GENERAL FUND REVENUE & ECONOMIC OUTLOOK

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Highlights

- The recession deepens pushing general fund collections well below forecast target. Now down 6.6% through December.
- Latest national forecasts indicate recession may last through fall of 2009.
- The persistence of the national recession (13 months and counting) continues to weaken the State's economy.
- Budget pressures mount with the prolonged economic downturn, and only a weak recovery expected to be underway to start 2010.

How Do 2008-09 Revenues Look So Far?

- FRD can report that through December, General Fund revenues are running $625 million below a $9.5 billion forecast target for the period.
  - Collections continue their downward trend. The growth in economy-based tax collections began to noticeably slow at the start of the fiscal year. December collections are a continuation of this trend. Total collections are now 6.6% below expectations.

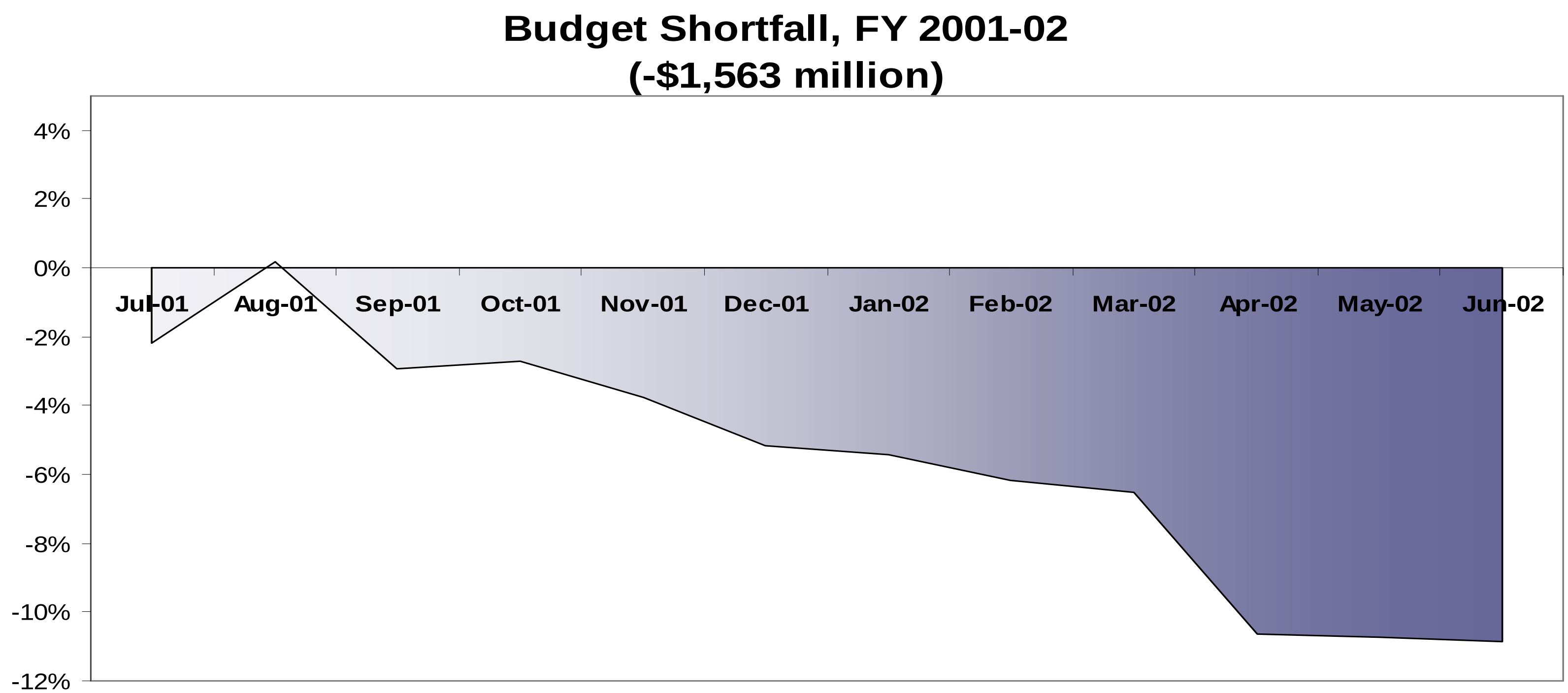
How Do 2008-09 Revenues Look So Far?

- Income tax withholding on wages and salaries are up 3% through December (long term average 6.4%).
  - Monthly and quarterly withholding payments continue to decline (Y/Y 6.8% decline). One reason for this decline is smaller businesses, who pay on a monthly or quarterly schedule, are cutting back.
  - Personal income tax refunds are on the rise – 15% higher than at this time last year.
- Sales tax collections take the biggest hit with economic conditions having a big affect on consumers. Second quarter baseline collections were down 8% over last year. Down 5.0% for the year.
- Two businesses taxes, Corporate Income and Franchise tax, are down a combined 30% for the year.
  - **The economy's impact on corporate income tax collections will not be fully understood until April 15th final payments.**

How Do 2008-09 Revenues Look So Far?

- The first six months of a fiscal year typically contain about half of the annual tax payments, but only 25% of forecast risk.
- Most of the remaining unpredictability comes in the April-June period and is centered on corporate income tax payments and non-withholding payments under the personal income tax.
  - This includes April 15 final payments (2008 tax year in this case) as well as April and June quarterly estimated tax payments for the 2009 tax year.

The Impact of April Payments & Refunds on Revenues

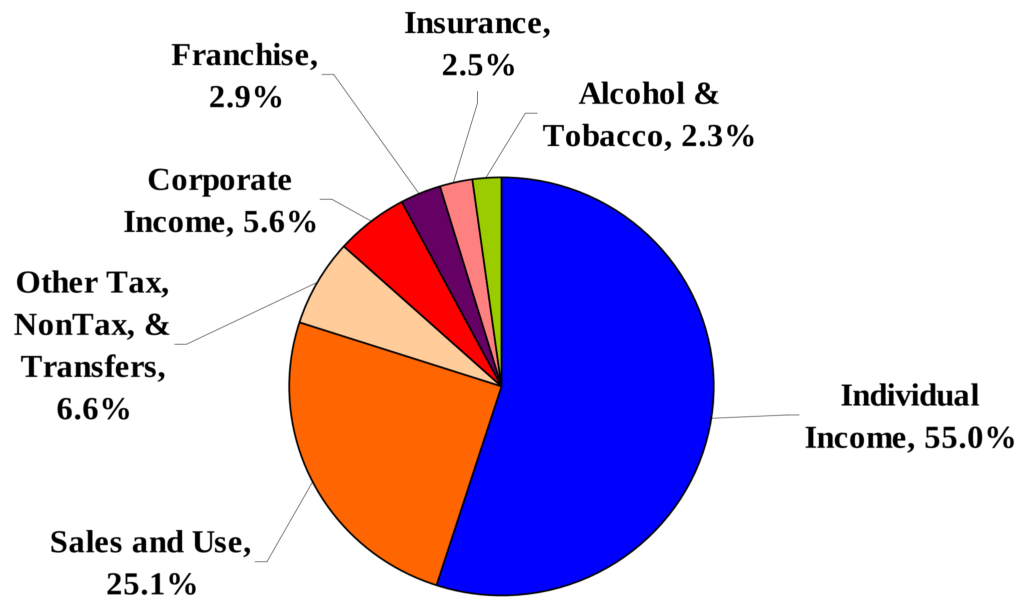


	Jul-01	Aug-01	Sep-01	Oct-01	Nov-01	Dec-01	Jan-02	Feb-02	Mar-02	Apr-02	May-02	Jun-02
Shortfall	-2.2%	0.2%	-2.9%	-2.7%	-3.8%	-5.2%	-5.4%	-6.2%	-6.5%	-10.6%	-10.7%	-10.8%

Shortfall in April 2002 nearly doubled the fiscal year-to-date shortfall total

State General Fund, FY 2007-08

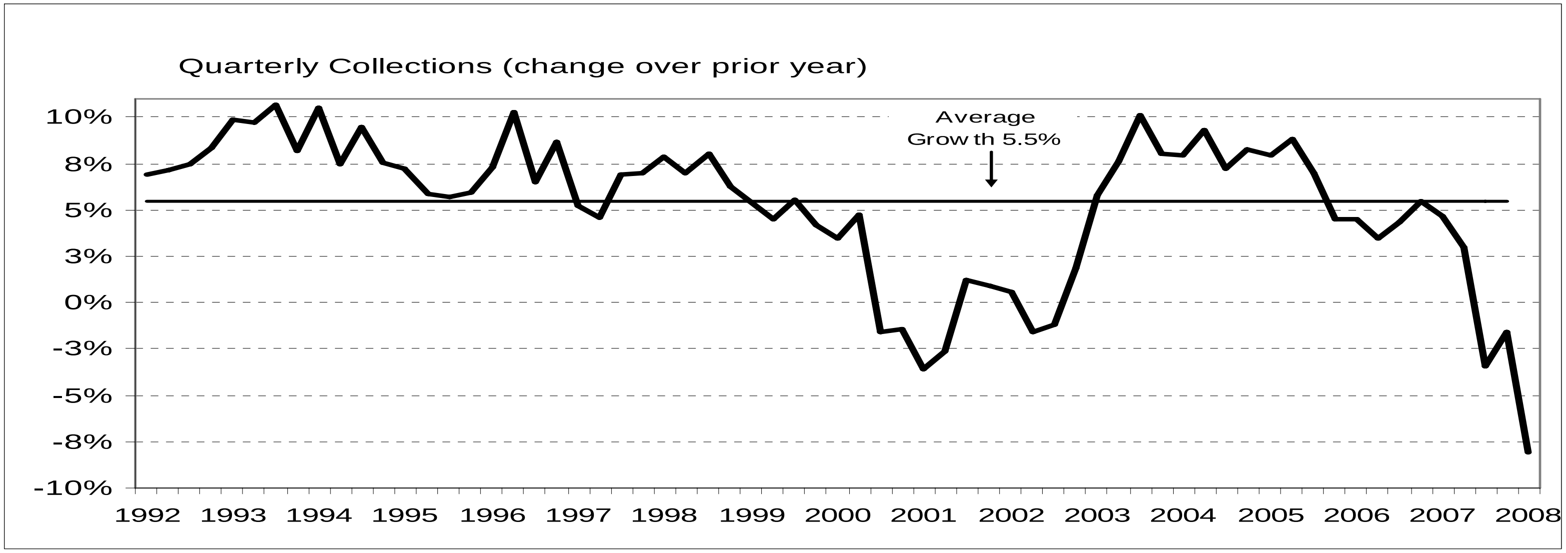
Eighty-six percent of the State's General Fund revenues are derived from the Personal Income Tax, the Sales & Use Tax, and the Corporate Income Tax. These three sources of revenue are directly tied to the economy.



Tracking Economy-Based Collections

A consumer-led recession is having its biggest impact on sales tax collections. Consumers are spending less on non-essential items this year and these are the items most likely to be in the State's sales tax base. Baseline collections were down 8% for the second quarter of the fiscal year.

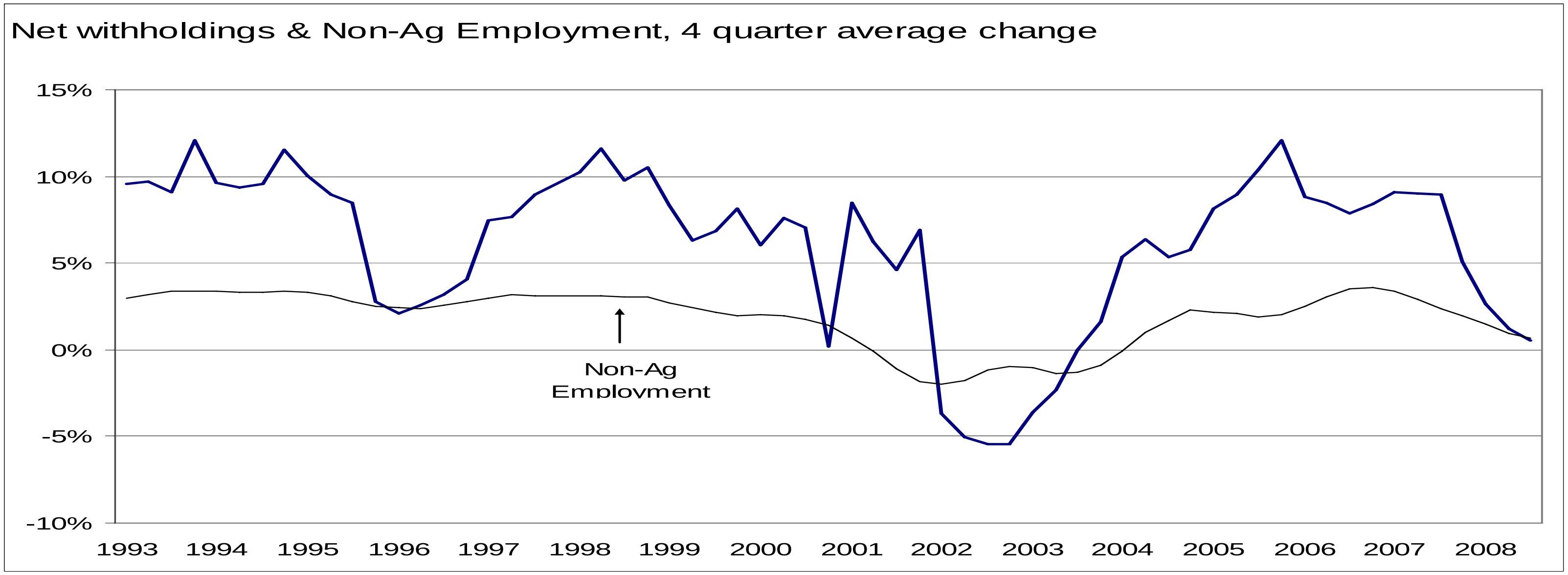
Sales & Use Tax Collections
(adjusted for tax law changes)



Tracking Economy-Based Collections (cont.)

Net withholding continues to steadily slow and is nearly 4.4% below a $4.5 billion target. The recession is now being felt broadly across most industry sectors and is reflected in the drop of wage & salary withholding collections.

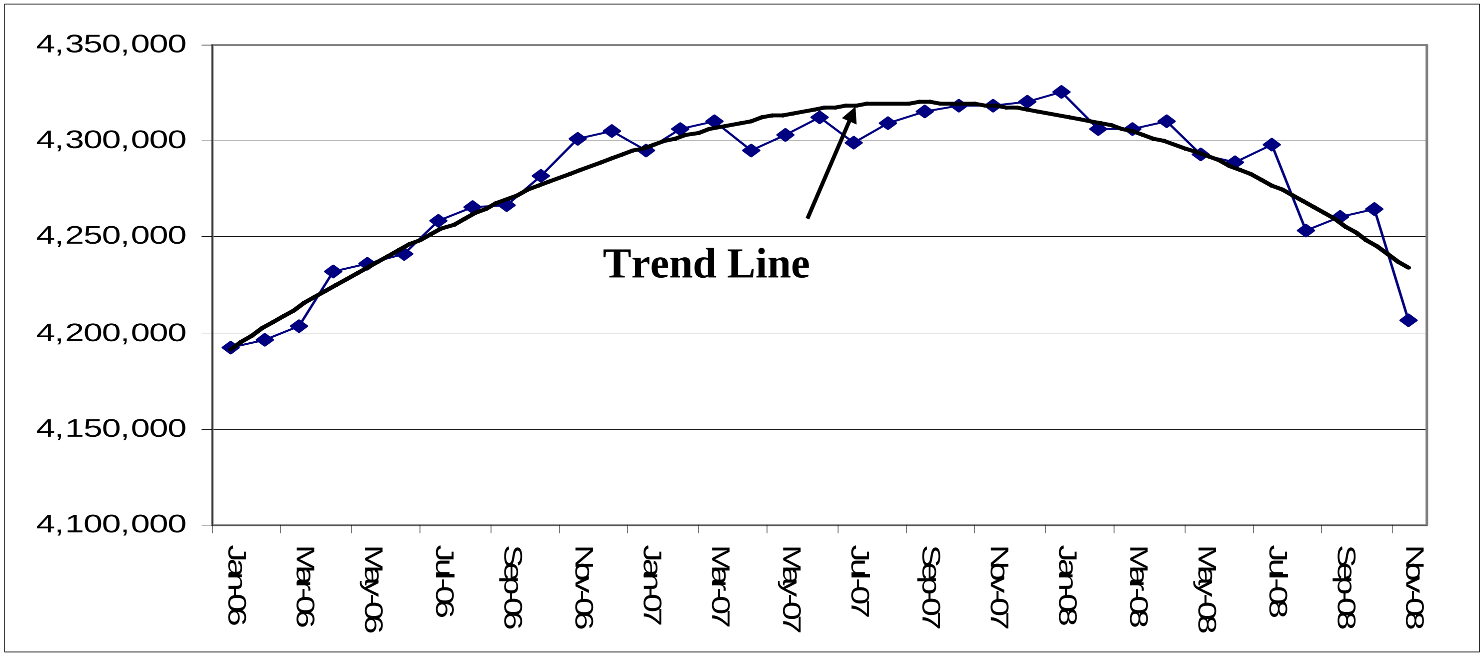
Withholding Tax Receipts



Tracking Economy-Based Collections (cont.)

Employment is a key indicator of the health of economy-based taxes. Since the start of the recession in December 2007, the state has 114,000 fewer people employed. This downward trend in employment is expected to persist for most, if not all, of 2009 and potentially into 2010.

Non-Agricultural Employment, Seasonally Adjusted



How are other states doing?

- Based on a recent survey by NCSL (Nov. 2008)
  - 44 states are “concerned” or “pessimistic” about their revenue outlook for FY09
  - 20 states below personal income tax targets
  - 28 states below sales tax targets
  - 23 states below corporate income tax targets
  - **26 states projecting FY10 budget gaps greater than 5% of budget**
  - 13 states may face budget gaps in FY08, FY09, and FY10 (including Georgia, South Carolina, and Virginia)

Business Cycles and Recessions

Recession Date*	Months
April 1960 – February 1961	10
December 1969 – November 1970	11
November 1973 – March 1975	16
January 1980 – July 1980	6
July 1981 – November 1982	16
July 1990 – March 1991	8
March 2001 – November 2001	8
December 2007 – ?	13 and counting

*The National Bureau of Economic Research (NBER) is a private academic group charged with dating expansions and contractions in the national economy

Business Cycles and State Revenues

NBER Recession Date*	Months	Revenue Shortfall	
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 – ?	?	?	

Thoughts on FY 2008-09 Outlook

- The State's economy continues to slip deeper into a recession, employment is down 114, 000 jobs and the unemployment rate is on the rise (7.9% in November).
- Economic conditions force consumers to be cautious and cutback on spending.
- With no job growth, lower wages and a consumer pullback revenue collections will continue to falter.
- Businesses are likewise being constrained and business income is on the decline.
- The net result is FY2008-09 collections could fall short of expectations by approximately $2 billion. A 10% shortfall.
- The magnitude of this shortfall would be consistent with other budget shortfalls during recessions.

The Economy and FY 2009-10 Outlook

- Wachovia's Economics Group "expects declines will persist for five consecutive quarters [2008:Q3 through 2009:Q3], the longest period of consecutive declines on record." This represents a growing consensus among national forecasters.
- Part of the reason a lengthy recession is forecast, is the housing/financial debacle takes a long time to unwind.
- Because the recession will affect much of 2009, and only in mid-2010 is a modest recovery expected, FY0910 revenue growth will be minimal.
- The net result is the recession's effects over the next two years will result in a difficult fiscal climate.

More on FY 2009-10 Outlook

- As noted, economic forecasters expect a prolonged recession and a sluggish recovery to follow.
  - Recession-like conditions for much of 2009, late-summer rebound at the earliest. Latest forecast expect zero to slightly negative growth for 2009:Q3.
  - A very sluggish recovery in 2010.
  - Employment lags behind recovery and does not begin to rebound from recession until the summer or fall of 2010
- Under the scenario outlined above, an austere revenue picture will unfold. In FY 2009-10, baseline (economy-based) revenue growth will be suppressed and well below the usual 5 to 6 percent.
- It is highly probable that it will be FY 2010-11, before revenues equal the amount budgeted in FY 2008-09.

Fed's Latest Actions

- On December 16, 2008, the Federal Reserve Board's Federal Open Market Committee (FOMC) lowered its target for the federal funds rate by at least 75 basis points to a range of zero to 25 basis points, the lowest rate in more than fifty years.
- In doing so, the FOMC cited a deteriorating economy (recession) and improved inflation outlook (diminishing).
- The FOMC also announced it will "employ all available tools to promote the resumption of sustainable growth and to preserve price stability." The Fed is committing to a continued expansion of its balance sheet to support financial markets and the U.S. economy.
- Newly elected President, Barack Obama, is pushing Congress for an $825 billion stimulus package ($550 spending and $275 in tax cuts). Details have yet to be worked out.

State’s Economic Outlook

- The State’s employment numbers began to weaken in February 2007 and these employment losses (114,000 jobs through November 2008) continue to grow. Even when jobs are retained, hours are cutback and wages are frozen.
- These job cutbacks and other market conditions have taken a toll on consumers Spending declines hurt most of the service and retail sectors. Only educational/health services are expected to add jobs in the coming year.
- Financial services, a stalwart growth industry in the State, has been hit extra hard by the financial market’s troubles. Job losses in this sector are now expected through most of 2010.
- The manufacturing sector continues to shed jobs (a rate of 2% to 4%), but this recession should not accelerate job losses like the last recession in 2001-2002, where manufacturing experienced quarterly declines of over 10%.

State's Economic Outlook

- Overall employment in the State is expected to fall this fiscal year by 1.5% and fall an additional 1% in FY 2009-10. This will translate into well below normal growth in personal income.
- Moody's economy.com forecasters envision only 2.1% growth in the State's personal income for FY 2009-10 (1.4% for wage & salary income). This is far less than the 6.0% to 7.0% annual growth in income experienced from 2004 to 2007.
- Housing and financial service related industries will continue to struggle for much of 2009, but some recover is envisioned for 2010.
- The State's economy is expected to slow significantly in 2009 as this historically long recession slowly comes to an end. The State will fair somewhat better than the nation during the recession and is positioned to outperform the nation once the recovery is underway.

Biennium Budget Outlook

- Mounting pressures for remainder of FY 2008-09 and into next biennium:
  - Potential for a significant revenue shortfall and limited growth in FY 2009-10
  - State Health Plan will need additional infusion of cash ($200 - $300 million in FY0809)
  - Medicaid and other income assistance programs are counter-cyclical to the economy
  - Post-secondary enrollment often runs counter-cyclical to the economy and could place added demands on universities and community colleges