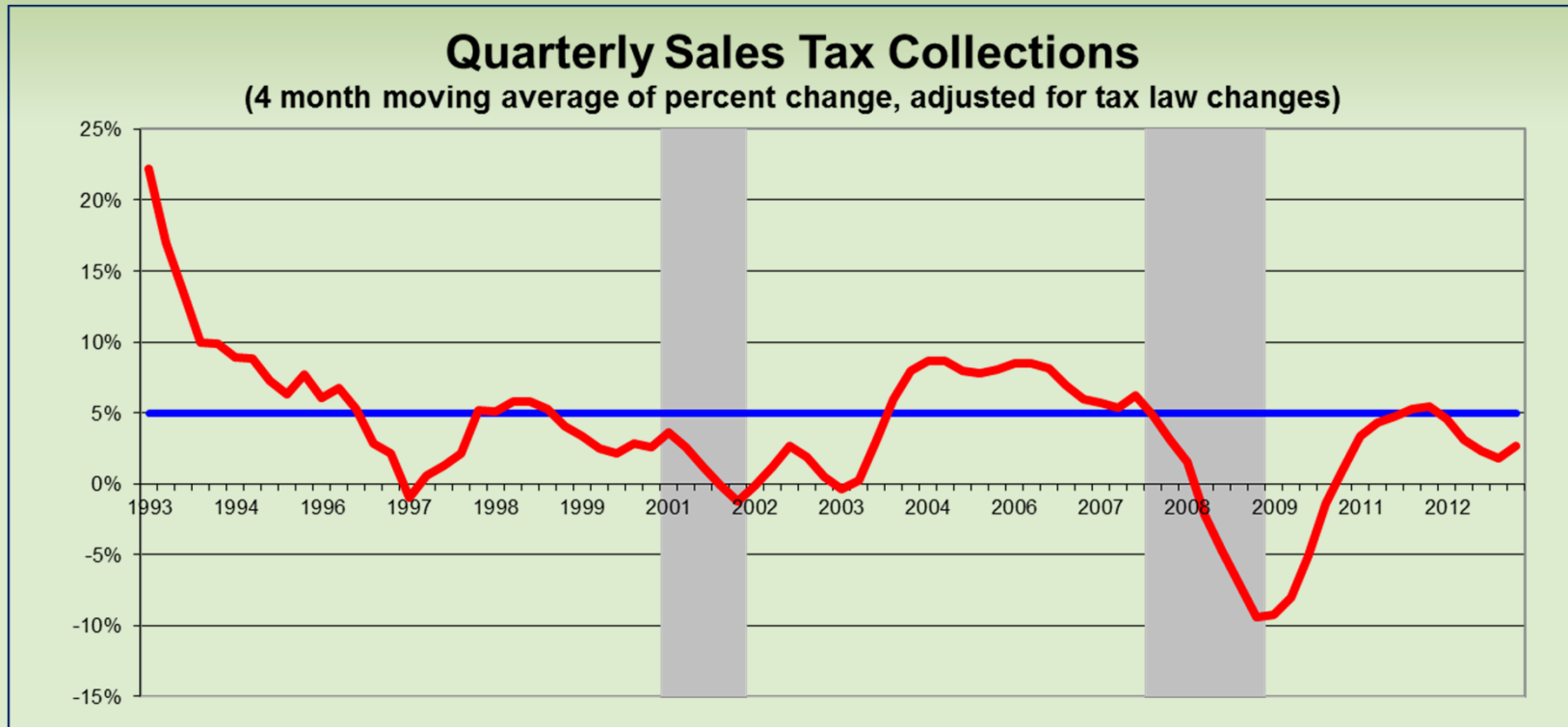
# FY 2013-14 First-Quarter Revenue

FISCAL YEAR-TO-DATE (millions)					
	Budget	Actual	Target	Actual	Y/Y Pct.
Net Tax Revenue	2013-14	2013-14	Difference	2012-13	Change
Individual Income	\$2,697.9	\$2,712.7	\$14.8	\$2,638.0	2.8%
Sales and Use	1,398.0	1,416.9	19.0	1,359.5	4.2%
Corporate Income	306.9	358.6	51.7	256.5	39.8%
Franchise	115.8	105.7	(10.1)	115.8	-8.7%
Other Tax Revenue	204.1	226.5	22.4	197.2	14.9%
<b>Total Tax Revenue</b>	<b>\$4,722.7</b>	<b>\$4,820.4</b>	<b>\$97.7</b>	<b>\$4,567.0</b>	<b>5.5%</b>
<b>Nontax Revenue &amp; Transfers</b>	<b>\$272.3</b>	<b>\$253.6</b>	<b>(\$18.7)</b>	<b>\$234.8</b>	<b>8.0%</b>
<b>Total General Fund Revenue</b>	<b>\$4,995.0</b>	<b>\$5,074.0</b>	<b>\$79.0</b>	<b>\$4,801.8</b>	<b>5.7%</b>

# FY 2013-14 First-Quarter Revenue

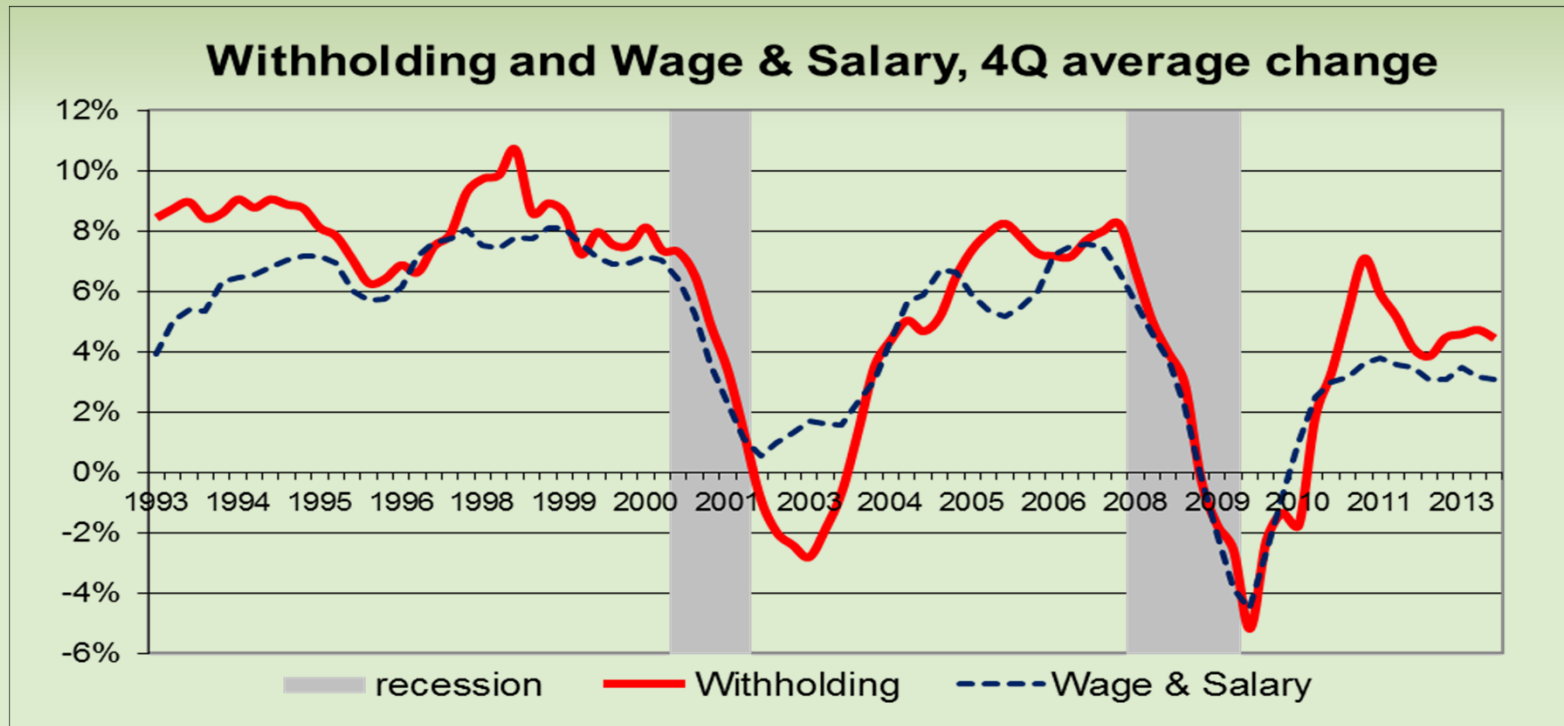
- Growth in key economy-based taxes, the wage and salary withholding income tax and the sales tax, moved in opposite directions.
  - Baseline Sales Tax growth maintained the solid growth established earlier in the summer and during the first quarter of the fiscal year net collections were 4.2 percent above last year (see page 5).
  - Net Personal Income withholding collections (withholdings less refunds) continue to grow, but the growth slowed in the first quarter of this fiscal year and personal income tax collections were below target with only 3.1 percent growth. (see page 6).

# Tracking Economy-Based Collections



Baseline growth for FY 2012-13 was only 2.4 percent. The year started slowly, but the last quarter finished strong with 5.5 percent growth. The consensus forecast growth rate for the current fiscal year is 2.9 percent but in the first quarter growth was 4.2 percent.

# Tracking Economy-Based Collections



Net Withholding income growth (withholdings less refunds) improved slightly in the second quarter of 2013, but have weakened the past three months growing at only 3.1 percent over last year compared to the 4.3 percent targeted growth rate.

# Prior Year Recap

- At the start of FY 2012-13, the economy was modestly improving and for the second year in a row slow growth in the spring and summer started off the new fiscal year. Throughout the fiscal year the economy strengthened, but economic activity remained below average. In this slow growth environment employment had trouble gaining traction.
- The moderate growth aligned with the consensus forecast; however, collections were \$537 million (2.7%) above the \$20.0 billion General Fund forecast.
  - Most of the surplus could be attributed to taxpayers shifting income into the 2012 tax year, which was the result of federal policymakers delaying decisions on tax rates for the 2013 tax year. Federal tax policy was not decided until the end of December 2012.



# Prior Year Recap

- Personal income tax collections were \$435.5 million over a \$10.5 billion forecast. Nearly \$285 million of the over-collections came from the twenty percent increase in final payments on April 15.
- Sales tax collections were very weak to start the year and despite a stronger final quarter, collections ended up \$161.6 million *less* than the \$5.45 billion forecast.
- Corporate income tax collections came in \$116.7 million above forecast with gross collections up 15.0 percent.
- Non-Tax revenue was up \$60.5 million, mostly from additional Master Settlement Agreement money, which was not included in the original revenue target.

# Prior Year Recap

Here's how key revenue items turned out (\$ million)

	<u>Budgeted</u>	<u>Actual</u>	<u>Difference</u>
<b>Personal Income Tax</b>			
Withholding*	\$10,288.2	\$10,315.0	\$26.8
% Yearly Growth		4.72%	
Non-Withholding**	\$2,468.5	\$2,853.1	\$384.5
% Yearly Growth		12.65%	
Net Collections	\$10,517.6	\$10,953.14	\$435.5
% Yearly Growth		6.59%	
<b>Sales Tax</b>			
Net Collections*	\$5,455.8	\$5,294.2	(\$161.6)
% Yearly Growth		0.7%	
<b>Corporate Income Tax</b>			
Net Collections*	\$1,075.0	\$1,191.7	\$116.7
% Yearly Growth		5.2%	

\*Collections less refunds and transfers.

\*\*Quarterly estimated payments plus April 15 tax payments.

# Economic Outlook and the Revenue Forecast

- The economic recovery has settled into a subpar growth pattern with growth closer to two percent than the average of three percent. The economy continues to improve, but not at a strong enough pace to produce a robust job market.
- Improvements in the overall economy are more widespread this year and housing appears poised to begin a solid recovery improving prospects for construction jobs which have been in decline since 2008.
- This slow growth pattern, however, leaves the economy, and in turn, the revenue forecast in a more vulnerable position with respect to negative economic and policy shocks.
  - For example, the recent stalemate with federal fiscal policy had the potential to be a drag on the overall economy and would have impacted the State's revenue stream.

# State's Economic Outlook

- The State's economy throughout this year has steadily been gaining strength. While we do not anticipate the pace of economic growth to significantly quicken, we do expect it to stay on a steady upward trend.
- Federal fiscal policy problems have the potential to derail the State's pace of growth and currently pose the greatest risk to the State's economic outlook.
- Speculatively, the federal fiscal policy of sequestration, which began this spring, may be part of the reason the State's wage and salary income tax collections have weakened.
  - North Carolina has over 67,000 federal government employees, plus many private sector firms that do business with the federal government. Employee furloughs and cutbacks on private sector contracts and grants have the potential to weaken wage income growth in the State.

# State's Economic Outlook

- In general, improvements in the overall economy have not been reflected by the State's employment picture – the unemployment rate has remained high (6<sup>th</sup> highest nationally in August) and total employment growth is weaker than hoped.
- North Carolina's Gross State Product, a measure of the State's economic output, kept pace with the nation's output in 2012, and is forecast to outperform the nation in 2013 and 2014.
- Despite output growing as fast or faster than the nation as a whole, the unemployment rate is expected to remain well-above the national rate.
  - Nationally the unemployment rate is at 7.3 percent compared to the State's rate of 8.7 percent (seasonally adjusted).
  - The second quarter of 2013 (April – June), non-farm employment grew at a slightly slower pace than nationally (1.5% compared to 1.6% nationally)

# State's Economic Outlook

- Employment is a key driver of General Fund revenues and is also an important focus of policymakers in the State. Therefore, the remainder of this report will focus on a few key aspects of the State's employment picture.
- Employment in the State is measured by two separate surveys that are collected for the Bureau of Labor Statistics by the U.S. Census Bureau.
  - The Current Population Survey (CPS) is a household survey used to estimate the size of the labor force, total employment, and the unemployment rate.
  - The Current Employment Statistics (CES) survey is a survey of businesses and government establishments and is used to estimate total industry employment and is often referred to as non-farm or payroll employment.

# State's Economic Outlook

- Compared to August of last year, total employment in the State only increased by 5,000 jobs. Nonetheless, the unemployment rate fell from 9.6 to 8.7 percent. The rate fell primarily because the number of people in the labor force fell by nearly 40,000.
- The CES non-farm survey over the same period shows industry employment increased by 66,700 jobs, a respectable 1.7 percent increase.
- Private sector employment grew last year by 78,400, but that was tempered by the fall in Government employment of 11,700 jobs.
- All major industry sectors, except for construction, gained in employment.
  - Construction jobs fell by 2.1 percent over last year. The 5.4 percent increase in weekly earnings (compared to a 0.2 percent loss the previous year) may be the harbinger that the construction industry is poised to reverse the five-year trend of job losses.



# State's Economic Outlook

The unemployment rate was 8.7 percent in August. Over the next six months the State's unemployment rate is expected to show gradual improvement. In the first quarter of 2014, the average monthly rate is forecast to be 8.3 percent.

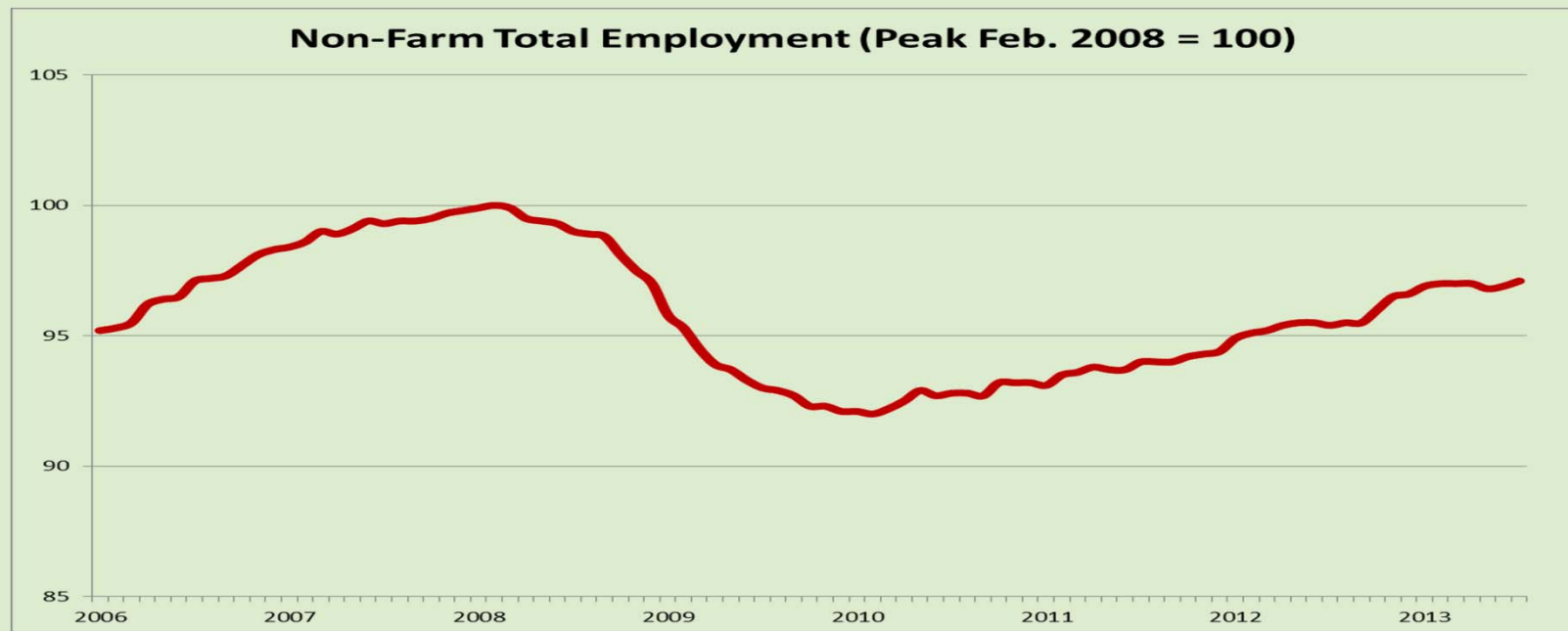


Source: Actual data from the NC Division of Employment Security, Forecast by FRD shaded in gray



# State's Economic Outlook

Changes in non-farm employment have moved at a similar pace as the overall economy. The chart below shows how the State has improved since employment peaked in February of 2008 (indexed to equal 100). Non-farm employment is now 2.9 percent below peak.



# State's Economic Outlook

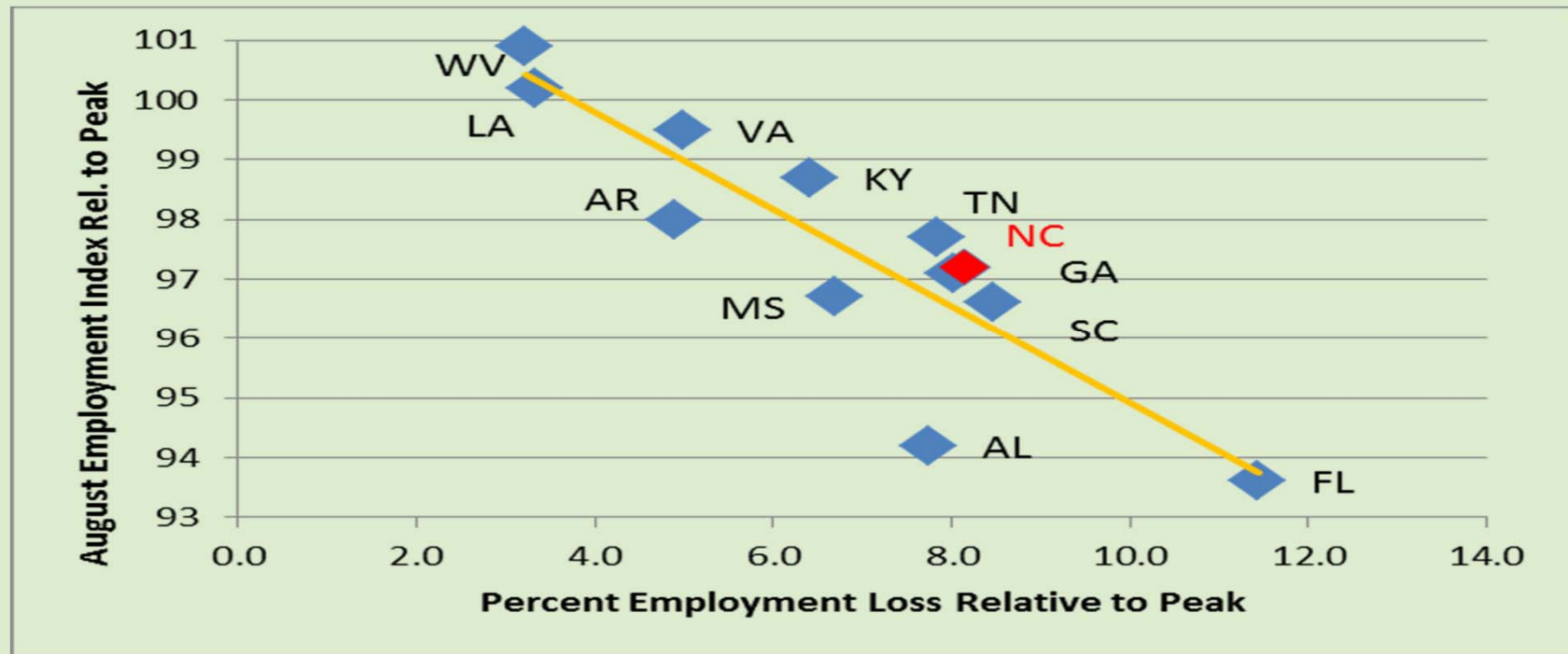
- While this report, as with many others, tends to focus on the unemployment rate, it can be a deceptive measure for understanding the improvement of a state or nation's employment.
- The unemployment rate is a ratio that needs to be understood with respect to its components – labor force size and total employment.
- For example, a higher unemployment rate may be reported because the work force is growing faster than employment. This was certainly North Carolina's case throughout much of the recession as the labor force grew despite a fall in employment. This led to a higher unemployment rate. Recently, the effect has been in the opposite direction as the labor force shrinks and employment is relatively unchanged, the rate has moved down.

# State's Economic Outlook

- Since the unemployment rate may not always give an accurate picture of the State's employment situation, how might you compare the State with respect to its neighbors and other states?
- One possible approach is to measure the relationship between the percent of jobs lost (8 percent for NC) and the current position of a state's employment relative to its peak employment (2.9 percent below peak in NC).
- The charts on the following pages plots that relationship with current employment relative to peak on the vertical axis and the amount of employment loss during the Great Recession on the horizontal axis.
- A trend line is produced, such that states above the trend are experiencing stronger employment growth, while states below the trend line are experiencing weaker growth.

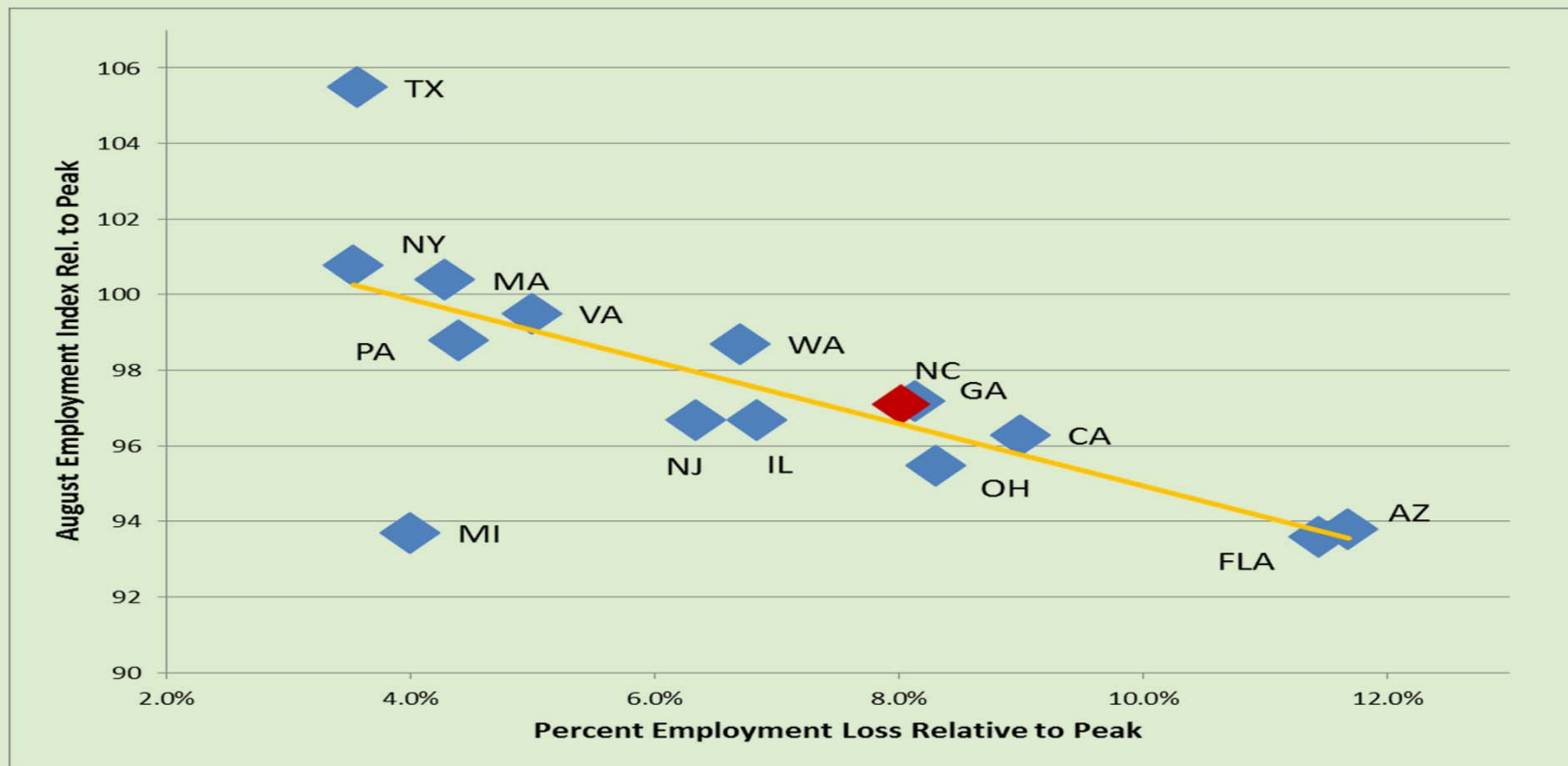
# State's Economic Outlook

This chart compares North Carolina to other states in our Census region (region 5). NC is slightly ahead of the general trend in employment growth. For example, Alabama experienced about the same percent of job loss during the recession as North Carolina, but has not recovered nearly as much of those losses relative to their peak employment.



# State's Economic Outlook

This chart shows how North Carolina compares to the 15 most populous states. As with the other chart, NC is slightly above trend.



# State's Economic Outlook

- Simply comparing unemployment rates can often be misleading when gauging a state's improvement in employment.
- These charts provide a different picture of how our State's employment picture is improving.
- North Carolina, Georgia, and Tennessee have some of the highest unemployment rates in the nation at 8.7, 8.7, and 8.5 percent, respectively. And yet, relative to peak employment and employment losses during the Great Recession, these states are performing better than the average trend for the twelve states in their census region.
- While the charts are another way to consider employment changes, they also only tell part of the story. Consider Texas and Michigan. Texas is well above trend bolstered by an industry mix that includes a large energy sector, while Michigan with a similar percent of job losses in the recession is still lagging behind due to an industry mix reliant on a changing transportation sector.

# Conclusions

- Current year revenue collections are slightly above the consensus target, and are up 1.6 percent for the fiscal year.
- The first quarter provided mixed results. Personal Income tax withholding on wages was below target. Sales tax collections and Corporate Income tax payments, on the other hand, are running ahead of target.
- The economy continues to strengthen, yet the pace of growth remains below average. The slow growth pattern makes us more susceptible to economic and policy shocks and places the risk to the forecast at a higher level.
- Some employment numbers have been slow to improve; however, the State's improvement in employment is tracking slightly above the average pace when compared with the amount of employment lost during the recession.