Quarterly General Fund
Revenue Report

OCTOBER 2016
BARRY BOARDMAN, PH.D.
Highlights

» Last fiscal year’s General Fund revenue exceeded the $21.7 billion budgeted amount by $419.6 million (2.0%).

» General Fund collections for the first quarter of this fiscal year are $158.3 million (3.1%) above the revenue target.
   - Personal Income tax collections account for $122.7 million of the revenue exceeding the target.

» A moderately stronger economic growth pattern re-emerged this spring and summer after a slowdown last winter. Most economic forecasts anticipate modest growth for the rest of the fiscal year.

» Growth in employment and total wages was solid last fiscal year and is expected to continue at a similar pace this year.
FY 2016-17 First-Quarter Revenue

» Through September, General Fund revenue was $158.3 million above the $5.1 billion target set for the first quarter of the fiscal year.

» Tax revenue was $151.8 million ahead of the $4.9 billion target.

<table>
<thead>
<tr>
<th>GENERAL FUND REVENUE BY SOURCE ($ millions)</th>
<th>FY 2016-17</th>
<th>FY 2015-16</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Tax Revenue</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual Income</td>
<td>$2,642.8</td>
<td>$2,765.5</td>
</tr>
<tr>
<td>Sales and Use</td>
<td>1,805.4</td>
<td>1,819.0</td>
</tr>
<tr>
<td>Corporate Income</td>
<td>224.1</td>
<td>218.6</td>
</tr>
<tr>
<td>Franchise</td>
<td>49.3</td>
<td>72.4</td>
</tr>
<tr>
<td>Other</td>
<td>215.0</td>
<td>212.9</td>
</tr>
<tr>
<td><strong>Total Net Tax Revenue</strong></td>
<td>$4,936.6</td>
<td>$5,088.4</td>
</tr>
<tr>
<td><strong>Nontax Revenue &amp; Transfers</strong></td>
<td>$195.5</td>
<td>$202.0</td>
</tr>
<tr>
<td><strong>Total General Fund Revenue</strong></td>
<td>$5,132.1</td>
<td>$5,290.4</td>
</tr>
</tbody>
</table>
FY 2016-17 First-Quarter Revenue

» The $151.8 million tax revenue target surplus is mainly due to Personal Income taxes. Over 75% of the target surplus, $122.7 million, is from Personal Income tax collections, which were 4.6% above target.

» Sales taxes are steady and running $13.6 million above a $1.8 billion target.

» Corporate tax collections (Income and Franchise combined) were $17.6 million above expectations.

» Non-tax revenue from fees and investments are $6.5 million above the $195.5 million target. Non-tax revenue does not always follow previous trends, making it difficult to project monthly targets.
FY 2016-17 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 (i.e., sales, withholding tax) typically track the experience of the last few months of the prior fiscal year.

  > Revenue from volatile sources (e.g., corporate and non-withholding personal income) are not fully realized until the second half of the fiscal year.

  > Ongoing adjustments to the Personal Income tax mean that April 2017 tax payments, which are always important to fiscal year totals, hold even greater uncertainty than usual.
Net Withholding income growth (i.e., withholdings less refunds) fell dramatically in FY 2014-15 due to tax law changes that affected the timing of tax collections. The quarterly collections are back to closely tracking with wage base growth. Strong withholding revenue started to develop this spring and has continued throughout the quarter.
Baseline growth in the first quarter of the fiscal year was 4.3%, which is above the projected 4.1% growth rate for the fiscal year. Sales tax growth has slowed down in 2016 with each quarter growing at a pace below the long-run average.
Prior Fiscal Year Recap

» At the start of FY 2015-16, the economy had settled into a steady, moderate growth pattern. The economy continued strengthening during the first-half of the fiscal year. Then the harsh winter, along with global economic setbacks, became a drag on the economy.

» The economy rebounded in the spring and the overall moderate growth for the fiscal year aligned with the consensus forecast.

» Collections were $419.6 million (or 2.0%) above the $21.7 billion General Fund forecast.

  > The 2.0% increase over forecast primarily resulted from a cautious consensus forecast made in light of the ongoing slow-growth national economy and global unrest.
Prior Fiscal Year Recap

» Personal Income tax collections were $599.6 million above a $11.3 billion forecast.

  > Withholding on wage and salary income was $293.1 million above expectations (3.1%);
  > Refunds were $115.8 million less than had been expected; and
  > Final Payments on the 2015 tax year were $129.0 million above projection.

» Sales tax collections did not meet forecast expectations, and were $190.4 million below the $6.6 billion forecast.

» Corporate income tax collections came in essentially on target at $27.1 million below the $1.1 billion forecast.
Prior Fiscal Year Recap

Here’s how key tax collections* turned out in FY 2015-16 ($ million)

<table>
<thead>
<tr>
<th></th>
<th>Budgeted</th>
<th>Actual</th>
<th>Difference</th>
<th>Change From Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Personal Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Withholding</td>
<td>$8,329.8</td>
<td>$8,740.2</td>
<td>$410.4</td>
<td>7.0%</td>
</tr>
<tr>
<td>Non-Withholding</td>
<td>$2,973.3</td>
<td>$3,165.0</td>
<td>191.7</td>
<td>8.6%</td>
</tr>
<tr>
<td>Net Collections</td>
<td>$11,303.1</td>
<td>$11,905.2</td>
<td>$599.6</td>
<td>7.5%</td>
</tr>
<tr>
<td><strong>Sales Tax</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Collections</td>
<td>$6,744.0</td>
<td>$6,559.5</td>
<td>($190.4)</td>
<td>4.9%</td>
</tr>
<tr>
<td><strong>Corporate Income Tax</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Collections</td>
<td>$1,085.1</td>
<td>$1,058.2</td>
<td>($27.1)</td>
<td>(20.3%)</td>
</tr>
</tbody>
</table>

* Withholding and Net Collections represent collections less refunds and transfers; non-withholding represents quarterly estimated payments plus April 15 tax payments.
Economic Outlook and the Revenue Forecast

» The economy has been unable to accelerate into overdrive. Instead, it continues to move at a steady, moderate pace. There is no sign of acceleration on the horizon.

» The economy is improving, but not at a strong enough pace to produce a robust employment and consumer markets.

» The most recent survey of macroeconomic forecasters by the Wall Street Journal foresees economic activity remaining at the current pace throughout the fiscal year.

» Fortunately, 82% of those economist believe the national economy faces less than a 1 in 4 chance of a recession this year.
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. Since the end of the Great Recession in 2009, the State’s economy has never gained sufficient momentum to enter a robust expansionary phase.

» Recent data on income and overall economic activity (Gross State Product) indicate that the State’s growth is beginning to outpace average growth for the nation.

» The typical pattern for the State is one in which downturns are bigger and upturns are more robust compared to the national average. It has taken seven years for that pattern to re-emerge.

» For the rest of the fiscal year, the expectation is that the State will continue to experience economic growth at a slightly faster pace than the nation.
Economic Outlook and the Revenue Forecast

- The State’s employment outlook has stabilized. Non-farm employment is expected to grow by 2.0% this fiscal year, similar to last fiscal year’s 2.1% growth. Non-farm employment is forecast to net 85,000 to 90,000 jobs in FY 2016-17.

  - A recent Babson Capital/UNC Charlotte Economic Forecast has a similar outlook. The forecast projects that in calendar year 2017, the State’s Non-farm employment will grow by 88,900 jobs and inflation-adjusted economic activity will increase by 2.2%.

- Last fiscal year, Non-farm employment grew by 88,500 jobs, which was not as robust as the 103,900 jobs added the previous year.
Economic Outlook and the Revenue Forecast

» Solid employment growth has helped reduce slack in the State’s labor market, and there has been greater pressure on individual wages to rise. Individual wage increases have lagged behind other improvements in the economy.

» The forecast expects the wage base to grow by 4.8% this fiscal year. This is similar to last fiscal year’s estimated growth of 5.0%, but less than the pre-recession growth rates of 6% to 7%.

» First-quarter Personal Income tax revenue on withholding suggests that we are seeing growth closer to last year’s 5.0% and perhaps even stronger.

» The revenue forecast, which is necessarily cautious, has aligned this first-quarter with expected economic conditions. Most revenue sources are tracking closely to projections, but as noted, income withholding revenue is ahead of forecast.
Conclusions

» Revenue collections are up 3.1% through the fiscal year’s first quarter.

» Personal Income tax withholding on wages led the way while Sales tax collections were essentially on target.

» The economy remains in a stable growth pattern. Forecasters project this pattern will persist through the fiscal year. There remains only a 1 in 5 chance of a recession in the next 6 months.

» Anticipated employment gains and wage growth, similar to what was experienced last year, look to be on track.

» A final caution: first-quarter revenue relative to budget targets rarely reflect how revenue for the full fiscal year will play out. The good news is that a solid cushion has been built this quarter, making it a little easier to reach the $22.1 billion revenue target for the fiscal year.