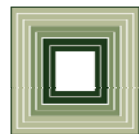


GENERAL FUND REVENUE REPORT & ECONOMIC OUTLOOK



**November 2009
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FISCAL RESEARCH DIVISION
A Staff Agency of the North Carolina General Assembly

Overview

- Revenues through the first four months of the fiscal year are 1.5 percent below target.
- Employment has yet to show improvement and continues to impact income tax withholdings and sales tax collections.
- The second quarter of this fiscal year will deserve close watching as revenues are expected to bottom out and a slow, modest recovery is expected as we go into 2010.
- The consensus believes a national economic recovery is underway. Unfortunately, only weak economic activity is likely the rest of the fiscal year.

How Do 2009-10 Revenues Look So Far?

- Collections through October are running \$95 million below a \$5.9 billion target.
- The first four months are 1.5 percent below target. The target reflects the increase in the sales tax and excise taxes (tobacco and alcoholic beverages), which began to show up in October. Net collections are down 4 percent from last year .
- The main weakness in collections continues to be the sales tax, which is tracking about two percentage points below expectations.

How Do 2009-10 Revenues Look So Far?

- Fiscal Year-to-Date Revenues (\$ billions)

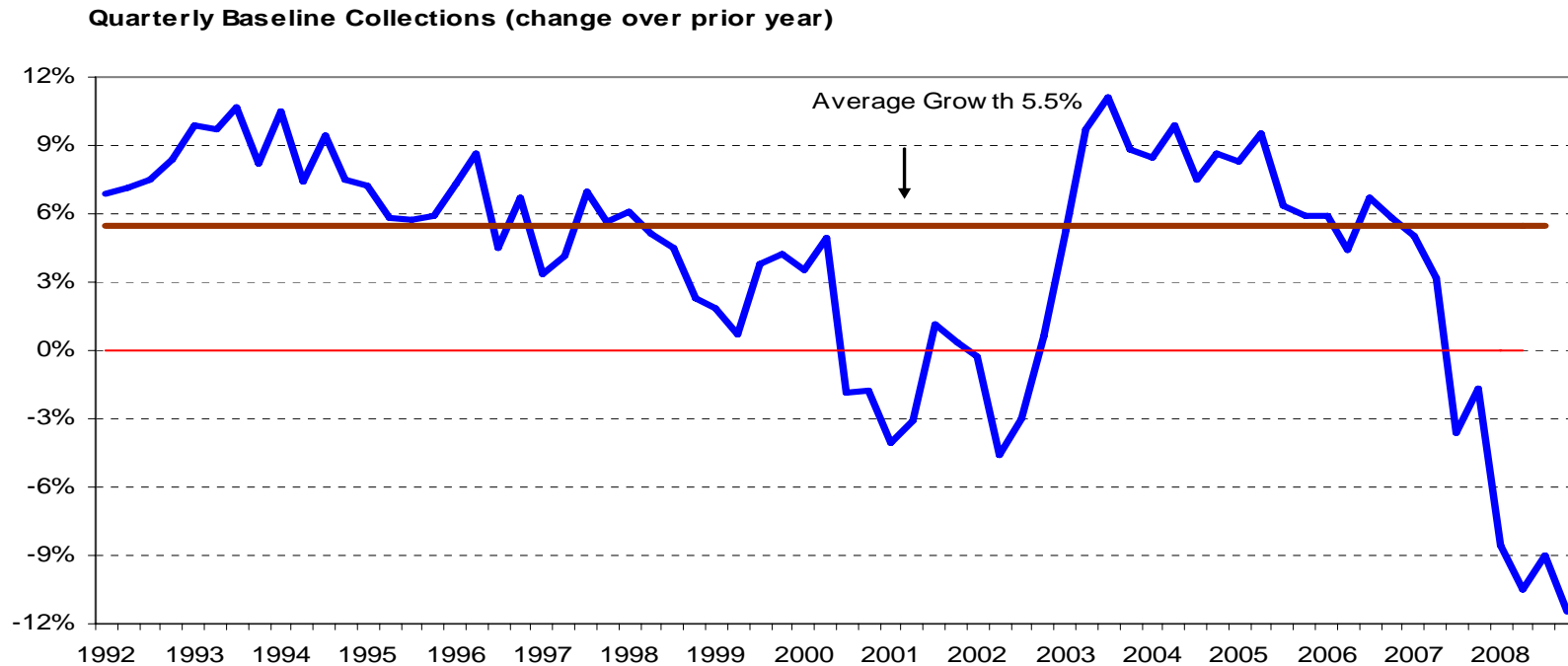
	Budget 2009-10	Actual 2009-10	Actual 2008-09
Tax Revenue	\$5.666	\$5.591	\$5.798
Non-Tax & Transfers	186.9	185.5	266.3
Total General Fund Revenue	\$5.882	\$5.787	\$6.064

How Do 2009-10 Revenues Look So Far?

- Through the first four months economy-based taxes still show no signs that an economic recovery is underway.
 - Baseline sales tax growth for July-October continues to fall and is down 11.7% vs. a 2.7% decline last year (see page 5).
 - Withholding tax collections continues to erode and are 3.5 percent below last year. The decline is consistent with budget expectations and will match closely the employment picture (see page 7).
 - Employment woes continue, although September saw a slight (seasonally adjusted) uptick in the number employed (see page 9).

Key Revenue Collection Trends: Sales Tax

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



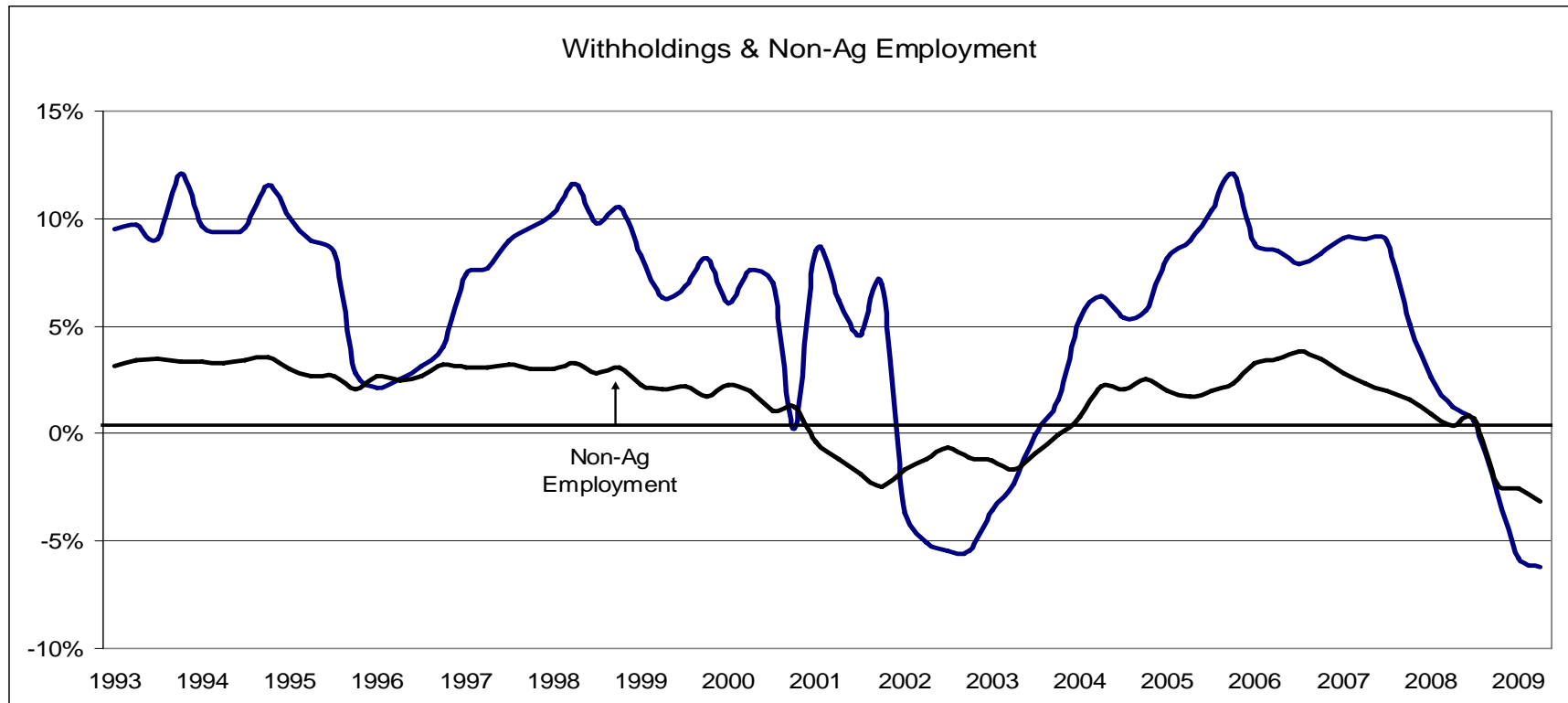
Sales tax collections continue to plummet in the 1st quarter of FY 2009-10.
Declines are more than double what they were the last recession

Key Revenue Collection Trends: Sales Tax

- Sales tax collections continue to perform very poorly in the current economic environment.
- There is added pressure on sales tax collections from the 1-cent increase that took effect in September. With continued weakness in collections there could be cause for concern.
- The budget forecast included a four percent decline in baseline growth, but the current pace of decline is closer to six percent. This means pressure will mount on collections to rebound as we go into the second-half of the fiscal year

Key Revenue Collection Trends: Personal Income Tax

Withholding Tax Receipts



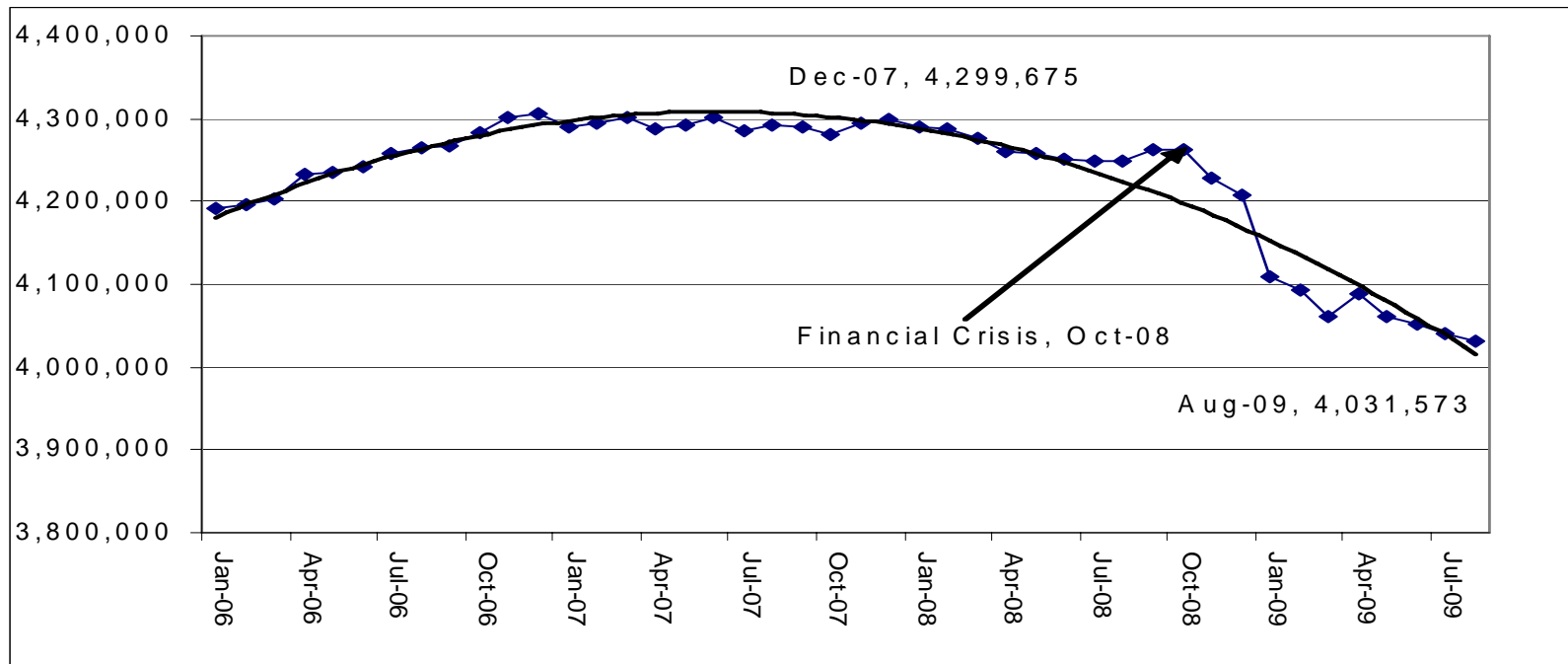
Withholding continues its downward trend coinciding with the decline in total employment.

Key Revenue Collection Trends: Personal Income Tax

- Withholdings (wage & salary income taxes) continue to fall as accelerated withholdings, representing most wage & salary taxpayers, were down 3.5 percent.
- Through October, net personal income (all payments plus salary withholdings less refunds and transfers) was down 2.7 percent below target. By comparison, this time last year, net income collections were 2.4 percent behind target.
- Until the employment situation improves, withholding taxes will continue to weaken.
- The effect of a changing economy on the more volatile taxes such as income from S-corps and capital gains will not be known until the second part of the fiscal year.

Key Revenue Collection Trends (Cont.)

Non-Ag Employment (seasonally adjusted)



Nearly 270,000 fewer people employed since start of recession, 230,000 since financial crisis in October 2008. The overall employment picture has a strong influence on income and sales taxes collections.

Revenue: Things to Watch

- The May revenue forecast was built on a scenario where the state's economic conditions would begin a gradual improvement by the 3rd quarter of the fiscal year.
- For that to happen, employment losses will have to abate, wage & salary incomes will need to show quarterly improvements, and consumer spending will have to rebound.
 - At this point last year the severity of the recession was just beginning to be felt. The first four months were basically no growth months and through October 2008, revenues were \$325 million below target.
 - The second quarter (October – December) saw significant erosion in sales tax collections with baseline collections falling by as much as nine percent below the previous year. Corporate and Individual estimated payments, which had been weak the first quarter, tumbled to 20-25 percent below the previous year. The state budget shortfall had grown to \$600 million by the end of December.

Revenue: Things to Watch

- The main key to a sustained recovery and an improving revenue picture will be employment.
 - According to a forecast by UNC-C's economic forecasters, 6 of the state's 10 non-agricultural industry sectors are expected to rebound in 2010 – wholesale & retail trade and services are expected to lead the way.
 - In order for the state to meet its 2009-10 budget forecast, a reversal in employment losses will need to materialize early in 2010.
- Are employment conditions improving?
 - The National Association of Business Economist's most recent survey indicated "planned business hiring" have increased for the first time since the start of the recession.
 - Plus, temporary employment, a precursor to permanent job hiring, has been steadily on the rise.

Revenue: Things to Watch

- The recovery is anticipated to follow the usual pattern of an investment recovery, followed by an improvement in consumer sentiment, and finally, a recover in the job market.
 - The investment recovery appears underway, but there is still a long way to go before employment makes significant strides.
- Housing appears to be showing some signs of life. An improving residential market could bolster consumer confidence and provide some stimulus to consumer spending, which ultimately will drive-up the demand for employment.
 - The extension and expansion of the home buyer's tax credit by congress may stimulate home buying decisions.

Economic Outlook

- The nation has been mired in the longest, sustained period of economic contraction since the depression of the 1930s. Many are calling it the Great Recession given the length and with job losses more than double the average recession.
- Most economist agree the recession has ended, but caution that a very slow recovery is underway.
- For the state, the intensity of the recession may be easing, but a robust recovery is not on the foreseeable horizon.
- The Federal Reserve Board in its last meeting decided to keep bank lending rates unchanged because they believe “economic activity is likely to remain weak” and “inflation will remain subdued for some time”.

Conclusions

- The second quarter of this fiscal year will be important for the state in order to meet the budget forecast for the year.
 - The projections anticipate a bottoming-out of declining collections and the onset of some improvement by December, especially in the sales tax.
 - Starting in October, the 1-cent state sales tax increase began to show up in monthly collections, which places an even greater burden on a sales tax recovery.
- Economic conditions will continue to be recession-like for the rest of 2009, but gradual improvements are expected. Signs of a recovery in employment are expected in the spring of 2010.
- Despite the anticipated gradual improvements in the economy, a robust expansionary economy is still a year or two away.
 - This Outlook and previous Revenue Outlooks can be found at FRD's website <http://www.ncleg.net/fiscalresearch/>