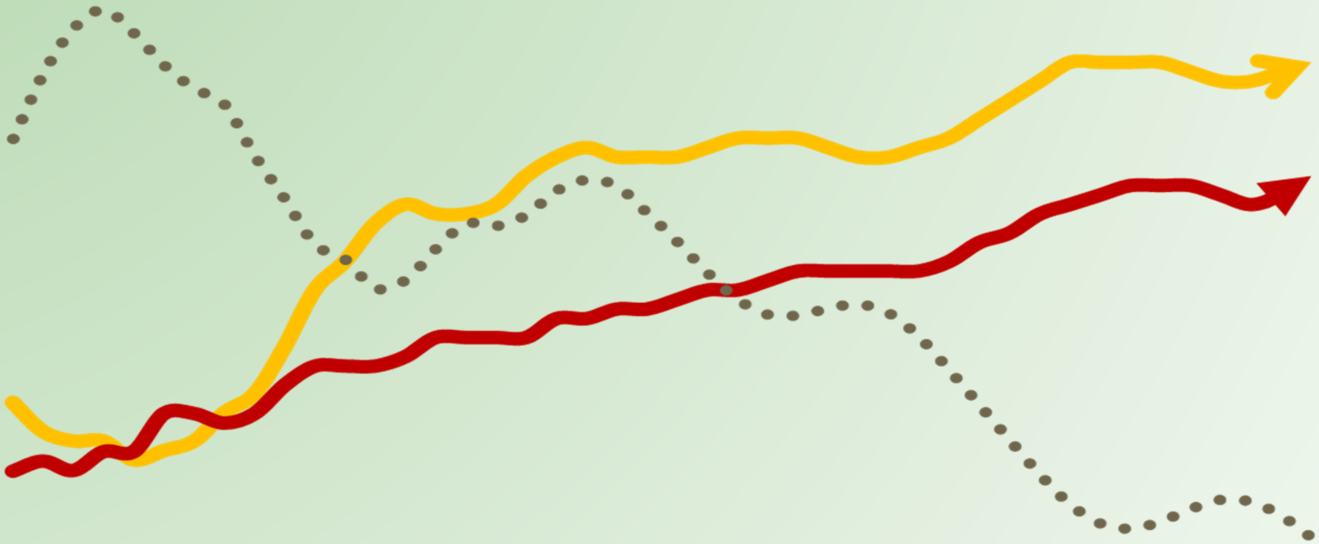
QUARTERLY GENERAL FUND REVENUE REPORT



October 2015

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

Highlights

- Prior fiscal year General Fund revenues were $448.2 million (2.1%) above the $21.0 billion budgeted amount.
- General Fund collections for the first quarter of the current fiscal year are $40.3 million (0.8%) above the revenue target.
- Collections on wage and salary income are running slightly ahead of forecast expectations, while Corporate Income tax has been quite a bit stronger than expected, up 13.4%.
- A moderate growth pattern re-emerged this spring and summer after a slowdown this winter. Most economic forecasts anticipate modest, steady growth for the remainder of 2015 and the beginning of 2016.
- Employment growth was solid during the last fiscal year and with continued solid growth there should be increased pressure on individual wages to rise.

FY 2015-16 First-Quarter Revenue

FISCAL YEAR-TO-DATE (millions)					
Net Tax Revenue	**Target 2015-16**	**Actual 2015-16**	**Target $ Difference**	**Target % Difference**	**Actual 2014-15**
Individual Income	$2,620.1	$2,641.9	$21.8	0.8%	$2,342.9
Sales and Use	1,730.9	1,742.5	11.6	0.7	1,614.0
Corporate Income	257.3	291.7	34.4	13.4	290.4
Franchise	56.3	38.3	(18.0)	(32.0)	56.9
Other	213.8	224.6	10.8	5.1	206.2
Total Tax Revenue	**$4,878.4**	**$4,939.1**	**$60.7**	**9.5%**	**$4,510.4**
Nontax Revenue & Transfers	**$216.6**	**$196.1**	**($20.5)**	**(9.4)**	**$154.7**
Total General Fund Revenue	**$5,095.0**	**$5,135.3**	**$40.3**	**0.8%**	**$4,665.1**

- Note that year-over-year comparisons may not be very helpful because they do not take into account recent tax changes, large one-time events such as non-tax payments and transfers, as well as other collection anomalies.

FY 2015-16 First-Quarter Revenue

- Through September, General Fund revenue was $40.3 million *above* the $5.1 billion target set for the first quarter of the fiscal year.
  - Tax revenues are $60.7 million ahead of the $4.9 billion target. Over half of the surplus, $34.4 million, is from Corporate Income tax collections, which were 13.4% above target.
  - Total Personal Income collections were $21.8 million above expectations. Collections on wage and salary withholding was 1.0% ahead of target.
  - Sales taxes remain steady and are running $11.6 million above a $1.7 billion target.
  - Non-tax revenue from fees and investments are $20.4 million below the $216.6 million target. Non-tax revenues do not always follow previous trends making it difficult to project monthly targets.

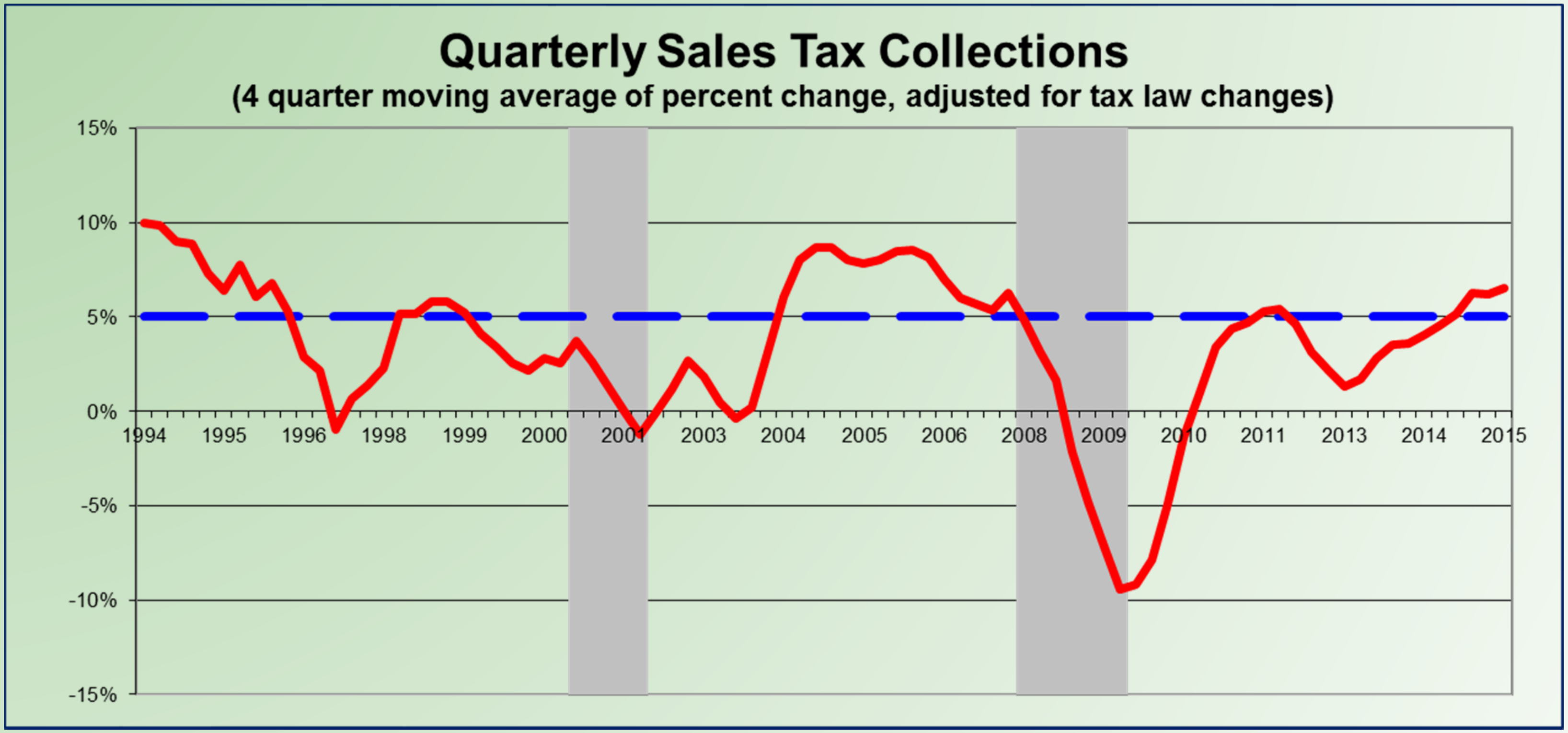
FY 2015-16 First-Quarter Revenue

- **Important Reminder:** The first several months of the fiscal year are typically the least important months as an indicator of revenue outcomes for the full fiscal year.
  - Major receipts in these months (sales, withholding tax) typically track the experience of the last few months of the prior fiscal year.
  - Revenue from volatile sources (corporate and non-withholding personal income) are not fully realized until the second half of the fiscal year.
  - Personal Income tax law changes that began in tax year 2014, including recently enacted changes, mean April 2016 payments may hold even greater importance than usual.

FY 2014-15 First-Quarter Revenue

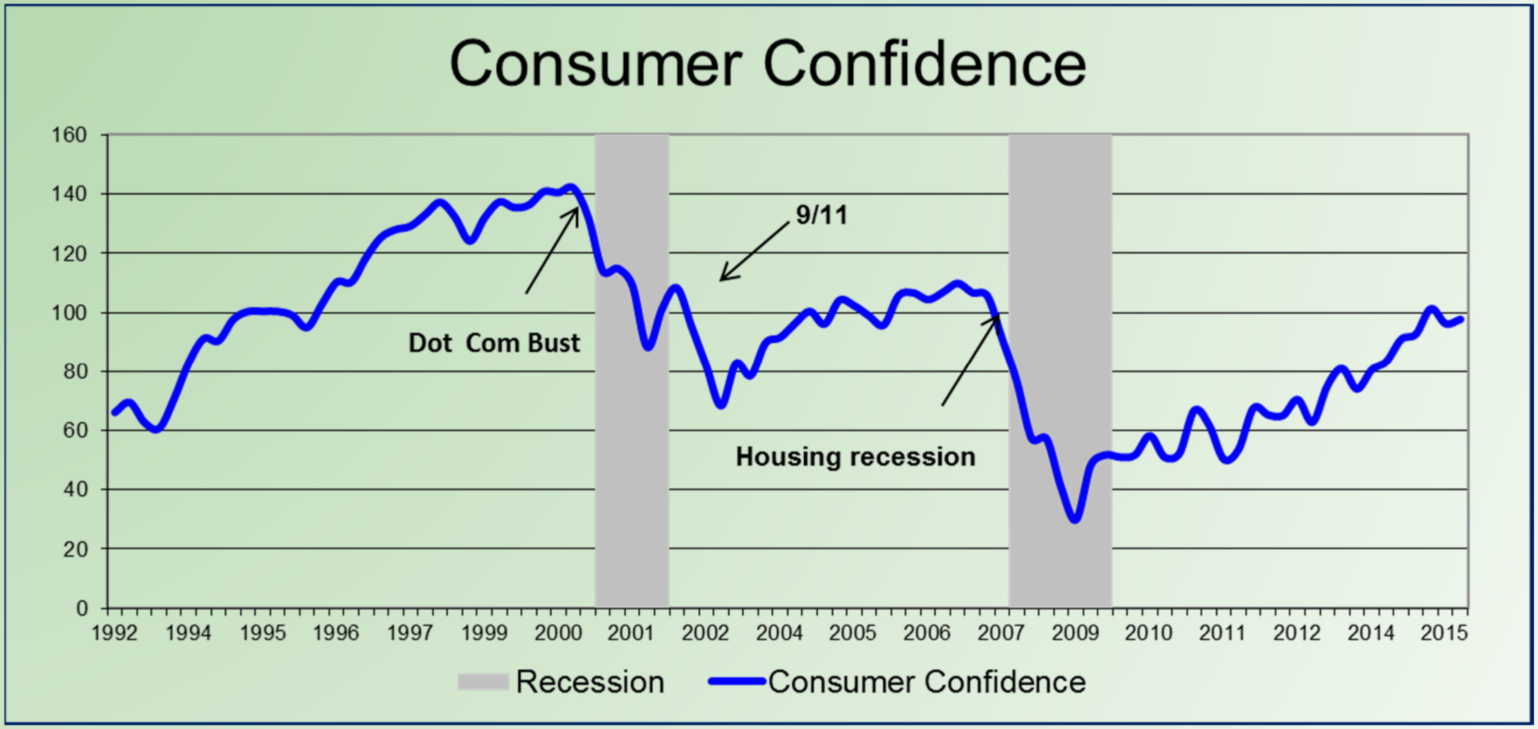
- Growth in key economy-based taxes (wage and salary withholding income tax and the sales tax) continue to move at a steady pace
  - Baseline Sales Tax growth the first quarter of the fiscal year were 5.1% above last year, this compared with the 4.7% yearly growth the previous quarter (see page 6).
  - Net Personal Income withholding collections (wage and salary withholdings less refunds) are slightly above expectations. Tax law changes affecting withholding are a year behind us now making year-over-year comparisons easier to understand. Growth in wage withholding this quarter was 5.4% (see page 8).

Tracking Economy-Based Collections



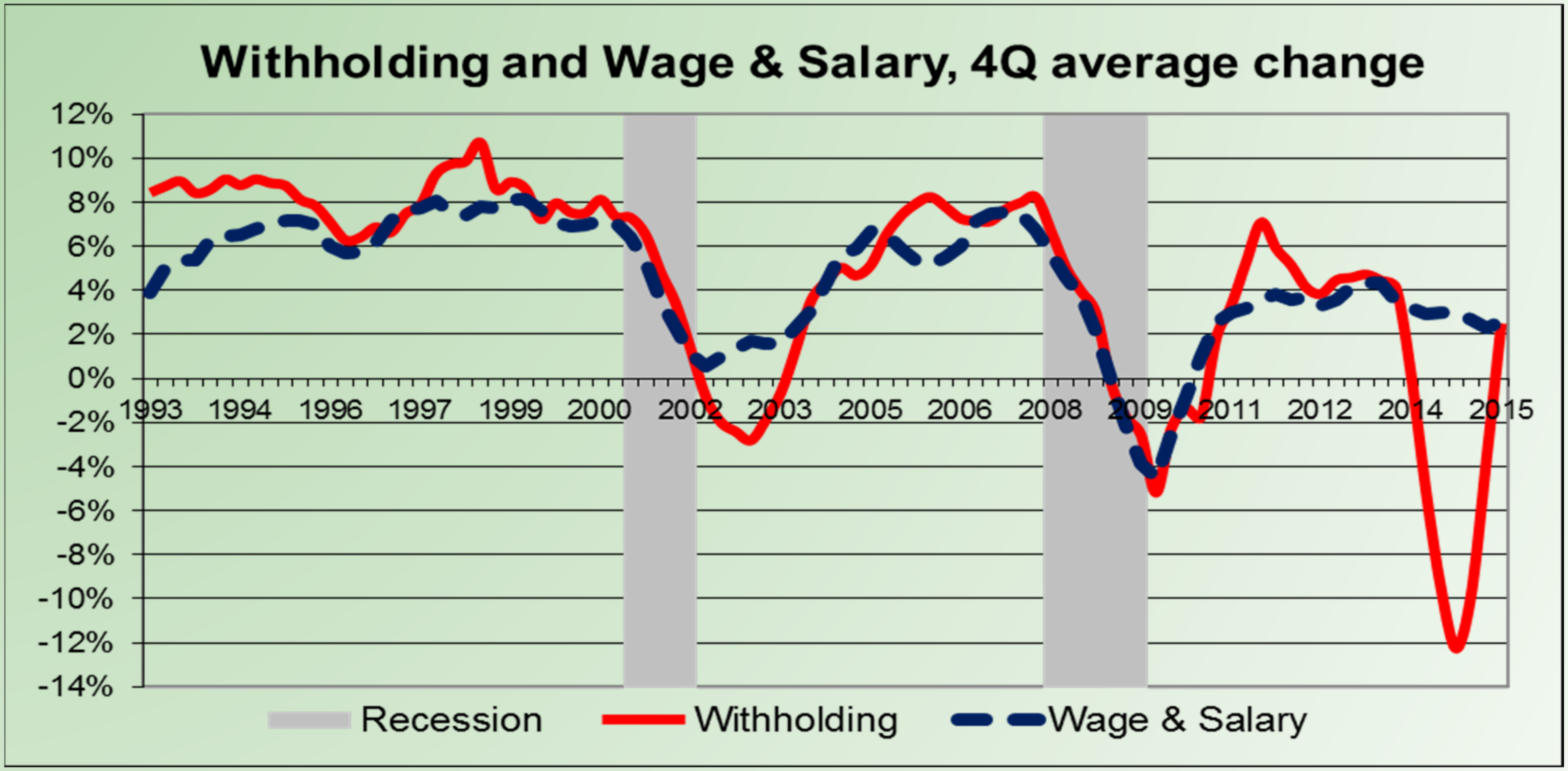
Baseline growth for FY 2014-15 improved to 5.6%, surpassing consensus forecast projections. Growth was not uneven during the fiscal year. The third quarter of the fiscal year grew at 6.2%, but slowed the final quarter to 4.7%.

Tracking Economy-Based Collections



One of the reasons Sales tax growth for FY 2014-15 improved to 5.6% was the improvement of consumer confidence. Confidence finally reached pre-recession levels during the fiscal year reflecting improvements in household balance sheets and labor markets.

Tracking Economy-Based Collections



Net Withholding growth (Personal Income tax withholdings less refunds) dropped off dramatically last year as a result of tax law changes affecting the timing of tax collections. The adjustments have been absorbed in the data and the quarterly collections are back to closely tracking with wage base growth.

Prior Fiscal Year Recap

- At the start of FY 2014-15, the economy had established a solid, yet moderate growth pattern. During the first-half of the fiscal year the economy continued to strengthen and economic activity picked up pace. The harsh winter at the start of 2015, along with growing global uncertainties temporarily stalled the economy, but by early spring the economy was back on track.
- The overall moderate growth for the fiscal year aligned with the consensus forecast; however, collections were $447.5 million, 2.1% above the $21.0 billion General Fund forecast.
- The 2.1% increase over forecast could be attributed to two factors affecting Income tax collections.

Prior Fiscal Year Recap

- The two factors affecting Income tax collections were:
  - Corporate taxable profits accelerated as wages remained low and write-offs on losses from the recession dwindled. This pushed collections 21.2% above forecast expectations.
  - Timing in personal income tax collections from changes enacted beginning with the 2014 tax year meant lower monthly withholding revenue - but higher final payments and smaller refunds in April. The forecast didn't fully capture those dynamics leading to a shortfall the previous fiscal year and a surplus in FY 2014-15.

Prior Fiscal Year Recap

- Personal income tax collections were $193.1 million above a $10.9 billion forecast. Refunds were $366 million less than had been expected. The lower refunds were related to changes in the tax which created a single, flat rate and a simpler, broader base.
  - Note: Withholding on wage and salary income was 1.0% *below* what had been expected. This was predominately because growth in wages from those currently employed did not materialize.
- Sales tax collections improved over last year as expected, and were essentially on target at $7.6 million above the $6.2 billion forecast.
- Corporate income tax collections came in $232.5 million above forecast. Down only 2.2% over last year despite a reduction in the tax rate from 6.0% to 5.0%.

Prior Fiscal Year Recap

Here’s how key revenue items turned out ($ million)

	Budgeted	Actual	Difference
Personal Income Tax			
Withholding*	$7,726.0	$8,003.6	$277.6
% Yearly Growth		5.0%	
Non-Withholding**	$3,159.4	$3,074.9	($84.5)
% Yearly Growth		16.0%	
Net Collections	$10,885.4	$11,078.5	$193.1
% Yearly Growth		7.8%	
Sales Tax			
Net Collections*	$6,244.4	$6,252.0	$7.6
% Yearly Growth		12.3%	
Corporate Income Tax			
Net Collections*	$1,095.2	$1,327.7	$232.5
% Yearly Growth		(2.2%)	

*Collections less refunds and transfers.

**Quarterly estimated payments plus April 15 tax payments.

Economic Outlook and the Revenue Forecast

- The economy has been unable to accelerate into overdrive, and continues to move at a steady, moderate pace. To date, there is no sign of an accelerating economy on the horizon.
- The economy does continue to gradually improve, but not at a strong enough pace to produce a robust job market. The most recent survey of macroeconomic forecasters by the Wall Street Journal foresees economic activity remaining at the current pace of growth the next two years.
- Unfortunately, 77% of those economist believe the economy faces more downside risk than upside risk with respect to their forecast. Global economic conditions were cited as the biggest concern.

Economic Outlook and the Revenue Forecast

- The State's economy, similar to the nation's, has steadily improved during this prolonged recovery phase in the business cycle. For both the nation and the State, since the end of the Great Recession in 2009, the economy has never gained sufficient momentum to enter a robust expansionary phase.
- State economic forecasts continue to expect the growth in overall economic activity to remain at or slightly below average. While robust expansionary growth is not projected, solid, steady growth is anticipated throughout the current biennium.
- These forecasts for continued moderate economic conditions are imbedded in the revenue forecast, and the first quarter of the fiscal year's results have been consistent with that view.

Economic Outlook and the Revenue Forecast

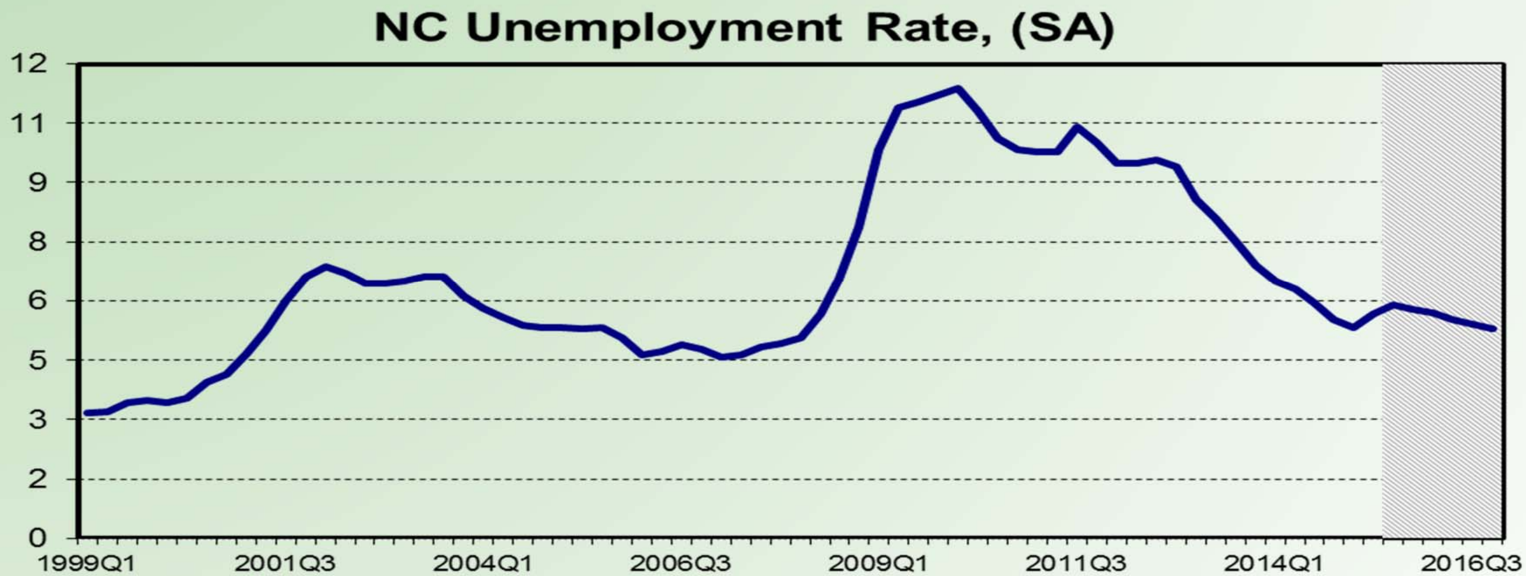
- The employment outlook for the State has stabilized and additional improvement is anticipated. Non-farm employment is expected to experience gains of 2.3% the first year of the biennium, which compares to growth of 2.5% this past fiscal year. Non-farm employment is forecast to net 90,000 to 100,000 jobs in each fiscal year.
- Consistent with this outlook is a recent statewide forecast produced in the Babson Capital/UNC Charlotte Economic Forecast. The forecast projects that in calendar year 2016, Non-farm employment will grow by 115,000 jobs, and inflation-adjusted economic activity will increase by 2.8%.
- This pace of employment growth should help reduce slack in the State's labor market and place greater pressure on individual wages to rise. Wage increases have lagged behind other improvements in the economy.

Economic Outlook and the Revenue Forecast

- While significant annual wage growth such as that seen before the last recession of 6% to 7% is not anticipated, the forecast does expect the wage base to grow by 4.1% during the fiscal year. This is well ahead of last fiscal year's estimated growth of 3.5%.
- For overall wage income to grow at the stronger pace, Non-farm employment will have to meet projected growth of 2.3% during the fiscal year.
- Last fiscal year, Non-farm employment grew by 97,900 jobs, which was similar to the 96,300 jobs added the previous year.
- Through the first two months of the fiscal year, Non-farm employment appears to have increased by 20,200 jobs (using preliminary data). The previous quarter (April – June) employment increased by only 18,800 jobs compared to 34,600 for the same period last year. The slowdown this summer in job growth was worrisome, but it seems to be back on track.

State's Economic Outlook

The unemployment rate was 5.9% in August (it was 6.0% August 2014). Over the next six months the State's unemployment rate is expected to stay above 5.5%. While solid job growth is expected, a growing labor force will keep the rate from falling by more than a few tenths of a percent. In the end of the first quarter of 2016, the monthly rate is forecast to be 5.6%.



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

Conclusions

- Current year revenue collections are up 0.8% through the first quarter of FY 2014-15.
- Personal Income tax withholding on wages and Sales tax collections were essentially on target. Corporate Income tax collections were up 13.4%.
- The economy remains in a stable, yet modest growth pattern. Forecasters project this pattern will persist at least through the next 9 to 12 months. Recession risks are slightly elevated do to this prolonged, below-average recovery, but remain below 20%.
- The revenue forecast built-in expectations of employment gains similar to what was experienced last year and increasing pressure on wages to rise. Thus far, there is no reason to think those expectations will not be realized.