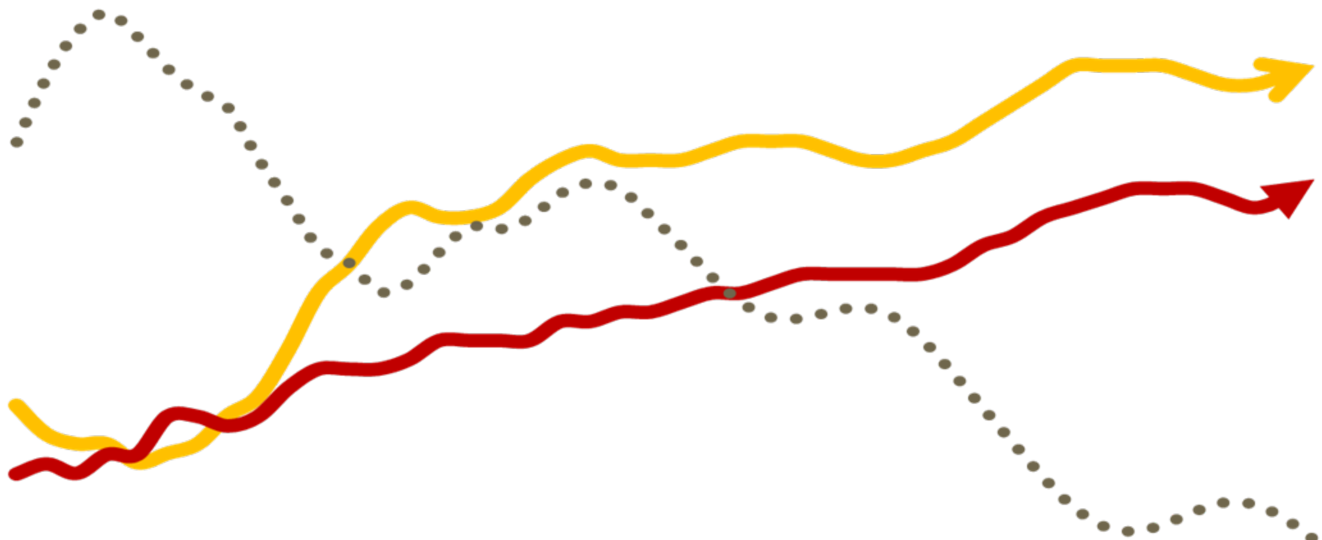
Quarterly General Fund Revenue Report



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

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Highlights

- Last fiscal year's General Fund revenue exceeded the $22.1 billion budgeted amount by $494.1 million (2.2%).
- General Fund collections for the first quarter of this fiscal year are $62.1 million (1.2%) below the revenue target.
  - Economy-based revenue is slightly below expectations for the first quarter.
- A moderately-stronger economic growth pattern re-emerged this spring and summer after a slowdown last winter. Economic forecasts anticipate modest growth for the rest of the fiscal year.
- Growth in employment and total wages was solid last fiscal year and is expected to continue at a positive pace this year.

FY 2017-18 First-Quarter Revenue

- Through September, General Fund revenue was $62.1 million *below* the $5.3 billion target set for the first quarter of the fiscal year.
- Tax revenue was $69.8 million (1.3%) *below* the $5.2 billion target.

GENERAL FUND REVENUE ($ millions)					
	FY 2017-18				FY 2016-17
Net Tax Revenue	Target	Actual (P)	$ | % Difference		Actual
Individual Income	$2,767.2	$2,753.0	($14.2)	(0.5)	$2,765.5
Sales and Use	1,930.6	1,868.1	(62.5)	(3.2)	1,818.4
Corporate Income	198.2	179.0	(19.2)	(9.7)	291.0
Franchise	76.9	79.6	2.7	3.5	72.4
Other	220.9	244.2	23.3	10.5	212.6
Total Net Tax Revenue	$5,193.8	$5,124.0	($69.8)	-1.3%	$5,087.4
Nontax Revenue & Transfers	$102.8	$110.6	$7.8	7.6%	$203.2
Total General Fund Revenue	**$5,296.6**	**$5,234.5**	**($62.1)**	**-1.2%**	**$5,290.6**

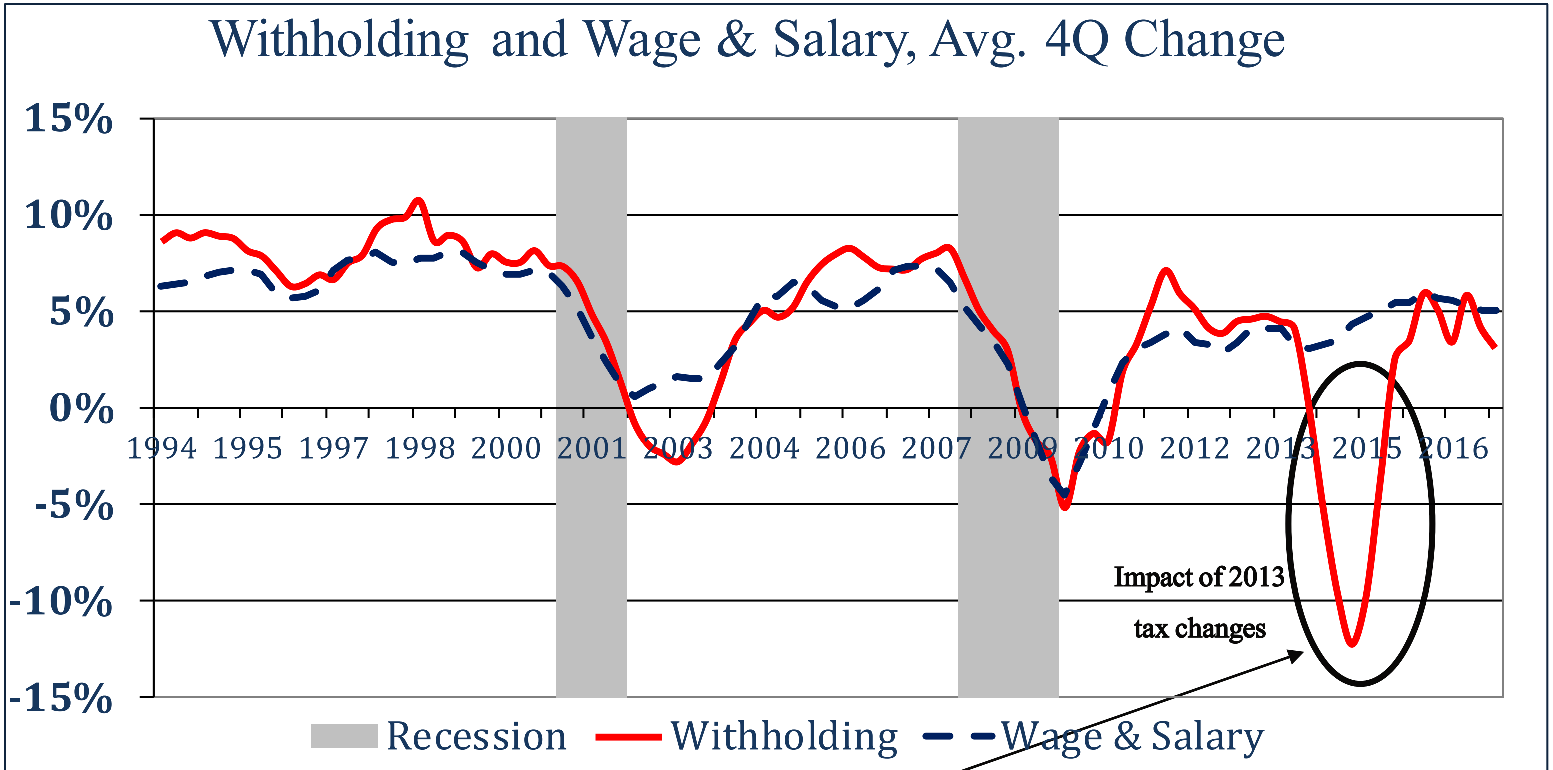
FY 2017-18 First-Quarter Revenue

- The $69.8 million tax revenue target shortfall is mainly due to slightly lower-than-expected gross collections, plus slightly higher tax refunds.
- Unexpected Estate Tax collections (repealed 5 years ago) added $9.8 million to tax revenues.
- Sales taxes are running $62.5 million below a $1.9 billion target. Refunds were $33 million higher than expected.
- Corporate tax collections (Income and Franchise combined) were $16.5 million below expectations.
- Non-tax revenue from fees and investments is $7.8 million above the $102.8 million target. Non-tax revenue does not always follow previous trends, making it difficult to project monthly targets.

FY 2017-18 First-Quarter Revenue

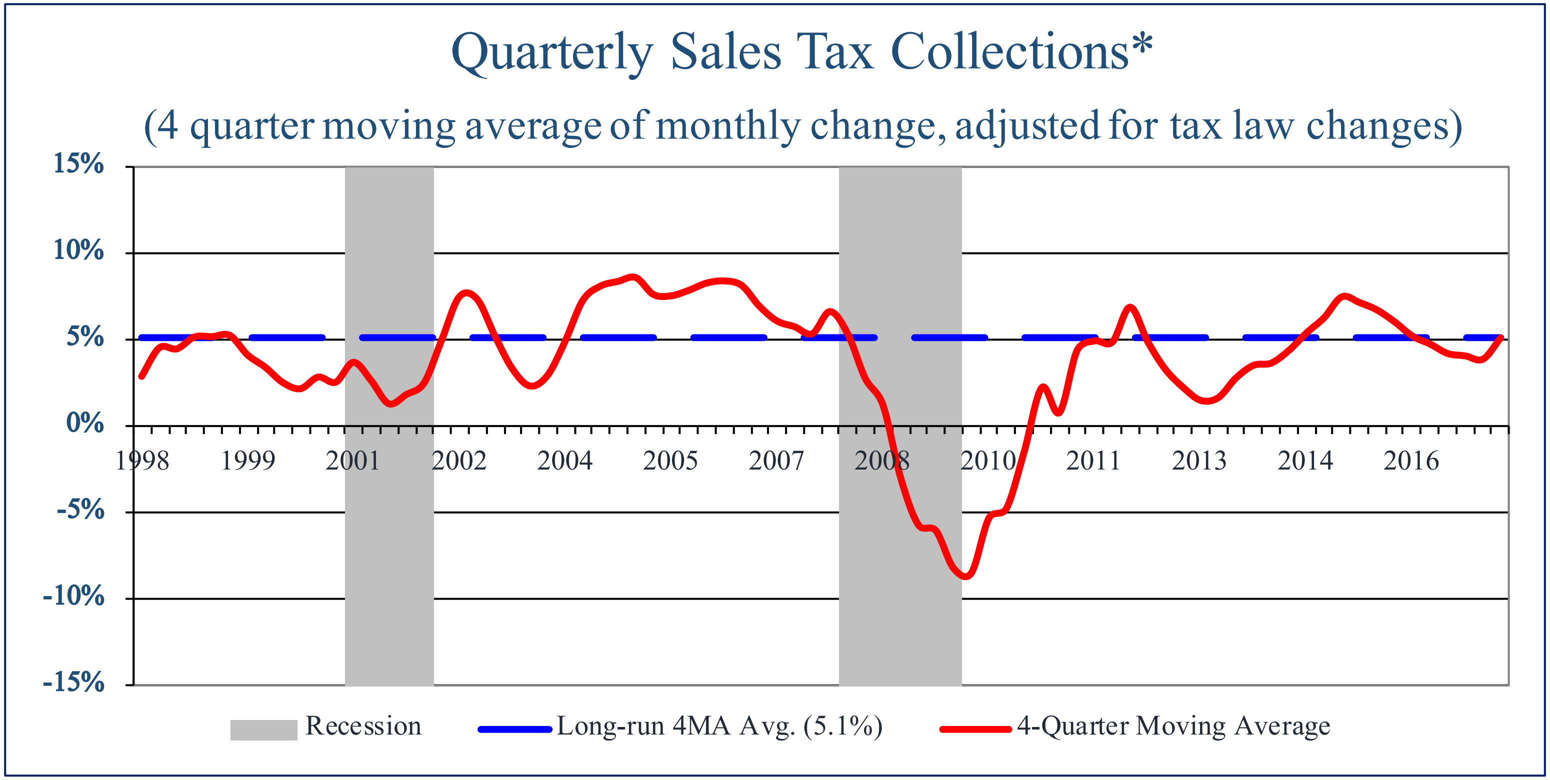
- **Important Reminder:** The first several months of the fiscal year are typically the least important months as an indicator of revenue outcomes for the full fiscal year.
  - Major receipts in these months (i.e., sales and withholding tax) typically track the experience of the last few months of the prior fiscal year.
  - Revenue from volatile sources (e.g., corporate and non-withholding personal income) are not fully realized until the second half of the fiscal year.
  - Ongoing adjustments to the Personal Income tax mean that April 2018 tax payments, which are always important to fiscal year totals, hold even greater uncertainty than usual.

Tracking Economy-Based Collections



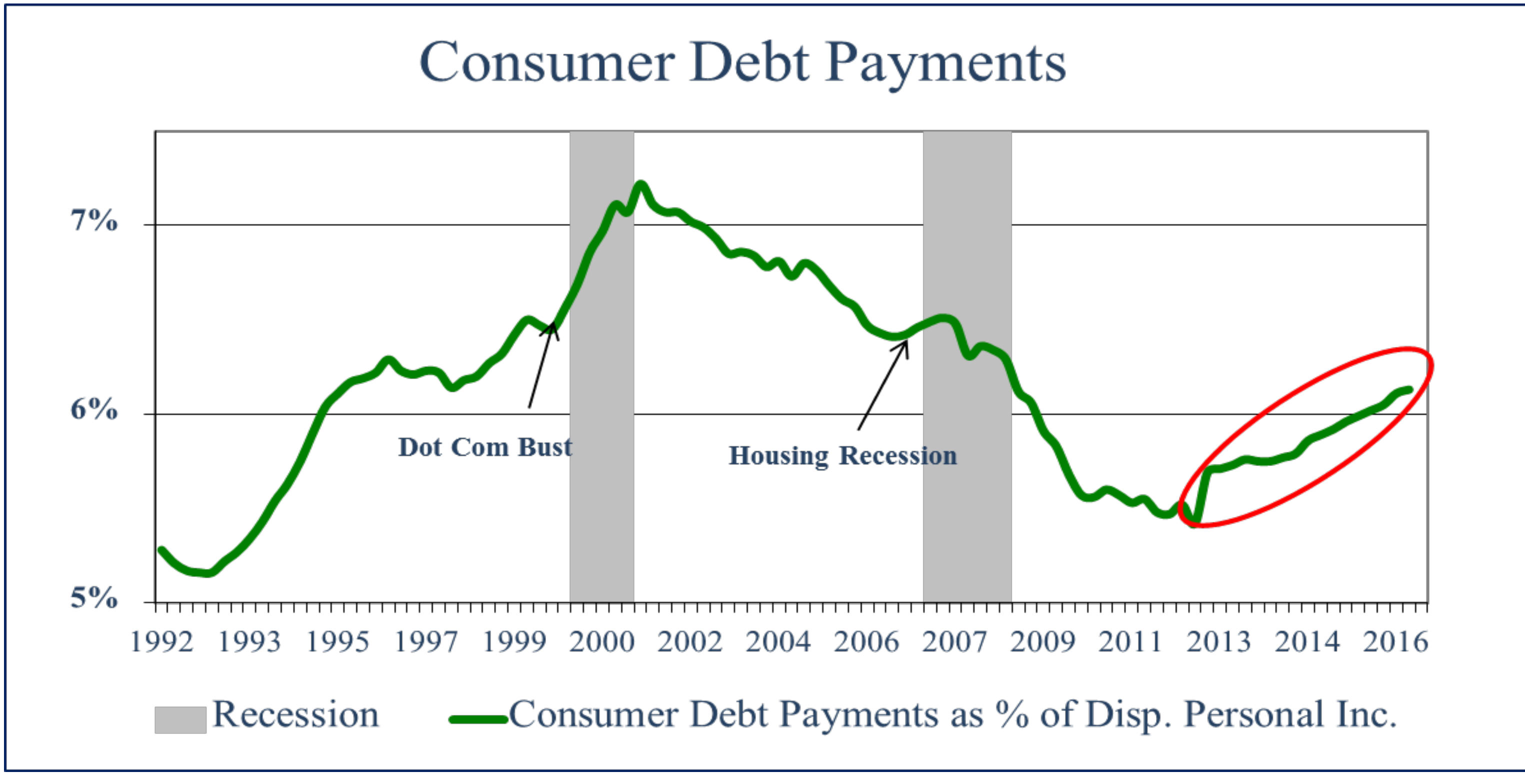
After adjusting for the tax changes, withholding has tracked closely with Wage & Salary growth. Withholding represented 47% of all tax revenue in FY17.

Tracking Economy-Based Collections



Baseline growth for FY 2016-17 improved to 5.0%, matching forecast projections. The final quarter of FY17 produced the strongest Y/Y growth of 8.2%. This offset weaker growth of 4.1% the first three quarters.

Tracking Economy-Based Collections



In the 1st half of 2017, disposable income grew only 2.9%, yet US consumption grew 4.6%. Given the slow wage growth, it has been rising debt that has helped maintain household consumption.

Prior Fiscal Year Recap

- At the start of FY 2016-17, the economy had settled into a steady, moderate growth pattern. The economy continued strengthening during the first-half of the fiscal year. Then the harsh winter across much of the US, along with global economic setbacks, became a drag on the economy.
- The economy rebounded in the spring and the overall moderate growth for the fiscal year aligned with the consensus forecast.
- Collections were $494.1 million (or 2.2%) above the $22.1 billion General Fund forecast.
  - The 2.2% increase over forecast primarily resulted from a cautious consensus forecast made in light of the continuing rollout of tax changes, a moderate economic growth scenario, and ongoing global instability.

Prior Fiscal Year Recap

GENERAL FUND REVENUE ($ millions)						
	FY 2016-17				FY 2015-16	
Net Tax Revenue	Target	Actual (P)	$ | % Difference		Actual	% Y/Y
Individual Income	$11,618.3	$11,969.7	$351.4	3.0%	$11,905.2	0.5%
Sales and Use	6,970.7	7,004.0	33.3	0.5	6,559.5	6.8%
Corporate Income	911.5	752.2	(159.3)	(17.5)	1,582.5	-52.5%
Franchise	551.9	748.1	196.2	35.5	524.4	42.7%
Other	1,251.3	1,263.3	12.0	1.0	1,244.7	1.5%
Total Net Tax Revenue	$21,303.7	$21,737.2	$433.5	2.0%	$21,291.9	2.1%
Nontax Revenue	$816.3	$876.9	$60.6	7.4%	$858.8	2.1%
Total General Fund Revenue	$22,119.9	$22,614.1	$494.1	2.2%	$22,150.7	2.1%

The May 2017 consensus forecast projected over-collections for the fiscal year at $580 million. In June, larger-than-expected Sales tax refunds plus settlements with corporate taxpayers reduced the year's over-collections.

Prior Fiscal Year Recap

- Personal Income tax collections were $351.4 million above a $11.6 billion forecast.
  - Withholding on wage and salary income was $204.2 million above expectations (1.9%);
  - Refunds were essentially on target; and
  - Final payments on the 2016 tax year were $79.1 million above projection.
- Sales tax collections met forecast expectations, and were $33.3 million above the $7.0 billion forecast.
- The business taxes of Corporate Income and Franchise tax were affected by processing delays and taxpayer settlements. On net, they were $18.1 million above the combined target of nearly $1.5 billion.

Prior Fiscal Year Recap

Here's how key tax collections* turned out in FY 2016-17 ($ million):

	FY15-16	FY16-17			
	Actual	Budgeted	Actual	% Change From: *Budget*	*Prior Year*
Personal Income					
Withholding	$ 8,740.2	$ 8,525.2	$ 8,729.4	2.4%	(0.1%)
Non-Witholding	3,165.0	3,093.1	3,240.2	4.8%	2.4%
Net Collections	11,905.2	11,618.3	11,969.6	3.0%	0.5%
Sales Tax					
Net Collections	6,559.5	6,970.7	7,004.0	0.5%	6.8%
Corporate Income Tax					
Net Collections	1,058.2	911.5	752.2	(17.5%)	(28.9%)

*Withholding and Net Collections represent collections less refunds and transfers; Non-Withholding represents quarterly estimated payments plus April 15 tax payments.

Economic Outlook & Revenue Forecast:
2017-19 Biennium Consensus Forecast

The forecast was based on moderate economic growth for each fiscal year:

» Consensus Forecast (May 2017)

	Revenues (billions)	Y/Y Change (millions)
FY18	$23.152	$538.6 (2.4%)
FY19	$24.135	$982.8 (4.2%)

» 2017 Session-Adjusted Forecast

	Revenue (billions)	Y/Y Change (millions)
FY18	$23.133	$519.4 (2.3%)
FY19	$23.594	$461.3 (2.0%)

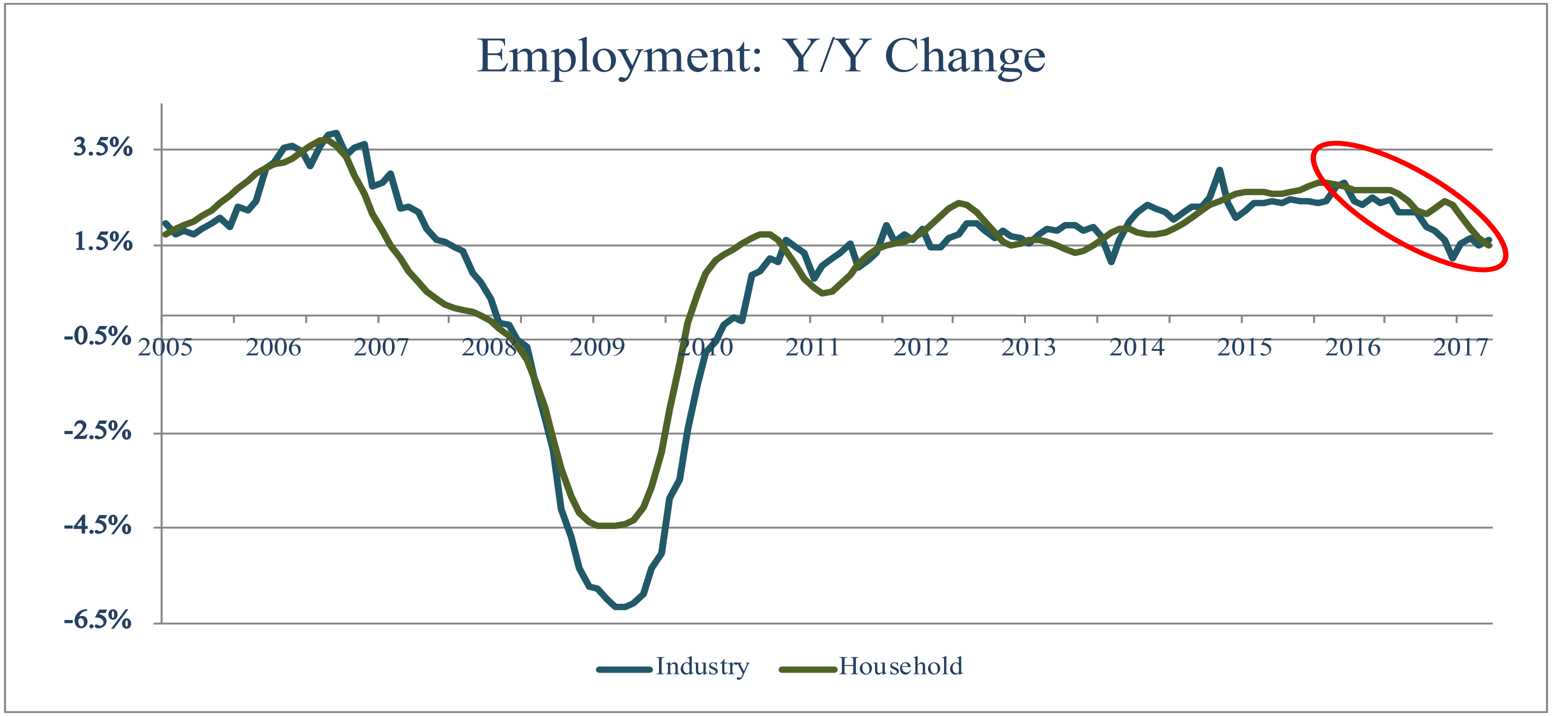
Economic Outlook & Revenue Forecast

- The economy has struggled to accelerate into overdrive; however, it is stronger now than it was a year ago.
- Improvements have not been strong enough to offset some of the weakness that persists in part of the economy.
  - The most recent Wall Street Journal survey of macroeconomic forecasters foresees economic activity remaining at the current pace throughout the fiscal year; but most of those forecasters have lower confidence than usual in their forecasts.
  - Inflation adjusted wage growth is stagnant, and while the stock market remains bullish on the economy, those gains are mostly being captured by the top 10% in terms of wealth.

Economic Outlook & Revenue Forecast

- Since the Great Recession ended in 2009, the State's economy, as well as the nation's, was stuck in a prolonged recovery marked by slow, uneven growth. It now appears the State's economy has finally gained sufficient momentum to enter an expansionary phase with more stable growth.
- Recent data on income and overall economic activity (Gross State Product) indicate the State's growth is starting to outpace average national growth.
- The State's typical pattern is one in which downturns are bigger and upturns are more robust compared to the national average. It took seven years for that pattern to develop after this last recession.
- Throughout the biennium the expectation is that the State will experience economic growth at a faster pace than the nation.

Economic Outlook & Revenue Forecast



Employment is a key driver of State revenue, and recently both Household and Industry employment growth have slowed. In the last 6 months, Industry employment grew at 1.5%, vs. 2.5% in the same period last year. Household employment (used to calculate the unemployment rate) has been flat the last 6 months, recording a small 5,000-job decline.

Economic Outlook & Revenue Forecast

- Despite the slowdown in employment growth, pressure on individual wages to rise is expected throughout the forecast period.
- The forecast expects the total wage base to grow by 4.8% this fiscal year. This is similar to last fiscal year's estimated growth of 4.7%, but less than the pre-recession growth rates of 6% to 7%.
- First-quarter Personal Income tax revenue on withholding suggests that we are seeing wage growth somewhat slower than the 4.7% forecast target.
- As noted, the growth in wages and sales are slightly below forecast. These key drivers of tax revenue will need to pick up the pace in order to avoid added pressure on the always important April 15th collections.

Conclusions

- Revenue collections are slightly below target – down 1.2% through the fiscal year's first quarter.
- The economy remains in a stable growth pattern. Forecasters project this pattern will persist through the fiscal year. How long can this stable growth last? The economy is experiencing the second-longest recovery on record: 9 months until it's the longest.
- The forecast anticipated employment gains and wage growth similar to what was experienced last year, so far they are slightly below growth targets.
- **A final caution**: first-quarter revenue relative to budget targets rarely reflect how revenue for the full fiscal year will play out. The good news is that this quarter's modest $62 million shortfall may have very little bearing on whether we reach the fiscal year's $23.1 billion revenue target.