GENERAL FUND REVENUE REPORT

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Highlights

- April revenues came in ahead of target and year-to-date collections are now $90 million ahead of forecast. A big April “surprise” never materialized, meaning that the $151.5 million end of year surplus for 2007-08 is far less than the surpluses of the last several years.

- Three economic events continue to drag down the US and NC economy: the housing recession, the financial crisis, and rising energy prices. They are taking a toll on consumer spending. It will be well into 2009 until the effects of these shocks have dissipated.

- The length and severity of the slowdown are the key factors influencing the May forecast revisions. The result is the FY 2008-09 forecast was revised downward with baseline growth declining from 4.7% to 3.5%.

Revenue Estimate Summary

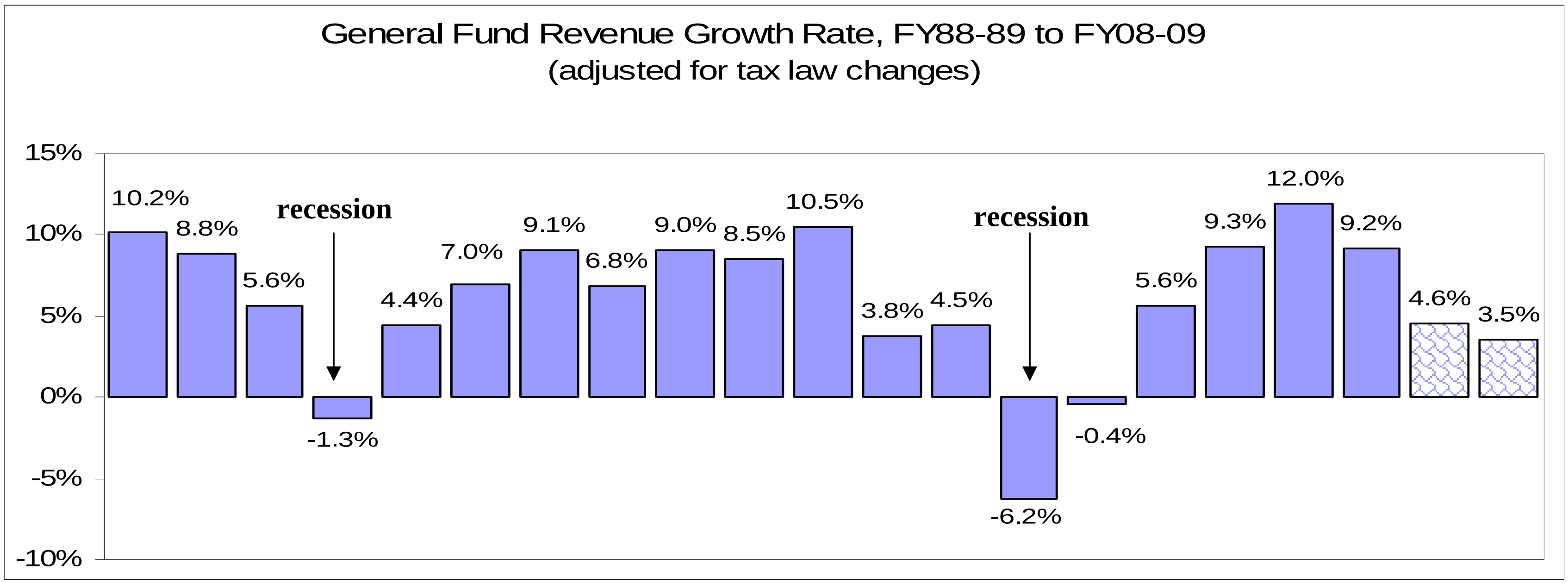
- General Fund revenue through April is $90 million ahead of the $16.8 billion target for the period.
- Based on the revised consensus forecast, General Fund Revenues for this fiscal year will come in $151.5 million over the budgeted amount ($19,907.2 vs. $19,755.7 budgeted):
  - Despite the weakening economy and the continued slowdown of the State's economy-based taxes, revenues still managed to come in slightly ahead of what was envisioned at this time last year.
  - The decision to plan for only modest growth in the FY 2007-08 budget helped the State avoid sizeable revenue shortfalls other states are grappling with as they go through the budgeting process this year.
- The revised baseline revenue growth for FY 2007-08 is 4.6% vs. 4.0% budgeted.

Revenue Estimate Summary (contd.)

- The revised General Fund consensus forecast includes a slight downward revision for FY 2008-09. Revenues are forecast to be $66.5 million less than was budgeted ($20869.5 vs. $20936.0 budgeted):
  - Three economic events continue to drag down the US and NC economy: the housing recession, the financial crisis, and rising energy prices. They continue to take a toll on consumer spending and it will be well into 2009 until the effects of these shocks have dissipated.
  - The length and severity of the slowdown are the key factors influencing the May forecast revisions for FY 2008-09. The results is the forecast was revised downward with baseline growth declining from 4.7% to 3.5%.

Revenue Estimate Summary (contd.)

The revised forecast envisions a significant slowdown in North Carolina's economy, but not a recession.

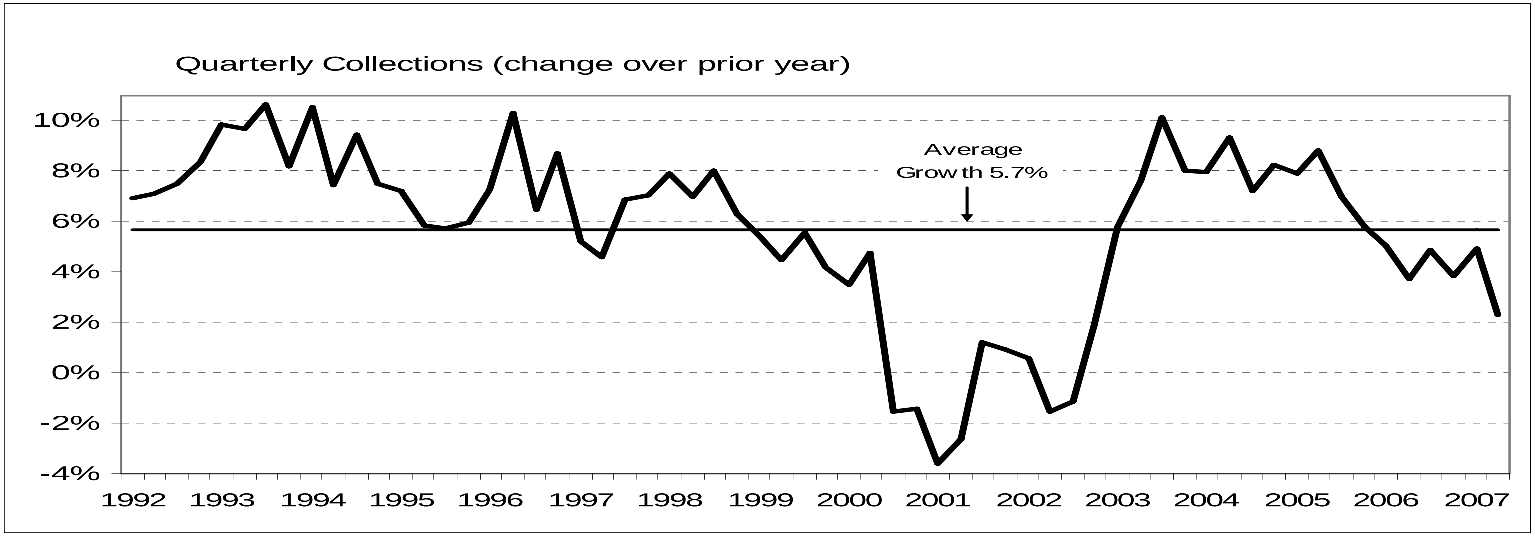


Note: The last two columns represent the current forecast baseline estimates.

Factors Leading to the Revised FY 2007-08 Forecast

The economy-based taxes (Personal & Corporate Income and Sales & Use) clearly indicate the economy is no longer in the expansion phase of the business cycle. An expansion that fueled large surpluses over the last several years. Baseline sales tax growth through April is at 2.5%, well below the long-term average of 5.7%. Significant weakness in consumer spending are expected for the rest of 2008.

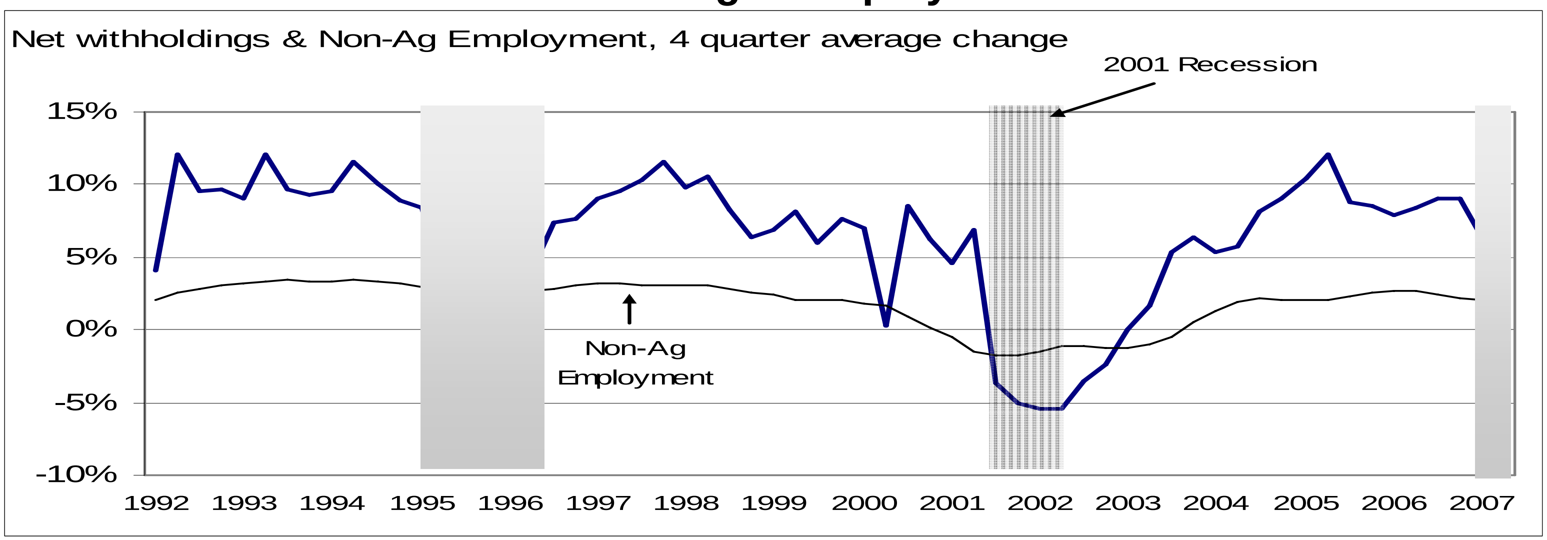
Sales & Use Tax Collections
(adjusted for tax law changes)



Factors Leading to the Revised FY 2007-08 Forecast (contd.)

Through April, withholding receipts were up over last year by 6.4%, but that represents a slowdown from 7.3% in January. The bright spot is that the current year-to-date rate of growth equals the historical average of 6.4%. This recent slowdown suggests that N.C. wage & salary employment is starting to feel the impact from the nation's economic distress. However, only a mid-cycle slowdown similar to 1995 is forecast for withholding, thus avoiding what occurred during the 2001 recession with zero or negative withholding growth that persisted for 6 quarters.

Withholding & Employment



Factors Leading to the Revised FY 2007-08 Forecast (contd.)

- Corporate profits remain steady:
  - Both the Corporate Income tax and the Franchise tax are expected to beat last year's growth forecast.
    - Price pressures from rising energy and commodity prices have yet to erode corporate profits.
    - Product demand from international markets have helped many firms remain in the black avoiding losses caused by the US economy's decline.

- A cautious budgeting approach made modest surpluses possible for these taxes in FY 0708.

FY 2008-09 Revenue Revisions

- Original baseline, economic-based growth was 4.7%. The revision lowers this growth to 3.5%:
  - The economy continues to be entangled by the housing recession and the slow unwinding of this problem will continue well into 2009.
  - Tighter financial markets, fueled by the sub-prime debacle are slowing investments and adding to the economic malaise.
  - Consumer debt, at an all time high, coupled with higher gas prices means consumer spending will stall. Gas prices are expected to stay above $3.50 through the Summer. Add to this picture sluggish employment growth through 2008 and very little growth in consumer spending can be anticipated prior to early to mid 2009.

FY 2008-09 Revenue Revisions (contd.)

- Economy-based taxes reflect the prolonged slowdown:
  - Withholding growth slows below long term trend. Wage & salary growth is revised down from 5.1% to 4.2% for the 2008 tax year.
  - Baseline sales tax growth drops to 3.1%, previously forecast at 4.4%.
- Volatile revenue sources have been pushed back slightly:
  - Non-withholding will decline for the 2008 and 2009 tax year after 4 years of modest to exceptional growth.
  - Corporate income taxes are revised downward from 4.6% to 2.4% baseline growth.

Risks to the Revised Forecast

- Two of the nation's leading forecasting firms (Moody's economy.com and Global Insight) have stated that the national economy is in the early stages of what will be a mild recession. A recession some economist see lasting through mid-summer. Those economist who are not calling for a recession are still forecasting a prolonged period of sluggish economic growth.
- I remain less pessimistic about the State's economic outlook as some economists are about the national economy. The State's economy will fare better than many Western states (California, Arizona), the northern Mid-West state (Michigan, Ohio), and Florida. These states comprise nearly 50% of the country's Gross Domestic Product (GDP).
- Because of the protracted and significant slowdown, expectations for revenue growth in FY 2008-09 have been lowered. Another major spike in energy prices or the continued deterioration in the housing and financial markets could deepen the economic slowdown and push the entire country into a recession. With the economy being dragged down by these events over the next 6 to 12 months, external shocks such as war or national disaster could spiral the economy downward into a full-out recession.

Risks to the Revised Forecast (contd.)

- Continued monitoring of the housing/credit crisis and the impact of rising food and gasoline prices on consumer spending, wages and job growth is crucial.

- The economy will remain at risk, especially consumer spending, for the following reasons:
  - the loss of household wealth, a result of the prolonged real estate downturn;
  - tighter consumer credit from the sub-prime/foreclosure debacle;
  - weakening income growth;
  - rising food and energy prices.

- Finally, any recovery during the second half of this year and the first half of 2009 will be modest at best. A true expansion may be two years away. The housing recession and the credit crisis are interrelated and will take a long time to unwind. We may be well into 2009 before we see an end to an excess in housing inventory and falling house prices.