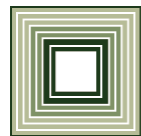


# THE STATE'S REVENUE OUTLOOK



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# Overview

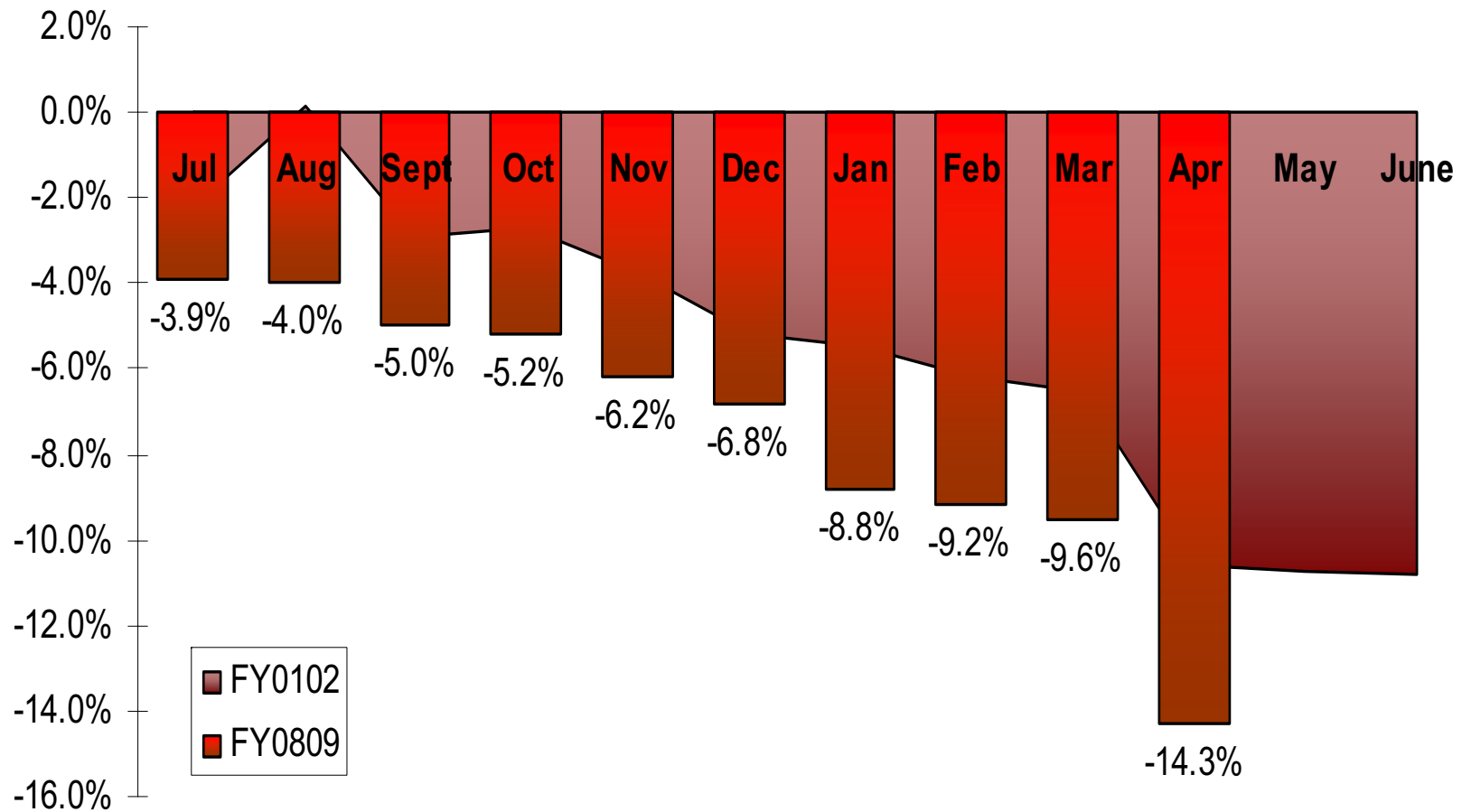
- Major revision of FY 2008-09 shortfall as April 15 tax payments plummet.
- Recession expected to last into the fall of this year, lowering expectations for FY 2009-10.
- Employment picture darkens as downturn spreads to all industry sectors.
- Revenues “setback” 5-years by longest recession in recent history.

# FY 2008-09 Budget Shortfall

**\$3.2 billion shortfall based on a \$20.8 billion revenue budget**

- Unprecedented 10.8% decline over last year's collections
  - Projected shortfall means collections expected to be 15% under budget. By comparison, the last 2 recessions were less than 11% below budget (see page 5).
  - April 15 Final Tax Payments were down 40% over last year. The last recession final payments were off by 18.5%.
  - Additionally, estimated payments for the 2009 tax year were 41% below last years payments.

# Impact of April Payments & Refunds



# Business Cycles and State Revenues

<b><u>NBER Recession Date</u></b>	<b><u>Months</u></b>	<b><u>Budget Shortfall</u></b>
July 1981 – Nov. 1982	16	FY 1981-82 -9.2%
July 1990 – March 1991	8	FY 1990-91 -8.1%
March 2001 – Nov. 2001	8	FY 2001-02 -10.8%
December 2007 – ?	17 and counting	FY 2008-09(e) -15.2%

# 2009-11 Biennium Forecast

**Consensus Forecast: FRD and OSBM agree to revise January 2009 revenue numbers**

	<u>Revised Revenues</u>	<u>Revision</u>
FY2008-09	\$17,682.3	(\$949.5)
<hr/>		
FY2009-10	\$17,516.4	(\$1,345.2)
FY2010-11	\$18,114.1	(\$1,790.0)

# 2009-11 Biennium Revenue: Economic Conditions

- The recession that began in December 2007, spurred by the housing market downturn, has now spread throughout the economy. Every sector of the economy is feeling the impact from the national and global downturn.
- Conditions worsened when the global financial market collapsed in October 2008, and pushed an already contracting economy into a prolonged and severe recession.
- It appears now that the worst may be behind us, but there is still a long way to go. Based on the most recent survey of national forecasters (Wall Street Journal, April 2009), a near consensus expects an economic recovery this year, but not until the last quarter.

# 2009-11 Biennium Revenue: Economic Conditions

- We agree with most of these and other analysts that a **sustainable economic recovery is still 4 to 6 months away**. We anticipate the State's experience will track closely with the national picture.
- Since employment is a lagging economic indicator, not changing direction until well after the turn in the business cycle, significant employment gains in the State may not occur until the end of 2010.
- Because the recession is now expected to carry into the fall and possibly winter, employment outlook for the state has been downgraded. Employment is now expected to experience losses closer to 3% in FY 2009-10 rather than a 1% loss envisioned when the January forecast was developed.



# 2009-11 Biennium Revenue: Economic Conditions

- Because employment is closely tied to income, employment losses from layoffs and cutbacks by key businesses such as the financial sector have dampened the prospects for growth in personal income over the biennium.
- The January forecast envisioned 2.1% and 4.9% growth in personal income for the respective fiscal years. Those numbers have been lowered to a negative 0.3% (-2.5% in wage & salary) and positive 2.4%, respectively.

## 2009-11 Biennium Revenue: Personal Income Tax

- A key reason for another year of volatile April income tax revenue was capital gains on stocks and real estate. We think these were down 35% for 2008, following increases of 27% in 2006 and 34% in 2007.
- During the recent expansionary cycle an unusually large share of the rise was due to real estate. The unsustainable increases in real estate came crashing to an end and this sector continues to be in decline.
- Another reason non-withholding fell was stock prices had fallen by nearly 40% at the end of 2008.

## 2009-11 Biennium Revenue: Personal Income Tax

- Therefore, the forecasting challenge is to acknowledge the long-term historical pattern of capital gains: a couple of years of hyper-growth followed by steep declines.
- For this reason the revised revenue forecast assumes another year of large losses eroding any gains for the 2009 tax year and as losses continue to mount a modest decline for the 2010 tax year.
- Withholding taxes from wage & salary income will also be depressed in 2009 and most of 2010 as it closely tracks changes in employment. A return to a long range growth pattern in 2011 is expected

# 2009-11 Biennium Revenue: Sales Tax

- In recent years, retail sales closely tracked the fortunes of the residential real estate market and consumer confidence. Sales in the foreseeable future will not be fueled by wealth from real estate and consumer confidence is at an all-time low.
- Consumers will be hard pressed to increase their spending with tighter credit, lower employment, and stagnant or falling wages. Thus, sales tax collections will continue to fall the first part of the biennium with only a modest rebound expected in 2010-11.
- The forecast has baseline sales taxes falling in 2009-10 by 4.0% and a mild up-tick of 2.1% growth the following year.

# 2009-11 Biennium Revenue: Corporate Income Tax

- Corporate profits are expected to decline through 2009. Rapid depletion of inventories has helped some businesses going into the rest of 2009 and 2010, but the severe global recession will assure weak demand for products even after the U.S. begins its recovery.
- Corporate income is always very volatile with yearly swings by as much as 30% to 40% depending on where we are in the business cycle.
- For the upcoming biennium we think these receipts will be relatively flat reflecting the very mild economic recovery, plus losses from the lengthy recession will continue to be taken against the bottom line.

# 2009-11 Biennium Revenue

- **Putting all these assumptions together leads to an estimated 1.9% lower baseline of General Fund revenues in 2009-10, and only 3.2% growth in 2010-11. These rates compare to 9.2% in 2006-07, 3.1% in 2007-08 and the projection for an unprecedented decline of 10.0% for 2008-09.**

# 2009-11 Biennium Revenue

- The revenue outlook for the 2009-11 biennium reflects a continuation of a severe and prolonged economic slowdown, with a mild, slowly developing, recovery in 2010. Employment will lag behind the recovery and revenue collections will lag behind improvements in the employment picture. Therefore, the prospects for revenue collections to return to long term growth patterns is not expected any earlier than 2011.

# 2009-11 Biennium Revenue

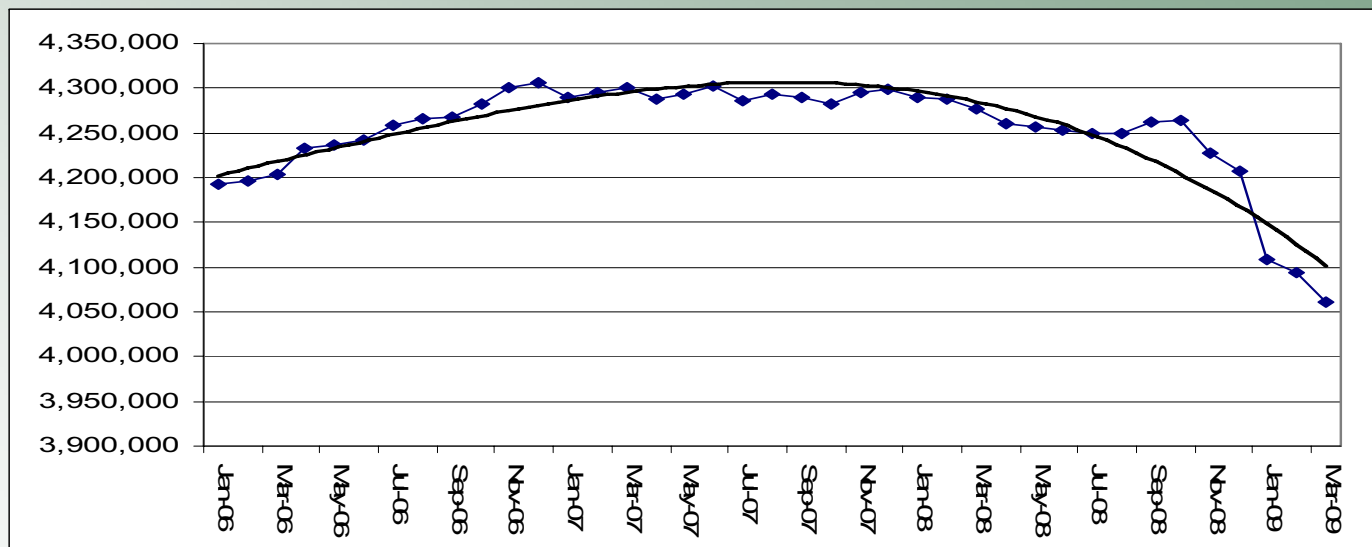
- Based on the revised consensus numbers and assuming a return to normal, long-term growth in 2011-12, it will be 2013-14 before revenues equal the \$20.8 billion budget number of 2008-09.



# KEY REVENUE COLLECTION TRENDS

# Key Revenue Collection Trends

## Non-Agricultural Employment, Seasonally Adjusted

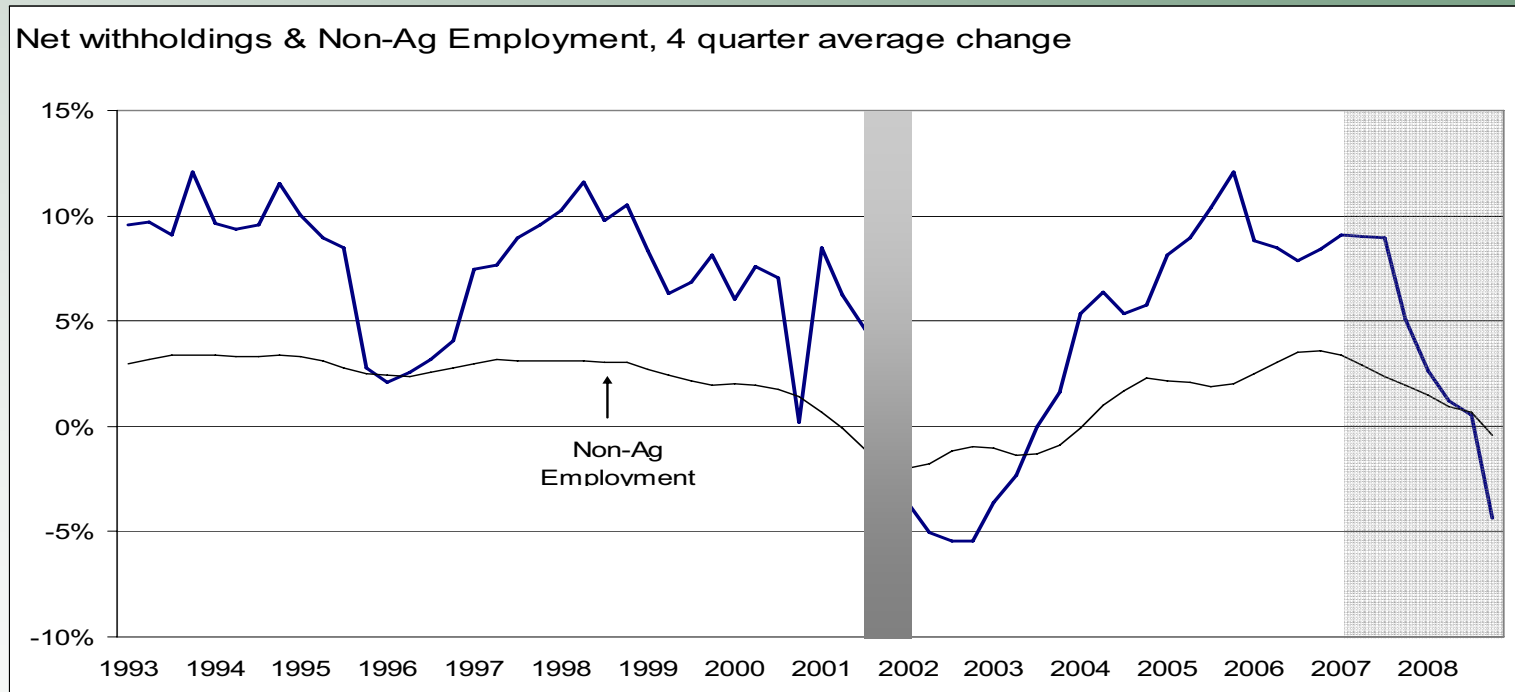


**In the last 12 months, seasonally adjusted non-ag employment is down 215,000 jobs, and nearly 235,000 jobs since the start of the recession.**

Source: North Carolina Employment Security Commission

# Key Revenue Collection Trends

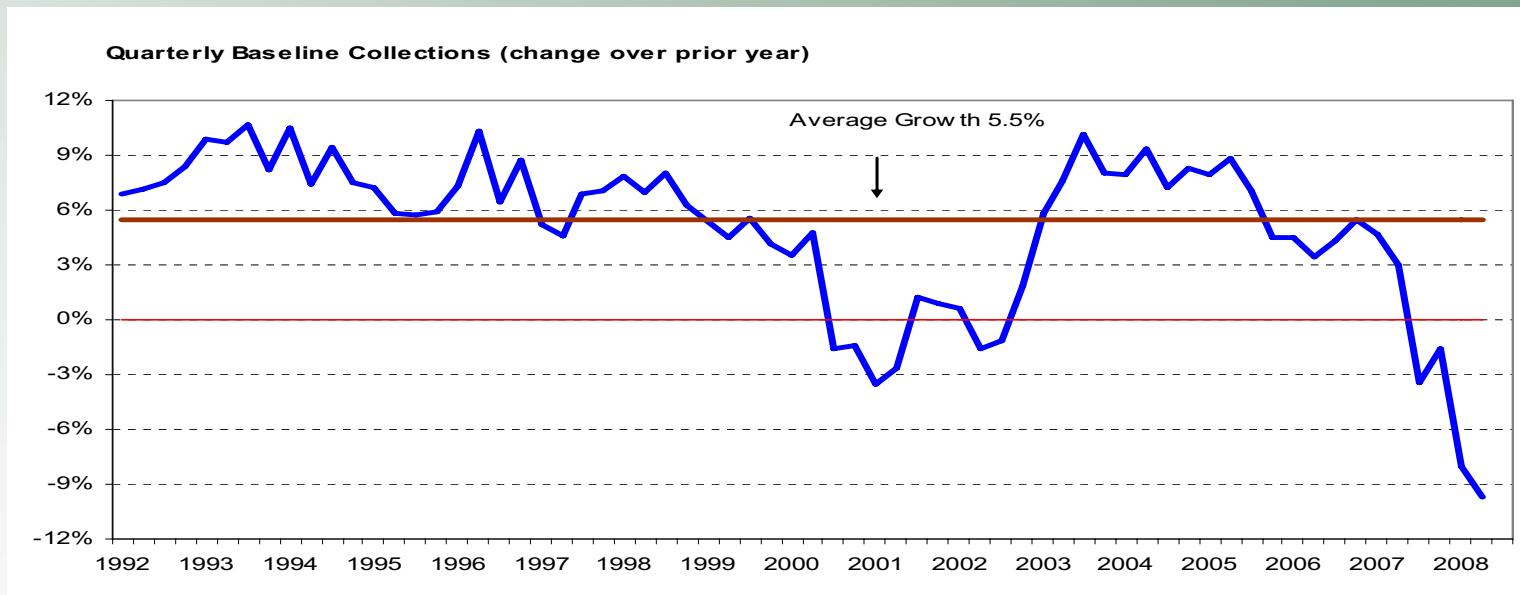
## Withholding Tax Receipts



**Withholding continues its downward trend coinciding with employment losses**

# Key Revenue Collection Trends

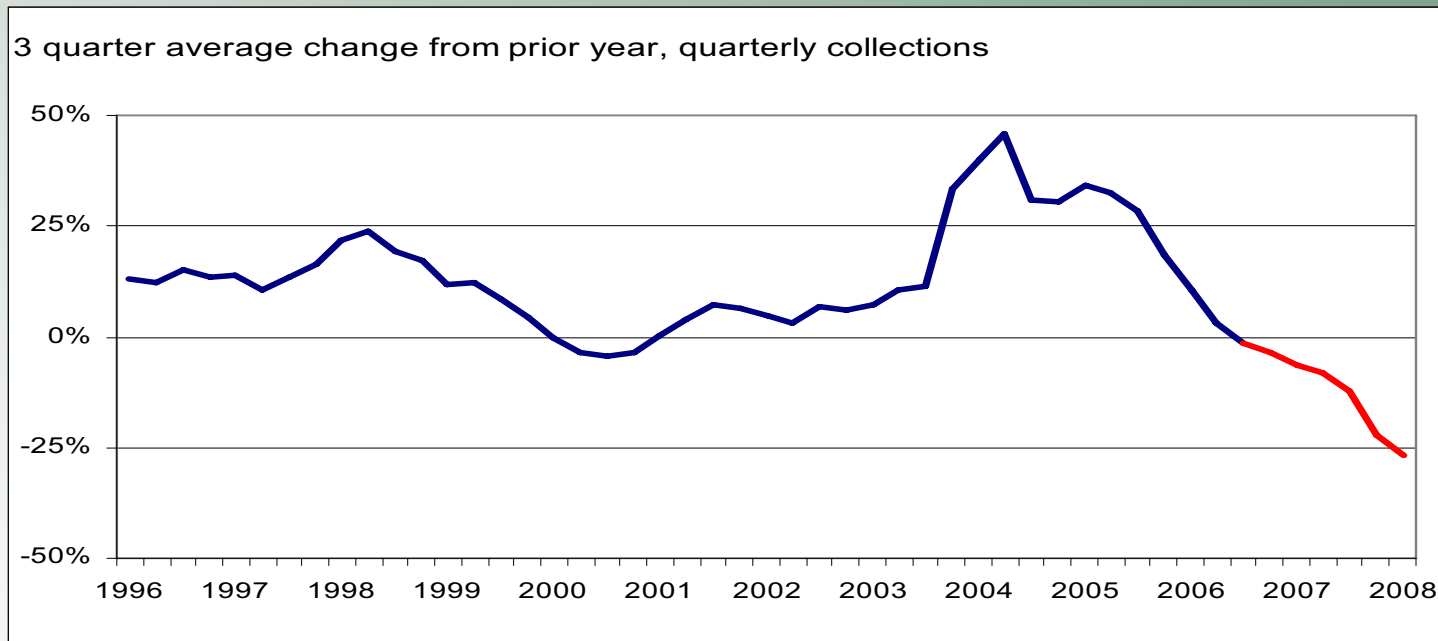
## Sales & Use Tax Collections (adjusted for tax law changes)



Sales tax collections go negative beginning the second quarter of 2008 and continue to plummet through 1<sup>st</sup> quarter of 2009.

# Key Revenue Collection Trends

## Real Estate Conveyance Collections



Real Estate Conveyance tax illustrates the magnitude of the housing build-up (2003-06) and subsequent recession in the housing market.