# North Carolina General Fund
# Revenue Consensus Forecast: May Revision

The Fiscal Research Division and the Office of State Budget and Management (informally, the Consensus Forecasting Group) have reached consensus on a revised FY 2020-21 General Fund revenue forecast. The forecast for FY 2020-21 was revised downward by $2.57 billion (9.9%) and now projects a $1.64 billion (6.6%) under-collection for the current fiscal year. The forecast includes an estimated shift of $1.01 billion out of FY 2019-20 and into FY 2020-21 due to delayed tax payments.

**May 2020 Consensus Revenue Forecast ($ in millions)**

| | **FY 2019-20** | **FY 2020-21** |
|---|---|---|
| Revised General Fund Revenue Forecast | $23,426.7 | $23,466.3 |
| Certified Revenue* | $25,069.8 | $26,033.0 |
| Shortfall | ($1,643.1) | ($2.566.9) |

*Includes September 2019 revenue forecast plus session law changes

### Forecast Summary: Uncharted Waters

Over the past two months, the response to the global coronavirus pandemic (COVID-19) has dramatically affected the economy. Unlike in prior downturns, the State and national economies entered a recession not because of structural economic problems but due to an external factor. Public health measures undertaken in response to COVID-19 resulted in shuttered businesses and the temporary or permanent loss of hundreds of thousands of jobs.

To put into perspective how dramatic this downturn in the economy has been, forecasts predict a drop of 7%-10% in U.S. Gross Domestic Product (a measure of economic activity) in this quarter, which compares to a 4% drop-off during the worst of the Great Recession.

Due to the unprecedented nature of the ongoing public health crisis, this forecast was produced with greater uncertainty than usual. The Consensus Forecasting Group looks to national macroeconomic forecasters who provide global, national, and state forecasts. These forecasters must try to judge how quickly the pandemic will recede and when consumers will participate in public events again. Forecasters must also grapple with how long the economy will take to rebuild and the extent to which federal relief programs will mitigate the economic damage.

For example, the recovery in consumer spending is uncertain. It will depend on consumer confidence related to both the trajectory of the pandemic and economic conditions. The pandemic and resulting economic stressors have caused consumers to shift their spending, foregoing non-essential purchases in favor of necessities. Some of this shift likely resulted from travel restrictions and the temporary closures of many businesses. But, in the wake of historic levels of unemployment and extraordinary stock market losses, fear stemming from financial uncertainty and

## Forecast Highlights

**FY 2019-20 Collections**
Collections are expected to fall below this year's certified revenue by $1.64 billion.

**FY 2020-21 Revenue**
Revenue is expected to fall short of the certified amount for next year by $2.57 billion.

**Economic Outlook**
The global coronavirus pandemic has sent the economy into a recession unlike anything seen before. Forecasts predict U.S. GDP to drop by 7% - 10% this quarter, compared to a 4% decline during the Great Recession.

**Revenue Outlook**
Due to the unprecedented nature of the public health crisis, this forecast was produced with greater uncertainty than usual.

**Staff Contact:**
Barry Boardman, Ph.D.
*Barry.Boardman@ncleg.gov*

Emma Turner
*Emma.Turner@ncleg.gov*

Fiscal Research Division
North Carolina General Assembly

**Economic Forecast Uncertainty**
While some economic activity may resume rapidly as travel restrictions and business closures are lifted, it remains uncertain how continuing health and financial risks will affect spending behavior

**Limited Collections Data**
At the time of this forecast, only one month of data showing the pandemic's impact was available, and this data was incomplete due to a five-day shutdown in tax payment processing due to COVID-19.

**Federal Tax Delays**
Delaying the Federal tax deadline until July 15th affected State collections because the State waived penalties and interest if State payments were made by July.

**Current Year Outlook Uncertain**
There has been a drop-off in tax collections that is driven by economic conditions, but the delays and limited data make it difficult to determine the magnitude.

**Economic Forecasts Vary**
The macroeconomic forecasts we consult are usually very consistent in their predictions, differing by only fractions of a percent. This time is different.

employment insecurity may have changed consumer behavior to some degree. As restrictions are lifted and businesses are allowed to re-open, forecasters expect a rebound in spending on discretionary goods, but some of the change in spending behavior is likely to persist. Ultimately, all of these factors are unknowns.

Added Uncertainty

In addition, two delays limited our ability to assess the State's revenue situation:

- The impact of the pandemic did not begin to materialize until late March, leaving only one month of relevant data available to us (April). Moreover, the April data is incomplete because of a five-day shutdown in the State's tax payment processing due to COVID-19. Complete and reliable revenue collections data through April, including important information on final payments of income tax, is usually a cornerstone of the May forecast.
- In response to federal delays in tax payments, the Governor, the Department of Revenue, and the General Assembly took action to extend many tax payment due dates from April to July, including Individual Income, Corporate Income, and Franchise tax payments.

Due to the high degree of uncertainty, the data limitations, and our need to forecast State revenue now to facilitate the budget process, this forecast contains only a bottom line revenue estimate instead of the usual line-item estimates.

**The Pandemic's Impact on Economic Conditions**

The Current Fiscal Year

Certainly, there has been a drop-off in tax collections that was driven by economic conditions, but it is difficult to determine the magnitude. In April, North Carolina was $1.2 billion below the revenue expectations for the month (31.5% yearly drop in revenue), but we do not know how much of the $1.2 billion below-target was from economic conditions versus delayed payments. Ultimately, the forecast estimated that the shift in tax payments from the current fiscal year into FY 2020-21 totaled $1.01 billion.

In addition to the revenue shift, all the forecasters we consult agree that the economy took a significant hit in the second quarter of this calendar year, and most predict a major drop-off in economic activity in May through June. However, the forecasts diverge with regard to the pace of the economic recovery beginning in the third quarter of this year (July–September) and continuing into 2021.

FY 2020-21

Typically, the macroeconomic forecasts we rely upon are very similar to one another, often differing by mere fractions of a percent. This time is different. Some forecasters expect consumers to adapt quickly, shifting their demand and preferences to address the risk of infection and beginning to spend again in the near term. Others expect a slow recovery, with only a small initial increase in activity as restrictions are lifted. In revising this forecast, we tried to balance the different scenarios projected for the national economy to produce a cautious forecast based on the information and data available to us now, in mid-May.

**Revised Revenue Forecast**
We attempt to balance the different forecast scenarios in order to produce a reasonably cautious forecast, given the uncertainty.

**Planned August Revision**
We plan to revise the forecast in early August once July collections have been tabulated, at which point we hope to have a stronger idea of how the pandemic is impacting the economy.

As a caveat, it is worth noting that none of the forecasts we consulted included a second wave of the pandemic hitting the U.S., which some public health experts believe could happen later in the year. That possibility represents an economic risk that is not contemplated in this consensus forecast.

**Future Revenue Forecasts**

> *"While the economic response has been both timely and appropriately large, it may not be the final chapter, given that the path ahead is both highly uncertain and subject to significant downside risks."* - Jerome Powell, Federal Reserve Chair, May 2020

After delayed payments are made in July, we expect to have a better sense of how much the current economic conditions are affecting State revenue. We also will have three more months of collection data that, hopefully, will be less noisy than the current single month of data now available to us.

Therefore, we will revise this "bottom line only" forecast in early August, after July collections have been tabulated and we have a stronger idea of how the pandemic is impacting the economy. At that time we will produce a forecast for each line item revenue source.

###