

GENERAL FUND REVENUE REPORT & ECONOMIC OUTLOOK

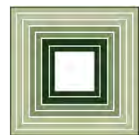


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FISCAL RESEARCH DIVISION

A Staff Agency of the North Carolina General Assembly

Highlights

- General Fund revenue through three quarters of the fiscal year is \$110 million above a \$14.3 billion revenue target.
- The State's economy has steadily been gaining strength. We anticipate the pace of economic growth to stay on a steady, upward trend.
- Federal sequestration policies may put the pace of growth at risk and as the effects begin to take hold this summer.
- Unlike the last several years, an “April surprise” is more likely especially given the added volatility from the new \$50k business exemption and taxpayers' reactions to federal tax changes.

2012-13 Revenue Through December

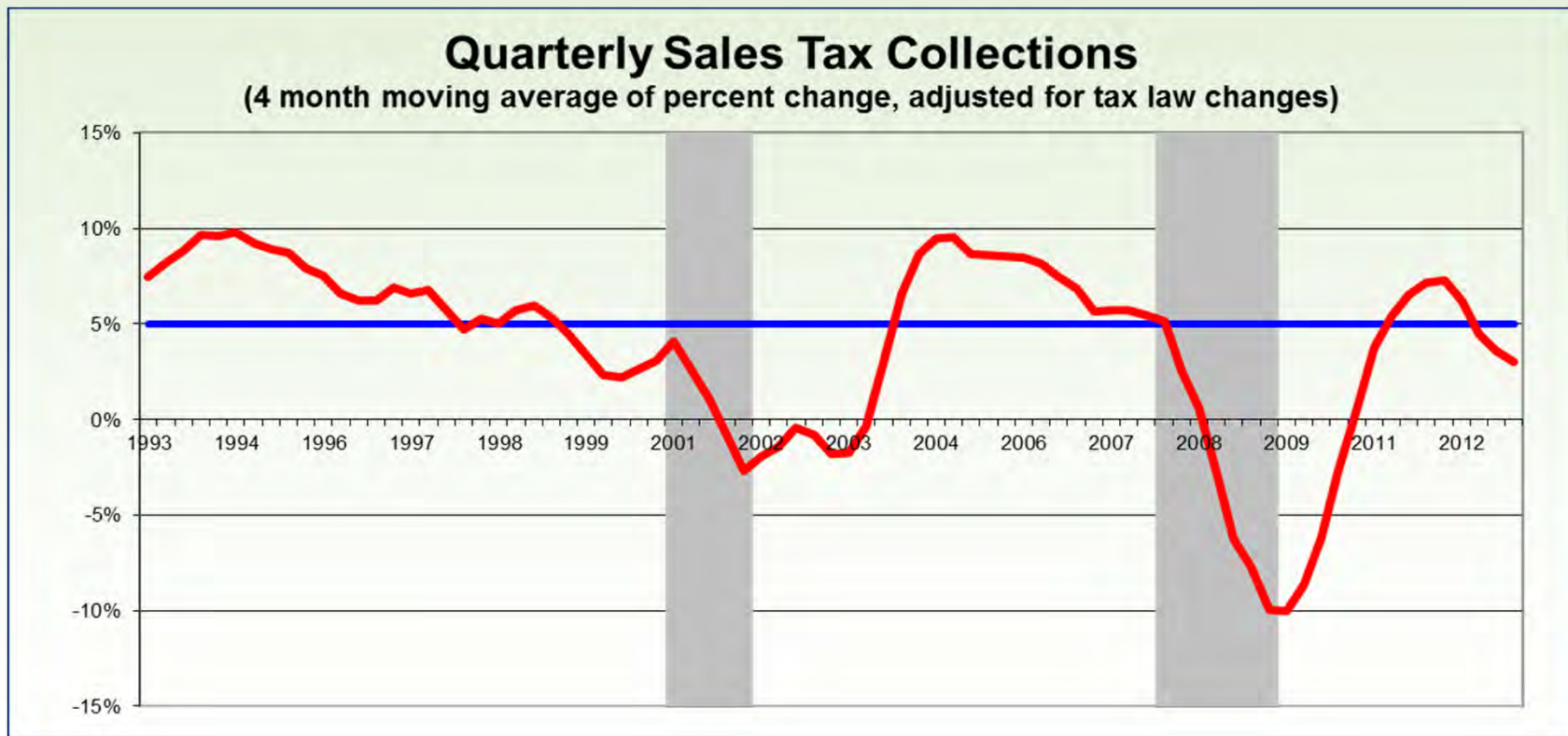
- Through March, General Fund revenue is \$110 million above a \$14.3 billion revenue target.
 - Tax revenues are \$126 million above a \$13.5 billion target.
 - Income tax collections are 1.5 % ahead of the budget target.
 - Sales tax collections remain weak with gross collections (total collections before refunds and transfers) 1.4% below target.
 - Non-tax revenues, which include short-term investment income and judicial fees, are \$16.3 million below the \$613 million target.

2012-13 Revenue Through December

- Through the first three quarters, income tax withholding on wages and salaries is up over last year by 5.6%.
 - The third quarter (Jan. – Mar.) withholding collections were slightly ahead of target with 5.2% growth.
- Baseline sales tax collections picked up the first two months of the third quarter growing above the 3.1% fiscal year target, but in March slowed to 2.8% growth.
 - The slowdown in March has been attributed to the two percent federal payroll tax cut that ended at the start of the year.
 - For the year, net sales tax collections (after refunds and transfers) are \$90 million below the \$4.0 billion target. The late summer slowdown in the economy is the main reason sales tax collections are below target. Since October, sales have tracked at or slightly above the budget targets.

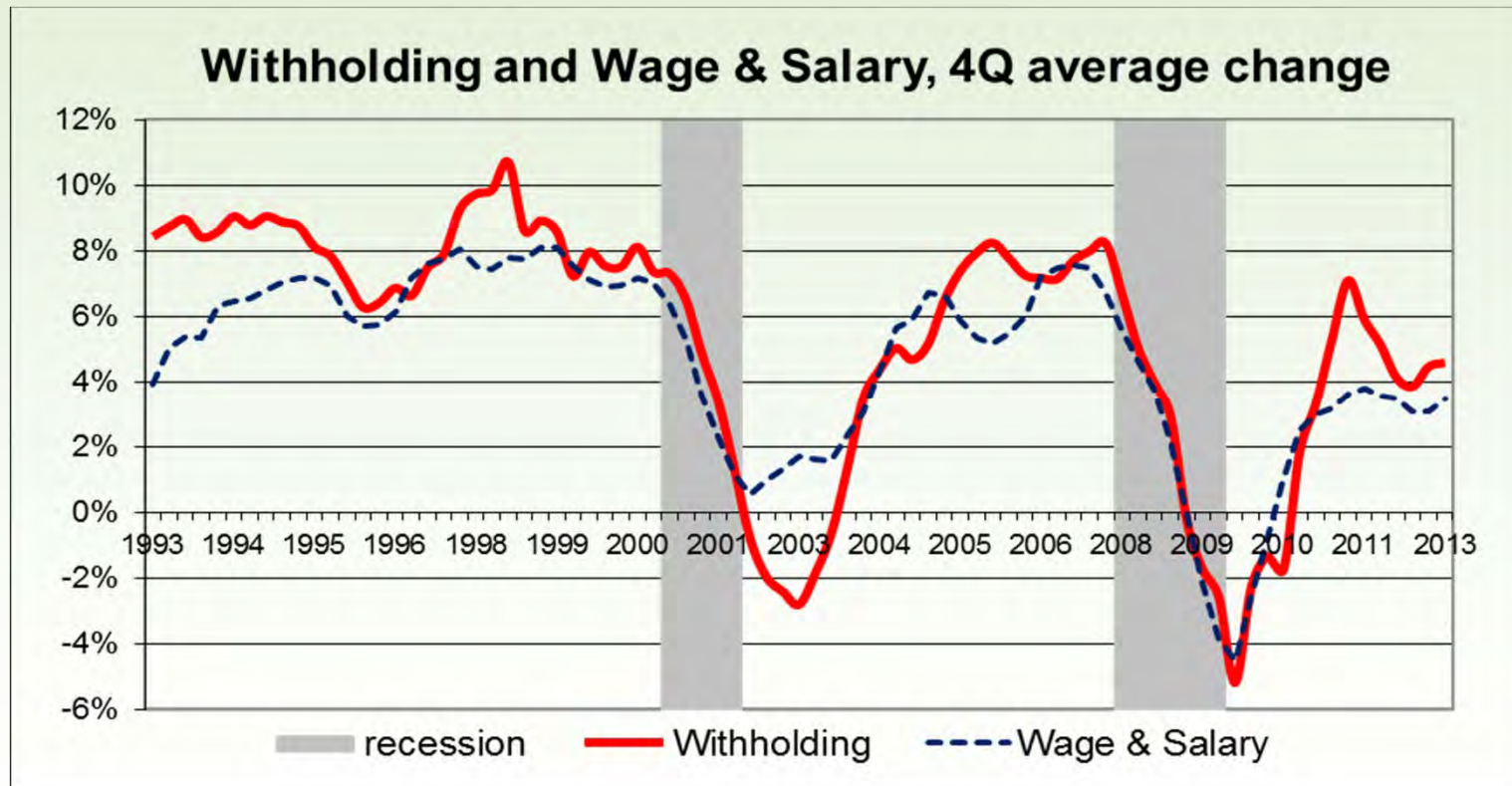
Tracking Economy-Based Collections

The consensus forecast expects baseline sales tax growth for FY 2012-13 to be 3.1%, well-below last year's growth of 6.3%. Weak growth the first-half of the fiscal year has put added pressure on the second-half of the fiscal year to meet this expectation. Thus far, the rebound in sales have not overcome the slow start.



Tracking Economy-Based Collections

The growth in Personal Income withholding continues to be the strongest, most consistent source of General Fund revenue and this fiscal year is no different. Third quarter growth picked up pace with the increase in wage and salary income.

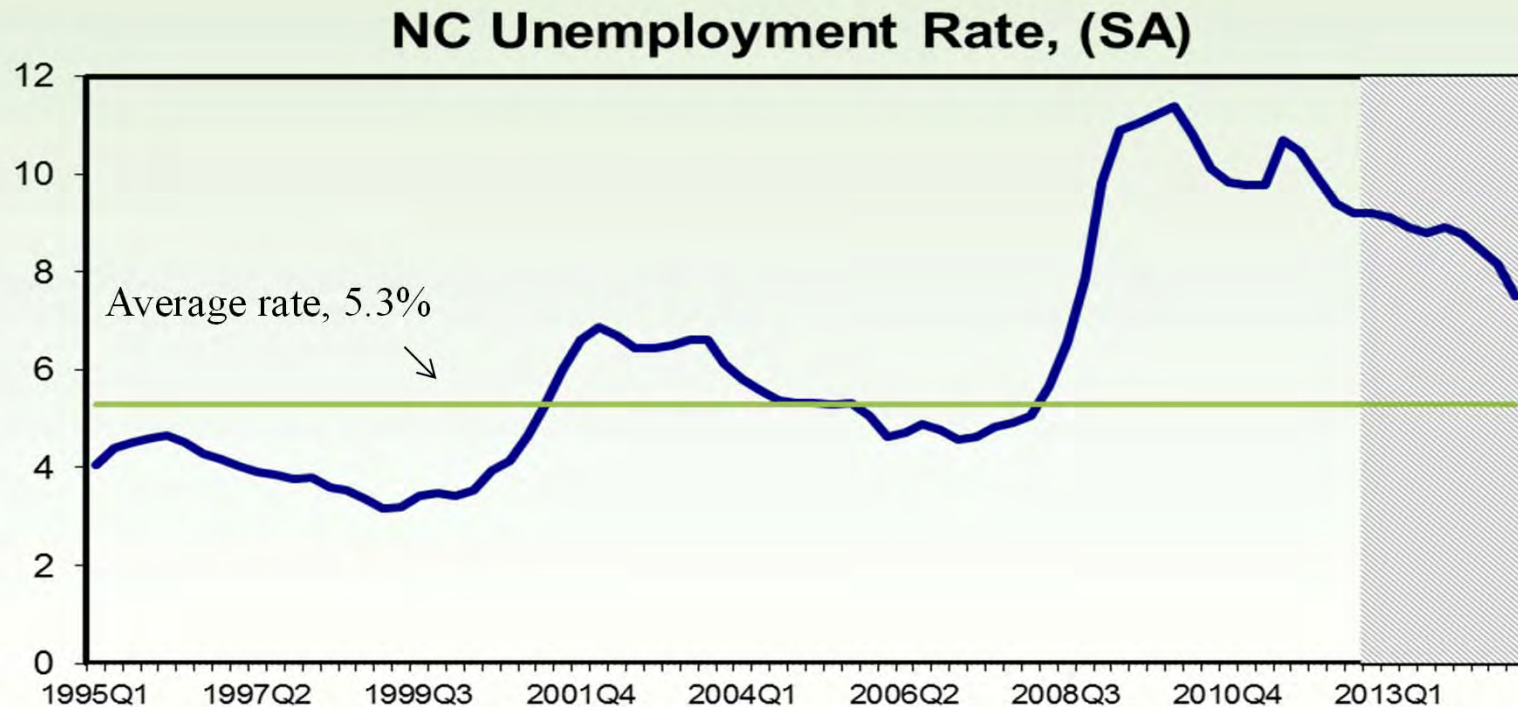


State's Economic Outlook

- Since the economic slowdown last spring, the State's economy has steadily been gaining strength. While we do not anticipate the pace of economic growth to significantly quicken, we do expect it to stay on a steady upward trend.
- Global economic uncertainty fueled part of the slowdown last year. Global conditions always offer some uncertainty, but they have substantially stabilized over the past several months, improving the chances for steady growth.
- The State's employment picture reflects the improvements in the overall economy. Nonetheless, we do not anticipate job growth to be strong enough to significantly lower the unemployment rate until mid-2014.
 - Since last year, the State added nearly 64,000 jobs. At the same time the labor force grew by 64,500 (seasonally adjusted). The combination of modest growth and a growing work force has kept the unemployment rate from falling.

State's Economic Outlook

- The unemployment rate was 9.4% in February. Unfortunately, over the next twelve months the State's unemployment rate is expected to show only slight improvement. In the fourth quarter of 2013 the rate is forecast to be 9.2%.



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

State's Economic Outlook

- One important element in the strengthening of the State's overall economy, especially the employment outlook, is the housing market. With so many jobs directly and indirectly tied to housing, the recent improvements in housing are encouraging. While the gains have not been statewide, the momentum is spreading.
- Ongoing federal policy decisions remain a question mark. Sequestration policies may have a bigger impact on North Carolina's economy than in many other states due to the strong military presence and the ancillary industries related to defense.
- Despite a possible slowdown this summer, we do continue to forecast that the State's economy will begin to expand faster than the US economy overall. Unfortunately, that outcome is unlikely to occur until we get closer to 2015.
- Key drivers expected to lead us to a stronger economy will be a rebound in consumer spending both here and abroad, that will spur growth in our tourism, export, and construction industries.

State's Economic Outlook

Non-Agricultural employment (seasonally adjusted) has increased by 197,000 jobs since employment bottomed-out in February 2010, but remains 136,400 below the peak in February 2008.



Source: NC Employment Security Commission

The Revenue Forecast



Revenue Forecast

Since the consensus forecast in early February, changes to the State's economic forecast is a bit of a mixed bag. Economic growth (GSP) for FY 2013-14 has been downgraded since the revenue forecast. Retail sales growth has been cut by nearly a third. However, both wages and employment are expected to improve faster than originally forecast.

<u>FY 2013-14 Growth Forecast</u>	<u>January</u>	<u>April</u>
Gross State Product (nominal GSP)	4.5%	3.6%
Wage & Salary Income	3.9%	5.8%
Employment (Non-Ag)	1.3%	1.5%
Unemployment Rate	8.8%	9.1%
Retail Sales	3.8%	2.7%

Revenue Forecast

- The 2013-15 biennium revenue forecast begins with anticipating how the current fiscal year will end. There are two important components to the end-of-year forecast that add uncertainty to the estimate.
 1. How much did taxpayers increase their 2012 incomes in response to federal tax policy uncertainty that still persisted in December? This will not only have an effect on how the current fiscal year ends, but has implications for the upcoming fiscal year.
 2. How will the new \$50k business exemption impact collections? The exemption will add volatility to the second-half of this fiscal year. The business exemption affects every taxpayer reporting non-passive, business income on their personal income tax form.

Revenue Forecast

- April collections always hold the potential to shift revenue forecast assumptions for both the current fiscal year and the upcoming fiscal year due to final income payments and refunds from the past tax year, and estimated payments from corporate and personal income taxpayers on the current tax year. Because of the added uncertainty surrounding this April, this month holds even greater interest than usual.
- The February consensus forecast tried to anticipate the directions the volatility would take, which included estimates on the increase in non-withholding income from 2012 and the reduction of some of those non-withholding dollars in the 2013 tax year. Non-withholding income includes both business income and investment income such as capital gains, interest income, and dividends.
- After April collections have been tabulated we will have a better sense of how well we anticipated the outcomes of these volatile components and whether a revision to the current revenue forecast would be warranted.

Conclusions

- The State's economy is expected to continue along the path of modest yet steady economic growth.
- The economy is on solid footing on most fronts, and improvements in the State's employment growth means the recovery will move along a sturdier track.
- Nonetheless, the ability to continue gaining ground may be sidetracked if the full effects from federal sequestration are allowed to take hold this summer.
- As usual, an "April surprise" provides some risk to the General Fund revenue forecast. With the added volatility this year, the magnitude of the "surprise" may be greater than we have grown accustomed to over the last several years.
- Because of the uncertainty surrounding taxpayer behavior affecting income in the 2013 tax year, it will require even greater caution than usual regarding any potential revision to the current consensus forecast.