

# GENERAL FUND REVENUE REPORT & ECONOMIC OUTLOOK

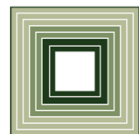


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**FISCAL RESEARCH DIVISION**

A Staff Agency of the North Carolina General Assembly

# Highlights

- General Fund revenue through February is above target, but by less than 1%.
- Key revenue sources, sales tax collections and withholding income tax, continue to out pace budget forecast projections.
- National and State economic data indicate the recovery is progressing at a slow pace.
- Employment picture is troublesome with little growth being reported.
- Major global risks are looming with inflation from rising food and gas prices, sovereign debt issues, and the disaster in Japan.

# How Do 2010-11 Revenues Look So Far?

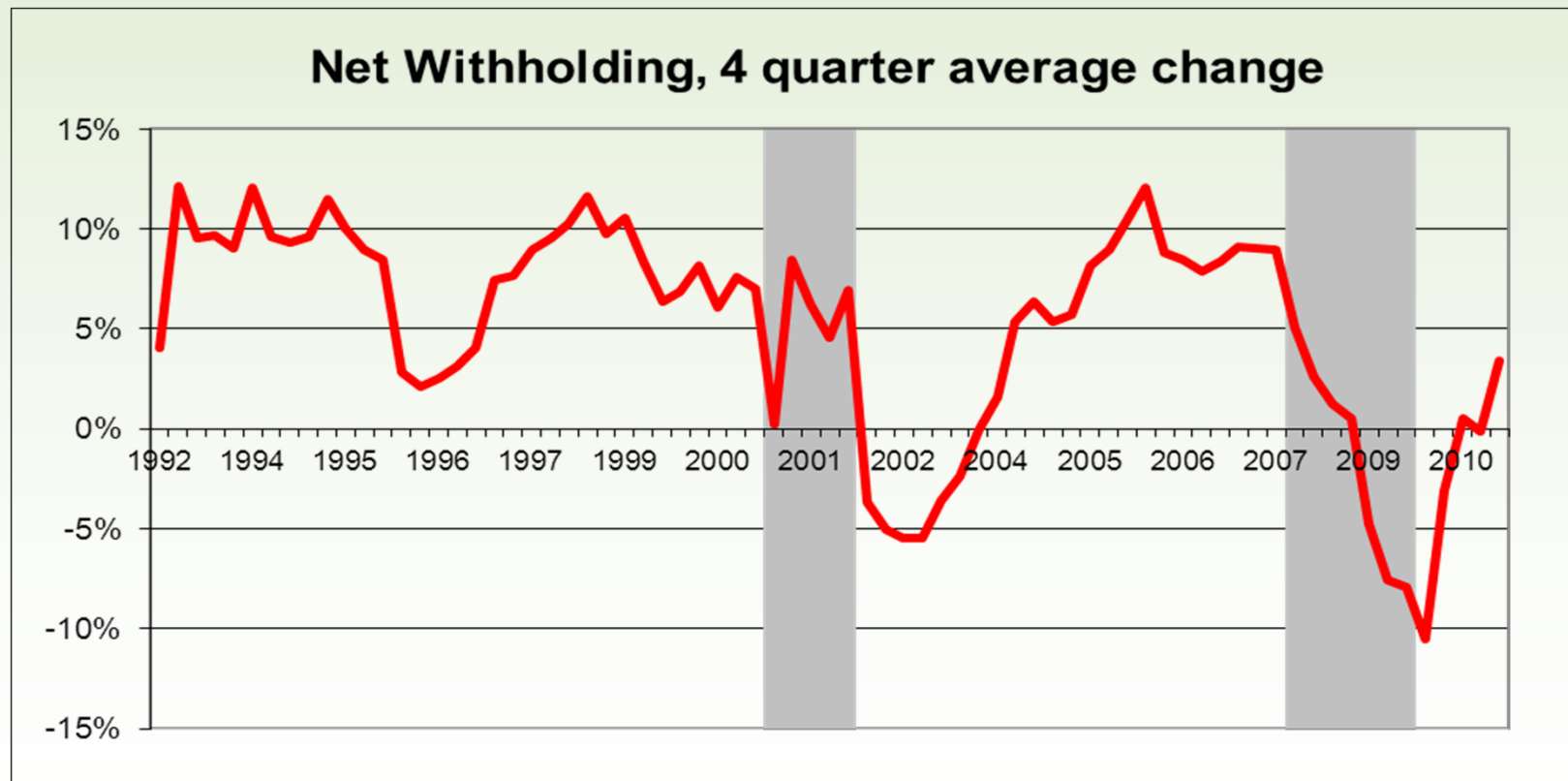
- Through February, General Fund revenues are \$78 million above a \$12.15 billion forecast target.
  - Tax revenues are \$129 million *above* the \$11.52 billion target. Non-tax revenues, which include short-term investment income and judicial fees, are \$51 million *below* the \$627 million target.
    - Sales tax and income tax collections, are running slightly ahead of their forecast targets.
    - The December/January estimated income payments were 12% higher than last year. This is the first time these payments have had yearly gains in almost 3 years.
  - **Most of the forecast volatility resides in the second half of the year.** Especially April, when large income payments and refunds come into play.

# How Do 2010-11 Revenues Look So Far?

- Net income tax withholding on wages and salaries are up 1.4% for the first seven months of the fiscal year.
  - Withholdings from larger employers have posted positive year-over-year gains the last several months and were up 7.1% in February, and 3.3% for the year.
- Gross Sales Tax collections have improved significantly and February's collections continued that trend. They were up over last year by 3.9%.
  - Baseline (tax-adjusted) sales tax collections for the first seven months of the fiscal year were up 2.8%.
  - Baseline collections for this fiscal year are slightly below where they were for the same period in FY 2005-06, despite a population increase of 800,000 people.
  - Per capita baseline collections are down 11% compared to five years ago.

# Tracking Economy-Based Collections

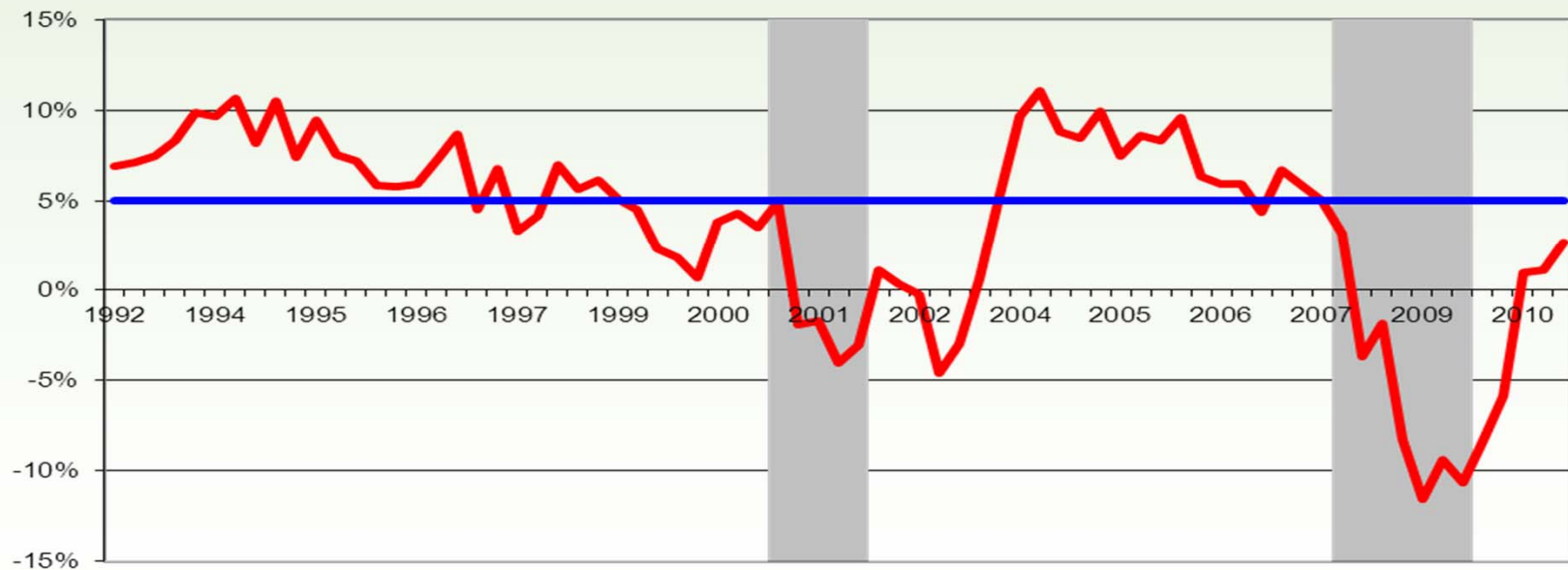
Net withholdings (wage and salary withholdings less refunds) continue to strengthen. These gains may stall out without some modest employment improvements this spring.



# Tracking Economy-Based Collections

Baseline sales tax collections are maintaining positive growth despite soft consumer confidence and little positive news available on the employment picture. If commodity prices (mostly food and gas) continue to increase, then sales tax collections will likely suffer. Neither gas or grocery store food are in the State's sales tax base.

**Quarterly Baseline Sales Tax Collections  
(change over prior year)**



# Key Economic Trends

Consumer confidence rose significantly in February, reaching its highest level since February 2008 (70.4). Confidence appears to be moving consistently higher, but it is still well below pre-recession levels. If food and gas prices continue to rise, this could dampen the recent boost in consumer confidence.

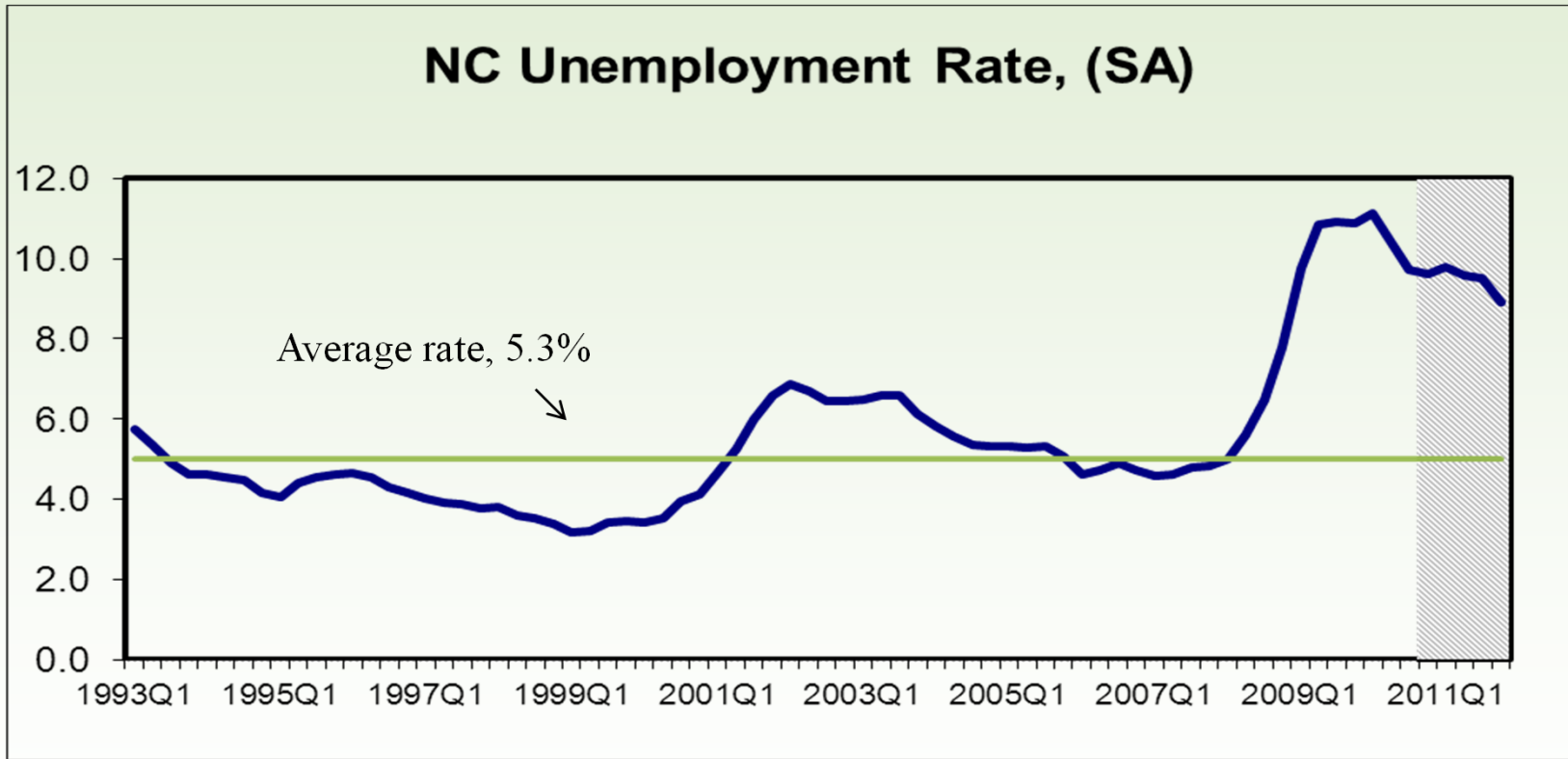
## Consumer Confidence



Source: The Conference Board

# Key Economic Trends

The unemployment rate (forecast shaded in gray) is expected to remain above 9% until the 4<sup>th</sup> quarter of 2011. The State's unemployment rate in January was 9.9%. It was 11.4% last February.

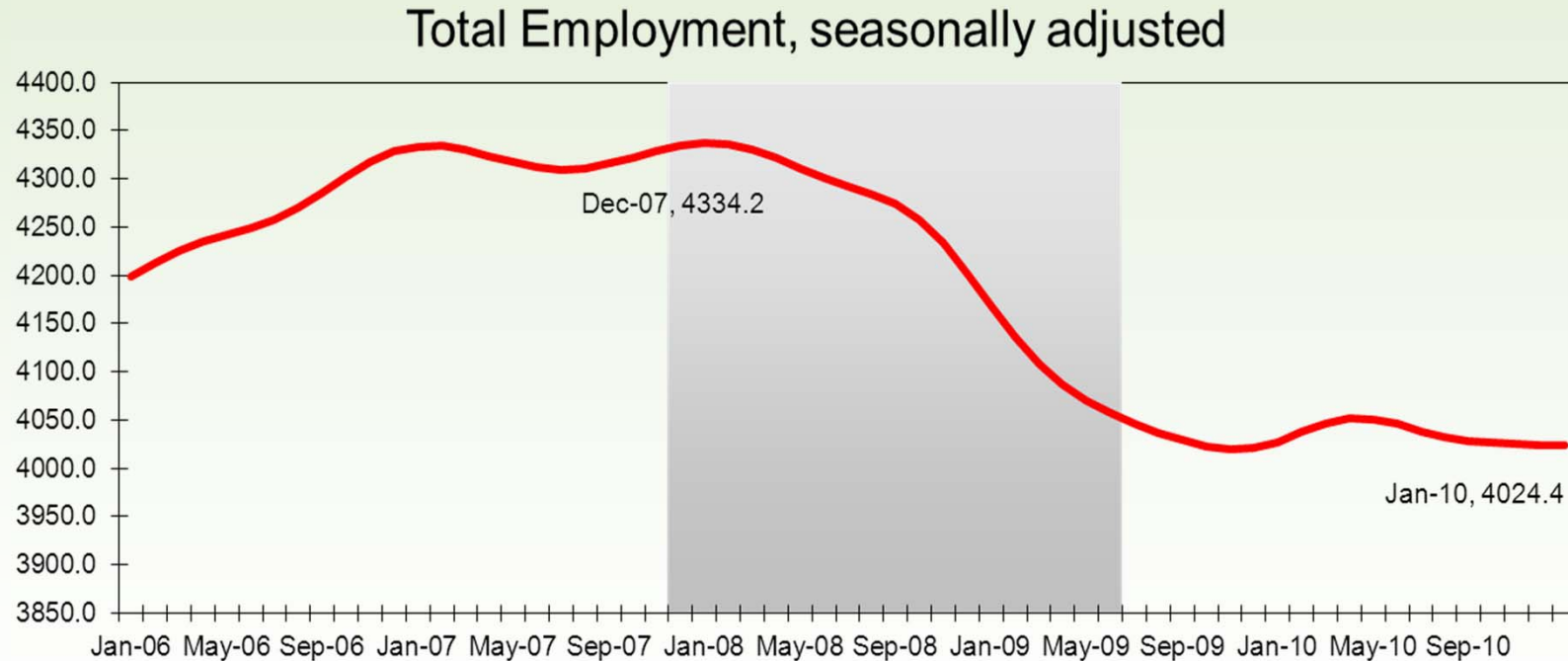


Source: Actual data from the NC Employment Security Commission



# Key Economic Trends

Total employment remains unresponsive 19 months into the economic recovery. With 300,000 fewer jobs and almost no growth since job losses bottomed-out, it is difficult to envision sustainable growth in the overall economy.



Source: NC Employment Security Commission

# Key Economic Trends

Initial claims, a measure of the number of jobless claims filed by individuals seeking to receive State jobless benefits, have dropped significantly since the onset of the recession. They are still elevated above the pre-recession levels of 2007.



Source: NC Employment Security Commission

# State's Economic Outlook

- Employment numbers in most of the State's industry sectors remain near recession levels.
  - Since the start of this fiscal year, establishment, non-farm employment has **fallen** by 12,000 jobs. Almost half of the loss has been in Government sector jobs.
- Compared to last January, Manufacturing, Trade, Financial, and Professional Services have posted modest gains. The Education and Government sectors, which had held steady for most of the recession have begun to shed jobs.
  - Private Sector Employment, Jan. 2010 to Jan. 2011: is **up** 2,100 jobs
  - Government Sector Employment, Jan. 2010 to Jan. 2011 : is **down** 7,700 jobs

# State's Economic Outlook

- The State's economic conditions continue to improve. Economic headwinds from the housing market's problems and the weak employment market are still a drag on economic growth and will persist throughout 2011.
  - The housing market is still out of balance with many more houses available than buyers, but foreclosures, which have exacerbated the housing market's woes, have begun to abate.
  - The glut of homes available for sale means there is little demand for new construction. Any rebound in construction jobs will have to come from commercial construction, which is starting to rebound.
  - The unemployment rate remains high, but initial claims for unemployment benefits are slowly returning to pre-recession levels and should start to move the rate downward.
- These improvements are quite modest and reflect the fragile nature of the economic expansion.

# State's Economic Outlook

- There has been little change in the outlook since our last report in January. Based on those and other recent forecasts for the State, significant changes in the employment picture should not be expected until the end of 2011 at the earliest.
  - Employment has a long way to go to reach pre-recession levels. Given the 6% decline that occurred during the recession, it could take another 2 to 3 years before the State returns to pre-recession levels of employment.
  - The slow rate of recovery is consistent with recessions caused by structural problems in the financial markets.
- Recent global turmoil has forecasters moving into a more cautious position. These problems, while significant, could be shrugged off by a more robust economy. Given the fragile nature of current economic conditions, this global turmoil has a greater chance of disrupting the progressing recovery.

# Major Forecast Risks

- Rising prices in commodities, stagnant employment growth, and little wage growth are a potent cocktail for an economic slowdown or downturn.
  - Turmoil in the Middle East has driven oil prices above \$100. Most economists think consumers and the overall economy can absorb this increase. If tensions continue to escalate and oil prices rise to the \$140 to \$150 a barrel range, then we will see some disruption to the economy.
- The European sovereign debt crisis has been on the back burner of late, but problems still persist and could yet prove to be a significant drag on the global economy.
- The disaster in Japan stemming from a powerful earthquake will have some short-term repercussions on the global economy. Current thought is the impact, while troublesome, will be relatively mild. If the nuclear plant problems grow, that could change.
  - Japan's economy is the third largest in the world behind the U.S. and China.

# Conclusions

- The State's economy is expected to follow the national trend and continue down the current path of a slow, steady recovery. Once the economy picks up steam, North Carolina is expected to outpace national average growth.
- The economy is gaining solid footing on many fronts, but as long as employment growth remains anemic, then the recovery will continue along a much slower track. This will also make the upturn in the economy more fragile and susceptible to economic shocks.
- Such types of shocks have reared their head of late and are poised to derail the recovery if they worsen.
- The greatest risk to General Fund revenue resulting from the fragile economic recovery and recent global events will be to next fiscal year's revenue projections (FY 2011-12). Those projections were predicated on an economy that was gaining strength with each quarter of the year.