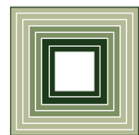


GENERAL FUND REVENUE REPORT & ECONOMIC OUTLOOK



February 2012
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FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Highlights

- General Fund revenues through February are \$145 million above an \$11.1 billion revenue target.
- Key revenue sources, sales tax collections and withholding income tax, continue to equal or surpass budget forecast.
- Recent economic data indicate the recovery is slowly regaining the traction lost this past summer and fall.
- The employment picture remains troublesome with very little growth being reported or expected for most of this year.
- Global economic risks continue to threaten the recovery, particularly rising gas prices and the Eurozone's debt problems.

How Do 2011-12 Revenues Look So Far?

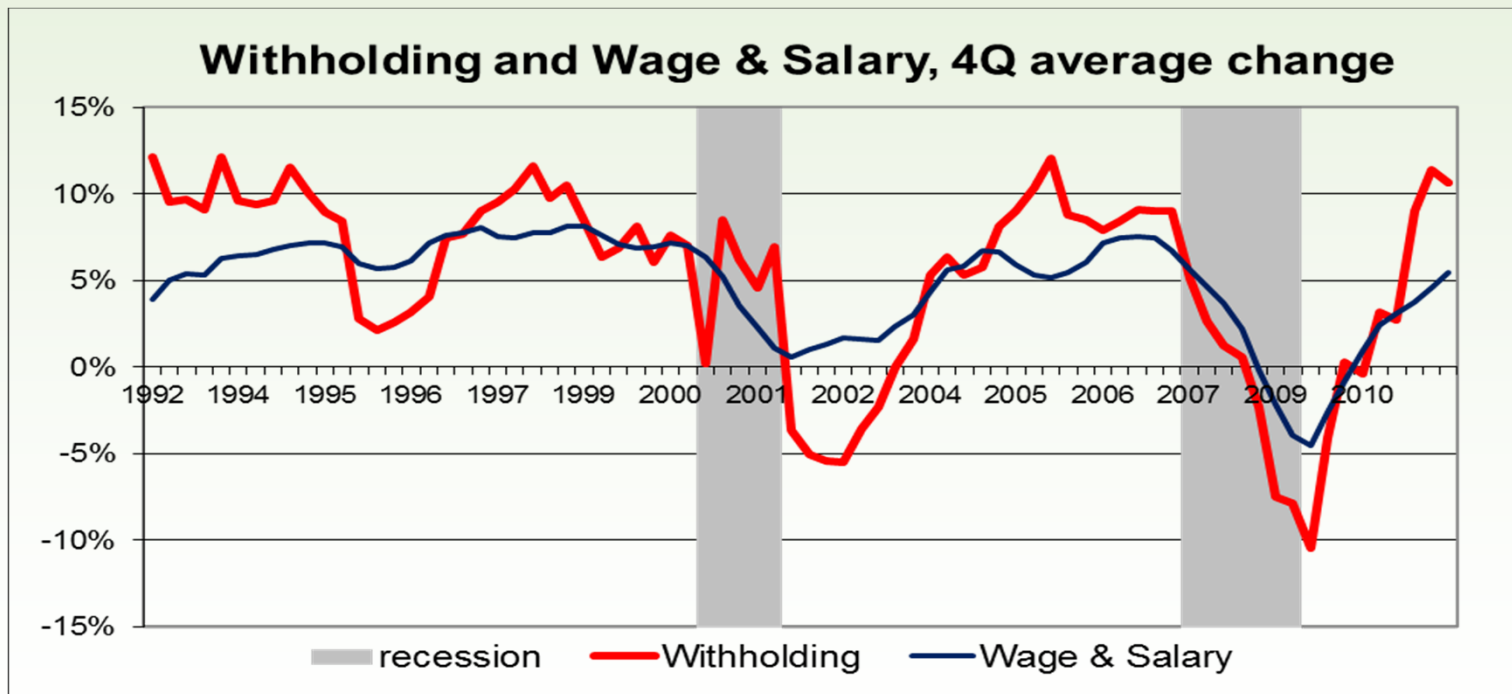
- Through February, General Fund revenues are \$145 million above a \$11.1 billion revenue forecast target.
 - Tax revenues are \$195 million *above* the \$10.5 billion target.
- Income tax collections are 3% above target, while sales tax collections are on target through February.
- The December/January estimated income payments were 2.3% higher than last year.
 - When small year-over-year changes occur in estimated payments, no insight can be gained with respect to net final payments in April.
- Non-tax revenues, which include short-term investment income and judicial fees, are \$50 million below the \$567 million target

How Do 2011-12 Revenues Look So Far?

- Income tax withholding on wages and salaries is up 2.4% for the first seven months of the fiscal year.
 - Withholdings from larger employers continue to post positive year-over-year gains and are 2.1% above target for the year.
- Baseline sales tax collections have improved significantly. January's collections were up 7.5% over last year.
 - Baseline (tax-adjusted) sales tax collections for the first seven months of the fiscal year were up 7.1%.
 - Baseline collections for this fiscal year are slightly below where they were for the same period in FY 2006-07, despite a population increase of 750,000+ people.
 - In other words, per capita baseline collections are down 7.2% compared to five years ago (see chart on page 6).

Tracking Economy-Based Collections

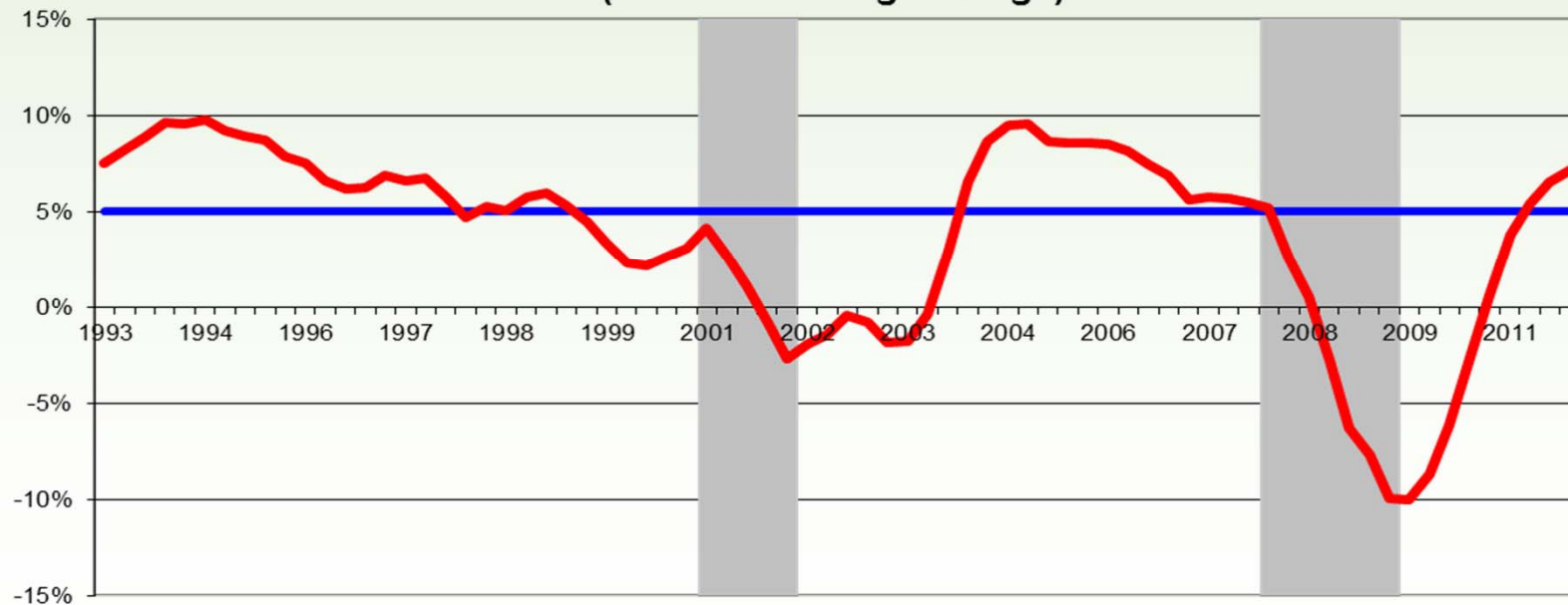
- Net withholdings (wage and salary withholdings less refunds) have improved significantly this past year. These gains have flattened out over the last several months and without further improvements in employment could begin to slip below revenue targets.



Tracking Economy-Based Collections

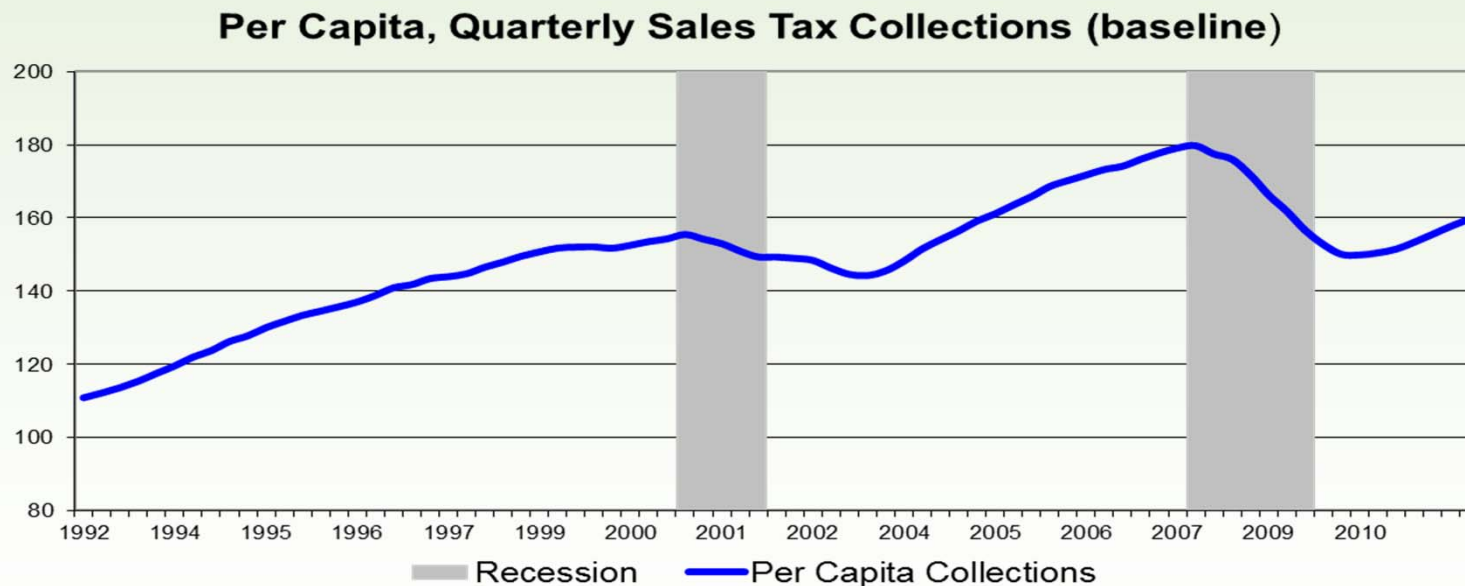
- Baseline sales tax collections continue positive growth despite a weak employment picture. If food and gas prices begin to increase, sales tax collections will likely suffer; neither gas or grocery store food are in the State's sales tax base.

**Quarterly Baseline Sales Tax Collections
(4 Month Moving Average)**



Tracking Economy-Based Collections

- January sales receipts were 1.5% below target. For the rest of the fiscal year, revenue targets are fairly aggressive with growth at 6%. Historically, sales receipts grow at just above 5%. Given that we are 7.2% below per capita collections from 5-years ago, the targets are less aggressive than they appear.



State's Economic Outlook

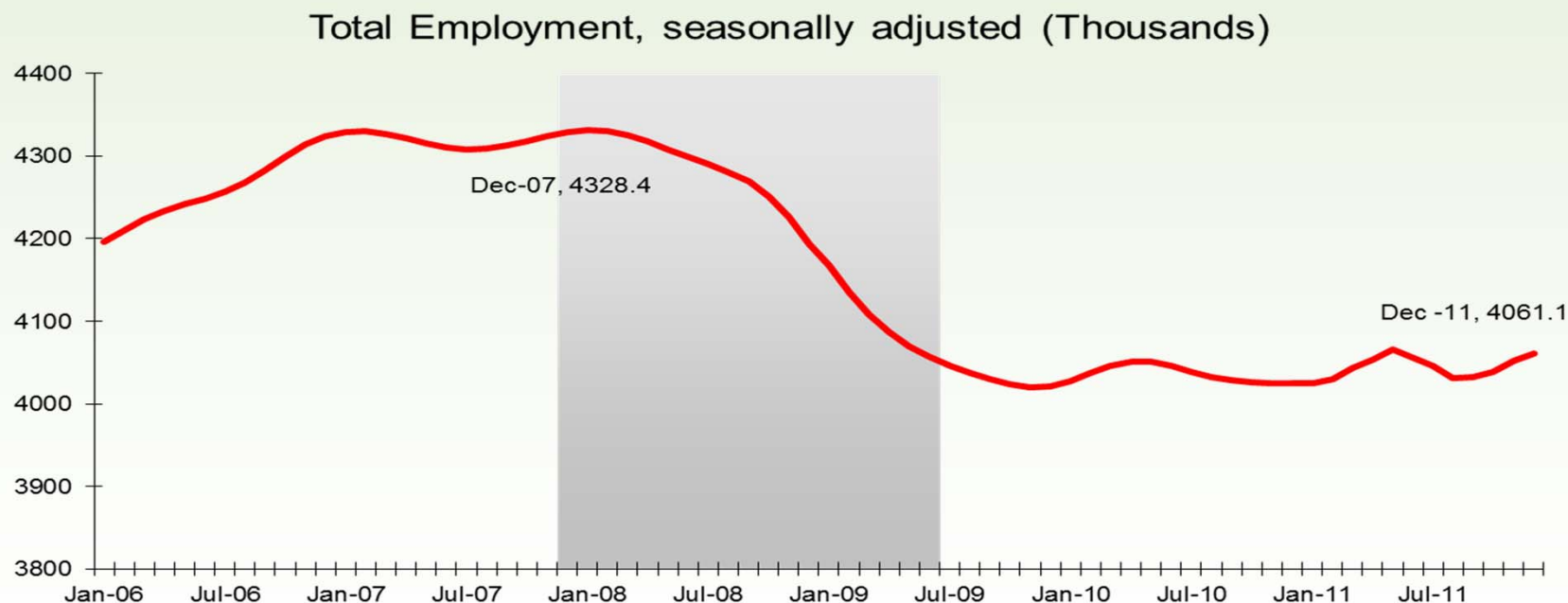
- There has been little change in the outlook since our last report in November. Recent forecasts for the nation and the State anticipate a subpar economy throughout 2012.
- Economic activity is picking up across the State with increases in Gross State Product (a broad measure of economic activity) anticipated with growth at or above average into 2013.
 - Unfortunately, the increase in economic activity is not translating into increases in employment.
 - Employment growth should gather steam during 2012, but growth will not be robust enough to push the unemployment rate below 9% until late 2013 or into 2014.

State's Economic Outlook

- Employment numbers in most of the State's industry sectors have barely moved off recession lows.
 - Since July 2011, non-farm employment has increased by only 4,500 jobs (0.5% increase).
 - Since the recession ended in June 2009, non-farm employment data shows a loss of 22,700 jobs through December 2011.
- Compared to last year, Manufacturing and Construction have posted no gains. Education & Health Services; Trade; and the Leisure & Hospitality sectors have gained between 1% and 3%.
- From December 2010 to December 2011:
 - Private sector employment increased by 12,400 jobs.
 - Government sector employment decreased by 7,900 jobs

Key Economic Trends

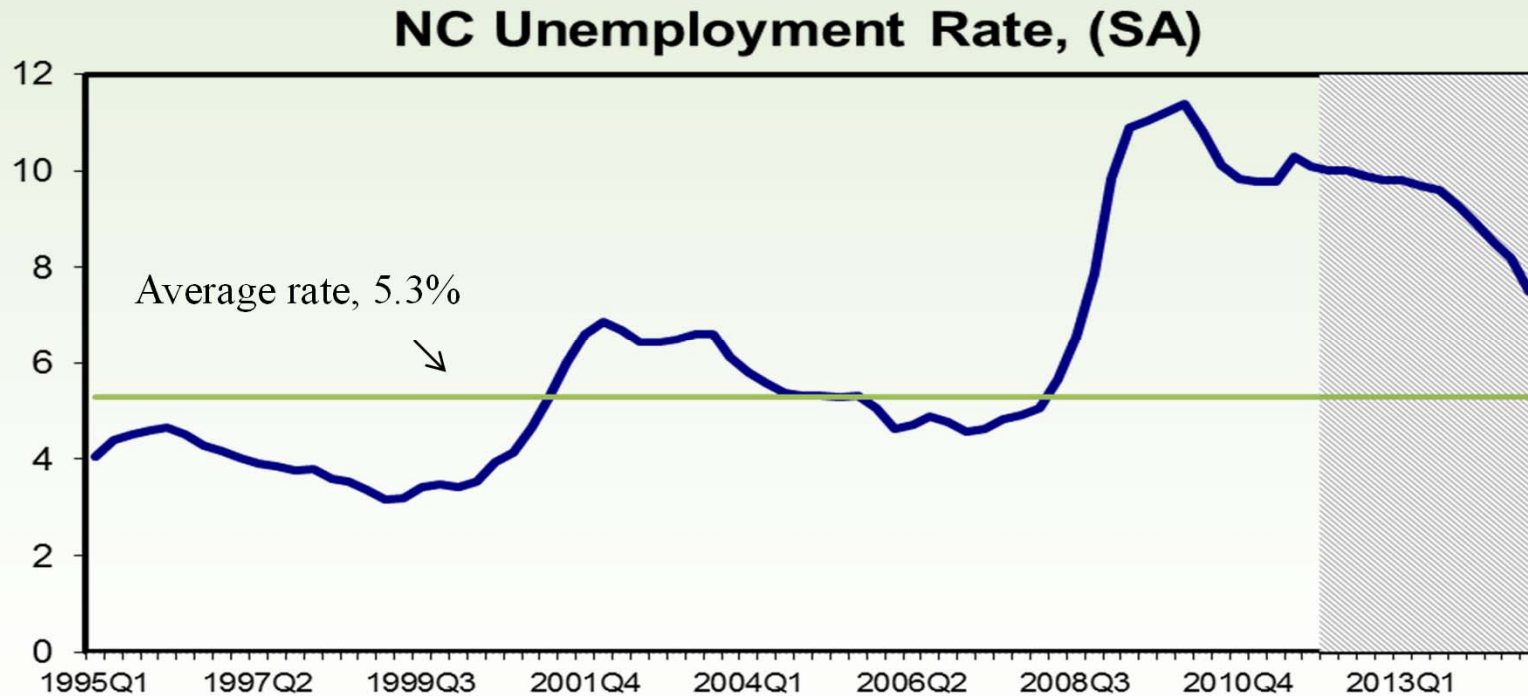
- Employment is still struggling to gain traction 30 months into the economic recovery. With almost 300,000 fewer jobs in the State and only 41,500 jobs added since losses bottomed-out in November 2009, strong growth in economic activity is unlikely to occur anytime soon.



Source: NC Employment Security Commission

Key Economic Trends

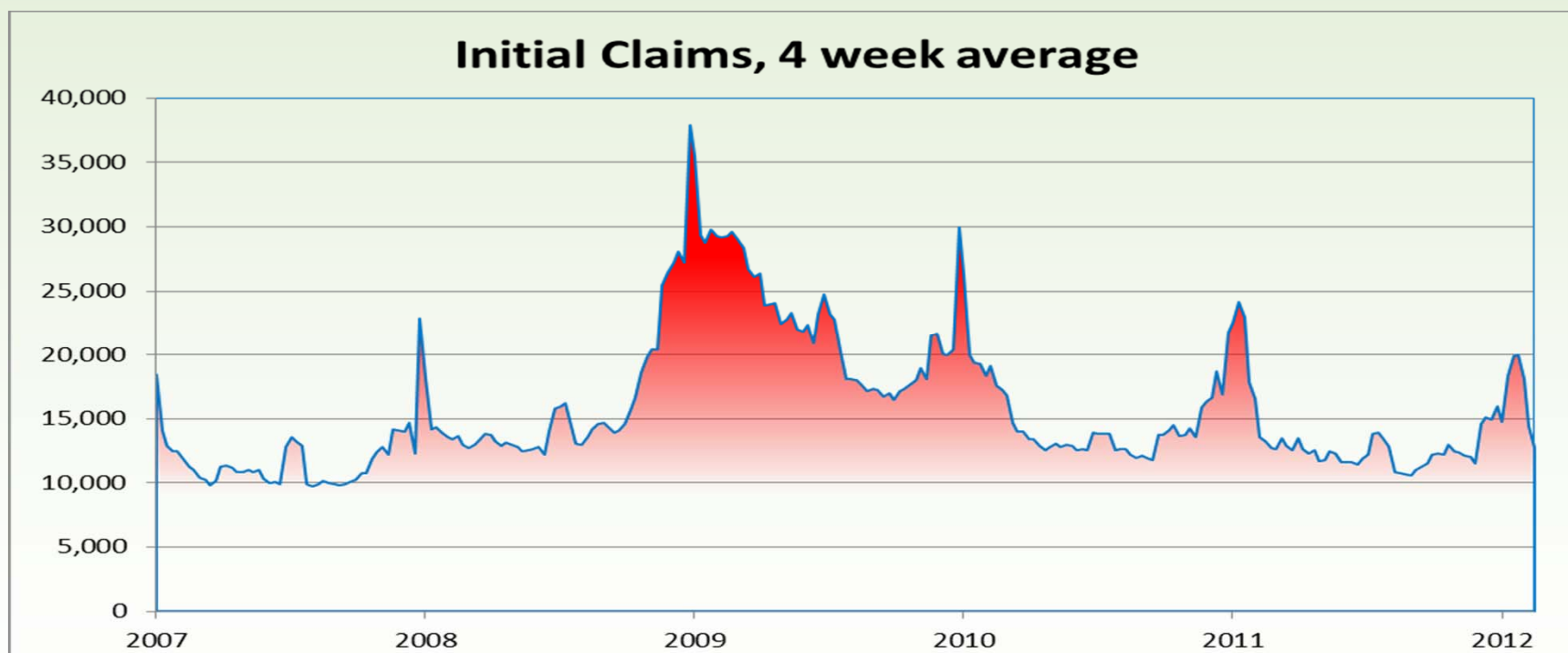
- The unemployment rate is expected to remain above 9.5% until the 4th quarter of 2012. The State's unemployment rate in December was 9.9%, nearly the same as February 2011 (9.8%).



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

Key Economic Trends

- There are signs that the job market is improving. Initial claims (the number of jobless claims filed by individuals seeking State jobless benefits) have lessened and are approaching the pre-recession levels of 2007.



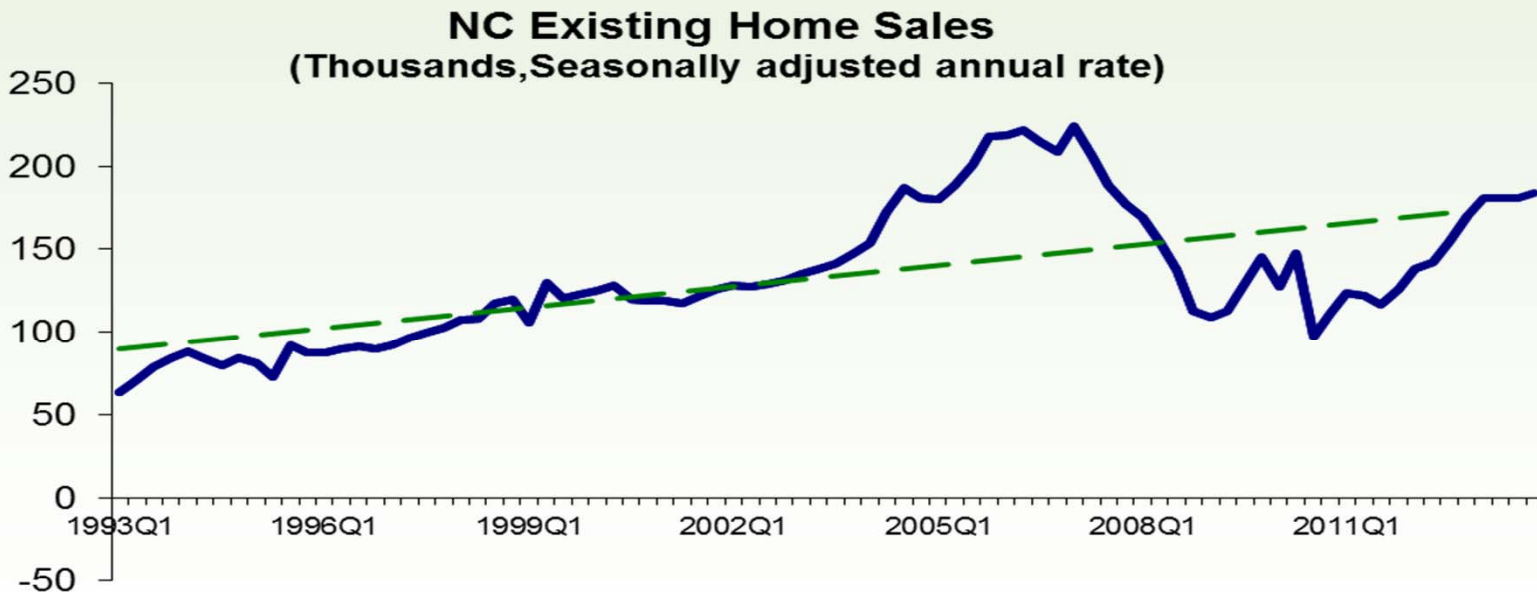
Source: NC Employment Security Commission

State's Economic Outlook

- One of the keys for improvement in the State is housing. The economic headwinds caused by the housing market's problems still persist four years after the start of the housing decline. Good news is the housing market is finally starting to show some improvements.
 - The housing market remains out of balance with more houses available than buyers. Foreclosures, which have exacerbated the housing market's woes, have begun to abate. Nonetheless, prices continue to fall as the market tries to clear the excess caused by falling demand and a rise in distressed (including foreclosed) homes for sell.
 - The housing surplus means there is little demand for new construction; however, recent forecasts expect new housing starts to increase by 2013. They reached a low of 33,296 in 2010, compared to the high of 95,408 in 2006.
 - Despite the State's apparently-modest exposure to the housing bubble in 2007, we have experienced one of the Southeast's slower housing recoveries. Florida and Georgia still lead the way in terms of housing difficulties.

Key Economic Trends

- The housing bubble began in 2002 and burst in 2008, causing home sales to plummet. The green dashed line indicates the long-term growth trend in existing home sales. Our forecast indicates that existing home sales will return to trend by the first quarter of 2013.



State's Economic Outlook

- **We have been here before!**
- Last year the economy appeared to be gaining solid footing and growth was poised to finally accelerate. The unemployment rate had fallen to 9.7% in May.
- Global turmoil in the Eurozone and the natural disaster in Japan were yet to unfold. By mid-summer it was clear that sovereign debt in Europe, supply disruptions in Japan, and rapidly-rising gas prices would place a major drag on the economy.
- The State's unemployment rate began to steadily increase and in September peaked at 10.5%.
 - In September there were an estimated 33,000 fewer people employed in the State than in May (seasonally adjusted).

State's Economic Outlook

- The State's economy weathered this slowdown and avoided a recession, revealing an underlying strength that could propel us forward at a much-improved pace, barring a return of some of the same old culprits.
 - **Caution:** Parts of Europe may already be in a mild recession, the debt problems are still unresolved, Japan is reporting negative economic growth, and energy prices are rising again.
- The slowdown this summer affected the State, but many key indicators continued to move upward from the lows of 2009 and 2010.
 - Wage and Salary income grew each quarter of last year.
 - Retail Sales have been steadily on the rise.
 - The job losses from May to September have been recovered.

Forecast Risks

- As noted, we have been here before, and in more ways than one. Just as with last year, the economy appears to be on more solid footing, but trouble is looming yet again with the threat of rising prices in commodities, continued slow employment growth, and potential recessions in Europe and Japan.
 - The US economy withstood the last round of negative economic shocks, but remains fragile. The question is, is the economy strong enough to withstand another round of shocks?
- Few if any economic forecasters envision our economy rising above moderate growth levels in 2012. Some are suggesting that employment growth is still a year or more away.
- This means that some of the assumptions made in the FY 2012-13 revenue forecast may not come to fruition. Fortunately, the biennium forecast adhered to a cautious philosophy, which could minimize the impact of recently downward revisions of economic forecasts.

Conclusions

- The State's economy is expected to continue following the national trend of slow, yet steady, economic growth.
- The economy is regaining solid footing on many fronts, but as long as the State's employment growth remains anemic, then the recovery will continue along a much slower track. This will also make the upturn in the overall 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 yet again.
- 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 2012-13). Those projections were predicated on an economy that was gaining strength with each quarter of the year.