NORTH CAROLINA GENERAL ASSEMBLY
Legislative Services Office
Paul Y. Coble, Legislative Services Officer

Fiscal Research Division
300 N. Salisbury Street, Suite 619
Raleigh, NC 27603-5925
Tel. 919-733-4910 Fax 919-715-3589

Mark Trogdon, Director

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MEMORANDUM

TO: North Carolina General Assembly

FROM: Barry Boardman, Ph.D.
Fiscal Research Division

SUBJECT: General Fund Revenue Consensus Forecast

Fiscal Research and the Office of State Budget and Management have reached a consensus on the revenue forecast for the 2017-19 biennium. The notes below summarize the forecast.

Forecast Summary

(1) The forecast expects FY 2016-17 collections to be above the budgeted amount by $552.5 million (up 2.5%)[1] and that stable, modest growth will occur during the next biennium. The anticipated revenue surplus is predominately the result of stronger-than-expected wage growth increasing both Personal Income tax and Sales tax collections.

Fiscal Year	Revenues (millions)	Change (millions)
2015-16	$22,152.1	
2016-17(e)	$22,672.6	$520.5
2017-18(e)	$23,166.7	$494.1
2018-19(e)	$24,155.4	$988.7

Given the significant changes to the State's tax code over the past several years, which have affected over $2 billion in revenue this fiscal year, the biennium forecast will continue the cautious approach used in the previous biennium. Nonetheless, the forecast projects that total baseline revenues (i.e., total collections adjusted for tax rate and base changes) will grow at a pace near the long-term average growth rate of 4.5 %.

[1] Average forecast error ± 2.5%

Current Fiscal Year Revenue

Despite the guarded approach taken in developing the current fiscal year's forecast and the current target surplus, risks persist with respect to the current year's revenue outlook. April always has the potential to be a volatile collection month where sources of income from dividends, capital gains, and business income can result in sizable swings in income tax collections. The added volatility from State tax code changes, including adjustments to the withholding tables made in the 2016 session, compounds the difficulty in estimating net revenue from April 15th tax returns. Potential tax changes at the federal level could impact the timing of gains and losses taken by taxpayers when filing their 2016 taxes and 2017 estimated payments. This potential could add to the volatility typically experienced in April.

(1) General Fund revenues are forecast to increase by 2.3 % over the amount collected in FY 2015-16. This is ahead of the -0.1% decline that was forecast in May 2016 and adjusted by the 2016 session**.** The result is an estimated revenue surplus of $552.5 million above the $22.1 billion budgeted amount for the current fiscal year (2.5% above forecast).

(2) Personal Income tax collections are estimated to be above the forecast by 3.9 % this year. Individual wages have finally begun to grow and overall wage growth is now expected to be 5.1 %. Withholding revenue is running nearly 2.5 % above forecast for the first seven months of the fiscal year. The anticipated surplus this fiscal year in Personal Income tax collections is predominately the result of the stronger than expected wage growth.

(3) Sales tax growth has improved and revenues are now estimated to be slightly ahead of the budgeted forecast by 1.3 %. Sales tax collections began to gain momentum this past spring, and as consumer confidence grew Sales tax collection stabilized. The Consumer Confidence Index, which measures how optimistic consumers are about the economy, reflects that most consumers remain confident about the economy. Continued lower gas pump prices are also providing some support for higher retail sales. The Sales tax base has been broadened to include services related to repairs, maintenance and certain installations. This change to the tax base adds some uncertainty to the forecast's expectation for Sales tax growth.

(4) Further complicating this year's forecast are how refunds and final payments may change as a result of changes to the Personal Income tax withholding tables. These changes are the result of a statutory adjustment on the amount to be withheld beginning in 2016 (0.1% more), and for 2017, the increase in the standard deduction.

Outlook for the 2017-19 Biennium

(1) Since the end of the Great Recession in 2009, the economy has made steady gains adding 75,000 to 95,000 jobs per year. However, overall economic activity remains at or slightly-below average, as truly robust, expansionary growth has yet to be seen. Accordingly, the forecast assumes steady, near-average growth throughout the upcoming biennium.

(2) The employment outlook for the State has stabilized over the last year, and continued improvement is anticipated. Employment is expected to experience steady gains of 1.8 % each year of the biennium. Non-farm employment is forecast to net 80,000 to 90,000 jobs in each fiscal year.

(3) Employment is closely tied to personal income, and projected employment gains should improve the prospects for better income growth. The consensus forecast envisions 2.0 % and 4.7 % growth in personal income collections for the respective fiscal years (growth rates include tax reductions enacted in 2015 and 2016). Those numbers are built primarily on the anticipation of employment gains placing upward pressure on wages. Wage and salary growth has been well below expectations, not keeping pace with the improving overall economy. Recent data on wages suggest that trend is beginning to change.

(4) Sales tax collections are forecast to increase by 4.7 % and 4.6 %, respectively this biennium, which is slightly above average. Several factors influence the forecast. Household balance sheets continue to improve and consumers are more confident about making spending decisions. Additionally, lower energy prices, which are expected to persist through most of 2017, continues to free up income for other purchases.

(5) Corporate Income tax collections are always volatile with yearly swings by as much as 30 to 35 %. After several years of double-digit growth, corporate profits are expected to moderate over the next several years. The 5.7 % growth expected over the biennium will be offset by recently-enacted Corporate Income tax rate reductions. The 5% tax rate from 2015 was lowered to 4% in 2016 and will drop again to 3 % in 2017. The result is that net Corporate Income tax collections will fall 10.5 % in the upcoming fiscal year and grow by 3.6 % in the following year.

(6) **Putting all these assumptions together yields 4.5 % baseline growth of General Fund revenues in 2017-18 and 4.7 % growth in 2018-19.** The following table compares baseline actual and expected growth rates over the past decade.

Fiscal Year	Baseline Growth Rate (%)
2007-08	5.4
2008-09	(11.2)
2009-10	(5.5)
2010-11	5.4
2011-12	6.2
2012-13	7.3
2013-14	0.8
2014-15	5.2
2015-16	5.4
2016-17 (e)	4.6
2017-18 (e)	4.5
2018-19 (e)	4.7

(7) The revenue outlook for the 2017-19 biennium reflects a forecast for moderate, steady economic growth. Employment growth is projected to continue at its current pace throughout the biennium. The forecast envisions growth in the economy established in 2016 to remain stable throughout the forecast period. The State's overall economic activity is expected to outpace the nation as a whole. Below are key income indicators that influenced the forecast.

KEY ECONOMIC INDICATORS: February 2017 Forecast

Economic Indicator	FY 2016-17	FY 2017-18	FY 2018-19
NC Real Gross State Product	2.3%	2.9%	3.1%
NC Total Non-Farm Employment	1.9%	1.8%	1.8%
NC Unemployment Rate	4.8%	4.6%	4.2%
NC Income: Total Personal	4.0%	5.2%	5.8%
NC Income: Wages & Salaries	5.1%	5.2%	5.7%
NC Retail Sales: Total	4.5%	4.9%	5.1%
NC Population	1.0%	1.0%	1.0%
Consumer Confidence Index	104.2	103.5	99.3

Source: FRD and OSBM, based on national and state forecasts provided by Moody's Analytic economy.com and IHS-Markit