



General Fund Revenue Update

State of North Carolina

REVENUE HIGHLIGHTS

- **FY 2018-19 Revenue**
Collections in the first half of the fiscal year were \$188.6 million above the revenue target.
- **Personal Economic Outlook**
The economy is on solid footing and remains in a stable growth pattern. Forecasters project this pattern will continue throughout 2019.
- **Revenue Outlook**
Economic conditions are tracking closely with expectations; collections are expected to remain on target throughout the fiscal year.
- **Tax Policy Changes**
The State's Personal Income tax rate reduction and its increased standard deduction for 2019 will slow the growth in Personal Income Tax collections. Meanwhile, a recent Supreme Court decision has increased sales and use tax collections.

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This report highlights the State's key revenue collections through December 2018, which is the halfway point of Fiscal Year 2018-19, and discusses the economic and revenue outlook for the rest of the fiscal year.

FY 2018-19 REVENUE THROUGH DECEMBER

For the first half of the fiscal year, General Fund revenue was \$188.6 million above the \$11.1 billion revenue target. The revenue targets are monthly projections based on the May 2018 consensus forecast, 2018 legislative session adjustments, and previous monthly collection trends.

Collections above the revenue target all occurred in the second quarter (Oct.-Dec.), which was \$209.7 million above target. The first quarter's revenue was essentially on track at \$0.8 million below target. Overall, the main General Fund revenue sources are running ahead of expectations. While it is important for revenue collections to keep pace with expectations, the forecast's risk and volatility reside in the second half of the year; slight variations in the first half of the fiscal year are neither unexpected nor concerning. Since the economy remains on solid footing, the risk of the State not reaching the projected revenue for the fiscal year is minimal.

Personal Income Taxes

Through December, net Personal Income tax (PIT) collections are 0.7% (or \$40.5 million) above target. Wage and salary withholding is above target by 2.2% (or \$114.1 million). Withholding gains are offset by lower-than-expected Estimated and Final Payments, which are \$54.4 million below target. Also, refunds were \$30.3 million higher than expected.

The above-target withholding collections suggest that the pace for wage & salary growth is slightly ahead of what was projected for the first half of the fiscal year, as withholding collections and wage growth typically are closely aligned.

Despite the revenue forecast for stronger wage growth in 2019, the amount of Personal Income tax collected in the second-half of the fiscal year is expected to be nearly the same as what was projected for the first-half. This is a result of the rate reduction and increase in the standard deduction for the 2019 tax year, which will lower the amount of withholdings on wage and salary income.

Sales and Use Taxes

Through December, net Sales and Use tax collections are ahead of target with revenue 1.1% above the 6-month target (up \$41.7 million). The consensus revenue forecast for the fiscal year expected 5.0% growth in net collections, which are collections net of refunds, distributions, and transfers. The forecast anticipated that collections would improve from 4.8% growth in the first half of the fiscal year to 5.2% in the second.

Sales tax growth is strong, partly due to a recent U.S. Supreme Court ruling about the collection of taxes for online sales.

Revenues from corporations (i.e., Corporate Income tax and some Franchise taxes) are more than \$100 million over target for the first six months of the fiscal year.

Non-Tax revenues account for nearly \$1 billion of the State's \$23.9 billion budget this fiscal year. These revenue sources are slightly below target for the first half of the fiscal year.

The national and State economy remain in a steady growth pattern, although a slowing in the global economy, trade wars, tighter financial conditions, and political instability are all capable of derailing the economy.

Baseline growth was a very strong 6.8% the first-half of the fiscal year, well ahead of the 4.4% post-recession average. Gross collections were up 7.1%, in part because of the U.S. Supreme Court's June 2018 ruling in *South Dakota v. Wayfair, Inc.*, which granted states additional authority to require retailers to collect and remit sales tax. However, net Sales tax collections were up only 3.7% due to a jump in refunds to taxpayers. Refunds are \$90.1 million higher than the target projection. Part of the reason refunds are higher than expected relates to the timing of when refunds are paid. Refund payments that were expected in June did not show up until August and were \$70 million higher than projected for that month.

Corporate Income and Franchise Taxes

The Corporate Income and Franchise tax collections from corporate taxpayers are a big reason why overall collections are 1.9% ahead of target. These two sources combined are \$82.9 million above the 6-month target; with Corporate Income tax collections \$37.1 million over and Franchise tax collections \$45.8 million over.

In addition to being over target, Corporate Income tax collections are up 16.5% over last year. However, this type of fluctuation is not unexpected. Corporate tax payments can vary considerably from the target in the first half of the fiscal year if the State receives even a few large tax payments or issues larger-than-expected refunds on previous years' tax liabilities. We will have a better picture of whether revenue from these two corporate taxes will meet the revenue forecast's projections later this Spring, when the State receives Final Payments on Corporate Income (April) and regular payments on Franchise taxes (March/April).

Non-Tax Revenue

Non-Tax collections for the first half of the fiscal year were projected at \$379.3 million. Revenue was slightly less than expected, missing the by target by \$4.6 million (or 1.2%). Weak collections in some Non-Tax revenue categories were offset by gains by investment income, which increased due to higher cash holdings and higher interest rates. Investment income was projected to generate \$45.6 million, but generated \$70.3 million for the first 6 months.

ECONOMIC OUTLOOK & REVENUE FORECAST

The economy is experiencing the second-longest recovery after a recession on record; in six more months it will surpass the 120-month expansion that ran from March 1991 to March, 2001. For now, most forecasters see a minimal risk of a downturn in the next six months, but the risk of a recession has increased.

Since August 2018, when the last General Fund Revenue Update was published, the economy's course has changed little. The economy is stronger now than it was a year ago, and is now experiencing solid growth in terms of both employment and wages. Nonetheless, there are headwinds on the horizon. A slowing global economy, trade wars, tighter financial conditions, and political instability are all capable of slowing or derailing the expansion.

In 2019, the national economy is expected to cool slightly with growth at or below 2.5%. Short-term economic stimulus from the federal tax changes boosted growth during the last half of 2018, but the stimulus has worn off, which means the economy is expected to return to a more modest pace of growth.

For North Carolina, current data on income and overall economic activity (i.e., Gross State Product) indicate that the State's economy is growing at a steady, solid pace. 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 the last recession.

For the rest of the fiscal year, expectations are that the State's economy will track very closely to the economic forecast underlying the consensus revenue forecast. Primarily, a tighter labor market will continue to boost wages and provide support for consumer demand.

APPENDIX

North Carolina General Fund Revenue by Revenue Source, Fiscal-Year-to-Date (\$ In Millions)

Tax Revenue	Target 2018-19	Actual 2018-19	Target Difference	Actual 2017-18	Y/Y Pct. Change
Personal Income	\$5,816.7	\$5,857.2	40.5	\$5,611.8	4.4%
Sales and Use	\$3,856.1	\$3,897.8	41.7	\$3,710.3	5.1%
Corporate Income	\$199.7	\$236.8	37.1	\$203.3	16.5%
Franchise	\$265.1	\$311.4	45.8	\$305.9	1.8%
Insurance	\$167.7	\$179.9	12.2	\$166.3	8.1%
Alcoholic Beverage	\$188.2	\$194.9	6.7	\$186.7	4.4%
Inheritance	\$0.0	\$0.2	0.2	\$10.0	
Privilege License	\$13.4	\$16.0	2.6	\$14.8	8.6%
Tobacco Products	\$131.0	\$132.9	1.9	\$132.1	0.6%
Real Estate Conveyance	\$37.7	\$41.1	3.4	\$37.3	10.4%
White Goods Disposal	\$2.7	\$2.1	(0.6)	\$5.5	-61.8%
Scrap Tire Disposal	\$6.3	\$6.5	0.2	\$5.9	10.7%
Mill Machinery	\$4.2	\$4.1	(0.1)	\$21.7	-81.2%
Solid Waste Disposal	\$5.7	\$6.3	0.6	\$5.9	6.2%
Other	\$0.2	\$0.3	0.1	\$3.3	
Total Tax Revenue	\$10,694.7	\$10,887.9	193.2	\$10,420.6	4.5%
Nontax Revenue					
Investment Income	\$45.6	\$70.3	24.7	\$40.9	71.8%
Judicial Fees	\$112.6	\$107.7	(4.9)	\$114.9	-6.3%
Insurance	\$21.8	\$15.5	(6.3)	\$18.9	-17.9%
Disproportionate Share	\$142.7	\$142.7	-	\$119.5	
Master Settlement Agreement	\$0.0	\$0.0	-	\$0.0	
Other	56.6	38.6	(18.0)	54.8	-29.5%
Total Nontax Revenue	\$379.3	\$374.7	(4.6)	\$349.0	7.4%
Total General Fund Revenue	\$11,074.0	\$11,262.6	188.6	\$10,769.6	4.6%